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EDEN BIOSCIENCE CORP  
Form 10-Q  
August 14, 2001

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UNITED STATES SECURITIES AND  
EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NUMBER 0-31499

EDEN BIOSCIENCE CORPORATION  
(Exact name of registrant as specified in its charter)

WASHINGTON 91-1649604  
(State or other (IRS Employer Identification No.)  
jurisdiction of incorporation  
or organization)

11816 NORTH CREEK PARKWAY NORTH  
BOTHELL, WASHINGTON 98011-8205  
(Address of Principal Executive Offices, including Zip Code)

(425) 806-7300  
(Registrant's Telephone Number, including Area Code)

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

Yes ☒ No ☐

State the number of shares outstanding of each of the registrant's classes of common equity, as of the latest practicable date:

| CLASS                           | OUTSTANDING AS OF AUGUST 1, 2001 |
|---------------------------------|----------------------------------|
| Common Stock, \$.0025 Par Value | 23,977,347                       |

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EDEN BIOSCIENCE CORPORATION

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### PART I -- FINANCIAL INFORMATION

#### Item 1. Financial Statements

EDEN BIOSCIENCE CORPORATION

#### CONDENSED BALANCE SHEETS

|                           | December 31,<br>2000<br>----- | June 30,<br>2001<br>-----<br>(Unaudited) |
|---------------------------|-------------------------------|------------------------------------------|
| ASSETS                    |                               |                                          |
| Current assets:           |                               |                                          |
| Cash and cash equivalents | \$ 86,556,865                 | \$ 63,428,310                            |

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|                             |               |               |
|-----------------------------|---------------|---------------|
| Accounts receivable         | 595,470       | 1,778,721     |
| Inventory                   | 1,321,241     | 2,539,655     |
| Other current assets        | 236,458       | 681,486       |
|                             | -----         | -----         |
| Total current assets        | 88,710,034    | 68,428,172    |
| Property and equipment, net | 9,479,872     | 19,460,846    |
| Other assets                | 310,715       | 1,754,402     |
|                             | -----         | -----         |
| Total assets                | \$ 98,500,621 | \$ 89,643,420 |
|                             | =====         | =====         |

## LIABILITIES AND SHAREHOLDERS' EQUITY

|                                                                                                                                                                       |               |               |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Current liabilities:                                                                                                                                                  |               |               |
| Accounts payable                                                                                                                                                      | \$ 1,415,730  | \$ 2,275,109  |
| Accrued expenses                                                                                                                                                      | 3,238,398     | 3,500,561     |
| Current portion of capital lease obligations                                                                                                                          | 275,316       | 262,505       |
|                                                                                                                                                                       | -----         | -----         |
| Total current liabilities                                                                                                                                             | 4,929,444     | 6,038,175     |
| Capital lease obligations, net of current portion                                                                                                                     | 330,394       | 221,597       |
| Other long-term liabilities                                                                                                                                           | --            | 204,228       |
|                                                                                                                                                                       | -----         | -----         |
| Total liabilities                                                                                                                                                     | 5,259,838     | 6,464,000     |
|                                                                                                                                                                       | -----         | -----         |
| Commitments and contingencies                                                                                                                                         |               |               |
| Shareholders' equity:                                                                                                                                                 |               |               |
| Convertible preferred stock, \$.01 par value,<br>10,000,000 shares authorized; no shares designated<br>at December 31, 2000 and June 30, 2001                         | --            | --            |
| Common stock, \$.0025 par value, 100,000,000 shares<br>authorized; issued and outstanding shares -<br>23,894,680 at December 31, 2000; 23,977,347 at<br>June 30, 2001 | 59,737        | 59,943        |
| Additional paid-in capital                                                                                                                                            | 131,844,183   | 132,131,819   |
| Deferred stock option compensation expense                                                                                                                            | (28,625)      | (19,385)      |
| Cumulative translation adjustment                                                                                                                                     | --            | (18,149)      |
| Accumulated deficit                                                                                                                                                   | (38,634,512)  | (48,974,808)  |
|                                                                                                                                                                       | -----         | -----         |
| Total shareholders' equity                                                                                                                                            | 93,240,783    | 83,179,420    |
|                                                                                                                                                                       | -----         | -----         |
| Total liabilities and shareholders' equity                                                                                                                            | \$ 98,500,621 | \$ 89,643,420 |
|                                                                                                                                                                       | =====         | =====         |

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

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## EDEN BIOSCIENCE CORPORATION

### CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

|               | Three Months Ended June 30, |            | Six Months Ended Jun |              |
|---------------|-----------------------------|------------|----------------------|--------------|
|               | -----                       | -----      | -----                | -----        |
|               | 2000                        | 2001       | 2000                 | 2001         |
|               | -----                       | -----      | -----                | -----        |
| Revenues:     |                             |            |                      |              |
| Product sales | \$ --                       | \$ 875,486 | \$ --                | \$ 4,000,000 |

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|                                                                                   |                |                |                |         |
|-----------------------------------------------------------------------------------|----------------|----------------|----------------|---------|
| Sales allowances                                                                  | --             | (300,032)      | --             | (1,     |
| Net revenues                                                                      | --             | 575,454        | --             | 3,      |
| Operating expenses:                                                               |                |                |                |         |
| Cost of goods sold                                                                | --             | 2,202,462      | --             | 3,      |
| Research and development                                                          | 2,852,738      | 3,439,446      | 5,116,156      | 5,      |
| Selling, general and administrative                                               | 994,243        | 3,586,436      | 1,910,928      | 6,      |
| Total operating expenses                                                          | 3,846,981      | 9,228,344      | 7,027,084      | 15,     |
| Loss from operations                                                              | (3,846,981)    | (8,652,890)    | (7,027,084)    | (12,    |
| Other income (expense):                                                           |                |                |                |         |
| Interest income                                                                   | 117,989        | 805,525        | 278,450        | 1,      |
| Interest expense                                                                  | (35,093)       | (22,410)       | (73,575)       |         |
| Total other income (expense)                                                      | 82,896         | 783,115        | 204,875        | 1,      |
| Net loss                                                                          | \$ (3,764,085) | \$ (7,869,775) | \$ (6,822,209) | \$ (10, |
| Historical basic and diluted net loss per share                                   | \$ (1.31)      | \$ (0.33)      | \$ (2.38)      | \$      |
| Historical weighted average shares outstanding used to compute net loss per share | 2,862,661      | 23,953,703     | 2,862,661      | 23,     |
| Pro forma basic and diluted net loss per share                                    | \$ (0.23)      |                | \$ (0.41)      |         |
| Weighted average shares outstanding used to compute pro forma net loss per share  | 16,656,765     |                | 16,656,765     |         |

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

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EDEN BIOSCIENCE CORPORATION

CONDENSED STATEMENTS OF CASH FLOWS  
(Unaudited)

|                                                                         | Six Months Ended June 30, |                 |
|-------------------------------------------------------------------------|---------------------------|-----------------|
|                                                                         | 2000                      | 2001            |
| Cash flows from operating activities:                                   |                           |                 |
| Net loss                                                                | \$ (6,822,209)            | \$ (10,333,984) |
| Adjustments to reconcile net loss to cash used in operating activities: |                           |                 |
| Depreciation and amortization                                           | 395,197                   | 528,032         |
| Amortization of stock option compensation expense                       | 46,434                    | 9,240           |
| Interest income on subscriptions receivable                             | (2,050)                   | --              |
| Loss (gain) on disposition of fixed assets                              | 2,852                     | (765)           |

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|                                                                        |              |               |
|------------------------------------------------------------------------|--------------|---------------|
| Increase in deferred rent payable                                      | --           | 171,728       |
| Changes in assets and liabilities:                                     |              |               |
| Accounts receivable                                                    | --           | (1,183,134)   |
| Inventory                                                              | --           | (1,218,414)   |
| Other assets                                                           | (771,658)    | (1,890,422)   |
| Accounts payable                                                       | (156,334)    | 862,203       |
| Accrued expenses                                                       | 1,156,370    | (1,303,673)   |
| Other liabilities                                                      | --           | 32,500        |
|                                                                        | -----        | -----         |
| Net cash used in operating activities                                  | (6,151,398)  | (14,326,689)  |
|                                                                        | -----        | -----         |
| Cash flows used in investing activities:                               |              |               |
| Purchases of property and equipment                                    | (1,447,365)  | (8,944,113)   |
| Proceeds from disposal of equipment                                    | --           | 2,733         |
|                                                                        | -----        | -----         |
| Net cash used in investing activities                                  | (1,447,365)  | (8,941,380)   |
|                                                                        | -----        | -----         |
| Cash flows from financing activities:                                  |              |               |
| Proceeds from capital equipment leases                                 | --           | 19,418        |
| Payments on capital equipment leases                                   | (169,343)    | (141,026)     |
| Offering costs                                                         | (14,657)     | --            |
| Proceeds from issuance of stock                                        | --           | 209,858       |
| Proceeds from exercise of stock options                                | 399,200      | 40,965        |
| Proceeds from exercise of common stock warrants                        | 885,662      | 37,019        |
|                                                                        | -----        | -----         |
| Net cash provided by (used in) financing activities                    | 1,100,862    | 166,234       |
|                                                                        | -----        | -----         |
| Effect of foreign currency exchange rates on cash and cash equivalents | --           | (26,720)      |
|                                                                        | -----        | -----         |
| Net decrease in cash and cash equivalents                              | (6,497,901)  | (23,128,555)  |
| Cash and cash equivalents at beginning of period                       | 13,107,250   | 86,556,865    |
|                                                                        | -----        | -----         |
| Cash and cash equivalents at end of period                             | \$ 6,609,349 | \$ 63,428,310 |
|                                                                        | =====        | =====         |
| Supplemental disclosures:                                              |              |               |
| Cash paid for interest                                                 | \$ 73,575    | \$ 47,385     |
| Accrued expenses for construction in process                           | --           | 1,565,767     |

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

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## EDEN BIOSCIENCE CORPORATION

### NOTES TO CONDENSED FINANCIAL STATEMENTS (INFORMATION AS OF AND FOR THE THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2000 AND 2001 IS UNAUDITED)

#### 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

##### ORGANIZATION AND BUSINESS

EDEN Bioscience Corporation ("EDEN(R)" or the "Company") was incorporated in the State of Washington on July 18, 1994. EDEN is a plant technology company focused on developing, manufacturing and marketing innovative natural products for agriculture. Prior to August 2000, the Company was a development stage company. In August 2000, the Company began sales of its initial product, Messenger(R).

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### BASIS OF PRESENTATION

The accompanying unaudited condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2000 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements and notes should be read in conjunction with the financial statements and notes for the year ended December 31, 2000 included in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 29, 2001.

In the opinion of management, the unaudited condensed financial statements include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial information set forth therein. Results of operations for the three months and six months ended June 30, 2001 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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.

### PROPERTY AND EQUIPMENT

Equipment and leasehold improvements are stated at historical cost. Improvements and replacements are capitalized. Maintenance and repairs are expensed when incurred. The provision for depreciation and amortization is determined using straight-line and accelerated methods, which allocate costs over estimated useful lives of two to 20 years. On January 1, 2001, the Company adopted the units-of-production method of depreciation for manufacturing equipment placed into service after that date. Equipment leased under capital leases is depreciated over the shorter of the equipment's estimated useful life or lease term, which ranges between three and five years.

### REVENUE RECOGNITION

The Company recognizes revenue from product sales, net of sales allowances, when the products are shipped and all significant obligations of the Company have been satisfied. Product sales revenue in the six months ended June 30, 2001 resulted from sales to six distributors, one of which accounted for

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EDEN BIOSCIENCE CORPORATION

NOTES TO CONDENSED FINANCIAL STATEMENTS  
(INFORMATION AS OF AND FOR THE THREE MONTHS AND SIX MONTHS ENDED  
JUNE 30, 2000 AND 2001 IS UNAUDITED)

\$3.4 million (72%) of product sales revenue and \$1.48 million (83%) of accounts receivable at June 30, 2001. Sales to another distributor accounted for \$603,000

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(13%) of product sales revenue for the six months ended June 30, 2001 and \$292,000 (16%) of accounts receivable at June 30, 2001.

### NET LOSS PER COMMON SHARE

Basic net loss per share is calculated as the net loss divided by the weighted average number of common shares outstanding during the period. Diluted net loss per share is calculated as the net loss divided by the sum of the weighted average number of common shares outstanding during the period plus the additional common shares that would have been issued had all dilutive warrants and options been exercised, less shares that would be repurchased with the proceeds from such exercises (treasury stock method). The effect of including outstanding options and warrants is antidilutive for all periods presented. Therefore, options and warrants have been excluded from the calculation of diluted net loss per share and consist of the following:

|                                         | As of June 30, |           |
|-----------------------------------------|----------------|-----------|
|                                         | 2000           | 2001      |
| Options to purchase common stock .....  | 2,468,000      | 2,649,537 |
| Warrants to purchase common stock ..... | 334,056        | 290,805   |

Pro forma basic and diluted net loss per share is calculated assuming the conversion of all convertible preferred stock at the beginning of the periods presented. The actual conversion of the preferred stock occurred on September 26, 2000, the effective date of the registration statement filed in connection with the company's initial public offering.

### 2. PROPERTY AND EQUIPMENT

Property and equipment, at cost, consists of the following:

|                                                      | December 31,<br>2000 | June 30,<br>2001 |
|------------------------------------------------------|----------------------|------------------|
| Equipment .....                                      | \$ 4,246,033         | \$ 10,228,921    |
| Equipment under capital leases .....                 | 1,174,262            | 1,137,501        |
| Leasehold improvements .....                         | 1,291,927            | 4,740,149        |
| Construction in progress .....                       | 5,246,799            | 6,687,101        |
|                                                      | 11,959,021           | 22,793,672       |
| Less accumulated depreciation and amortization ..... | (2,479,149)          | (3,332,826)      |
| Net property and equipment .....                     | \$ 9,479,872         | \$ 19,460,846    |

### 3. ACCRUED EXPENSES

Accrued expenses consist of the following:

December 31,                      June 30,

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|                                   | 2000        | 2001        |
|-----------------------------------|-------------|-------------|
|                                   | -----       | -----       |
| Compensation and benefits .....   | \$1,542,700 | \$1,730,374 |
| Field trial expenses .....        | 550,013     | 578,841     |
| Sales and marketing expense ..... | 415,267     | 144,766     |
| Other .....                       | 730,418     | 1,046,580   |
|                                   | -----       | -----       |
| Total accrued expenses .....      | \$3,238,398 | \$3,500,561 |
|                                   | =====       | =====       |

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

This discussion and analysis should be read in conjunction with our unaudited condensed financial statements and accompanying notes included in this document and the 2000 audited financial statements and notes thereto included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 29, 2001.

The following discussion of our financial condition and results of operations contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. We use words such as "anticipate," "believe," "expect," "future" and "intend" and similar expressions to identify forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the factors described below and under the caption "Factors That May Affect Our Business, Future Operating Results and Financial Condition" set forth at the end of this Item 2. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q. The cautionary statements made in this document should be read as being applicable to all related forward-looking statements wherever they appear in this document.

### OVERVIEW

We are a plant technology company focused on developing, manufacturing, and marketing innovative natural products for agriculture. We have a fundamentally new, patented and proprietary technology that we believe will significantly improve plant protection and crop production worldwide. We believe our technology and initial product offer innovative solutions versus traditional plant protection and crop enhancement alternatives and, importantly, avoid the substantial and growing public resistance to chemical pesticides and gene-based biotechnology. Commercial sales of Messenger, our initial product, began in August 2000.

We have incurred significant operating losses since inception. As of June 30, 2001, we had an accumulated deficit of \$49.0 million. We incurred a net loss of \$7.9 million for the quarter ended June 30, 2001, an increase of \$4.1 million (108%) from \$3.8 million in the comparable quarter of 2000. The net loss for the six months ended June 30, 2001 was \$10.3 million, or \$3.5 million (51%) more than the \$6.8 million loss for the six months ended June 30, 2000. We expect to incur additional losses as we expand and enhance our research and development activities and sales and marketing capabilities in the United States and in foreign countries.



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### RESULTS OF OPERATIONS

Three Months and Six Months Ended June 30, 2000 and 2001

#### Revenues

We generated our first revenue from product sales in August 2000, when we began selling our first commercial product, Messenger. Product sales revenue in the three months and six months ended June 30, 2001 totaled \$875,000 and \$4.7 million, respectively. No product sales revenue was recorded in the first six months of 2000. Sales in the first six months of 2001 were made to six distributors, of which two accounted for more than 10% of revenue during that period. Sales to United Agri Products, a subsidiary of ConAgra Foods, Inc., accounted for \$3.4 million (72%) of product sales revenue for the six months ended June 30, 2001 and \$1.48 million (83%) of accounts receivable at June 30, 2001. Sales to Western Farm Service accounted for \$603,000 (13%) of product sales revenue for the six months ended June 30, 2001 and \$292,000 (16%) of accounts receivable at June 30, 2001. We believe sales for the first

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six months of 2001 were significantly lower than our expectations due primarily to the severity of the growers' economic conditions in our initially targeted markets, principally cotton and citrus.

#### Sales Allowances

Sales allowances represent allowances granted to independent distributors for sales and marketing support, product warehousing and delivery and information exchange. Sales allowances were \$300,000 (34% of product sales) for the three months ended June 30, 2001 and \$1.7 million (36% of product sales) for the six months then ended. No such allowances were granted in the first six months of 2000. We believe the sales allowance percentage will range between 30% and 40% as we proceed with the commercialization of Messenger.

#### Cost of Goods Sold

Cost of goods sold includes the cost of raw materials, labor and overhead required to manufacture Messenger. Cost of goods sold was \$2.2 million for the three months ended June 30, 2001 and \$3.2 million for the six months then ended. No such costs were incurred in the first six months of 2000. During the quarter ended June 30, 2001, we recorded a charge to costs of goods sold of \$1.4 million related to the write-down of inventory consisting primarily of bulk Messenger product. The write-down is the result of the following general factors. First, the demand for Messenger was significantly less than our expectations, which we believe is primarily due to the severity of the growers' economic conditions in our initially targeted markets. Although we scaled back our manufacturing activities during the quarter, inventory levels still exceeded our requirements based on our current nine-month revenue forecasts. Second, we intend to replace our current Messenger product formula with an improved formula that we expect will be approved by the EPA within the next nine months, at which time we expect to begin commercial production and sales of the new formula. Last, we eliminated bulk material that did not meet our highest standards as a result of a change, since rectified, in the manufacturing process at our new facility. Based on these factors, we recorded the charge in the second quarter of 2001. Also included in second quarter cost of goods sold are costs incurred while our manufacturing plant was not in production. We expect to continue to incur idle capacity costs for the next several months.

#### Research and Development Expenses

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Research and development expenses consist primarily of personnel and related costs, field trials and laboratory, regulatory, patents and facility and equipment expenses. Research and development expenses were \$3.4 million for the second quarter of 2001, an increase of \$587,000 (20%) from \$2.8 million in the comparable quarter of 2000. For the first six months of 2001, research and development expenses were \$5.7 million, an increase of \$568,000 (11%) over \$5.1 million for the same period in 2000. This increase was primarily due to an increase in the number of international field development personnel and increased field trial costs incurred to pursue foreign regulatory approval. We expect to incur additional increases in research and development expenses as we expand our domestic and international field trial programs, pursue additional international regulatory approvals, develop new products and enhance our harpin-related technology platform.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of payroll and related expenses for sales and marketing, executive and administrative personnel; advertising, marketing and professional fees; and other corporate expenses. Selling, general and administrative expenses were \$3.6 million for the second quarter of 2001, an increase of \$2.6 million (260%) from \$1.0 million in the comparable quarter

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of 2000. For the first six months of 2001, selling, general and administrative expenses were \$6.5 million, an increase of \$4.6 million (242%) over \$1.9 million for the same period in 2000. This increase is due primarily to costs associated with hiring additional sales, marketing and administrative personnel and continuance of our 2001 sales and marketing campaign to build Messenger brand awareness and to educate growers on the benefits of using Messenger. We expect selling, general and administrative expenses to decrease in the third and fourth quarters of this year as the growing season ends, and to increase in 2002 as we enter a new growing season and as we continue to hire additional personnel to support anticipated growth and the commercialization of Messenger, enhance information systems and expand our sales and marketing capability.

### Interest Income

Interest income consists of earnings on our cash and cash equivalents. Interest income was \$806,000 for the second quarter of 2001, an increase of \$688,000 (583%) from \$118,000 in the comparable quarter of 2000. For the first six months of 2001, interest income was \$2.0 million, an increase of \$1.7 million (612%) over \$278,000 for the same period in 2000. The increased interest income resulted from the investment of net proceeds received in our initial public offering, which closed on October 2, 2000. Interest income is affected by interest rate movements and will decline as we use cash in operations and purchase property and equipment.

### Interest Expense

Interest expense consists of interest we pay on capital leases used to finance our equipment purchases. Interest expense was \$22,000 for the quarter ended June 30, 2001, a decrease of \$13,000 (37%) from \$35,000 in the comparable quarter of 2000. For the six months ended June 30, 2001, interest expense was \$47,000, a decrease of \$27,000 (36%) from \$74,000 for the same period in 2000. This decrease resulted from lower average principal balances as we paid down our capital lease obligations. We expect interest expense to fluctuate as we pay off existing capital leases and enter into new capital leases.

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### Income Taxes

We have realized a net loss from operations in each period since we began doing business. As of December 31, 2000, we had accumulated approximately \$36.0 million of net operating loss carryforwards for federal income tax purposes. These carryforwards expire between 2009 and 2015. The annual use of these net operating loss carryforwards may be limited in the event of a cumulative change in ownership of more than 50%.

### LIQUIDITY AND CAPITAL RESOURCES

Since our inception, we have financed our operations primarily through the sale of equity securities. Prior to October 2000, the majority of our capital was raised through private sales of our preferred stock, which resulted in net proceeds of approximately \$36.5 million. In October 2000, we received \$91.5 million of net proceeds from the initial public offering of 6.67 million shares of our common stock. To a lesser extent, we have financed our equipment purchases through lease financings. As of June 30, 2001, we had cash and cash equivalents of \$63.4 million.

Net cash used in operations for the six months ended June 30, 2001 was \$14.3 million, an increase of \$8.1 million (131%) from \$6.2 million in the comparable period of 2000. These operating cash outflows resulted primarily from losses from operations and an increase in working capital and other assets.

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Investing activities for the six months ended June 30, 2001 used cash of \$8.9 million, an increase of \$7.5 million (536%) over \$1.4 million in the comparable period of 2000. This increase is due primarily to property and equipment purchased and leasehold improvements made in connection with a major expansion of our manufacturing facilities, which was substantially completed during the first quarter of this year, and our research and development and administration facility, which is expected to be completed in the third quarter of this year. Capital expenditures for the remainder of this year are expected to total \$5 million to \$6 million.

Financing activities for the six months ended June 30, 2001 provided cash of \$166,000, a decrease of \$934,000 (85%) from the \$1.1 million provided in the comparable period of 2000. This decrease resulted primarily from a reduction of approximately \$1.0 million in proceeds from the exercise of common stock options and warrants and the issuance of common stock. As of June 30, 2001, our future minimum payments under capital lease obligations totaled \$571,000 and are payable over the next five years.

We expect to increase our operating expenditures as we expand our sales and marketing capabilities and research and development activities. In addition, we expect to make capital expenditures during the remainder of this year of up to approximately \$6 million, primarily to complete construction of our new research and development and administration facility. These operating and capital expenditures will use a material amount of our cash resources. We believe that our existing cash and cash equivalents of \$63.4 million at June 30, 2001 will be sufficient to meet our anticipated cash needs for operating activities, working capital and capital expenditures for at least the next 12 months. Our future capital requirements will depend on the success of our operations.

In the future, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financings or from other sources. We may be unable to obtain adequate or favorable financing at that time.

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### FACTORS THAT MAY AFFECT OUR BUSINESS, FUTURE OPERATING RESULTS AND FINANCIAL CONDITION

You should carefully consider the risks described below, together with all of the other information included in this quarterly report on Form 10-Q. The risks and uncertainties described below are not the only ones facing our company. If any of the following risks actually occurs, our business, financial condition or operating results could be harmed.

WE ARE AT AN EARLY STAGE OF DEVELOPMENT AND ARE SUBJECT TO THE RISKS OF A NEW ENTERPRISE AND THE COMMERCIALIZATION OF A NEW TECHNOLOGY.

We began our operations in 1994 and have recently initiated marketing activities designed to promote the distribution and sale of our first product, Messenger, in the United States. We have not proven our ability to commercialize any products. Our early stage of development, the newness of our technology and the uncertain nature of the market in which we compete make it difficult to assess our prospects or predict our future operating results. We are subject to risks and uncertainties frequently encountered in the establishment of a new business enterprise, particularly in the rapidly changing market for plant protection and yield enhancement products. These risks include our inability to transition from a company with a research focus to a company capable of supporting commercial activities, including manufacturing, regulatory approval and compliance, marketing, sales, distribution and quality control and assurance. Our inability to adequately address these risks could cause us to be unprofitable or to cease operations.

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WE CURRENTLY DEPEND ON A SINGLE PRODUCT AND OUR DEVELOPMENT AND COMMERCIALIZATION OF THAT PRODUCT MAY NOT BE SUCCESSFUL.

For the immediately foreseeable future we will be dependent on the successful development and commercialization of one product, Messenger, which is based on a new technology. While Messenger has been subject to numerous field tests on a wide variety of crops with favorable results, we have only recently begun sales of Messenger, and Messenger could prove to be commercially unsuccessful. Messenger may not prove effective or economically viable for all crops or markets. In addition, because Messenger has not been put to widespread commercial use over significant periods of time, no assurance can be given that adverse consequences might not result from the use of Messenger, such as soil or other environmental degradation, the development of negative effects on animals or plants or reduced benefits in terms of crop yield or protection.

The markets for Messenger and other harpin-based products we may develop are unproven. Messenger may not gain commercial acceptance or success. If we are unable to successfully achieve broad market acceptance of Messenger, we may not be able to generate enough product revenues in the future to achieve profitability. A variety of factors will determine the success of our market development and commercialization efforts and the rate and extent of market acceptance of Messenger, including our ability to implement and maintain an appropriate pricing policy for Messenger, general economic conditions in agricultural markets, including commodity prices, climatic conditions and the extent that growers, regulatory authorities and the public accept new agricultural practices and products developed through biotechnology.

OUR PRODUCT DEVELOPMENT EFFORTS, WHICH ARE BASED ON AN INNOVATIVE TECHNOLOGY THAT IS COMMERCIALY UNPROVEN, MAY NOT BE SUCCESSFUL.

Our harpin and harpin-related technology is new, in an early stage of

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development and commercially unproven. It may take years and significant capital investment to develop viable enhancements of Messenger or new products based on our harpin and harpin-related technology. Risks inherent in the development of products based on innovative technologies include the possibility that:

- new products or product enhancements will be difficult to produce on a large scale or will be uneconomical to market;
- proprietary rights of third parties will prevent us from marketing products; and
- third parties will market superior or equivalent products or will market their products first.

INABILITY TO PRODUCE A HIGH QUALITY PRODUCT AS WE INCREASE OUR MANUFACTURING CAPACITY COULD IMPAIR OUR BUSINESS.

To be successful, we will have to manufacture Messenger in large quantities at acceptable costs while also preserving high product quality. If we cannot maintain high product quality on a large scale, we may be unable to achieve market acceptance of our products and our sales would likely suffer. Moreover, we do not have back-up manufacturing systems and, as a result, any failure of any component required in the manufacturing process could delay or impair our ability to manufacture Messenger in the quantities that we may require.

We intend to continue to make changes to our manufacturing processes and facilities in order to improve the efficiency and quality of our manufacturing activities. We cannot guarantee that we will be successful in this regard, and specifically that the changes we make will improve our manufacturing activities. We may encounter difficulties in the production of our current or future products, including

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problems involving manufacturing yields, quality control and assurance, shortages of qualified personnel and compliance with regulatory requirements. Even if we are successful in developing our manufacturing capability and processes, we do not know whether we will satisfy the requirements of our distributors or customers.

WE HAVE A HISTORY OF LOSSES SINCE INCEPTION, WE EXPECT TO CONTINUE TO INCUR LOSSES AND WE MAY NOT ACHIEVE OR SUSTAIN PROFITABILITY.

We have incurred operating losses in each quarter since inception and we expect to continue to incur further operating losses for the foreseeable future. From our inception in July 1994 to June 30, 2001, we have accumulated a deficit of approximately \$49.0 million. For the six-months ended June 30, 2001, we had a net loss of \$10.3 million and for the years ended December 31, 2000 and 1999, we had net losses of \$15.7 million and \$9.4 million, respectively. To date, our revenues have been limited. We expect our future revenues to come primarily from the sale of Messenger and other products, and these sales are highly uncertain. We expect to continue to devote substantial resources to expand our research and development activities, maintain and operate our manufacturing facility and expand our sales and marketing activities for the commercialization of Messenger worldwide. As a result, we will need to generate significant revenues to achieve and maintain profitability. We may never generate profits, and if we do become profitable, we may be unable to sustain or increase profitability on a quarterly or annual basis.

IF OUR ONGOING OR FUTURE FIELD TRIALS ARE UNSUCCESSFUL, WE MAY BE UNABLE TO

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ACHIEVE MARKET ACCEPTANCE OR OBTAIN REGULATORY APPROVAL OF OUR PRODUCTS.

The successful completion of multiple field trials in domestic and foreign locations on many crops is critical to the success of our product development and marketing efforts. If our ongoing or future field trials are unsuccessful or produce inconsistent results or unanticipated adverse side effects, or if we are unable to collect reliable data, regulatory approval of our products could be delayed or withheld or we may be unable to achieve market acceptance of our products. Although we have conducted successful field trials on a broad range of crops, we cannot be certain that additional field trials conducted on a greater number of acres, or on crops for which we have not yet conducted field trials, will be successful. Moreover, the results of our ongoing and future field trials are subject to a number of conditions beyond our control, including weather-related events such as droughts and floods, severe heat and frost, hail, tornadoes and hurricanes. Generally, we pay third parties, such as growers, consultants and universities, to conduct our field tests for us. Incompatible crop treatment practices or misapplication of the product by third parties could interfere with the success of our field trials.

RAPID CHANGES IN TECHNOLOGY COULD RENDER OUR PRODUCTS UNMARKETABLE OR OBSOLETE.

We are engaged in an industry characterized by extensive research efforts and rapid technological development. Our competitors, many of which have substantially greater technological and financial resources than we do, may develop plant protection and yield enhancement technologies and products that are more effective than ours or that render our technology and products obsolete or uncompetitive. To be successful, we will need to continually enhance our products and to design, develop and market new products that keep pace with new technological and industry developments.

INABILITY TO DEVELOP ADEQUATE SALES AND MARKETING CAPABILITIES COULD PREVENT US FROM SUCCESSFULLY COMMERCIALIZING MESSENGER AND OTHER PRODUCTS WE MAY DEVELOP.

We currently have limited sales and marketing experience and capabilities. Our internal sales and marketing staff consists primarily of sales and marketing specialists and field development specialists who are trained to educate growers and independent distributors on the uses and benefits of Messenger.

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We will need to further develop our sales, marketing and field development capabilities in order to enhance our commercialization efforts, which will involve substantial costs. These specialists require a high level of technical expertise and knowledge regarding Messenger's capabilities and other plant protection and yield enhancement products and techniques. We cannot assure you that our specialists and other members of our sales and marketing team will successfully compete against the sales and marketing operations of our current and future competitors that may have more established relationships with distributors and growers. Failure to recruit, train and retain important sales and marketing personnel, such as our sales and marketing specialists and field development specialists, or the inability of new sales and marketing personnel to effectively market and sell Messenger and other products we may develop, could impair our ability to gain market acceptance of our products and cause our sales to suffer.

WE MAY BE UNABLE TO ESTABLISH AND MAINTAIN SUCCESSFUL RELATIONSHIPS WITH INDEPENDENT DISTRIBUTORS, WHICH COULD ADVERSELY AFFECT OUR SALES.

We intend to rely on independent distributors of agri-chemicals to distribute and assist with the marketing and sale of Messenger and other

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products we may develop. We have engaged several independent distributors and retailers for the distribution and sale of Messenger. Our future revenue growth will depend in large part on our success in establishing and maintaining these sales and distribution channels. We are in the early stages of developing our distribution network and we may be unable to establish these relationships in a timely or cost-effective manner. Moreover, we cannot assure you that the distributors and retailers with which we partner will focus adequate resources on selling our products or will be successful in selling them. Many of our potential distributors and retailers are in the business of distributing and sometimes manufacturing other, possibly competing, plant protection and yield enhancement products and may perceive Messenger as a threat to various product lines currently being manufactured or distributed by them. In addition, the distributors may earn higher margins by selling competing products or combinations of competing products. If we are unable to establish or maintain successful relationships with independent distributors, we will need to further develop our own distribution capabilities, which would be expensive and time-consuming and the success of which would be uncertain.

Two of our distributors accounted for an aggregate of approximately 85% of our product sales for the six months ended June 30, 2001 and 99% of our accounts receivable balance as of June 30, 2001. One distributor, United Agri Products, a subsidiary of ConAgra Foods, Inc., accounted for approximately 72% of our product sales revenue and 83% of our accounts receivable balance, and Western Farm Service Company accounted for approximately 13% of our product sales revenue and 16% of our accounts receivable balance as of June 30, 2001. We anticipate that we will continue to extend credit to these distributors. If either of these distributors, or any other distributor which purchases a significant amount of our products, were to discontinue purchasing our products at any time, our sales would be adversely affected. In addition, the failure of either of these distributors, or of any other distributor to which we extend a significant amount of credit, to pay its account, now or in the future, may harm our operating results.

INABILITY TO OBTAIN REGULATORY APPROVALS, OR TO COMPLY WITH ONGOING AND CHANGING REGULATORY REQUIREMENTS, COULD DELAY OR PREVENT SALES OF MESSENGER AND OTHER POTENTIAL PRODUCTS.

The field testing, manufacture, sale and use of plant protection and yield enhancement products, including Messenger and other products we may develop, are extensively regulated by the EPA and state, local and foreign governmental authorities. These regulations substantially increase the cost and time associated with bringing our products to market. If we do not receive the necessary governmental approvals to test, manufacture and market our products, or if the regulatory authorities revoke our approvals or grant them subject to restrictions on their use, we may be unable to sell our products and our business may fail.

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In April 2000, we received conditional approval from the EPA to market and sell our first product, Messenger, in the United States. We are required, however, to obtain regulatory approval from certain state and foreign regulatory authorities before we market Messenger in those jurisdictions. Although we are authorized to sell Messenger in 48 states on virtually all crops and in California on strawberry, we have not yet received approval for Messenger in Colorado or for use on other crops in California. We have also received authorization to sell Messenger in Ecuador, though we have not yet obtained authorization to sell Messenger in any other foreign countries. Certain of these jurisdictions may apply different criteria than the EPA in connection with their approval processes.

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If we make significant enhancements in Messenger's design as a result of our ongoing research and development projects, additional EPA approvals may be required. Moreover, we cannot assure you that we will be able to obtain approval for marketing additional harpin-based products or product extensions that we may develop. For example, while the EPA has in place a registration procedure for products such as Messenger that is streamlined in comparison to the registration procedure for chemical pesticides, there can be no assurance that all of our products or product extensions will be eligible for the streamlined procedure or that additional requirements will not be added by the EPA that could make the procedure more time-consuming and costly for our future products.

Even after we obtain all necessary regulatory approvals to market and sell Messenger and other products we may develop, Messenger and other such products will be subject to continuing review and extensive regulatory requirements. The EPA, as well as state and foreign governmental authorities, could withdraw a previously approved product from the market upon receipt of newly discovered information, including an inability to comply with regulatory requirements, the occurrence of unanticipated problems with the product or other reasons. In addition, federal, state and foreign regulations relating to crop protection products developed through biotechnology are subject to public concerns and political circumstances, and, as a result, regulations have changed and may change substantially in the future. These changes may result in limitations on the manufacturing, marketing or use of Messenger or other products that we may develop and commercialize.

INABILITY TO SATISFY THE CONDITIONS OF OUR EPA AND CALIFORNIA REGISTRATIONS COULD LIMIT OR PREVENT SALES OF MESSENGER.

The EPA conditioned its approval of our Messenger registration on the requirement that we conduct four additional studies by April 19, 2001 that are designed to further demonstrate the safety of our product. These studies were completed and submitted to the EPA on April 16, 2001. In addition, our registration to sell Messenger in California, which is limited to sales for use on strawberry for disease management, is conditioned on the requirement that we submit data from several additional studies within various required timeframes over the next two years. If we are unable to conduct the studies required by the California Department of Pesticide Regulation in a timely manner, or if the results of the studies are unacceptable to the EPA or the CDPR, as applicable, the EPA or the CDPR may revoke its approvals or impose limitations on the use of Messenger that could have a negative impact on our sales. Because EPA and state approvals are required for commercial sales of Messenger, the loss of such approvals for any reason, including our inability to satisfy the conditions of our EPA registration, would prevent further sales of Messenger.

INABILITY TO COMPLY WITH REGULATIONS APPLICABLE TO OUR FACILITIES AND PROCEDURES COULD DELAY, LIMIT OR PREVENT OUR RESEARCH AND DEVELOPMENT OR MANUFACTURING ACTIVITIES.

Our research and development and manufacturing facilities and procedures are subject to continual review and periodic inspection. To comply with the regulations applicable to these facilities and procedures, we must spend funds, time and effort in the areas of production, safety and quality

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control and assurance to help ensure full technical compliance. If the EPA or another regulator determines that we are not in compliance, regulatory approval of our products could be delayed or withheld or we may be required to limit or cease our research and development or manufacturing activities or pay a monetary fine. If we were required to limit or cease our research and development



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activities, our ability to develop new products would be impaired. In addition, if we were required to limit or cease our manufacturing activities, our ability to produce Messenger in commercial quantities would be impaired or prohibited, which would have an adverse effect on our sales.

IF THIRD-PARTY MANUFACTURERS FAIL TO ADEQUATELY PERFORM, WE COULD BE UNABLE TO MEET DEMAND AND OUR REVENUES COULD BE IMPAIRED.

We currently depend on independent manufacturers to perform certain portions of our production process. We intend to engage, and we are in discussions with, additional third-party manufacturers to perform this process. Any failure or delay in the ability of our current or any future manufacturers to provide us with material they produce could adversely affect our ability to produce Messenger in the quantities necessary to satisfy the requirements of our distributors or customers, or could increase our costs associated with obtaining such materials. In addition, the time and resources that our current or future third-party manufacturers devote to our business are not within our control. We cannot ensure that our current or future third-party manufacturers will perform their obligations to meet our quality standards, that we will derive cost savings or other benefits from our relationships with them or that we will be able to maintain a satisfactory relationship with them on commercially acceptable terms. Moreover, these manufacturers may support products that compete directly or indirectly with ours, or offer similar or greater support to our competitors. If any of these events were to occur, our business and operations could be adversely affected.

INTERNATIONAL EXPANSION WILL SUBJECT US TO RISKS ASSOCIATED WITH INTERNATIONAL OPERATIONS, WHICH COULD ADVERSELY AFFECT BOTH OUR DOMESTIC AND OUR INTERNATIONAL OPERATIONS.

Our success depends in part on our ability to expand internationally as we obtain regulatory approvals to market and sell our products in other countries. We have been conducting field trials in several international locations, and we hired personnel in Mexico and Europe to develop operations in those regions. International expansion of our operations could impose substantial burdens on our resources, divert management's attention from domestic operations and otherwise adversely affect our business. Furthermore, international operations are subject to several inherent risks, especially different regulatory requirements and reduced protection of intellectual property rights, that could adversely affect our ability to compete in international markets and have a negative effect on our operating results.

INABILITY TO ADDRESS STRAIN ON OUR RESOURCES CAUSED BY GROWTH COULD RESULT IN OUR INABILITY TO EFFECTIVELY MANAGE OUR BUSINESS.

As we add manufacturing, marketing, sales, field development and other personnel, both domestically and internationally, during the commercialization of Messenger, and expand our manufacturing and research and development capabilities, we expect that our operating expenses and capital requirements will increase. Our ability to manage growth effectively requires us to continue to expend funds to improve our operational, financial and management controls, reporting systems and procedures. In addition, we must effectively expand, train and manage our employee base. We will be unable to effectively manage our business if we are unable to timely and successfully alleviate the strain on our resources caused by growth in our business, which could adversely affect our operating results.

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The market for plant protection and yield enhancement products is intensely competitive, rapidly changing and undergoing consolidation. We may be unable to compete successfully against our current and future competitors, which may result in price reductions, reduced margins and the inability to achieve market acceptance of our products.

Many companies are engaged in developing plant protection and yield enhancement products. Our competitors include major international agri-chemical companies, specialized biotechnology companies and research and academic institutions. Many of these organizations have significantly more capital, research and development, regulatory, manufacturing, distribution, sales, marketing, human and other resources than we do. As a result, they may be able to devote greater resources to the development, manufacture, promotion or sale of their products, receive greater resources and support from independent distributors, initiate or withstand substantial price competition or take advantage of acquisition or other opportunities more readily. Further, many of the large agri-chemical companies have a more diversified product offering than we do, which may give these companies an advantage in meeting customer needs by enabling them to offer integrated solutions to plant protection and yield enhancement.

INABILITY TO PROTECT OUR PATENTS AND PROPRIETARY RIGHTS IN THE UNITED STATES AND FOREIGN COUNTRIES COULD LIMIT OUR ABILITY TO COMPETE EFFECTIVELY SINCE OUR COMPETITORS MAY TAKE ADVANTAGE OF OUR RESEARCH AND DEVELOPMENT EFFORTS.

Our success depends on our ability to obtain and maintain patent and other proprietary-right protection for our technology and products in the United States and other countries. If we are unable to obtain or maintain these protections, we may not be able to prevent third parties from using our proprietary rights. We also rely on trade secrets, proprietary know-how and continuing technological innovation to remain competitive. We have taken measures to protect our trade secrets and know-how, including the use of confidentiality agreements with our employees, consultants and advisors. It is possible that these agreements may be breached and that any remedies for a breach will not make us whole. We generally control and limit access to, and the distribution of, our product documentation and other proprietary information. Despite our efforts to protect these proprietary rights, unauthorized parties may copy aspects of our products and obtain and use information that we regard as proprietary. We also cannot guarantee that other parties will not independently develop our know-how or otherwise obtain access to our technology.

The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant problems and incurred significant costs in protecting their proprietary rights in these foreign countries.

Patent law is still evolving relative to the scope and enforceability of claims in the fields in which we operate. We are like many biotechnology companies in that our patent protection is highly uncertain and involves complex legal and technical questions for which legal principles are not firmly established. Our patents and those patents for which we have license rights may be challenged, narrowed, invalidated or circumvented. In addition, our issued patents may not contain claims sufficiently broad to protect us against third parties with similar technologies or products, or provide us with any competitive advantage. We are not certain that our pending patent applications will be issued. Moreover, our competitors could challenge or circumvent our patents or pending patent applications.

The U.S. Patent and Trademark Office and the courts have not established a consistent policy regarding the breadth of claims allowed in biotechnology patents. The allowance of broader claims may

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increase the incidence and cost of patent interference proceedings and the risk of infringement litigation. On the other hand, the allowance of narrower claims may limit the value of our proprietary rights.

OTHER COMPANIES MAY CLAIM THAT WE INFRINGE THEIR INTELLECTUAL PROPERTY OR PROPRIETARY RIGHTS, WHICH COULD CAUSE US TO INCUR SIGNIFICANT EXPENSES OR BE PREVENTED FROM SELLING OUR PRODUCTS.

Our success depends on our ability to operate without infringing the patents and proprietary rights of third parties. Product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. Future patents issued to third parties may contain claims that conflict with our patents. Although we believe that our current product does not infringe the proprietary rights of any third parties, third parties could assert infringement claims against us in the future. Any litigation or interference proceedings, regardless of their outcome, would probably be costly and require significant time and attention of our key management and technical personnel. Litigation or interference proceedings could also force us to:

- stop or delay selling, manufacturing or using products that incorporate the challenged intellectual property;
- pay damages; or
- enter into licensing or royalty agreements that may be unavailable on acceptable terms.

IF WE DO NOT ADEQUATELY DISTINGUISH MESSENGER FROM GENETICALLY MODIFIED PLANTS AND CERTAIN OTHER PRODUCTS, PUBLIC CONCERNS OVER THOSE PRODUCTS COULD NEGATIVELY IMPACT MARKET ACCEPTANCE OF MESSENGER.

Claims that genetically engineered products are unsafe for consumption or pose a danger to the environment have led to public concerns and negative public attitudes, particularly in Europe. We intend to distinguish Messenger and harpin-related technologies from products that genetically modify plants. While our technology does involve genetic modification in the process of manufacturing Messenger, Messenger and harpin-related technologies are topically applied and do not genetically modify the plant's DNA. If the public or potential customers perceive Messenger as a genetically modified product, Messenger may not gain market acceptance. Similarly, countries that have imposed more restrictive regulations on genetically modified plants, including Japan and certain members of the European Union, may perceive Messenger as a genetically modified product. If so, regulators in those countries may impose more restrictive regulations on Messenger, which could delay, limit or impair our ability to market and sell Messenger in those countries.

WE MAY BE EXPOSED TO PRODUCT LIABILITY CLAIMS, WHICH COULD ADVERSELY AFFECT OUR OPERATIONS.

We may be held liable or incur costs to settle product liability claims if any products we develop, or any products that use or incorporate any of our technologies, cause injury or are found unsuitable during product testing, manufacturing, marketing, sale or use. These risks exist even with respect to products that have received, or may in the future receive, regulatory approval, registration or clearance for commercial use. We cannot guarantee that we will be able to avoid product liability exposure.

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We currently maintain product liability insurance at levels we believe are sufficient and consistent with industry standards for companies at our stage of development. We cannot guarantee that our product liability insurance is adequate, and, at any time, it is possible that such insurance coverage may not be available on commercially reasonable terms or at all. A product liability claim could result in liability to us greater than our assets and insurance coverage. Moreover, even if we have adequate

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insurance coverage, product liability claims or recalls could result in negative publicity or force us to devote significant time and attention to matters other than those in the normal course of business.

INABILITY TO RETAIN OUR KEY EMPLOYEES AND OTHER SKILLED MANAGERIAL AND TECHNICAL PERSONNEL COULD IMPAIR OUR ABILITY TO MAINTAIN AND EXPAND OUR BUSINESS.

We are highly dependent on the efforts and abilities of our current key managerial and technical personnel, particularly Jerry L. Butler, our Chief Executive Officer and President, and Dr. Zhongmin Wei, our Vice President of Research. Our success will depend in part on retaining the services of Mr. Butler and Dr. Wei and our other existing key management and technical personnel and on attracting and retaining new, highly qualified personnel. Inability to retain our existing key management and technical personnel or to attract additional qualified personnel could, among other things, delay our product development and marketing and sales efforts. Although Mr. Butler and Dr. Wei have signed agreements with us that limit their ability to compete directly with us in the future, nothing prevents either of them from leaving EDEN. Moreover, in our field, competition for qualified management and technical personnel is intense. In addition, many of the companies with which we compete for experienced personnel have greater financial and other resources than we do. As a result of these factors, we may be unable to recruit, train and retain sufficient qualified personnel.

WE MAY HAVE TO REDUCE OPERATIONS IF WE ARE UNABLE TO MEET OUR FUNDING REQUIREMENTS.

We will require substantial additional funding to continue our research and development activities, maintain and operate our manufacturing facilities and commercialize products worldwide. If we are unable to generate sufficient cash flow from operations, or obtain funds through additional financing, we may have to delay, curtail or eliminate some or all of our research and development, field testing, marketing and manufacturing programs. We believe that our existing capital resources will be sufficient to support our operations for at least the next year. Our future capital requirements will depend on the success of our operations.

If our capital requirements vary from our current plans, we may require additional financing sooner than we anticipate. Financing may be unavailable to us when needed or may not be available to us on acceptable terms.

OUR OPERATING RESULTS ARE LIKELY TO FLUCTUATE, RESULTING IN AN UNPREDICTABLE LEVEL OF SALES AND EARNINGS AND POSSIBLY IN A DECREASE IN OUR STOCK PRICE.

Our operating results for a particular quarter or year are likely to fluctuate, which could result in uncertainty surrounding our level of sales and earnings and possibly result in a decrease in our stock price. Numerous factors will contribute to the unpredictability of our operating results. In particular, our sales are expected to be highly seasonal. Sales of plant protection and yield enhancement products are dependent on planting and growing seasons,

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climatic conditions, economic and other variables, which we expect to result in substantial fluctuations in our quarterly sales and earnings. For example, weather-related events such as droughts and floods, severe heat and frost, hail, tornadoes and hurricanes could decrease demand for our product and any future products we may develop and have an adverse impact on our operating results from quarter to quarter. In addition, most of our expenses, such as employee compensation and lease payments for facilities and equipment, are relatively fixed. Our expense levels are based, in part, on our expectations regarding future sales. As a result, any shortfall in sales relative to our expectations could cause significant changes in our operating results from quarter to quarter. Other factors may also contribute to the unpredictability of our operating results, including the size and timing of significant customer transactions, the delay or deferral of customer use of our products and the fiscal or quarterly budget cycles of our customers. For example, customers may purchase large quantities of our products in a particular quarter to store and use over long periods of time, or time their purchases to

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coincide with the availability of capital, which may cause significant fluctuations in our operating results for a particular quarter or year.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not currently hold any derivative instruments, and we do not engage in hedging activities. Also, we do not have any outstanding variable rate debt and currently do not enter into any material transactions denominated in a foreign currency. Therefore, our direct exposure to interest rate and foreign exchange fluctuation is currently not material to our results of operations. We believe that the market risk arising from holdings of our financial instruments is not material.

## PART II -- OTHER INFORMATION

### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

- (a) On September 26, 2000, the SEC declared effective our Registration Statement on Form S-1, as amended (Registration No. 333-41028), as filed with the SEC in connection with our initial public offering. Proceeds to EDEN, after accounting for \$7.0 million in underwriting discounts and commissions and approximately \$1.6 million in other expenses, were \$91.5 million.

To date, of the net offering proceeds, we have used approximately \$12.4 million to expand and enhance our manufacturing and research and development facilities, and approximately \$16.6 million for working capital and general corporate purposes. The remaining portion of the net offering proceeds has been invested in cash equivalent investments. Our use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus included as part of the Registration Statement.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) The 2001 annual meeting of shareholders of EDEN Bioscience Corporation was held on May 17, 2001.
- (b) The following directors were elected into three classes:

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| Class<br>-----                                                 | Name<br>-----                                                  | For<br>-----                           |
|----------------------------------------------------------------|----------------------------------------------------------------|----------------------------------------|
| Class I Directors to serve one-year terms expiring in 2002     | Oscar C. Sandberg<br>John W. Titcomb, Jr.                      | 18,377,779<br>18,378,479               |
| Class II Directors to serve two-year terms expiring in 2003    | Albert A. James<br>Agatha L. Maza                              | 18,434,779<br>18,378,179               |
| Class III Directors to serve three-year terms expiring in 2004 | Jerry L. Butler<br>Jon E. M. Jacoby<br>William T. Weyerhaeuser | 18,090,653<br>18,435,179<br>18,434,979 |

There were no broker nonvotes in the election of directors since brokers who hold shares for the accounts of their clients have discretionary authority to vote such shares with respect to election of directors.

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## ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

The following exhibits are being filed as part of this quarterly report on Form 10-Q.

### (a) Exhibits.

| EXHIBIT<br>NUMBER<br>----- | DESCRIPTION<br>-----                                                         |
|----------------------------|------------------------------------------------------------------------------|
| 10.15                      | Lease, dated May 29, 2001, between S/I North Creek I, LLC and the Registrant |
| 11.1                       | Statement re computation of per share loss.                                  |

### (b) Reports on Form 8-K.

There were no reports on Form 8-K filed during the three months ended June 30, 2001.

## SIGNATURES

Pursuant to the requirements 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.

EDEN BIOSCIENCE CORPORATION

Date: August 14, 2001

By: /s/ BRADLEY S. POWELL

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Bradley S. Powell  
Vice President of Finance, Secretary  
and Chief Financial Officer  
(principal financial and accounting  
officer)

