

ENZO BIOCHEM INC  
Form 10-Q  
December 10, 2009

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 October 31, 2009

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-09974

**ENZO  
BIOCHEM,  
INC.**

(Exact name of registrant as specified in its charter)

New York

13-2866202

(State or Other Jurisdiction of Incorporation or Organization)

(IRS. Employer Identification No.)

527 Madison Ave, New York, New York

10022

(Address of Principal Executive office)

(Zip Code)

212-583-0100

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant has required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 45 of Regulation S-T (§232.405 of that chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes  No

As of December 1, 2009 the Registrant had approximately 37,858,000 shares of common stock outstanding.

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ENZO BIOCHEM, INC.  
FORM 10-Q  
October 31, 2009

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**Part 1** Financial Information  
**Item 1** Financial Statements

**ENZO BIOCHEM, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share data)

	<b>October 31, 2009 (unaudited)</b>	<b>July 31, 2009 (audited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 6,074	\$ 6,929
Short term investments	40,308	43,306
Accounts receivable, net of allowances	13,699	12,480
Inventories	9,686	9,264
Prepaid expenses and other	2,661	2,482
	72,428	74,461
Total current assets		
Property, plant and equipment, net	11,824	11,323
Goodwill	25,166	24,896
Intangible assets, net	21,953	22,009
Other	389	439
	131,760	133,128
Total assets	\$ 131,760	\$ 133,128
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable trade	\$ 4,098	\$ 4,242
Accrued liabilities	8,150	8,426
Other current liabilities	794	1,062
Deferred taxes	210	213
	13,252	13,943
Total current liabilities		
Deferred revenue		38
Deferred taxes	2,328	2,366
Commitments and contingencies		
Stockholders equity:		
Preferred Stock, \$.01 par value; authorized 25,000,000 shares; no shares issued or outstanding		
Common Stock, \$.01 par value; authorized 75,000,000 shares; shares issued: 38,592,705 at October 31, 2009 and 38,589,880 at July 31, 2009	386	386
Additional paid-in capital	306,602	306,280
Less treasury stock at cost: 735,554 shares at October 31, 2009 and at July 31, 2009	(10,440)	(10,440)
Accumulated deficit	(181,535)	(179,721)
Accumulated other comprehensive income	1,167	276
	116,180	116,781
Total stockholders equity		
Total liabilities and stockholders equity	\$ 131,760	\$ 133,128

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



**ENZO BIOCHEM, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**  
(in thousands, except per share data)

	Three Months Ended October 31,	
	2009	2008
<b>Revenues:</b>		
Product revenues	\$ 10,744	\$ 9,976
Royalty and license fee income	3,311	2,916
Clinical laboratory services	11,110	8,172
	<u>25,165</u>	<u>21,064</u>
<b>Operating expenses:</b>		
Cost of product revenues	5,055	6,805
Cost of clinical laboratory services	6,781	6,091
Research and development expense	2,444	2,003
Selling, general, and administrative expense	11,580	9,190
Provision for uncollectible accounts receivable	912	1,859
Legal expense	256	1,210
	<u>27,028</u>	<u>27,158</u>
Operating loss	(1,863)	(6,094)
<b>Other income (expense)</b>		
Interest income	9	410
Other income	19	34
Foreign currency loss	(58)	(582)
	<u>(1,893)</u>	<u>(6,232)</u>
Loss before income taxes	(1,893)	(6,232)
Benefit (provision) for income taxes	79	(138)
	<u>(1,814)</u>	<u>(6,370)</u>
Net loss	\$ (1,814)	\$ (6,370)
<b>Net loss per common share:</b>		
Basic	\$ (0.05)	\$ (0.17)
Diluted	\$ (0.05)	\$ (0.17)
<b>Weighted average common shares outstanding:</b>		
Basic	37,855	37,337
Diluted	37,855	37,337

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

**ENZO BIOCHEM, INC**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
**AND COMPREHENSIVE LOSS**  
**Three months ended October 31, 2009**  
**(UNAUDITED)**  
**(In thousands, except share data)**

	<u>Common Stock Shares</u>	<u>Treasury Stock Shares</u>	<u>Common Stock Amount</u>	<u>Additional Paid-in Capital</u>	<u>Treasury Stock Amount</u>	<u>Accumulated Deficit</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Total Stockholders Equity</u>	<u>Comprehensive Loss</u>
Balance at July 31, 2009	38,589,880	735,554	\$ 386	\$ 306,280	\$ (10,440)	\$ (179,721)	\$ 276	\$ 116,781	
Net loss for the period ended October 31, 2009						(1,814)		(1,814)	\$ (1,814)
Vesting of restricted stock	2,825								
Stock based compensation charges				322				322	
Foreign currency translation adjustments							891	891	891
Comprehensive loss									\$ (923)
Balance at October 31, 2009	38,592,705	735,554	\$ 386	\$ 306,602	\$ (10,440)	\$ (181,535)	\$ 1,167	\$ 116,180	

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

**ENZO BIOCHEM, INC**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
**(in thousands)**

	Three Months Ended	
	October 31, 2009	2008
Cash flows from operating activities:		
Net loss	\$ (1,814)	\$ (6,370)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization of property, plant and equipment	529	494
Amortization of intangible assets	414	260
Provision for uncollectible accounts receivable	912	1,859
Write off and/or reserve taken for obsolete inventory	174	62
Income tax benefit	(119)	(105)
Share based compensation charges	322	394
Deferred revenue recognized	(113)	(122)
Foreign currency loss on intercompany loan	16	582
Changes in operating assets and liabilities:		
Accounts receivable	(2,078)	664
Inventories	(487)	410
Prepaid expenses	(171)	724
Accounts payable trade	(99)	(1,059)
Accrued liabilities	(141)	779
Other current liabilities	(193)	(37)
Total adjustments	(1,034)	4,905
Net cash used in operating activities	(2,848)	(1,465)
Cash flows from investing activities:		
Purchases of short term investments	(70,301)	(77,701)
Maturities of short term investments	73,299	37,953
Capital expenditures	(1,128)	(829)
Decrease in security deposits and other assets	49	342
Net cash provided (used in) investing activities	1,919	(40,235)
Cash flows from financing activities:		
Proceeds from the exercise of stock options		348
Net cash provided by financing activities		348
Effect of exchange rate changes on cash and cash equivalents	74	(144)
Decrease in cash and cash equivalents	(855)	(41,496)
Cash and cash equivalents - beginning of period	6,929	78,322
Cash and cash equivalents - end of period	\$ 6,074	\$ 36,826

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





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## ENZO BIOCHEM, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As of October 31, 2009  
and for the three month period ended  
October 31, 2009 and 2008  
(Unaudited)

### Note 1 Basis of Presentation

The accompanying consolidated financial statements include the accounts of Enzo Biochem, Inc. and its wholly-owned subsidiaries, Enzo Clinical Labs, Enzo Life Sciences, Enzo Therapeutics and Enzo Realty LLC, collectively referred to as the Company or Companies. The consolidated balance sheet as of October 31, 2009, consolidated statement of stockholders' equity and comprehensive loss for the three months ended October 31, 2009, and the consolidated statements of operations and consolidated statements of cash flows for the three months ended October 31, 2009 and 2008 are unaudited. In the opinion of management, all adjustments (which include normal recurring adjustments) necessary to present fairly the financial position and operating results for the interim periods have been made. Certain information and footnote disclosure, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, have been condensed or omitted. The consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended July 31, 2009 and notes thereto contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. The consolidated balance sheet at July 31, 2009 has been derived from the audited financial statements at that date. The results of operations for the three months ended October 31, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending July 31, 2010.

#### *Recent Accounting Pronouncements*

Effective August 1, 2009, the Company adopted The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC or Codification) of Generally Accepted Accounting Principles Overall. The Codification established one source for all U.S. GAAP and became the source of authoritative accounting principles for nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification is not intended to change existing GAAP and as such did not have an impact on the consolidated financial statements of the Company.

The adoption of the following accounting standards and updates during the first three months of fiscal 2010 did not result in a significant impact to our consolidated financial statements.

On June 15, 2009, we adopted the accounting pronouncement that amends the requirements for disclosures about fair value of financial instruments, regarding the fair value of financial instruments for annual, as well as interim, reporting periods. This pronouncement was effective prospectively for all interim and annual reporting periods ending after June 15, 2009.

Effective August 1, 2009, we adopted the revised accounting standard relating to business combinations, including assets acquired and liabilities assumed arising from contingencies. This standard requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and applies to all transactions and other events in which one entity obtains control over one or more other businesses. Upon our adoption of this standard, we will be required to expense certain transaction costs and related fees associated with business combinations that were previously capitalized. In addition, with the adoption of this standard, changes to valuation allowances for acquired deferred income tax assets and adjustments to unrecognized tax benefits acquired generally are to be recognized as adjustments to income tax expense rather than goodwill.

Effective August 1, 2009, we adopted the accounting standard regarding the determination of the useful life of intangible assets that removes the requirement to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions, and replaces it with a requirement that an entity consider its own historical experience in renewing similar arrangements, or a consideration of market participant assumptions in the absence of historical experience. This standard also requires entities to disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangements.

*Reclassifications*

Certain amounts in fiscal 2009 have been reclassified to conform to current year presentation. In Fiscal 2009, the Company reclassified certain payroll taxes and employee benefits included in selling, general and administrative expense to cost of sales. The payroll taxes and benefits reclassified were approximately \$285,000 for the three months ended October 31, 2008.

Note 2 Short-term Investments

At October 31, 2009 and July 31, 2009, the Company's short-term investments, whose fair value approximates cost, are in U.S. Government Treasury bills, which are purchased at discounts with remaining maturities of less than ninety days.

The Company has adopted the accounting pronouncement that establishes a common definition for fair value to be applied to existing GAAP that require the use of fair value measurements, establishes a framework for measuring fair value and expands disclosure about such fair value measurements. The adoption of the pronouncement did not have an impact on the Company's financial position or operating results, but did expand certain disclosures.

The pronouncement defines fair value 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. Additionally, the pronouncement requires the use of valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. These inputs are prioritized below:

*Level 1:* Observable inputs such as quoted market prices in active markets for identical assets or liabilities.

*Level 2:* Observable market-based inputs or unobservable inputs that are corroborated by market data.

*Level 3:* Unobservable inputs for which there is little or no market data, which require the use of the reporting entity's own assumptions.

At October 31, 2009 and July 31, 2009, the Company's short-term investments are classified as Level 1 assets.

Note 3 Acquisitions

**Assay Designs, Inc.**

On March 12, 2009, Enzo Life Sciences, Inc. and Enzo Life Sciences Acquisition, Inc., a newly formed wholly owned subsidiary of Enzo Life Sciences, Inc. ( Acquisition Sub ), entered into an asset purchase agreement ( Purchase Agreement ) with Assay Designs, Inc. ( Assay Designs ). Assay Designs, a privately owned company with annual sales of approximately \$11 million, was engaged in researching, developing, manufacturing, distributing, marketing and selling specialty immunological and biochemical protein detection kits, assays, reagents, antibodies, recombinant proteins and related products and providing related services for use in the biotechnology, pharmaceutical and life sciences research industries ( Business ). Under the terms of the Purchase Agreement, Acquisition Sub purchased from Assay Designs substantially all of its assets, including trade accounts receivable, inventory, fixed assets, and intellectual property, used in or related to the Business and assumed certain of Assay Designs' liabilities, including trade accounts payable, capital lease obligations and certain other current liabilities.

The execution of the Purchase Agreement and the closing of the transaction occurred simultaneously on March 12, 2009. The purchase price consisted of \$12,228,000 in cash, exclusive of acquisition costs of approximately \$540,000, and was subject to an upward or downward post-closing purchase price adjustment based on Assay Designs' working capital as of the closing date, \$100,000 of which was held in escrow for approximately 60-90 days to secure the payment of any downward post-closing purchase price adjustment and \$750,000 of which will be held in escrow for 12 months to secure the payment of any indemnification obligations of Assay Designs under the Purchase Agreement. Subsequent to the acquisition date, the Company paid \$270,000 in additional purchase price in connection with the working capital adjustment and released the \$100,000 escrow amount. The Company expects the cost of the acquisition to be increased when the integration plan to consolidate a facility and the involuntary termination of certain employees is finalized and the cost is determinable during the measurement period. The Assay Design Acquisition strengthens the Company's position as a global provider of life sciences reagents by broadening our product offerings and manufacturing capabilities.

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The acquisition was funded with the Company's cash. Effective March 12, 2009, Assay Designs became a wholly-owned subsidiary of Enzo Life Sciences. The consolidated financial statements include the results of operations for Assay Designs from the date of acquisition.

The following table presents the preliminary estimated fair values of the assets acquired and liabilities assumed (in thousands) as of the date of acquisition:

Current assets	\$ 4,235
Property and equipment	1,747
Other assets	11
Intangible assets	6,360
Goodwill	1,803
	<hr/>
Total assets acquired	14,156
	<hr/>
Less:	
Current liabilities	1,115
	<hr/>
Total liabilities assumed	1,115
	<hr/>
Net assets acquired	\$ 13,041
	<hr/>

The preliminary purchase price allocation is based on management's estimate of acquired tangible and intangible assets and will be adjusted based on the final valuation to be completed within one year from the acquisition date. The excess of the total purchase price over the fair value of the net assets acquired, including the estimated fair value of the identifiable intangible assets, has been allocated to goodwill.

**Biomol International, L.P.**

On May 8, 2008, Enzo Life Sciences, Inc. acquired substantially all of the U.S. based assets and certain liabilities of Biomol International, LP ( Biomol LP ) through a newly formed US subsidiary Biomol International, Inc. and all of the stock of Biomol s wholly-owned United Kingdom subsidiary, Affinity Limited, through Axxora UK, a wholly-owned subsidiary of Enzo Life Sciences, collectively referred to as Biomol for approximately \$18.1 million in cash and stock, subject to adjustment, exclusive of acquisition costs of approximately \$800,000 and two contingent earn-out payments accounted for as additional purchase consideration if and when the contingencies are resolved beyond a reasonable doubt. At closing, the purchase price was satisfied as follows: \$12.9 million in cash was paid to Biomol LP, issuance of 352,000 shares of Enzo common stock, at fair market value, to Biomol LP, \$1.5 million in cash was paid to an escrow agent for the two-year period following the closing to satisfy any indemnification obligations of the sellers under the Agreement and \$550,000 was paid to an escrow agent, for the 60 day period following the closing to satisfy any specified purchase price adjustments. The \$550,000 was released by the escrow agent in August 2008. The earn-outs of \$2.5 million on each of the next two anniversaries of the acquisition date will be based on attaining certain revenue and EBITDA targets, as defined. The Agreement provides for the delivery of the earn-out statement within 75 days of the respective anniversary dates. Biomol was a privately owned, closely held global manufacturer and marketer of specialty life sciences research products. Effective May 8, 2008, Biomol became a wholly-owned subsidiary of Enzo Life Sciences. The acquisition was financed with the Company s cash and cash equivalents and Enzo common stock. The consolidated financial statements include the results of operations for Biomol from the date of acquisition. Effective February 2, 2009, the names of Biomol International, Inc. and Affinity Limited were changed to Enzo Life Sciences International, Inc. and Enzo Life Sciences (UK) Ltd., respectively.

In June 2009, the conditions for the first annual earn-out of \$2.5 million were met and the Company recorded \$2.5 million of additional goodwill. The Company issued 202,196 shares of Enzo common stock at fair value and paid \$1.5 million in cash to satisfy the \$2.5 million earn-out liability.

The following table presents the estimated fair values of the assets acquired and liabilities assumed (in thousands) as of the date of acquisition:

Current assets	\$ 5,167
Property and equipment	939
Other assets	18
Intangible assets	7,660
Goodwill	9,226
	<hr/>
Total assets acquired	23,010
	<hr/>
Less:	
Current liabilities	1,100
Deferred tax liabilities	609
	<hr/>
Total liabilities assumed	1,709
	<hr/>
Net assets acquired	\$ 21,301
	<hr/>

The purchase price allocation is based on a valuation of acquired tangible and intangible assets based on the final valuation completed in fiscal 2009. The Company determined the fair value of the identifiable intangible assets based on various factors including: cost, discounted cash flow and relief from royalty approaches in determining the purchase price allocation. The excess of the total purchase price over the fair value of the net assets acquired, including the estimated fair value of the identifiable intangible assets, has been allocated to goodwill.

For financial reporting purposes, useful lives for the intangibles acquired in the acquisitions have been assigned as follows:

Customer relationships	8-15 years
Trademarks	Indefinite
Other intangibles	4-5 years

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The following unaudited pro forma financial information presents the combined results of operations of the Company and the acquisition completed in fiscal 2009 as if the acquisition had occurred as of August 1, 2008. The pro forma financial information reflects appropriate adjustments primarily for amortization of intangible assets and interest expense. The pro forma financial information presented is not necessarily indicative of either the actual consolidated operating results had the acquisitions been completed at the beginning of each period or future operating results of the consolidated entities.

<u>In thousands, except per share data</u>	<u>Three months ended October 31, 2008</u>	
Net revenues	\$	23,887
Net loss	\$	(6,525)
Net loss per common share basic and diluted	\$	(0.17)
<u>Note 4 Net loss per share</u>		

Basic net income (loss) per share represents net income (loss) divided by the weighted average number of common shares outstanding during the period. The dilutive effect of potential common shares, consisting of outstanding stock options and unvested restricted stock, is determined using the treasury stock method. Diluted weighted average shares outstanding for the three months ended October 31, 2009 and 2008 do not include the potential common shares from stock options and unvested restricted stock because to do so would have been antidilutive. Accordingly, basic and diluted net loss per share is the same during these periods.

The following table summarizes the potential number of shares issued from exercise of in the money stock options, net of shares repurchased with the option exercise proceeds and potential shares from restricted stock awards, which are excluded from the computation of diluted net loss per share.

<u>(In thousands)</u>	<u>Three months ended October 31, 2009</u>		<u>2008</u>
Potential net shares, issued from exercise of in the money employee and director stock options and restricted stock awards, excluded from diluted net loss per share calculation	153,000	119,000	

The following table summarizes the number of out of the money options excluded from the computation of diluted net loss per share because the effect of their potential exercise is anti-dilutive.

<u>(In thousands)</u>	<u>Three months ended October 31, 2009</u>		<u>2008</u>
Out of the money employee and director stock options	1,181,000	1,659,000	

Note 5 Share-based compensation

The following table sets forth the amount of expense related to share-based payment arrangements included in specific line items in the accompanying statements of operations:

<u>In thousands</u>	<u>Three months ended October 31, 2009</u>		<u>2008</u>
Cost of product revenues	\$	3	\$
Research and development		3	22
Selling, general and administrative		316	372

\$ 322 \$ 394

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No excess tax benefits were recognized during the three month periods ended October 31, 2009 and 2008.

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*Stock option plans*

A summary of the activity relating to the Company's stock option plans for the three month period ended October 31, 2009 is as follows:

	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Aggregate Intrinsic Value</u>
Outstanding at August 1, 2009	1,191,519	\$ 14.41	\$
Exercised		\$	
Cancelled	(10,485)	\$ 11.95	
Outstanding and exercisable at end of period	<u>1,181,034</u>	<u>\$ 14.44</u>	<u>\$</u>

As of October 31, 2009, there was no unrecognized compensation cost related to unvested stock option-based compensation.

During the three months ended October 31, 2008, the Company received cash proceeds of approximately \$348,000, from the exercise of 44,586 stock options. There were no stock option exercises during the three months ended October 31, 2009. The aggregate intrinsic value of stock options exercised during the three months ended October 31, 2008, including the non-cash transactions (Note 6) was approximately \$1.4 million.

*Restricted Stock Awards*

A summary of the activity pursuant to the Company's restricted stock awards for the three months ended October 31, 2009 is as follows:

	<u>Awards</u>	<u>Weighted Average Award Price</u>
Unvested at August 1, 2009	377,900	\$ 6.05
Awarded		\$
Vested	(2,825)	\$ 11.84
Forfeited	(100)	\$ 13.79
Unvested at end of period	<u>374,975</u>	<u>\$ 6.02</u>

The fair value of a restricted stock award is determined based on the closing stock price on the award date. As of October 31, 2009, there was approximately \$1.3 million of total unrecognized compensation cost related to unvested restricted stock-based compensation to be recognized over a weighted average remaining period of one and half years.

The total number of shares available for grant as stock options or award as restricted stock is approximately 401,300 as of October 31, 2009.

Note 6 Supplemental disclosure for statement of cash flows

Supplemental information with respect to the Company's consolidated statements of cash flows is as follows (In thousands):

<b>Three months ended</b>	
<b>October 31,</b>	
<b>2009</b>	<b>2008</b>



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Taxes paid net	<u>\$</u>	<u>6</u>	<u>\$</u>	<u>39</u>
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During the three months ended October 31, 2008, certain officers of the Company exercised 206,576 stock options in a non-cash transaction. The officers surrendered 99,985 shares of previously acquired common stock to exercise the stock options. The Company recorded approximately \$1.1 million, the market value of the surrendered shares, as treasury stock. There were no stock options exercises during the three month ended October 31, 2009.

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Note 7 Comprehensive loss and Accumulated Other Comprehensive Income

During the three months ended October 31, 2009 and 2008, total comprehensive loss was approximately \$0.9 million and \$7.9 million, respectively. At October 31, 2009 and July 31, 2009, the accumulated other comprehensive income relates to foreign currency translation adjustments.

Note 8- Inventories

At October 31, 2009 and July 31, 2009 inventories, net of reserves of \$1.2 million and \$1.0 million, respectively, consist of:

In 000 s	October 31, 2009	July 31, 2009
Raw materials	\$ 484	\$ 499
Work in process	1,206	1,801
Finished products	7,996	6,964
	<u>\$ 9,686</u>	<u>\$ 9,264</u>

Note 9 Goodwill and intangible assets

The Company's change in the net carrying amount of goodwill by business segment is as follows (in thousands):

	Enzo Life Sciences	Enzo Clinical Labs	Total
Balance August 1, 2009	\$ 17,444	\$ 7,452	\$ 24,896
Other	7		7
Foreign currency translation	263		263
Balance October 31, 2009	<u>\$ 17,714</u>	<u>\$ 7,452</u>	<u>\$ 25,166</u>

Intangible assets, all of which are included in the Life Sciences segment, consist of the following (in thousands):

	October 31, 2009			July 31, 2009		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Finite-lived intangible assets:						
Patents	\$ 11,027	\$ (10,061)	\$ 966	\$ 11,027	(10,030)	\$ 997
Customer relationships	12,283	(1,361)	10,922	12,125	(1,190)	10,935
Non-compete and employment agreements	483	(310)	173	469	(280)	189
Website and acquired content	1,015	(353)	662	1,005	(303)	702
Licensed technology and other	589	(179)	410	588	(83)	505
Indefinitely-lived intangible assets:						
Trademarks	8,820		8,820	8,681		8,681
Total	<u>\$ 34,217</u>	<u>\$ (12,264)</u>	<u>\$ 21,953</u>	<u>\$ 33,895</u>	<u>\$ (11,886)</u>	<u>\$ 22,009</u>

At October 31, 2009, the weighted average useful life of finite-lived intangible assets was approximately ten and a quarter years.



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Note 10 Accrued Liabilities and Other Current Liabilities

At October 31, 2009 and July 31, 2009, accrued liabilities consist of:

<u>In 000 s</u>	<u>October 31, 2009</u>	<u>July 31, 2009</u>
Legal	\$ 1,695	\$ 1,095
Payroll, benefits, and commissions	1,981	2,737
Research and development	721	656
Professional fees	1,421	1,752
Other	2,332	2,186
	<u>\$ 8,150</u>	<u>\$ 8,426</u>

At October 31, 2009 and July 31, 2009, other current liabilities consist of:

<u>In 000 s</u>	<u>October 31, 2009</u>	<u>July 31, 2009</u>
Deferred revenue	738	850
Other	56	212
	<u>\$ 794</u>	<u>\$ 1,062</u>

Note 11 - Income taxes

At the end of each interim reporting period, the Company estimates its effective income tax rate expected to be applicable for the full year. This estimate is used to determine the income tax provision or benefit on a year-to-date basis and may change in subsequent interim periods.

The Company's effective tax rate benefit (provision) for the three months ended October 31, 2009 was 4.2% compared to (2.2%) during the three months ended October 31, 2008. The tax benefit and (provision) for the periods were based on state and local taxes, domestic and foreign tax for tax deductible goodwill and indefinite lived intangibles, and book to tax differences for acquired inventory.

The Company's effective tax rate for both periods differed from the expected net operating loss carryforward benefit at the U.S. federal statutory rate of 34% primarily due to the inability to recognize such benefit. The carryforward benefit cannot be recognized because of uncertainties relating to future taxable income in terms of both its timing and its sufficiency, which would enable the Company to realize the federal carryforward benefit.

The Company files a consolidated Federal income tax return. The Company files a combined, California, and New York State and City return with certain subsidiaries. Other subsidiaries file separate state and foreign tax returns.

The Company files income tax returns in the U.S. Federal jurisdiction, various U.S. state jurisdictions, and several foreign jurisdictions. With few exceptions, the periods that remain subject to examination are fiscal years ended July 31, 2006 through 2009. In connection with a business combination, the Company recorded as of May 31, 2007 approximately \$300,000 for an uncertain tax position, including accrued interest of \$39,000, with respect to a deemed dividend. During the three months ended October 31, 2009, the Company reduced the balance of this liability by approximately \$106,000 and recognized a corresponding tax benefit as a result of the expiration of the statute of limitations. The Company's policy is to recognize interest and penalties accrued on any uncertain tax positions as a component of income tax expense.

Note 12 Royalty and licensing income

In fiscal 2005, the Company as plaintiff finalized and executed a settlement and license agreement with Digene Corporation to settle a patent litigation lawsuit (the Agreement). Digene Corporation was acquired by QIAGEN. The license agreement with the

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Company was assigned to QIAGEN Gaithersburg Inc. ( Qiagen ). The Agreement provides for the Company to receive quarterly running royalties on the net sales of Qiagen products subject to the license until the expiration of the patent in April 2018. During the three months ended October 31, 2009 and 2008, the Company recorded royalties from the Agreement of approximately \$2.6 million and \$2.3 million, respectively,

During the three months ended October 31, 2009 and 2008, the Company recorded approximately \$0.7 million and \$0.6 million, respectively, in royalties and license fee income under a licensing agreement with Abbott Molecular, Inc. ( Abbott ) entered into in fiscal 2007.

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Note 13 Segment reporting

The Company has three reportable segments: Life Sciences, Therapeutics, and Clinical Labs. The Company's Life Sciences segment develops, manufactures, and markets products to research and pharmaceutical customers. The Company's Therapeutic segment conducts research and development activities for therapeutic drug candidates. The Clinical Labs segment provides diagnostic services to the health care community. The Company evaluates segment performance based on segment income (loss) before taxes. Costs excluded from segment income (loss) before taxes and reported as Other, consist of corporate general and administrative costs which are not allocable to the three reportable segments.

Management of the Company assesses assets on a consolidated basis only and, therefore, assets by reportable segment have not been included in the reportable segments below. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

The following financial information (in thousands) represents the operating results of the reportable segments of the Company:

**Three months ended October 31, 2009**

	<u>Life Sciences</u>	<u>Therapeutics</u>	<u>Clinical Labs</u>	<u>Other</u>	<u>Consolidated</u>
<b>Revenues:</b>					
Product revenues	\$ 10,744	\$	\$	\$	\$ 10,744
Royalty and license fee income	3,311				3,311
Clinical laboratory services			11,110		11,110
	<u>14,055</u>		<u>11,110</u>		<u>25,165</u>
<b>Operating expenses:</b>					
Cost of product revenues	5,055				5,055
Cost of clinical laboratory services			6,781		6,781
Research and development	1,777	667			2,444
Provision for uncollectible accounts receivable			912		912
Selling, general, and administrative and legal	5,172		4,251	2,413	11,836
	<u>12,004</u>	<u>667</u>	<u>11,944</u>	<u>2,413</u>	<u>27,028</u>
Total operating expenses					
Operating income (loss)	2,051	(667)	(834)	(2,413)	(1,863)
<b>Other income (expense):</b>					
Interest income				9	9
Other income	3		16		19
Foreign exchange loss	(58)				(58)
	<u>\$ 1,996</u>	<u>\$ (667)</u>	<u>\$ (818)</u>	<u>\$ (2,404)</u>	<u>\$ (1,893)</u>
Income (loss) before income taxes					
Depreciation and amortization included above	\$ 666	\$ 13	\$ 235	\$ 29	\$ 943
	<u>\$ 666</u>	<u>\$ 13</u>	<u>\$ 235</u>	<u>\$ 29</u>	<u>\$ 943</u>
<b>Share-based compensation included in above:</b>					
Cost of product revenues	\$	\$	\$ 3	\$	\$ 3
Research and development	3				3
Selling, general and administrative and legal	32		24	260	316
	<u>\$ 35</u>	<u>\$</u>	<u>\$ 27</u>	<u>\$ 260</u>	<u>\$ 322</u>
Total					

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Capital expenditures	\$	455	\$	622	\$	51	\$	1,128
		<u>          </u>		<u>          </u>		<u>          </u>		<u>          </u>
		15						

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Three months ended October 31, 2008

	Life Sciences	Therapeutics	Clinical Labs	Other	Consolidated
<b>Revenues:</b>					
Product revenues	\$ 9,976				\$ 9,976
Royalty and license fee income	2,916				2,916
Clinical laboratory services			\$ 8,172		8,172
	12,892		8,172		21,064
<b>Operating expenses:</b>					
Cost of product revenues	6,805				6,805
Cost of clinical laboratory services			6,091		6,091
Research and development	1,199	\$ 804			2,003
Provision for uncollectible accounts receivable			1,859		1,859
Selling, general and administrative and legal	3,212		3,622	\$ 3,566	10,400
Total operating expenses	11,216	804	11,572	3,566	27,158
Operating income (loss)	1,676	(804)	(3,400)	(3,566)	(6,094)
<b>Other income (expense)</b>					
Interest income			45	365	410
Other income	34				34
Foreign exchange loss	(582)				(582)
Income (loss) before income taxes	\$ 1,128	\$ (804)	\$ (3,355)	\$ (3,201)	\$ (6,232)
Depreciation and amortization included above	\$ 477	\$ 10	\$ 237	\$ 30	\$ 754
<b>Share-based compensation included in above:</b>					
Cost of product revenues	\$ 7				\$ 22
Research and development	14	\$ 15			372
Selling, general and administrative and legal			\$ 76	\$ 282	394
Total	\$ 21	15	\$ 76	\$ 282	\$ 394
Capital expenditures	\$ 238	\$ 28	\$ 545	\$ 18	\$ 829

**Note 14 - Contingencies**

Shahram K. Rabbani ( Mr. Rabbani ), former Secretary and Treasurer and current member of the board of directors of the Company and the former President of Enzo Clinical Labs, Inc., in connection with the termination of his employment, submitted on October 31, 2009 a demand for arbitration and related statement of claim to the American Arbitration Association. The statement of claim names the Company, Dr. Elazar Rabbani, the Chairman of the Board and Chief Executive Officer of the Company, and Barry W. Weiner, the President and Chief Financial Officer and a member of the board of directors of the Company, as respondents and alleges, among other things, claims relating to the termination of Mr. Rabbani s employment as President of Clinical Labs. The statement of claim purports to allege claims for breach of contract against the Company, unlawful retaliation under the Sarbanes-Oxley s whistleblower statute (the Claims ) against the Company, Dr. Rabbani and Mr. Weiner, and tortious interference with contract against Dr. Rabbani and Mr. Weiner. Mr. Rabbani seeks damages of no less than \$10 million including attorneys fees, costs, and punitive damages. The Company believes the Claims are without merit and intends to defend vigorously against them.

Subsequent to April 30, 2009, the Company conducted a review, as directed by a special committee of the Board of Directors, relating to the aforementioned Claims pertaining to Enzo Clinical Labs. The review concluded that the purported Claims were



unsubstantiated.

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On September 18, 2009, Mr. Rabbani amended his statement of claim to add a claim for defamation against the Company and a claim against the Company, Dr. Rabbani and Mr. Weiner seeking a declaratory judgment. The Company also believes these additional claims are without merit and intends to defend vigorously against them.

Documentary discovery has commenced, and an arbitration hearing has been scheduled for March 2, 2010. Mr. Rabbani also filed a complaint for unlawful retaliation under the Sarbanes-Oxley Act's whistleblower statute with the Department of Labor against the Company, Dr. Rabbani and Mr. Weiner arising out of the same facts and occurrences. The Company believes the Claims are without merit and intends to defend vigorously against them.

### Note 15 Subsequent Events

The Company has evaluated events and transactions subsequent to October 31, 2009 through December 10, 2009, the date the financial statements were filed with the SEC as part of this Form 10-Q. No events require recognition in the consolidated financial statements or in the notes to the consolidated financial statements by the Company.

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes and other information included elsewhere in this Quarterly Report on Form 10-Q.

### Forward-Looking Statements

Our disclosure and analysis in this report, including but not limited to the information discussed in this Item 2, contain forward-looking information about our Company's financial results and estimates, business prospects and products in research that involve substantial risks and uncertainties. From time to time, we also may provide oral or written forward-looking statements in other materials we release to the public. Forward-looking statements give our current expectations or forecasts of future events. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as anticipate, estimate, expect, project, intend, plan, believe, will, and other words and terms of similar meaning in connection with a discussion of future operations or financial performance. In particular, these include statements relating to future actions, prospective products or product approvals, future performance or results of current and anticipated products, sales efforts, expenses, interest rates, foreign exchange rates, intellectual property matters, the outcome of contingencies, such as legal proceedings, and financial results.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from past results and those anticipated, estimated or projected. As a result, investors are cautioned not to place undue reliance on any of our forward-looking statements. Investors should bear this in mind as they consider forward-looking statements.

We do not assume any obligation to update or revise any forward-looking statement that we make, even if new information becomes available or other events occur in the future. We are also affected by other factors that may be identified from time to time in our filings with the Securities and Exchange Commission, some of which are set forth in Item 1A - Risk Factors in our Form 10-K filing for the 2009 fiscal year. You are advised to consult any further disclosures we make on related subjects in our Forms 10-Q, 8-K and 10-K reports to the Securities and Exchange Commission. Although we have attempted to provide a list of important factors which may affect our business, investors are cautioned that other factors may prove to be important in the future and could affect our operating results. You should understand that it is not possible to predict or identify all such factors or to assess the impact of each factor or combination of factors on our business. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

### **Overview**

The Company is a life sciences and biotechnology company focused on harnessing genetic processes to develop research tools and therapeutics and the provision of diagnostic services to the medical community. Since its founding in 1976, Enzo's strategic focus has been on the development, for commercial purposes, of enabling technologies in the life sciences field. Enzo's pioneering work in genomic analysis coupled with its extensive patent estate and enabling platforms have strategically positioned Enzo to play a crucially important role in the rapidly growing life sciences and molecular medicine marketplaces.

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We are comprised of three operating companies that have evolved out of our core competence: the use of nucleic acids as informational molecules and the use of compounds for immune modulation. These wholly owned operating companies conduct their operations through three reportable segments. Below are brief descriptions of each of the three operating segments (see Note 13 in the notes to consolidated financial statements):

**Enzo Life Sciences** is a company that manufactures, develops and markets functional biology and cellular biochemistry products and tools to research and pharmaceutical customers world-wide and has amassed a large patent and technology portfolio. The company's sources of revenue is from the direct sales of products consisting of labeling and detection reagents for the genomics and sequencing markets and royalty and licensing fee income. The pioneering platforms developed by Enzo Life Sciences enable the development of a wide range of products in the research products marketplace.

The division is internationally recognized and acknowledged as a leader in manufacturing, in-licensing, and commercialization of over 12,000 innovative high quality research reagents in the primary key research areas of epigenetics, live cell analysis, protein degradation pathways and metabolism. The division is an established source for a comprehensive panel of products to scientific experts in the fields of Antibiotics, Autophagy, Cancer, Cell Cycle, Cell Death, Cell Signaling, Cell trafficking, Genomics/Molecular Biology, Immunology, Inflammation, Lipid Signaling, Neurobiology, Protein Degradation, ROS/RNS and Stress/Heat Shock.

**Enzo Clinical Labs** is a regional clinical laboratory serving the greater New York and New Jersey medical community. The Company believes having clinical diagnostic services allows us to capitalize firsthand on our extensive advanced molecular and cytogenetic capabilities and the broader trends in predictive and personalized diagnostics. We offer a menu of routine and esoteric clinical laboratory tests or procedures used in general patient care by physicians to establish or support a diagnosis, monitor treatment or medication, or search for an otherwise undiagnosed condition. We operate a full-service clinical laboratory in Farmingdale, New York, a network of 30 patient service centers throughout greater New York and New Jersey, a stand alone stat or rapid response laboratory in New York City, and a full-service phlebotomy department. Payments for clinical laboratory testing services are made by the Medicare program, healthcare insurers and patients.

**Enzo Therapeutics** is a biopharmaceutical company that has developed multiple novel approaches in the areas of gastrointestinal, infectious, ophthalmic and metabolic diseases, many of which are derived from the pioneering work of Enzo Life Sciences. The Company has focused its efforts on developing treatment regimens for diseases and conditions in which current treatment options are ineffective, costly, and/or cause unwanted side effects. This focus has generated a clinical and preclinical pipeline, as well as more than 40 patents and patent applications.

### Recent Developments

#### Assay Designs, Inc.

On March 12, 2009, Enzo Life Sciences, Inc. and Enzo Life Sciences Acquisition, Inc., a wholly owned subsidiary of Enzo Life Sciences, Inc. ( Acquisition Sub ), entered into an asset purchase agreement ( Purchase Agreement ) with Assay Designs, Inc. ( Assay Designs or ADI ). Assay Designs, a privately owned company with annual sales of approximately \$11 million, was engaged in researching, developing, manufacturing, distributing, marketing and selling specialty immunological and biochemical protein detection kits, assays, reagents, antibodies, recombinant proteins and related products and providing related services for use in the biotechnology, pharmaceutical and life sciences research industries ( Business ). Under the terms of the Purchase Agreement, Acquisition Sub purchased from Assay Designs substantially all of its assets, including trade accounts receivable, inventory, fixed assets, intellectual property and goodwill, used in or related to the Business and assumed certain of Assay Designs' liabilities, including trade accounts payable, capital lease obligations and certain other accrued and other current liabilities.

The execution of the Purchase Agreement and the closing of the transaction occurred simultaneously on March 12, 2009. The purchase price consisted of \$12,228,000 in cash exclusive of acquisition costs of approximately \$540,000, subject to an upward or downward post-closing purchase price adjustment based on Assay Designs' working capital as of the closing date, \$100,000 of which will be held in escrow for approximately 60-90 days to secure the payment of any downward post-closing purchase price adjustment and \$750,000 of which will be held in escrow for 12 months to secure the payment of any indemnification obligations of Assay Designs under the Purchase Agreement. Subsequent to the acquisition date, the Company paid \$270,000 in additional purchase price in connection with the working capital adjustment and released the \$100,000 escrow amount. The Company expects the cost of the acquisition to be increased when the integration plan to consolidate a facility and the involuntary termination of certain employees is finalized and the cost is determinable during the measurement period.

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The Assay Designs acquisition strengthens the Company's position as a global provider of life sciences reagents by broadening our product offerings and manufacturing capabilities. Effective March 12, 2009, Assay Designs became a wholly-owned subsidiary of Enzo Life Sciences. The acquisition was funded with the Company's cash. The consolidated financial statements include the results of operations for Assay Designs from the date of acquisition.

### Biomol International L.P.

On May 8, 2008, Enzo Life Sciences, Inc. acquired substantially all of the U.S. based assets and certain liabilities of Biomol International, LP (Biomol LP) through a newly formed US subsidiary Biomol International, Inc. and all of the stock of Biomol's wholly-owned United Kingdom subsidiary, Affinity Limited, through Axxora UK, a wholly-owned subsidiary of Enzo Life Sciences, collectively referred to as Biomol for approximately \$18.1 million in cash and stock, subject to adjustment, exclusive of acquisition costs of approximately \$800,000 and two contingent earn-out payments which will be accounted for as additional purchase consideration over the next two years if and when the contingencies are resolved beyond a reasonable doubt. At closing, the purchase price was satisfied as follows: \$12.9 million in cash was paid to Biomol LP, issuance of 352,000 shares of Enzo common stock, at fair market value, to Biomol LP, \$1.5 million in cash was paid to an escrow agent for the two-year period following the closing to satisfy any indemnification obligations of the sellers under the Agreement and \$550,000 was paid to an escrow agent, for the 60 day period following the closing to satisfy any specified purchase price adjustments. The \$550,000 was released by the escrow agent in August 2008. The earn-outs of \$2.5 million on each of the first two anniversaries of the acquisition date will be based on attaining certain revenue and EBITDA targets, as defined. In June 2009, the conditions for the first annual earn-out of \$2.5 million were met and the Company recorded \$2.5 million of additional goodwill. The Company issued 202,196 shares of Enzo common stock at fair value and paid \$1.5 million in cash to satisfy the \$2.5 million earn-out liability.

**Results of Operations**  
**Three months ended October 31, 2009 as compared to October 31, 2008**

Comparative Financial Data for the Three Months Ended October 31,

(in thousands)

	<u>2009</u>	<u>2008</u>	<u>Increase (Decrease)</u>	<u>% Change</u>
<b>Revenues:</b>				
Product revenues	\$ 10,744	\$ 9,976	\$ 768	8%
Royalty and license fee income	3,311	2,916	395	14
Clinical laboratory services	11,110	8,172	2,938	36
<b>Total revenues</b>	<b>25,165</b>	<b>21,064</b>	<b>4,101</b>	<b>19</b>
<b>Operating expenses:</b>				
Cost of product revenues	5,055	6,805	(1,750)	(26)
Cost of laboratory services	6,781	6,091	690	11
Research and development	2,444	2,003	441	22
Selling, general, and administrative	11,580	9,190	2,390	26
Provision for uncollectible accounts receivable	912	1,859	(947)	(51)
Legal expenses	256	1,210	(954)	(79)
<b>Total operating expenses</b>	<b>27,028</b>	<b>27,158</b>	<b>(130)</b>	<b>(1)</b>
<b>Operating loss</b>	<b>(1,863)</b>	<b>(6,094)</b>	<b>4,231</b>	<b>69</b>
<b>Other income (expense):</b>				
Interest income	9	410	(401)	(98)
Other income	19	34	(15)	(44)
Foreign currency loss	(58)	(582)	524	(90)
<b>Loss before income taxes</b>	<b>\$ (1,893)</b>	<b>\$ (6,232)</b>	<b>\$ 4,339</b>	<b>70</b>

**Consolidated Results:**

The 2009 period and the 2008 period refer to the three months ended October 31, 2009 and 2008, respectively. The 2009 period includes the three months results of ADI which was acquired on March 12, 2009.

Product revenues increased overall by \$0.8 million in 2009 to \$10.7 million as compared to the 2008 period. Our core product revenues demonstrated strong organic growth of 26% or \$1.0 million and the revenue from the recently acquired ADI contributed acquisition growth of 27% or \$2.7 million. This overall growth was partially offset by declines in our low margin third-party distribution business of \$2.9 million of which one customer accounted for \$2.0 million of the decline.

Royalty and license fee income during the 2009 period was \$3.3 million compared to \$2.9 million in the 2008 period, an increase of \$0.4 million or 14%. Royalties are primarily earned from the reported net sales of Qiagen products subject to a license agreement and from a license agreement with Abbott. During the 2009 period, the Company recognized royalties of approximately \$2.6 million from Qiagen, an increase of approximately \$0.3 million over the 2008 period, and royalties and license fees under the Abbott License Agreement of approximately \$0.7 million, an increase of \$0.1 million over the 2008 period. There are no direct expenses relating to royalty and license fee income.

Clinical laboratory revenues during the 2009 period were \$11.1 million compared to \$8.2 million in the 2008 period. The 2009 period's increase over the 2008 period was \$2.9 million or 36%. During the 2009 period revenue increased due to higher service volume. In addition, during the 2008 period revenues were adversely affected by contractual adjustments of \$2.2 million. These immaterial contractual adjustments related to computational errors that affected the calculated expected reimbursement rate in

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fiscal 2008, 2007 and 2006 and for periods prior to August 1, 2005 for the majority of payers and credits issued which were not accrued for timely.

The cost of product revenues during the 2009 period was \$5.1 million compared to \$6.8 million in the 2008 period, a decrease of \$1.7 million or 26%. The decrease is primarily due to the impact of \$1.8 million in lower costs from non-recurring low margin third-party distribution business, reduced fair value accounting adjustments of \$0.4 million in accordance with purchase accounting rules and reclassification of \$0.8 million in costs relating from the realignment of manufacturing facilities and personnel.

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Such amounts in 2009 were partially offset by product cost relating to ADI of \$1.0 million. We believe that cost of product revenues for future periods will be affected by, among other things, the further integration of acquired businesses in addition to sales volumes, competitive conditions and foreign currency rates.

The cost of clinical laboratory services during the 2009 period was \$6.8 million as compared to \$6.1 million in the 2008 period, an increase of \$0.7 million or 11%. The Company incurred increased costs partially due to increased service volume in 2009. Increases occurred in reagent costs and supplies of \$0.3 million, laboratory personnel costs of \$0.2 million and outside reference lab costs of \$0.2 million. Laboratory personnel costs increased primarily due to additional headcounts in phlebotomists to expand patient collection sites and other personnel to manage expanded internal operations.

Research and development expenses were approximately \$2.4 million during the 2009 period, compared to \$2.0 million in the 2008 period, an increase of \$0.4 million or 22%. The increase was principally attributed to higher costs of \$0.5 million at Enzo Life Sciences primarily related to Assay Designs offset by \$0.1 million in lower clinical trial and related activities at the Therapeutics segment.

Selling, general and administrative expenses were approximately \$11.6 million during the 2009 period as compared to \$9.2 million in the 2008 period, an increase of \$2.4 million or 26%. The increase was primarily due to the net increase at the Enzo Life Sciences segment of \$2.0 million in the 2009 period which included approximately \$1.1 million of selling, general and administrative expenses related to Assay Designs operations, the impact of realigning manufacturing facilities and certain personnel of \$0.8 million and \$0.2 million in costs relating to the on-going corporate identity program. The Clinical Lab segment's selling general and administrative increased \$0.6 million primarily due to increased payroll and related benefits of \$0.2 million, professional fees of \$0.2 million, and other expenses of \$0.2 million. These increases were offset by a decrease in the Other segment's selling general and administrative of approximately \$0.2 million, primarily due to decreases in payroll and payroll related costs of \$0.1 million and consulting and professional fees of \$0.1 million.

The provision for uncollectible accounts receivable, primarily relating to the Clinical Labs segment was \$0.9 million for the 2009 period as compared to \$1.9 million in the 2008 period, a decrease of \$1.0 million or 51%. During the 2008 period, the Company recorded a charge of \$1.1 million attributed to increased provisions for the Clinical Labs legacy billing system, which was replaced in August 2008, due to reduced collection efforts relating to the legacy billing system and increased provisions required based on changes in payer mix.

Legal expense was \$0.3 million during the 2009 period compared to \$1.2 million in the 2008 period, a decrease of \$0.9 million or 79%, due to reduction in services provided relating to certain patent litigation matters and the reimbursement of \$0.5 million in legal costs under our Directors and Officers insurance policy.

Interest income was \$9,000 during the 2009 period as compared to \$0.4 million during the 2008 period. The interest income decrease during the 2009 period is attributed to the decline in interest rates in response to monetary policy actions taken by the U.S. Federal Reserve. Furthermore, the Company had higher average invested balances during the 2008 period. The Company earns interest by investing primarily in short term US treasury bills, and money market accounts.

The loss on foreign currency was \$0.1 million during the 2009 period, due to the slight strengthening of foreign currencies relative to the US dollar during the period and the positive impact that had on settled transactions during the period. During the 2008 period, the loss on foreign currency transactions was \$0.6 million primarily due to an inter-company term loan denominated in British pounds sterling. The currency depreciated significantly against the US dollar during the 2008 period but not the 2009 period.

The Company's effective income tax rate benefit for the 2009 period was 4.2% compared to a provision of (2.2%) during the 2008 period. The tax benefit (provision) for the 2009 and 2008 periods were based on state and local taxes, domestic and foreign tax for tax deductible goodwill and indefinite lived intangibles, and book to tax differences for acquired inventory and differed from the expected net operating loss carry forward benefit at the U.S. federal statutory rate of 34% primarily due to the inability to recognize such benefit. The carry forward benefit cannot be recognized because of uncertainties relating to future taxable income, in terms of both its timing and its sufficiency. In the 2009 period, the Company recognized a benefit of \$0.1 million primarily as a result of the expiration of the statute of limitations for an uncertain tax position.

## Segment Results

The Life Sciences segment's income before taxes was \$2.0 million for the 2009 period as compared to \$1.1 million for the 2008 period. Product revenues increased by \$0.8 million in the 2009 period primarily due to the contribution of product revenues from the March 2009 acquisition of Assay Designs and organic growth from our core products which replaced low margin, high volume distribution product revenues principally to one customer. Royalty and license fee income increased \$0.4 million from the Qiagen agreement and the Abbott license agreement. The segment's gross margin of \$9.0 million, which increased \$3.0 million in 2009, was negatively impacted by \$0.1 million representing the fair value adjustment attributed to the sale of inventory acquired from Assay Designs. The remaining fair value adjustment attributed to inventory acquired from Assay Designs of \$0.2 million will negatively impact gross margins through the third quarter of fiscal 2010. Gross profit margins increased to 64% from 47% due to favorable impact from ADI's higher margin, which replaced lower margin revenue in 2008, lower inventory fair value adjustments and realignment of personnel from manufacturing to trading activity. The segment's other operating expenses, including selling, general and administrative, legal and research and development, increased by approximately \$2.5 million during the 2009 period primarily due to the inclusion of Assay Designs expenses and the impact of the aforementioned realignment of personnel. The segment experienced a non-cash foreign currency loss of \$0.1 million during the 2009 period resulting from the impact that slightly strengthening foreign currencies had on settled transactions and on an intercompany loan denominated in pounds sterling. In aggregate, the inventory fair value adjustment and amortization of intangibles negatively impacted the segment operating results in the 2009 period by \$0.5 million.

The Clinical Laboratory segment's loss before taxes was \$0.8 million for the 2009 period as compared to a loss of \$3.4 million in the 2008 period. The revenue from laboratory services increased in the 2009 period by \$2.9 million due to increased service volume and during the 2008 period revenues were adversely affected by contractual adjustments of \$2.2 million. The gross profit of \$4.3 million, which increased \$2.2 million in 2009, was impacted by the non-recurring charge to contractual expense of \$2.2 million in 2008 and higher service volume in 2009 offset by the increase in the cost of laboratory services of \$0.7 million. In the 2009 period, the selling, general and administrative costs increased by approximately \$0.6 million primarily due to increases in payroll and payroll related costs of \$0.2 million and other operating costs of \$0.4 million. The provision for uncollectible accounts receivables decreased by \$1.0 million as compared to the 2008 period.

The Therapeutics segment's loss before income taxes was approximately \$0.7 million for the 2009 period as compared to a loss of \$0.8 million for the 2008 period. The decrease in the segment loss of \$0.1 million was primarily due to decreases in clinical trial activities of \$0.1 million and salaries and related costs.

The Other segment's loss before taxes for the 2009 period was approximately \$2.4 million as compared to \$3.2 million in the 2008 period, a decrease of \$0.8 million. The Other segment's 2009 period loss reflects a decrease in payroll and payroll related costs of \$0.1 million, a decline in professional fees and consulting costs and public relations of \$0.2 million and a decrease in legal expenses of \$0.9 million due to the reimbursement of \$0.5 million in legal fees and reduced services provided relating to certain patent litigation activity. Interest income declined \$0.4 million due to the decline in interest rates. The Company earns interest by investing primarily in short term US government treasury bills, and money market accounts.

## Liquidity and Capital Resources

At October 31, 2009, the Company had cash and cash equivalents of \$6.1 million and short-term investments of \$40.3 million, or \$46.4 in aggregate as compared to \$50.2 million at July 31, 2009. Short term investments are in US Government treasury bills. The Company had working capital of \$59.2 million at October 31, 2009 compared to \$60.5 million at July 31, 2009. The decrease in working capital was primarily the result of funding capital expenditures and the period net loss during the 2009 period.

Net cash used in operating activities for the three months ended October 31, 2009 was approximately \$2.9 million as compared to \$1.5 million for the three months ended October 31, 2008. The increase in net cash used in operating activities in the 2009 period over the 2008 period of approximately \$1.4 million was primarily due to changes in operating assets and liabilities of \$4.7 million from 2008 to 2009, offset by the decrease in the period net loss and by the effect of lower non-cash adjustments in the 2009 period over the 2008 period aggregating \$3.3 million.

Net cash provided by investing activities was approximately \$1.9 million as compared to a use of cash of \$40.2 million in the year ago period. The change is primarily due to the net increase in short term investments in US Government instruments of \$39.8 million in the 2008 period. In the 2009 period net maturities of short-term investments of \$3.0 million were offset by capital expenditures of \$1.1 million.



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There were no financing activities in 2009. Net cash provided by financing activities was approximately \$0.3 million in the 2008 period, attributed primarily to stock options exercise proceeds. There were no stock option exercises in the 2009 period.

### Biomol International L.P.

On May 8, 2008, the Company's wholly-owned subsidiary, Enzo Life Sciences, acquired substantially all of the U.S. based assets of Biomol International, L.P. (Biomol) through Enzo Life Sciences' newly-formed subsidiary, Biomol International, Inc., and all of the outstanding capital stock of Biomol's two wholly owned United Kingdom subsidiaries through Enzo Life Sciences' wholly owned subsidiary, Axxora (UK) Ltd. (the Biomol Acquisition), for a purchase price of \$18 million, comprised of \$15 million in cash, subject to downward adjustment based on net asset value on the closing date, and \$3 million of unregistered common stock of the Company. In addition, Biomol may be entitled to receive a maximum of \$5 million in earn-out payments over the next two years, payable in two installments of \$2.5 million on each of the next two anniversaries of the closing date, if certain revenues and EBITDA targets for the acquired business are attained. The earn-out payments, if any, will be payable in a combination of cash and shares of the Company's common stock, provided no more than 50% of the earn-out payments will be paid in stock. In June 2009, the conditions for the first annual earn-out of \$2.5 million were met and the Company recorded \$2.5 million of additional goodwill. The Company issued 202,196 shares of Enzo common stock at fair value and paid \$1.5 million in cash to satisfy the \$2.5 million earn-out liability.

The Company believes that its current cash position is sufficient for its foreseeable liquidity and capital resource needs over the next 12 months, although there can be no assurance that future events will not alter such view.

### **Contractual Obligations**

There have been no material changes to our Contractual Obligations as reported in our Form 10-K for the fiscal year ended July 31, 2009.

Management is not aware of any material claims, disputes or settled matters concerning third party reimbursement that would have a material effect on our financial statements.

### **Critical Accounting Policies**

The Company's discussion and analysis of its financial condition and results of operations are based upon Enzo Biochem, Inc.'s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses; these estimates and judgments also affect related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates, including those related to contractual adjustments, allowance for uncollectible accounts, inventory, intangible assets and income taxes. The Company bases its estimates on experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

#### Product revenues

Revenues from product sales are recognized when the products are shipped and title transfers, the sales price is fixed or determinable and collectibility is reasonably assured. During the three months ended October 31, 2008, one customer in the Life Science segment represented \$2.2 million of total product revenues.

#### Royalties

Royalty revenues are recorded in the period earned. Royalties received in advance of being earned are recorded as deferred revenues.

#### License fees and multiple element arrangements

When evaluating multiple element arrangements, the Company considers whether the components of the arrangement represent separate units of accounting, which requires subjective determinations and requires management to make judgments about the fair value of the individual elements and whether such elements are separable from the other aspects of the contractual relationship.



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Revenues Clinical laboratory services

Revenues from the clinical laboratory are recognized upon completion of the testing process for a specific patient and reported to the ordering physician. These revenues and the associated accounts receivable are based on gross amounts billed or billable for services rendered, net of a contractual adjustment, which is the difference between amounts billed to payers and the expected approved reimbursable settlements from such payers.

The following are tables of the Clinical Labs segment's net revenues and percentages by revenue category for the three months ended October 31, 2009 and 2008:

<u>Revenue category</u>	<b>Three months ended October 31, 2009</b>		<b>Three months ended October 31, 2008</b>	
	<b>(In thousands)</b>	<b>(in %)</b>	<b>(In thousands)</b>	<b>(in %)</b>
Medicare	\$ 2,852	26	\$ 2,300	28
Third-party payer	4,867	44	3,880	48
Patient self-pay	2,149	19	1,227	15
HMO's	1,242	11	765	9
<b>Total</b>	<b>\$ 11,110</b>	<b>100%</b>	<b>\$ 8,172</b>	<b>100%</b>

The Company provides services to certain patients covered by various third-party payers, including the Federal Medicare program. Laws and regulations governing Medicare are complex and subject to interpretation for which action for noncompliance includes fines, penalties and exclusion from the Medicare programs. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing.

Other than the Medicare program, one provider whose programs are included in the Third-party payer and Health Maintenance Organizations (HMO's) categories represented 26% and 27% of the Clinical Labs net revenues for the three months ended October 31, 2009 and 2008.

Contractual Adjustment

The Company's estimate of contractual adjustment is based on significant assumptions and judgments, such as its interpretation of payer reimbursement policies, and bears the risk of change. The estimation process is based on the experience of amounts approved as reimbursable and ultimately settled by payers, versus the corresponding gross amount billed to the respective payers. The contractual adjustment is an estimate that reduces gross revenue, based on gross billing rates, to amounts expected to be approved and reimbursed. Gross billings are based on a standard fee schedule we set for all third party payers, including Medicare, HMO's and managed care. The Company adjusts the contractual adjustment estimate quarterly, based on its evaluation of current and historical settlement experience with payers, industry reimbursement trends, and other relevant factors. The other relevant factors that affect our contractual adjustment include the monthly and quarterly review of: 1) current gross billings and receivables and reimbursement by payer, 2) current changes in third party arrangements, 3) the growth of in-network provider arrangements and managed care plans specific to our Company.

Our clinical laboratory business is primarily dependent upon reimbursement from third-party payers, such as Medicare (which principally serves patients 65 and older) and insurers. We are subject to variances in reimbursement rates among different third-party payers, as well as constant changes of reimbursement rates. Changes that decrease reimbursement rates or coverage would negatively impact our revenues.

The number of individuals covered under managed care contracts or other similar arrangements has grown over the past several years and may continue to grow in the future. In addition, Medicare and other government healthcare programs continue to shift to managed care. These trends may negatively affect our revenues per test.

During the three months ended October 31, 2009 and 2008, the contractual adjustment percentages, determined using current and historical reimbursement statistics, were 82.5% and 77.9%, respectively, of gross billings. During the three months ended October 31, 2008 the Company also made a \$2.2 million adjustment increasing the contractual allowance to correct immaterial errors in the

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computation of the contractual allowance percentages affecting the periods August 1, 2005 through July 31, 2008 and periods prior to August 1, 2005, and credits not recorded correctly. The adjustment increased the 2008 period's loss before income tax by \$2.2 million or \$0.06 per share.

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The Company believes the negative impact on revenues from the decline in reimbursement rates or the shift to managed care, other primary third party payers, or similar arrangements may be offset by the positive impact of the number of tests we perform. However, there can be no assurance that we can increase the number of tests we perform or that if we do increase the number of tests we perform, that we can maintain that higher number of tests performed, or that an increase in the number of tests we perform would result in increased revenue.

The Company estimates (by using a sensitivity analysis) that each 1% point change in the contractual adjustment percentage could result in a change in clinical laboratory services revenues of approximately \$636,000, and \$348,000 for the three months ended October 31, 2009 and 2008, respectively, and a change in the net accounts receivable of approximately \$295,000 as of October 31, 2009.

Our clinical laboratory financial billing system records gross billings using a standard fee schedule for all payers and does not record contractual adjustment by payer at the time of billing. Adjustments to our standard fee schedule will impact the contractual adjustment recorded. Therefore, we are unable to quantify the effect of contractual adjustment recorded during the current period that relates to revenue recorded in a previous period. However, we can reasonably estimate our contractual adjustment to revenue on a timely basis based on our quarterly review process, which includes:

an analysis of industry reimbursement trends;

an evaluation of third-party reimbursement rates changes and changes in reimbursement arrangements with third-party payers;

a variance reimbursement analysis of current and historical claim settlement and reimbursement experience with payers;

an analysis of current gross billings and receivables by payer.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are reported at realizable value, net of allowances for doubtful accounts, which is estimated and recorded in the period of the related revenue.

The following is a table of the Company's net accounts receivable by segment. The clinical laboratory segment's net receivables are detailed by billing category and as a percent to its total net receivables. At October 31, 2009 and July 31, 2009, approximately 38% and 40%, respectively, of the Company's net accounts receivable relates to its clinical laboratory business, which operates in the New York and New Jersey Metropolitan areas.

The Life Sciences segment's accounts receivable, of which \$2.0 million or 23% and \$2.1 million or 28% represents foreign receivables as of October 31, 2009 and July 31, 2009 respectively, includes royalty receivables of \$3.2 million and \$2.5 million, as of October 31, 2009 and July 31, 2009, respectively, of which approximately \$2.6 million and \$1.9 million, respectively is from Qiagen Corporation (Note 12).

Net accounts receivable

Billing category	As of October 31, 2009		As of July 31, 2009	
	(In 000 s)	(in %)	(In 000 s)	(in %)
Clinical Labs				
Medicare	\$ 1,150	22	\$ 1,113	22
Third party payers	2,170	42	2,003	40
Patient self-pay	1,510	30	1,635	32
HMO s	314	6	303	6
Total clinical labs	\$ 5,144	100%	\$ 5,054	100%
Total life sciences	8,555		7,426	

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Total accounts receivable	\$ 13,699	\$ 12,480
	<u>          </u>	<u>          </u>
	25	

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Changes in the Company's allowance for doubtful accounts are as follows:

In 000 s	October 31, 2009	July 31, 2009
Beginning balance	\$ 4,786	\$ 886
Provision for doubtful accounts	912	5,189
Write-offs, net	(814)	(1,289)
Ending balance	\$ 4,884	\$ 4,786

For the Clinical Labs segment, the allowance for doubtful accounts represents amounts that the Company does not expect to collect after the Company has exhausted its collection procedures. The Company estimates its allowance for doubtful accounts in the period the related services are billed and adjusts the estimate in future accounting periods as necessary. It bases the estimate for the allowance on the evaluation of historical collection experience, the aging profile of accounts receivable, the historical doubtful account write-off percentages, payer mix, and other relevant factors.

The allowance for doubtful accounts includes the balances, after receipt of the approved settlements from third party payers for the insufficient diagnosis information received from the ordering physician, which result in denials of payment and the uncollectible portion of receivables from self payers, including deductibles and copayments, which are subject to credit risk and patients' ability to pay. During the three months ended October 31, 2009 and 2008, the Company determined an allowance for doubtful accounts less than 210 days and wrote off 100% of accounts receivable over 210 days, as it assumed those accounts are uncollectible, except for certain fully reserved balances, principally related to Medicare. These accounts have not been written off because the payer's filing date deadline has not occurred or the collection process has not been exhausted. The Company's collection experience on Medicare receivables beyond 210 days has been insignificant. The Company adjusts the historical collection analysis for recoveries, if any, on an ongoing basis.

The Company's ability to collect outstanding receivables from third party payers is critical to its operating performance and cash flows. The primary collection risk lies with uninsured patients or patients for whom primary insurance has paid but a patient portion remains outstanding. The Company also assesses the current state of its billing functions in order to identify any known collection or reimbursement issues in order to assess the impact, if any, on the allowance estimates, which involves judgment. The Company believes that the collectibility of its receivables is directly linked to the quality of its billing processes, most notably, those related to obtaining the correct information in order to bill effectively for the services provided.

Should circumstances change (e.g. shift in payer mix, decline in economic conditions or deterioration in aging of receivables), our estimates of net realizable value of receivables could be reduced by a material amount. During the three month period ended October 31, 2009 versus 2008, our bad debt expense decreased by \$0.9 million. During the 2008 period, the Company recorded a charge of \$1.1 million attributed to increased provisions for the Clinical Labs legacy billing system, which was replaced in August 2008, due to reduced collection efforts relating to the legacy billing system and increased provisions required based on changes in payer mix. The Company is presently managing two systems until the legacy system collection efforts are deemed completed. Billing for laboratory services is complicated because of many factors, especially: the differences between our standard gross fee schedule for all payers and the reimbursement rates of the various payers we deal with, disparity of coverage and information requirements among the various payers, and disputes with payers as to which party is responsible for reimbursement.

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The following table indicates the Clinical Labs aged gross receivables by payer group (in thousands), which is prior to adjustment to gross receivables for: 1) contractual adjustment, 2) fully reserved balances not yet written off, and 3) other revenue adjustments.

<b>As of October 31, 2009</b>	<b>Total Amount</b>	<b>%</b>	<b>Medicare Amount</b>	<b>%</b>	<b>Third Party Payers Amount</b>	<b>%</b>	<b>Self-pay Amount</b>	<b>%</b>	<b>HMO s Amount</b>	<b>%</b>
1-30 days	\$ 19,775	65%	\$ 3,836	69%	\$ 9,668	69%	\$ 2,783	39%	\$ 3,488	98%
31-60 days	3,674	12%	331	6%	2,025	15%	1,280	18%	38	2%
61-90 days	2,383	8%	305	5%	973	7%	1,093	15%	12	%
91-120 days	1,718	6%	185	3%	554	4%	972	14%	7	%
121-150 days	962	3%	133	2%	348	3%	480	7%	1	%
Greater than 150 days*	1,691	6%	791	14%	346	2%	552	8%	2	%
<b>Totals</b>	<b>\$ 30,203</b>	<b>100%</b>	<b>\$ 5,581</b>	<b>100%</b>	<b>\$ 13,914</b>	<b>100%</b>	<b>\$ 7,160</b>	<b>100%</b>	<b>\$ 3,548</b>	<b>100%</b>

<b>As of July 31, 2009</b>	<b>Total Amount</b>	<b>%</b>	<b>Medicare Amount</b>	<b>%</b>	<b>Third Party Payers Amount</b>	<b>%</b>	<b>Self-pay Amount</b>	<b>%</b>	<b>HMO s Amount</b>	<b>%</b>
1-30 days	\$ 19,251	70%	\$ 3,193	61%	\$ 9,695	73%	\$ 2,882	51%	\$ 3,481	99%
31-60 days	4,508	17%	894	16%	1,957	15%	1,635	29%	22	1%
61-90 days	1,783	6%	256	5%	680	5%	836	15%	11	%
91-120 days	1,019	4%	249	5%	483	4%	280	5%	7	%
121-150 days	340	1%	134	3%	202	2%		%	4	%
Greater than 150 days**	636	2%	536	10%	100	1%		%		%
<b>Totals</b>	<b>\$ 27,537</b>	<b>100%</b>	<b>\$ 5,262</b>	<b>100%</b>	<b>\$ 13,117</b>	<b>100%</b>	<b>\$ 5,633</b>	<b>100%</b>	<b>\$ 3,525</b>	<b>100%</b>

\* Total includes \$486 fully reserved over 210 days as of October 31, 2009.

\*\* Total includes \$340 fully reserved over 210 days as of July 31, 2009.

*Income Taxes*

The Company accounts for income taxes under the liability method of accounting for income taxes. Under the liability method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The liability method requires that any tax benefits recognized for net operating loss carry forwards and other items be reduced by a valuation allowance where it is not more likely than not the benefits will be realized in the foreseeable future.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under the liability method, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

In fiscal 2008, the Company adopted the accounting pronouncement that prescribes a more-likely-than-not threshold for the recognition and derecognition of tax positions, provides guidance on the accounting for interest and penalties relating to tax positions and requires that the cumulative effect of applying the provisions of the pronouncement be reported as an adjustment to the opening balance of retained earnings or other appropriate components of equity or net assets in the statement of financial position. The Company did not have any significant unrecognized tax positions and there was no material effect on our financial condition or results of operations as a result of implementing the pronouncement.



### *Inventory*

The Company values inventory at the lower of cost (first-in, first-out) or market. Work-in-process and finished goods inventories consist of material, labor, and manufacturing overhead. On a quarterly basis, we review inventory quantities on hand and analyze the provision for excess and obsolete inventory based on our estimate of sales forecasts based on sales history and anticipated future demand. Our estimate of future product demand may not be accurate and we may understate or overstate the provision for excess and obsolete inventory. Accordingly, unanticipated changes in demand could have a significant impact on the value of our inventory and results of operations. At October 31, 2009 and July 31, 2009, our reserve for excess and obsolete inventory was \$1.2 million and \$1.0 million, respectively.

### *Goodwill and Indefinite-Lived Intangibles*

Goodwill, representing the cost of acquired businesses in excess of the fair value of net assets acquired, and indefinite-lived intangibles are not amortized, but are evaluated annually for impairment. The Company performs its annual impairment test as of the first day of its fiscal fourth quarter or if indicators of potential impairment exist. Goodwill is considered impaired if the carrying amount of the reporting unit exceeds its estimated fair value. In assessing the recoverability of goodwill, the Company reviews both quantitative as well as qualitative factors to support its assumptions with regard to fair value. The fair value of a reporting unit, which is based on geographic region, is estimated using both a discounted cash flow model and a weighted average multiple of earnings before interest and taxes from comparable companies. To date, there have been no impairment charges recorded. As of May 1, 2009, one of the Company's reporting unit's fair value exceeded its carrying value by 10%. This reporting unit's goodwill was \$5.3 million at the date of our annual impairment test. In determining fair value, the Company makes certain judgments, including the identification of reporting units and the selection of comparable companies. If these estimates or their related assumptions change in the future as a result of changes in strategy and/or market conditions, the Company may be required to record an impairment charge.

### *Intangible Assets*

Intangible assets (exclusive of patents), arose primarily from acquisitions and primarily consist of customer relationships, trademarks, licenses, employment and non-compete agreements, and website and database content. Finite-lived intangible assets are amortized according to their estimated useful lives, which range from 4 to 15 years. The Company has capitalized certain legal costs directly incurred in pursuing patent applications as patent costs. When such applications result in an issued patent, the related costs are amortized over a ten year period or the life of the patent, whichever is shorter, using the straight-line method. The Company reviews its issued patents and pending patent applications, and if it determines to abandon a patent application or that an issued patent no longer has economic value, the unamortized balance in deferred patent costs relating to that patent is immediately expensed.

### *Recent Accounting Pronouncements*

Effective August 1, 2009, the Company adopted The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC or Codification) of Generally Accepted Accounting Principles Overall. The Codification established one source for all U.S. GAAP and became the source of authoritative accounting principles for nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The Codification is not intended to change existing GAAP and as such did not have an impact on the consolidated financial statements of the Company.

The adoption of the following accounting standards and updates during the first three months of fiscal 2010 did not result in a significant impact to our consolidated financial statements.

On June 15, 2009, we adopted the accounting pronouncement that amends the requirements for disclosures about fair value of financial instruments, regarding the fair value of financial instruments for annual, as well as interim, reporting periods. This pronouncement was effective prospectively for all interim and annual reporting periods ending after June 15, 2009.

Effective August 1, 2009, we adopted the revised accounting standard relating to business combinations, including assets acquired and liabilities assumed arising from contingencies. This standard requires the use of the acquisition method of accounting, defines the acquirer, establishes the acquisition date and applies to all transactions and other events in which one entity obtains control over one or more other businesses. Upon our adoption of this standard, we will be required to expense certain transaction costs and related fees associated with business combinations that were previously capitalized. In addition, with the adoption of this standard, changes to valuation allowances for acquired deferred income tax assets and adjustments to unrecognized tax benefits acquired generally are to be recognized as adjustments to income tax expense rather than goodwill.

Effective August 1, 2009, we adopted the accounting standard regarding the determination of the useful life of intangible assets that removes the requirement to consider whether an intangible asset can be renewed without substantial cost or material modifications to the existing terms and conditions, and replaces it with a requirement that an entity consider its own historical experience in renewing similar arrangements, or a consideration of market participant assumptions in the absence of historical experience. This standard also requires entities to disclose information that enables users of financial statements to assess the extent to which the expected future cash flows associated with the asset are affected by the entity's intent and/or ability to renew or extend the arrangements.

### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk from changes in foreign currency exchange rates and, to a much lesser extent, interest rates on investments in short-term instruments, which could impact our results of operations and financial position. We do not currently engage in any hedging or market risk management tools. There have been no material changes with respect to market risk previously disclosed in our Annual Report on Form 10-K for our 2009 fiscal year.

#### *Foreign Currency Exchange Rate Risk*

The financial reporting of our non-U.S. subsidiaries is denominated in currencies other than the U.S. dollar. Since the functional currency of our non-U.S. subsidiaries is the local currency, foreign currency translation adjustments are accumulated as a component of accumulated other comprehensive income in stockholders' equity. Assuming a hypothetical aggregate change of 10% in the exchange rates of foreign currencies against the U.S. dollar at October 31, 2009, our assets and liabilities would increase or decrease by \$2.1 million and \$0.4 million, respectively, and our net sales and net (loss) or earnings would increase or decrease by \$1.6 million and \$0.4 million, respectively, on an annual basis.

We also maintain intercompany balances and loans receivable with subsidiaries with different local currencies. These amounts are at risk of foreign exchange losses if exchange rates fluctuate. Assuming a hypothetical aggregate change of 10% in the exchange rates of foreign currencies against the U.S. dollar at October 31, 2009, our pre-tax earnings would be favorably or unfavorably impacted by approximately \$0.3 million, on an annual basis.

#### *Interest Rate Risk*

Our excess cash is invested in highly liquid short term money market funds and short term investments in US Government agency discount notes with high credit ratings. Changes in interest rates may affect the investment income we earn on money market funds and short term investments and therefore affect our cash flows and results of operations. As of October 31, 2009, we were exposed to interest rate change market risk with respect to our money market accounts and short term investments totaling \$41.2 million. The money market accounts and short-term investments yield or bear interest rates ranging from 0% to 0.5%. Each 100 basis point (or 1%) fluctuation in interest rates will increase or decrease interest income on the money market funds and short-term investments by approximately \$0.4 million on an annual basis.

As of October 31, 2009, we did not maintain any fixed or variable interest rate financing.

**Item 4. Controls and Procedures**

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, the Company's management conducted an evaluation (as required under Rules 13a-15(b) and 15d-15(b) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) of the Company's disclosure controls and procedures (as such term is defined under the Exchange Act), under the supervision and with the participation of the principal executive officer and the principal financial officer. Based on this evaluation, the principal executive officer and the principal financial officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report. Notwithstanding the foregoing, a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that it will detect or uncover failures within the Company to disclose material information otherwise required to be set forth in the Company's periodic reports.

(b) Changes in Internal Controls over Financial Reporting

There was no change in the Company's internal controls over financial reporting during the fiscal quarter covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

Item 1. Legal Proceedings

There have been no other material developments with respect to previously reported legal proceedings discussed in the annual report on Form 10-K for the fiscal year ended July 31, 2009 filed with the Securities and Exchange Commission. See Note 14.

Item 1A. Risk Factors

There have been no material changes from the risk factors disclosed in Part 1, Item 1, of the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2009.

Item 6. Exhibits

<u>Exhibit No.</u>	<u>Exhibit</u>
3.1	Certificate of Incorporation, as amended March 17, 1980 (previously filed as an exhibits to the Company's Registration Statement on Form S-18 (File No. 2-67359) and incorporated herein by reference)
3.2	Certificate of Amendment of the Certificate of Incorporation, dated June 3, 1981 (previously filed as an exhibit to the Company's Form 10-K for the year ended July 31, 1981 and incorporated herein by reference)
3.3	Certificate of Amendment to the Certificate of Incorporation, dated March 13, 1980 (previously filed with the Company's Annual Report on Form 10-K for the year ended July 31, 1989 and incorporated herein by reference)
3.4	Amended and Restated Bylaws (previously filed with the Company's Current Report on Form 8-K January 29, 2008 and is incorporated herein by reference)
31.1	Certification of Elazar Rabbani, Ph.D. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Barry Weiner pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Elazar Rabbani, Ph.D. pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Barry Weiner pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

