MORGAN STANLEY
Form 424B2
December 12, 2018

The information in this preliminary pricing supplement is not complete and may be changed. We may not deliver these notes until a final pricing supplement is delivered. This preliminary pricing supplement and the accompanying prospectus, product supplement and index supplement do not constitute an offer to sell these notes and we are not soliciting an offer to buy these notes in any state where the offer or sale is not permitted.

Subject to Completion, Preliminary Pricing Supplement dated December 12, 2018

PROSPECTUS Dated November 16, 2017	***Pricing Supplement No. 1,315 to***
PRODUCT SUPPLEMENT Dated November 16, 2017	***Registration Statement Nos. 333-221595; 333-221595-01***
INDEX SUPPLEMENT Dated November 16, 2017	***Dated , 2018***
	Rule 424(b)(2)

Morgan Stanley Finance LLC

STRUCTURED INVESTMENTS

Opportunities in U.S. Equities

$

Leveraged Buffered S&P 500® Index-Linked Notes due

Fully and Unconditionally Guaranteed by Morgan Stanley

Principal at Risk Securities

The notes are unsecured obligations of Morgan Stanley Finance LLC ("MSFL") and are fully and unconditionally guaranteed by Morgan Stanley. **The notes will not bear interest.** The amount that you will be paid on your notes on the stated maturity date (expected to be the second scheduled business day after the determination date) is based on the performance of the S&P 500® Index as measured from the trade date to and including the determination date (expected to be between 27 and 30 months after the trade date). If the final underlier level on the determination date is greater than the initial underlier level (set on the trade date and may be higher or lower than the actual closing level of the underlier on the trade date), the return on your notes will be positive, subject to the maximum settlement amount (expected to be between $1,309.78 and $1,363.42 for each $1,000 face amount of your notes). If the underlier declines by up to 15.00% from the initial underlier level, you will receive the face amount of your notes. **However, if the underlier declines by more than 15.00% from the initial underlier level, the return on your notes will be negative. You could lose your entire investment in the notes.** The notes are notes issued as part of MSFL's Series A Global Medium-Term Notes program.

All payments are subject to our credit risk. If we default on our obligations, you could lose some or all of your investment. These notes are not secured obligations and you will not have any security interest in, or otherwise have any access to, any underlying reference asset or assets.

To determine your payment at maturity, we will calculate the underlier return, which is the percentage increase or decrease in the final underlier level from the initial underlier level. On the stated maturity date, for each $1,000 face amount of your notes, you will receive an amount in cash equal to:

if the underlier return is *positive* (the final underlier level is *greater than* the initial underlier level), the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) $1,000 *times* (b) 180% *times* (c) the underlier return, subject to the maximum settlement amount;

if the underlier return is *zero* or *negative* but *not below* -15.00% (the final underlier level is *equal to* or *less than* the initial underlier level but not by more than 15.00%), $1,000; or

if the underlier return is *negative* and is *below* -15.00% (the final underlier level is *less than* the initial underlier level by more than 15.00%), the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) approximately 1.1765 *times* (b) the *sum* of the underlier return *plus* 15.00% *times* (c) $1,000.

Under these circumstances, you will lose some or all of your investment.

You should read the additional disclosure herein so that you may better understand the terms and risks of your investment.

The estimated value on the trade date will be approximately $995.20 per note, or within $10.00 of that estimate. See "Estimated Value" on page 2.

	Price to public[(1)]	*Agent's commissions*	*Proceeds to us[(2)]*
Per note	*$1,000*	*$0*	*$1,000*
Total	*$*	*$*	*$*

(1) Morgan Stanley & Co. LLC ("MS & Co.") will sell all of the notes that it purchases from us to an unaffiliated dealer at the original issue price of 100.00%, or $1,000 per face amount of notes. Such dealer will sell the notes to investors at the same price without a discount or commission. Investors that purchase and hold the notes in fee-based accounts may be charged fees based on the amount of assets held in those accounts, including the notes. For more information, see "Additional Information About the Notes—Supplemental information regarding plan of distribution; conflicts of interest."

(2) See "Additional Information About the Notes—Use of proceeds and hedging" beginning on page 19.

The notes involve risks not associated with an investment in ordinary debt securities. See "Risk Factors" beginning on page 10.

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these notes, or determined if this document or the accompanying product supplement, index supplement and prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The notes are not deposits or savings accounts and are not insured by the Federal Deposit Insurance Corporation or any other governmental agency or instrumentality, nor are they obligations of, or guaranteed by, a bank.

You should read this document together with the related product supplement, index supplement and prospectus, each of which can be accessed via the hyperlinks below. Please also see "Terms" on page 3 and "Additional Information About the Notes" on page 19.

MORGAN STANLEY

About Your Prospectus

The notes are notes issued as part of MSFL's Series A Global Medium-Term Notes program. This prospectus includes this preliminary pricing supplement and the accompanying documents listed below. This preliminary pricing supplement constitutes a supplement to the documents listed below and should be read in conjunction with such documents:

Prospectus dated November 16, 2017

Product Supplement dated November 16, 2017

Index Supplement dated November 16, 2017

The information in this preliminary pricing supplement supersedes any conflicting information in the documents listed above. In addition, some of the terms or features described in the listed documents may not apply to your notes.

ESTIMATED VALUE

The Original Issue Price of each note is $1,000. This price includes costs associated with issuing, selling, structuring and hedging the notes, which are borne by you, and, consequently, the estimated value of the notes on the Trade Date will be less than $1,000. We estimate that the value of each note on the Trade Date will be approximately $995.20, or within $10.00 of that estimate. Our estimate of the value of the notes as determined on the Trade Date will be set forth in the final pricing supplement.

What goes into the estimated value on the Trade Date?

In valuing the notes on the Trade Date, we take into account that the notes comprise both a debt component and a performance-based component linked to the Underlier. The estimated value of the notes is determined using our own pricing and valuation models, market inputs and assumptions relating to the Underlier, instruments based on the Underlier, volatility and other factors including current and expected interest rates, as well as an interest rate related to our secondary market credit spread, which is the implied interest rate at which our conventional fixed rate debt trades in the secondary market.

What determines the economic terms of the notes?

In determining the economic terms of the notes, including the Upside Participation Rate, the Cap Level, the Maximum Settlement Amount and the Buffer Amount, we use an internal funding rate, which is likely to be lower than our secondary market credit spreads and therefore advantageous to us. If the issuing, selling, structuring and hedging costs borne by you were lower or if the internal funding rate were higher, one or more of the economic terms of the notes would be more favorable to you.

What is the relationship between the estimated value on the Trade Date and the secondary market price of the notes?

The price at which MS & Co. purchases the notes in the secondary market, absent changes in market conditions, including those related to the Underlier, may vary from, and be lower than, the estimated value on the Trade Date, because the secondary market price takes into account our secondary market credit spread as well as the bid-offer spread that MS & Co. would charge in a secondary market transaction of this type and other factors. However, because the costs associated with issuing, selling, structuring and hedging the notes are not fully deducted upon issuance, for a period of up to 3 months following the issue date, to the extent that MS & Co. may buy or sell the notes in the secondary market, absent changes in market conditions, including those related to the Underlier, and to our secondary market credit spreads, it would do so based on values higher than the estimated value. We expect that those higher values will also be reflected in your brokerage account statements.

MS & Co. may, but is not obligated to, make a market in the notes, and, if it once chooses to make a market, may cease doing so at any time.

SUMMARY INFORMATION

The Leveraged Buffered S&P 500® Index-Linked Notes, which we refer to as the notes, are unsecured obligations of MSFL and are fully and unconditionally guaranteed by Morgan Stanley. The notes will pay no interest, do not guarantee any return of principal at maturity and have the terms described in the accompanying product supplement, index supplement and prospectus, as supplemented or modified by this document. The notes are notes issued as part of MSFL's Series A Global Medium-Term Notes program.

References to "we," "us," and "our" refer to Morgan Stanley or MSFL, or Morgan Stanley and MSFL collectively, as the context requires.

Terms

Capitalized terms used but not defined herein have the meanings assigned to them in the accompanying product supplement and prospectus. All references to "Buffer Rate," "Cash Settlement Amount," "Closing Level," "Determination Date," "Face Amount," "Final Underlier Level," "Initial Underlier Level," "Maximum Settlement Amount," "Original Issue Price," "Stated Maturity Date," "Trade Date," "Trading Day," "Underlier," "Underlier Return" and "Upside Participation Rate" herein shall be deemed to refer to "downside factor," "payment at maturity," "index closing value," "valuation date," "stated principal amount," "final index value," "initial index value," "maximum payment at maturity," "issue price," "maturity date," "pricing date," "index business day," "underlying index," "index return" and "leverage factor," respectively, as used in the accompanying product supplement.

If the terms described herein are inconsistent with those described in the accompanying product supplement or prospectus, the terms described herein shall control.

Issuer: Morgan Stanley Finance LLC

Guarantor: Morgan Stanley

Underlier: S&P 500® Index

Underlier Publisher: S&P Dow Jones Indices LLC

Notes: The accompanying product supplement refers to the notes as the "PLUS."

Specified currency: U.S. dollars ("$")

Face Amount: Each note will have a Face Amount of $1,000; $ in the aggregate for all the notes; the aggregate Face Amount of notes may be increased if the Issuer, at its sole option, decides to sell an additional amount of the notes on a date subsequent to the date hereof.

Denominations: $1,000 and integral multiples thereof

Cash Settlement Amount (on the Stated Maturity Date): For each $1,000 Face Amount of notes, we will pay you on the Stated Maturity Date an amount in cash equal to:

- if the Final Underlier Level is *greater than* or *equal to* the Cap Level, the Maximum Settlement Amount;
- if the Final Underlier Level is *greater than* the Initial Underlier Level but *less than* the Cap Level, the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) $1,000 *times* (b) the Upside Participation Rate *times* (c) the Underlier Return;
- if the Final Underlier Level is *equal to* or *less than* the Initial Underlier Level but *greater than* or *equal to* the Buffer Level, $1,000; or
- if the Final Underlier Level is *less than* the Buffer Level, the *sum* of (i) $1,000 *plus* (ii) the *product* of (a) $1,000 *times* (b) the Buffer Rate *times* (c) the *sum* of the Underlier Return and the Buffer Amount.

You will lose some or all of your investment at maturity if the Final Underlier Level is less than the Buffer Level. Any payment of the Cash Settlement Amount is subject to the credit of the Issuer.

Initial Underlier Level: To be determined on the Trade Date. The Initial Underlier Level may be higher or lower than the actual Closing Level of the Underlier on the Trade Date; provided that the Initial Underlier Level will not be higher than the highest level of the Underlier on the Trade Date.

Final Underlier Level: The Closing Level of the Underlier on the Determination Date, except in the limited circumstances described under "Description of PLUS—Postponement of Valuation Date(s)" on page S-44 of the accompanying product supplement, and subject to adjustment as provided under "Description of PLUS—Discontinuance of Any Underlying Index or Basket Index; Alteration of Method of Calculation" on page S-47 of the accompanying product supplement.

Underlier Return: The *quotient* of (i) the Final Underlier Level *minus* the Initial Underlier Level *divided* by (ii) the Initial Underlier Level, expressed as a percentage

Upside Participation Rate: 180%

Cap Level (to be set on the Trade Date): Expected to be between 117.21% and 120.19% of the Initial Underlier Level

Maximum Settlement Amount (to be set on the Trade Date): Expected to be between $1,309.78 and $1,363.42 for each $1,000 Face Amount of notes

Buffer Level: 85.00% of the Initial Underlier Level

Buffer Amount: 15.00%

Buffer Rate: The *quotient* of the Initial Underlier Level *divided* by the Buffer Level, which equals approximately 117.65%

Trade Date:

Original Issue Date (Settlement Date) (to be set on the Trade Date): Expected to be the fifth scheduled Business Day following the Trade Date

Determination Date (to be set on the Trade Date): Expected to be between 27 and 30 months after the Trade Date, subject to postponement as described in the accompanying product supplement on page S-44 under "Description of PLUS—Postponement of Valuation Date(s)."

Stated Maturity Date (to be set on the Trade Date): Expected to be the second scheduled Business Day following the Determination Date, subject to postponement as described below. The Stated Maturity Date is a pricing term and will be determined by us on the Trade Date.

Postponement of Stated Maturity Date: If the scheduled Determination Date is not a Trading Day or if a market disruption event occurs on that day so that the Determination Date as postponed falls less than two Business Days prior to the scheduled Stated Maturity Date, the Stated Maturity Date of the notes will be postponed to the second Business Day following that Determination Date as postponed.

Closing Level: As described under "Description of PLUS—Some Definitions—index closing value" on page S-37 of the accompanying product supplement

Business Day: As described under "Description of PLUS—Some Definitions—business day" on page S-36 of the accompanying product supplement

Trading Day: As described under "Description of PLUS—Some Definitions—index business day" on page S-37 of the accompanying product supplement. The product supplement refers to a Trading Day as an "index business day."

Market disruption event: The following replaces in its entirety the section entitled "Description of PLUS—Some Definitions—market disruption event" on page S-37 of the accompanying product supplement:

"Market disruption event" means, with respect to the Underlier:

(i) the occurrence or existence of:

(a) a suspension, absence or material limitation of trading of securities then constituting 20 percent or more, by weight, of the Underlier (or the successor index) on the relevant exchanges for such securities for more than two hours of trading or during the one-half hour period preceding the close of the principal trading session on such relevant exchange, or

4

(b) a breakdown or failure in the price and trade reporting systems of any relevant exchange as a result of which the reported trading prices for securities then constituting 20 percent or more, by weight, of the Underlier (or the successor index), or futures or options contracts, if available, relating to the Underlier (or the successor index) or the securities then constituting 20 percent or more, by weight, of the Underlier during the last one-half hour preceding the close of the principal trading session on such relevant exchange are materially inaccurate, or

(c) the suspension, material limitation or absence of trading on any major U.S. securities market for trading in futures or options contracts or exchange-traded funds related to the Underlier (or the successor index), or in futures or options contracts, if available, relating to securities then constituting 20 percent or more, by weight, of the Underlier (or the successor index) for more than two hours of trading or during the one-half hour period preceding the close of the principal trading session on such market,

in each case as determined by the calculation agent in its sole discretion; and

(ii) a determination by the calculation agent in its sole discretion that any event described in clause (i) above materially interfered with our ability or the ability of any of our affiliates to unwind or adjust all or a material portion of the hedge position with respect to the notes.

For the purpose of determining whether a market disruption event exists at any time, if trading in a security included in the Underlier is suspended, absent or materially limited at that time, then the relevant percentage contribution of that security to the value of the Underlier shall be based on a comparison of (x) the portion of the value of the Underlier attributable to that security relative to (y) the overall value of the Underlier, in each case immediately before that suspension or limitation.

For the purpose of determining whether a market disruption event has occurred: (1) a limitation on the hours or number of days of trading will not constitute a market disruption event if it results from an announced change in the regular business hours of the relevant exchange or market, (2) a decision to permanently discontinue trading in the relevant futures or options contract or exchange-traded fund will not constitute a market disruption event, (3) a suspension of trading in futures or options contracts or exchange-traded funds on the Underlier, or futures or options contracts, if available, relating to securities then constituting 20 percent or more, by weight, of the Underlier, by the primary securities market trading in such contracts or funds by reason of (a) a price change exceeding limits set by such securities exchange or market, (b) an imbalance of orders relating to such contracts or funds, or (c) a disparity in bid and ask quotes relating to such contracts or funds will constitute a suspension, absence or material limitation of trading in futures or options contracts or exchange-traded funds related to the Underlier and (4) a “suspension, absence or material limitation of trading” on any relevant exchange or on the primary market on which futures or options contracts or exchange-traded funds related to the Underlier are traded will not include any time when such securities market is itself closed for trading under ordinary circumstances.

Trustee: The Bank of New York Mellon

Calculation Agent: MS & Co.

Issuer Notice To Registered Security Holders, the Trustee and the Depositary: In the event that the Stated Maturity Date is postponed due to postponement of the Determination Date, the Issuer shall give notice of such postponement and, once it has been determined, of the date to which the Stated Maturity Date has been rescheduled (i) to each registered holder of the notes by mailing notice of such postponement by first class mail, postage prepaid, to such registered holder's last address as it shall appear upon the registry books, (ii) to the Trustee by facsimile confirmed by mailing such notice to the Trustee by first class mail, postage prepaid, at its New York office and (iii) to The Depository Trust Company (the "depositary") by telephone or facsimile, confirmed by mailing such notice to the depositary by first class mail, postage prepaid. Any notice that is mailed to a registered holder of the notes in the manner herein provided shall be conclusively presumed to have been duly given to such registered holder, whether or not such registered holder receives the notice. The Issuer shall give such notice as promptly as possible, and in no case later than (i) with respect to notice of postponement of the Stated Maturity Date, the Business Day immediately preceding the scheduled Stated Maturity Date and (ii) with

respect to notice of the date to which the Stated Maturity Date has been rescheduled, the Business Day immediately following the actual Determination Date for determining the Final Underlier Level.

The Issuer shall, or shall cause the Calculation Agent to, (i) provide written notice to the Trustee and to the depositary of the amount of cash, if any, to be delivered with respect to each Face Amount of notes, on or prior to 10:30 a.m. (New York City time) on the Business Day preceding the Stated Maturity Date, and (ii) deliver the aggregate cash amount due with respect to the notes, if any, to the Trustee for delivery to the depositary, as holder of the notes, on the Stated Maturity Date.

CUSIP no.: 61768DUD5

ISIN: US61768DUD55

HYPOTHETICAL EXAMPLES

The following table and chart are provided for purposes of illustration only. They should not be taken as an indication or prediction of future investment results and are intended merely to illustrate the impact that the various hypothetical Closing Levels of the Underlier on the Determination Date could have on the Cash Settlement Amount.

The examples below are based on a range of Final Underlier Levels that are entirely hypothetical; no one can predict what the level of the Underlier will be on any day during the term of the notes, and no one can predict what the Final Underlier Level will be on the Determination Date. The Underlier has at times experienced periods of high volatility — meaning that the level of the Underlier has changed considerably in relatively short periods — and its performance cannot be predicted for any future period.

The information in the following examples reflects hypothetical rates of return on the notes assuming that they are purchased on the Original Issue Date at the Face Amount and held to the Stated Maturity Date. The value of the notes at any time after the Trade Date will vary based on many economic and market factors, including interest rates, the volatility of the Underlier, our creditworthiness and changes in market conditions, and cannot be predicted with accuracy. Any sale prior to the Stated Maturity Date could result in a substantial loss to you.

Key Terms and Assumptions	
Face Amount:	$1,000
Upside Participation Rate:	180.00%
Hypothetical Cap Level:	118.700% of the Initial Underlier Level
Hypothetical Maximum Settlement Amount:	$1,336.60 per $1,000 Face Amount of notes (133.660% of the Face Amount) (the midpoint of the expected range set forth on the cover of this pricing supplement)
Minimum Cash Settlement Amount:	None
Buffer Level:	85.00% of the Initial Underlier Level
Buffer Rate:	Approximately 117.65%
Buffer Amount:	15.00%

· *Neither a market disruption event nor a non-Trading Day occurs on the Determination Date.*

· *No discontinuation of the Underlier or alteration of the method by which the Underlier is calculated.*

· *Notes purchased on the Original Issue Date at the Face Amount and held to the Stated Maturity Date.*

Moreover, we have not yet set the Initial Underlier Level that will serve as the baseline for determining the Underlier Return and the amount that we will pay on the notes, if any, at maturity. We will not do so until the Trade Date. As a result, the actual Initial Underlier Level may differ substantially from the level of the Underlier at any time prior to the Trade Date.

For these reasons, the actual performance of the Underlier over the term of the notes, as well as the Cash Settlement Amount, if any, may bear little relation to the hypothetical examples shown below or to the historical levels of the Underlier shown elsewhere in this document. For information about the historical levels of the Underlier during recent periods, see “The Underlier” below.

The levels in the left column of the table below represent hypothetical Final Underlier Levels and are expressed as percentages of the Initial Underlier Level. The amounts in the right column represent the hypothetical Cash Settlement Amount, based on the corresponding hypothetical Final Underlier Level (expressed as a percentage of the Initial Underlier Level), and are expressed as percentages of the Face Amount of notes (rounded to the nearest one-thousandth of a percent). Thus, a hypothetical Cash Settlement Amount of 100% means that the value of the cash payment that we would deliver for each

$1,000 Face Amount of notes on the Stated Maturity Date would equal 100% of the Face Amount of notes, based on the corresponding hypothetical Final Underlier Level (expressed as a percentage of the Initial Underlier Level) and the assumptions noted above. The numbers appearing in the table and chart below may have been rounded for ease of analysis.

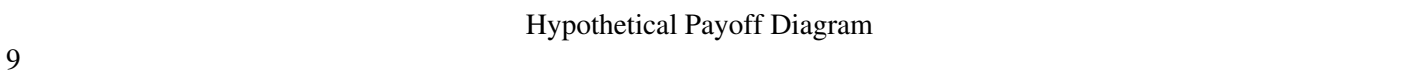
Hypothetical Final Underlier Level (as Percentage of Initial Underlier Level)	**Hypothetical Cash Settlement Amount (as Percentage of Face Amount)**
200.000%	133.660%
175.000%	133.660%
150.000%	133.660%
125.000%	133.660%
120.000%	133.660%
118.700%	**133.660%**
110.000%	118.000%
105.000%	109.000%
103.000%	105.400%
100.000%	**100.000%**
90.000%	100.000%
85.000%	**100.000%**
80.000%	94.118%
75.000%	88.235%
50.000%	58.824%
25.000%	29.412%
0.000%	**0.000%**

If, for example, the Final Underlier Level were determined to be 25.000% of the Initial Underlier Level, the Cash Settlement Amount would be approximately 29.412% of the Face Amount of notes, as shown in the table above. As a result, if you purchased your notes on the Original Issue Date at the Face Amount and held them to the Stated Maturity Date, you would lose approximately 70.588% of your investment. If you purchased your notes at a premium to the Face Amount, you would lose a correspondingly higher percentage of your investment.

If the Final Underlier Level were determined to be 150.000% of the Initial Underlier Level, the Cash Settlement Amount would be capped at the Maximum Settlement Amount (expressed as a percentage of the Face Amount), or 133.660% of each $1,000 Face Amount of notes, as shown in the table above. As a result, if you purchased the notes on the Original Issue Date at the Face Amount and held them to the Stated Maturity Date, you would not benefit from any increase in the Final Underlier Level above the Hypothetical Cap Level of 118.700% of the Initial Underlier Level.

Payoff Diagram

The following chart shows a graphical illustration of the hypothetical Cash Settlement Amount (expressed as a percentage of the Face Amount of notes), if the Final Underlier Level (expressed as a percentage of the Initial Underlier Level) were any of the hypothetical levels shown on the horizontal axis. The chart shows that any hypothetical Final Underlier Level (expressed as a percentage of the Initial Underlier Level) of less than the Buffer Level of 85.00% (the section left of the 85.00% marker on the horizontal axis) would result in a hypothetical Cash Settlement Amount of less than 100% of the Face Amount of notes (the section below the 100% marker on the vertical axis), and, accordingly, in a loss of principal to the holder of the notes. The chart also shows that any hypothetical Final Underlier Level (expressed as a percentage of the Initial Underlier Level) of greater than 118.700% (the section right of the Hypothetical Cap Level of 118.700% marker on the horizontal axis) would result in a capped return on your investment and a Cash Settlement Amount equal to the Maximum Settlement Amount.



RISK FACTORS

The following is a non-exhaustive list of certain key risk factors for investors in the notes. For further discussion of these and other risks, you should read the section entitled "Risk Factors" in the accompanying product supplement and prospectus. We also urge you to consult your investment, legal, tax, accounting and other advisers in connection with your investment in the notes.

The Notes Do Not Pay Interest Or Guarantee The Return Of Any Of Your Principal

The terms of the notes differ from those of ordinary debt securities in that the notes do not pay interest and do not guarantee any return of principal at maturity. If the Final Underlier Level has declined by an amount greater than the Buffer Amount of 15.00% from the Initial Underlier Level, you will receive for each note that you hold a Cash Settlement Amount that is less than the Face Amount of each note by an amount proportionate to the decline in the level of the Underlier below 85.00% of the Initial Underlier Level times the Buffer Rate of approximately 117.65%. As there is no minimum Cash Settlement Amount on the notes, you could lose your entire initial investment.

Also, the market price of your notes prior to the Stated Maturity Date may be significantly lower than the purchase price you pay for your notes. Consequently, if you sell your notes before the Stated Maturity Date, you may receive significantly less than the amount of your investment in the notes.

The Appreciation Potential Of The Notes Is Limited By The Maximum Settlement Amount

The appreciation potential of the notes is limited by the Maximum Settlement Amount of $1,309.78 to $1,363.42 per note, or 130.978% to 136.342% of the Face Amount. The actual Maximum Settlement Amount will be determined on the Trade Date. Although the Upside Participation Rate provides 180% exposure to any increase in the Final Underlier Level over the Initial Underlier Level, because the Cash Settlement Amount will be limited to 130.978% to 136.342% of the Face Amount for the notes, any increase in the Final Underlier Level over the Initial Underlier Level by more than 17.21% to 20.19% of the Initial Underlier Level will not further increase the return on the notes.

The Stated Maturity Date Of The Notes Is A Pricing Term And Will Be Determined By Us On The Trade Date

We will not fix the Stated Maturity Date until the Trade Date, and so you will not know the exact term or the Determination Date of the notes at the time that you make your investment decision. The term could be as short as approximately 2 years and 3 months, and as long as approximately 2 years and 6 months. You should be willing to hold your notes for up to approximately 2 years and 6 months, and the Stated Maturity Date selected by us could have an impact on the value of the notes. For example, if the Underlier appreciates, a note with a shorter term will result in

a higher annualized return based on that appreciation than a note with a longer term. In addition, the Underlier may be lower on the actual Determination Date and the Cash Settlement Amount may be lower than if the Determination Date and Stated Maturity Date had been set differently in the three-month range.

If You Purchase Your Notes At A Premium To The Face Amount, The Return On Your Investment Will Be Lower Than The Return On Notes Purchased At The Face Amount, And The Impact Of Certain Key Terms Of The Notes Will Be Negatively Affected

The Cash Settlement Amount will not be adjusted based on the issue price you pay for the notes. If you purchase notes at a price that differs from the Face Amount of notes, then the return on your investment in such notes held to the Stated Maturity Date will differ from, and may be substantially less than, the return on notes purchased at the Face Amount. If you purchase your notes at a premium to the Face Amount and hold them to the Stated Maturity Date, the return on your investment in the notes will be lower than it would have been had you purchased the notes at the Face Amount or at a discount to the Face Amount. In addition, the impact of the Buffer Level and the Cap Level on the return on your investment will depend upon the price you pay for your notes relative to the Face Amount. For example, if you purchase your notes at a premium to the Face Amount, the Cap Level will reduce your potential percentage return on the notes to a greater extent than would have been the case for notes purchased at the Face Amount or at a discount to the Face Amount. Similarly, the Buffer Level will provide less

protection of the investment amount for notes purchased at a premium to the Face Amount than for notes purchased at the Face Amount or a discount to the Face Amount.

The Underlier Reflects The Price Return Of The Stocks Composing The Underlier, Not A Total Return

The return on the notes is based on the performance of the Underlier, which reflects the changes in the market prices of the stocks composing the Underlier. It is not, however, linked to a "total return" version of the Underlier, which, in addition to reflecting those price returns, would also reflect all dividends and other distributions paid on the stocks composing the Underlier. The return on the notes will not include such a total return feature.

The Market Price Will Be Influenced By Many Unpredictable Factors

Several factors, many of which are beyond our control, will influence the value of the notes in the secondary market and the price at which MS & Co. may be willing to purchase or sell the notes in the secondary market, including: the level of the Underlier, volatility (frequency and magnitude of changes in value) of the Underlier and dividend yield of the Underlier, interest and yield rates, time remaining to maturity, geopolitical conditions and economic, financial, political and regulatory or judicial events that affect the Underlier or equities markets generally and which may affect the Final Underlier Level of the Underlier and any actual or anticipated changes in our credit ratings or credit spreads. The level of the Underlier may be, and has been, volatile, and we can give you no assurance that the volatility will lessen. See "The Underlier" below. You may receive less, and possibly significantly less, than the Face Amount per note if you try to sell your notes prior to maturity.

The Notes Are Subject To Our Credit Risk, And Any Actual Or Anticipated Changes To Our Credit Ratings Or Credit Spreads May Adversely Affect The Market Value Of The Notes

You are dependent on our ability to pay all amounts due on the notes at maturity, and therefore you are subject to our credit risk. If we default on our obligations under the notes, your investment would be at risk and you could lose some or all of your investment. As a result, the market value of the notes prior to maturity will be affected by changes in the market's view of our creditworthiness. Any actual or anticipated decline in our credit ratings or increase in the credit spreads charged by the market for taking our credit risk is likely to adversely affect the market value of the notes.

As A Finance Subsidiary, MSFL Has No Independent Operations And Will Have No Independent Assets

As a finance subsidiary, MSFL has no independent operations beyond the issuance and administration of its securities and will have no independent assets available for distributions to holders of the notes if they make claims in respect of such notes in a bankruptcy, resolution or similar proceeding. Accordingly, any recoveries by such holders will be limited to those available under the related guarantee by Morgan Stanley and that guarantee will rank *pari passu* with all other unsecured, unsubordinated obligations of Morgan Stanley. Holders will have recourse only to a single claim against Morgan Stanley and its assets under the guarantee. Holders of the notes should accordingly assume that in any such proceedings they could not have any priority over and should be treated *pari passu* with the claims of other unsecured, unsubordinated creditors of Morgan Stanley, including holders of Morgan Stanley-issued securities.

The Amount Payable On The Notes Is Not Linked To The Level Of The Underlier At Any Time Other Than The Determination Date

The Final Underlier Level will be based on the Closing Level on the Determination Date, subject to adjustment for non-Trading Days and certain market disruption events. Even if the level of the Underlier appreciates prior to the Determination Date but then drops by the Determination Date, the Cash Settlement Amount may be less, and may be significantly less, than it would have been had the Cash Settlement Amount been linked to the level of the Underlier prior to such drop. Although the actual level of the Underlier on the Stated Maturity Date or at other times during the term of the notes may be higher than the Final Underlier Level, the Cash Settlement Amount will be based solely on the Closing Level on the Determination Date.

Investing In The Notes Is Not Equivalent To Investing In The Underlier

Investing in the notes is not equivalent to investing in the Underlier or its component stocks. Investors in the notes will not have voting rights or rights to receive dividends or other distributions or any other rights with respect to stocks that constitute the Underlier.

Adjustments To The Underlier Could Adversely Affect The Value Of The Notes

The publisher of the Underlier may add, delete or substitute the stocks constituting the Underlier or make other methodological changes that could change the level of the Underlier. The publisher of the Underlier may discontinue or suspend calculation or publication of the Underlier at any time. In these circumstances, the calculation agent will have the sole discretion to substitute a successor index that is comparable to the discontinued Underlier and is permitted to consider indices that are calculated and published by the calculation agent or any of its affiliates. If the calculation agent determines that there is no appropriate successor index, the Cash Settlement Amount on the notes will be an amount based on the closing prices at maturity of the securities composing the Underlier at the time of such discontinuance, without rebalancing or substitution, computed by the calculation agent in accordance with the formula for calculating the Underlier last in effect prior to discontinuance of the Underlier.

The Rate We Are Willing To Pay For Securities Of This Type, Maturity And Issuance Size Is Likely To Be Lower Than The Rate Implied By Our Secondary Market Credit Spreads And Advantageous To Us. Both The Lower Rate And The Inclusion Of Costs Associated With Issuing, Selling, Structuring And Hedging The Notes In The Original Issue Price Reduce The Economic Terms Of The Notes, Cause The Estimated Value Of The Notes To Be Less Than The Original Issue Price And Will Adversely Affect Secondary Market Prices

Assuming no change in market conditions or any other relevant factors, the prices, if any, at which dealers, including MS & Co., may be willing to purchase the notes in secondary market transactions will likely be significantly lower than the Original Issue Price, because secondary market prices will exclude the issuing, selling, structuring and hedging-related costs that are included in the Original Issue Price and borne by you and because the secondary market prices will reflect our secondary market credit spreads and the bid-offer spread that any dealer would charge in a secondary market transaction of this type as well as other factors.

The inclusion of the costs of issuing, selling, structuring and hedging the notes in the Original Issue Price and the lower rate we are willing to pay as issuer make the economic terms of the notes less favorable to you than they otherwise would be.

However, because the costs associated with issuing, selling, structuring and hedging the notes are not fully deducted upon issuance, for a period of up to 3 months following the issue date, to the extent that MS & Co. may buy or sell the notes in the secondary market, absent changes in market conditions, including those related to the Underlier, and to our secondary market credit spreads, it would do so based on values higher than the estimated value, and we expect

that those higher values will also be reflected in your brokerage account statements.

The Estimated Value Of The Notes Is Determined By Reference To Our Pricing And Valuation Models, Which May Differ From Those Of Other Dealers And Is Not A Maximum Or Minimum Secondary Market Price

These pricing and valuation models are proprietary and rely in part on subjective views of certain market inputs and certain assumptions about future events, which may prove to be incorrect. As a result, because there is no market-standard way to value these types of securities, our models may yield a higher estimated value of the notes than those generated by others, including other dealers in the market, if they attempted to value the notes. In addition, the estimated value on the Trade Date does not represent a minimum or maximum price at which dealers, including MS & Co., would be willing to purchase your notes in the secondary market (if any exists) at any time. The value of your notes at any time after the date hereof will vary based on many factors that cannot be predicted with accuracy, including our creditworthiness and changes in market conditions. See also “The Market Price Will Be Influenced By Many Unpredictable Factors” above.

The Notes Will Not Be Listed On Any Securities Exchange And Secondary Trading May Be Limited

The notes will not be listed on any securities exchange. Therefore, there may be little or no secondary market for the notes. MS & Co. may, but is not obligated to, make a market in the notes and, if it once

chooses to make a market, may cease doing so at any time. When it does make a market, it will generally do so for transactions of routine secondary market size at prices based on its estimate of the current value of the notes, taking into account its bid/offer spread, our credit spreads, market volatility, the notional size of the proposed sale, the cost of unwinding any related hedging positions, the time remaining to maturity and the likelihood that it will be able to resell the notes. Even if there is a secondary market, it may not provide enough liquidity to allow you to trade or sell the notes easily. Since other broker-dealers may not participate significantly in the secondary market for the notes, the price at which you may be able to trade your notes is likely to depend on the price, if any, at which MS & Co. is willing to transact. If, at any time, MS & Co. were to cease making a market in the notes, it is likely that there would be no secondary market for the notes. Accordingly, you should be willing to hold your notes to maturity.

The Calculation Agent, Which Is A Subsidiary Of Morgan Stanley And An Affiliate Of MSFL, Will Make Determinations With Respect To The Notes

As calculation agent, MS & Co. will determine the Initial Underlier Level and the Final Underlier Level and will calculate the Cash Settlement Amount you receive at maturity, if any. Moreover, certain determinations made by MS & Co. in its capacity as calculation agent, may require it to exercise discretion and make subjective judgments, such as with respect to the occurrence or non-occurrence of market disruption events and the selection of a successor index or calculation of the Final Underlier Level in the event of a market disruption event or discontinuance of the Underlier. These potentially subjective determinations may adversely affect the Cash Settlement Amount at maturity, if any. For further information regarding these types of determinations, see “Description of PLUS—Postponement of Valuation Date(s)” and “—Calculation Agent and Calculations” in the accompanying product supplement. In addition, MS & Co. has determined the estimated value of the notes on the Trade Date.

Hedging And Trading Activity By Our Affiliates Could Potentially Adversely Affect The Value Of The Notes

One or more of our affiliates and/or third-party dealers expect to carry out hedging activities related to the notes (and possibly to other instruments linked to the Underlier or its component stocks), including trading in the stocks that constitute the Underlier as well as in other instruments related to the Underlier. As a result, these entities may be unwinding or adjusting hedge positions during the term of the notes, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the Determination Date approaches. Some of our affiliates also trade the stocks that constitute the Underlier and other financial instruments related to the Underlier on a regular basis as part of their general broker-dealer and other businesses. Any of these hedging or trading activities on or prior to the Trade Date could potentially increase the Initial Underlier Level, and, therefore, could increase the level at or above which the Underlier must close on the Determination Date so that investors do not suffer a loss on their initial investment in the notes. Additionally, such hedging or trading activities during the term of the notes, including on the Determination Date, could adversely affect the level of the Underlier on the Determination Date, and, accordingly, the Cash Settlement Amount an investor will receive at maturity, if any. Furthermore, if the dealer from which you purchase notes is to conduct trading and hedging activities for us in connection with the notes, that dealer may profit in connection with such trading and hedging activities and such profit, if any, will be in addition to the compensation that the dealer receives for the sale of the notes to you. You should be aware that the potential to earn a profit in connection with hedging activities may create a further incentive for the dealer to sell the notes to you, in addition to

the compensation they would receive for the sale of the notes.

We May Sell An Additional Aggregate Face Amount Of Notes At A Different Issue Price

At our sole option, we may decide to sell an additional aggregate Face Amount of notes subsequent to the date hereof. The issue price of the notes in the subsequent sale may differ substantially (higher or lower) from the issue price you paid as provided on the cover of this document.

Past Performance is No Guide to Future Performance

The actual performance of the Underlier over the term of the notes, as well as the amount payable at maturity, may bear little relation to the historical Closing Levels of the Underlier or to the hypothetical return examples set forth herein. We cannot predict the future performance of the Underlier.

The U.S. Federal Income Tax Consequences Of An Investment In The Notes Are Uncertain

Please read the discussion under "Tax Considerations" in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement (together, the "Tax Disclosure Sections") concerning the U.S. federal income tax consequences of an investment in the notes. If the Internal Revenue Service (the "IRS") were successful in asserting an alternative treatment, the timing and character of income on the notes might differ significantly from the tax treatment described in the Tax Disclosure Sections. For example, under one possible treatment, the IRS could seek to recharacterize the notes as debt instruments. In that event, U.S. Holders would be required to accrue into income original issue discount on the notes every year at a "comparable yield" determined at the time of issuance and recognize all income and gain in respect of the notes as ordinary income. Additionally, as discussed under "United States Federal Taxation—FATCA" in the accompanying product supplement, the withholding rules commonly referred to as "FATCA" would apply to the notes if they were recharacterized as debt instruments. The risk that financial instruments providing for buffers, triggers or similar downside protection features, such as the notes, would be recharacterized as debt is greater than the risk of recharacterization for comparable financial instruments that do not have such features. We do not plan to request a ruling from the IRS regarding the tax treatment of the notes, and the IRS or a court may not agree with the tax treatment described in the Tax Disclosure Sections.

In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect. Both U.S. and Non-U.S. Holders should consult their tax advisers regarding the U.S. federal income tax consequences of an investment in the notes, including possible alternative treatments, the issues presented by this notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

THE UNDERLIER

The S&P 500® Index, which is calculated, maintained and published by S&P Dow Jones Indices LLC ("S&P"), consists of stocks of 500 component companies selected to provide a performance benchmark for the U.S. equity markets. The calculation of the S&P 500® Index is based on the relative value of the float adjusted aggregate market capitalization of the 500 component companies as of a particular time as compared to the aggregate average market capitalization of 500 similar companies during the base period of the years 1941 through 1943. For additional information about the S&P 500® Index, see the information set forth under "S&P 500® Index" in the accompanying index supplement.

In addition, information about the Underlier may be obtained from other sources including, but not limited to, the Underlier Publisher's website (including information regarding (i) the Underlier's top ten constituents and (ii) the Underlier's sector weightings). We are not incorporating by reference into this document the website or any material it includes. Neither the issuer nor the agent makes any representation that such publicly available information regarding the Underlier is accurate or complete.

Information as of market close on December 11, 2018:

Bloomberg Ticker Symbol:	SPX
Current Index Value:	2,636.78
52 Weeks Ago:	2,659.99
52 Week High (on 9/20/2018):	2,930.75
52 Week Low (on 2/8/2018):	2,581.00

The following graph sets forth the daily Closing Levels of the Underlier for each quarter in the period from January 1, 2013 through December 11, 2018. The Closing Level of the Underlier on December 11, 2018 was 2,636.78. We obtained the information in the graph below from Bloomberg Financial Markets without independent verification. The Underlier has at times experienced periods of high volatility. The actual performance of the Underlier over the term of the notes, as well as the amount payable at maturity, may bear little relation to the historical Closing Levels of the Underlier or to the hypothetical return examples set forth herein. We cannot predict the future performance of the Underlier. You should not take the historical levels of the Underlier as an indication of its future performance, and no assurance can be given as to the Closing Level of the Underlier on the Determination Date.

S&P 500®
Index

Daily
Index
Closing
Values

January 1,
2013 to
December
11, 2018

TAX CONSIDERATIONS

Although there is uncertainty regarding the U.S. federal income tax consequences of an investment in the notes due to the lack of governing authority, in the opinion of our counsel, Davis Polk & Wardwell LLP, under current law, and based on current market conditions, a note should be treated as a single financial contract that is an "open transaction" for U.S. federal income tax purposes.

Assuming this treatment of the notes is respected and subject to the discussion in "United States Federal Taxation" in the accompanying product supplement, the following U.S. federal income tax consequences should result based on current law:

- A U.S. Holder should not be required to recognize taxable income over the term of the notes prior to settlement, other than pursuant to a sale or exchange.

- Upon sale, exchange or settlement of the notes, a U.S. Holder should recognize gain or loss equal to the difference between the amount realized and the U.S. Holder's tax basis in the notes. Such gain or loss should be long-term capital gain or loss if the investor has held the notes for more than one year, and short-term capital gain or loss otherwise.

In 2007, the U.S. Treasury Department and the Internal Revenue Service (the "IRS") released a notice requesting comments on the U.S. federal income tax treatment of "prepaid forward contracts" and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; the degree, if any, to which income (including any mandated accruals) realized by non-U.S. investors should be subject to withholding tax; and whether these instruments are or should be subject to the "constructive ownership" rule, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose an interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the notes, possibly with retroactive effect.

As discussed in the accompanying product supplement, Section 871(m) of the Internal Revenue Code of 1986, as amended, and Treasury regulations promulgated thereunder ("Section 871(m)") generally impose a 30% (or a lower applicable treaty rate) withholding tax on dividend equivalents paid or deemed paid to Non-U.S. Holders with respect to certain financial instruments linked to U.S. equities or indices that include U.S. equities (each, an "Underlying Security"). Subject to certain exceptions, Section 871(m) generally applies to securities that substantially replicate the economic performance of one or more Underlying Securities, as determined based on tests set forth in the applicable Treasury regulations (a "Specified Security"). However, pursuant to an IRS notice, Section 871(m) will not apply to

securities issued before January 1, 2021 that do not have a delta of one with respect to any Underlying Security. Based on our determination that the notes do not have a delta of one with respect to any Underlying Security, our counsel is of the opinion that the notes should not be Specified Securities and, therefore, should not be subject to Section 871(m).

Our determination is not binding on the IRS, and the IRS may disagree with this determination. Section 871(m) is complex and its application may depend on your particular circumstances, including whether you enter into other transactions with respect to an Underlying Security. If withholding is required, we will not be required to pay any additional amounts with respect to the amounts so withheld. You should consult your tax adviser regarding the potential application of Section 871(m) to the notes.

Both U.S. and non-U.S. investors considering an investment in the notes should read the discussion under "Risk Factors" in this document and the discussion under "United States Federal Taxation" in the accompanying product supplement and consult their tax advisers regarding all aspects of the U.S. federal income tax consequences of an investment in the notes, including possible alternative treatments, the issues presented by the aforementioned notice and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

The discussion in the preceding paragraphs under "Tax considerations" and the discussion contained in the section entitled "United States Federal Taxation" in the accompanying product supplement, insofar as

they purport to describe provisions of U.S. federal income tax laws or legal conclusions with respect thereto, constitute the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of an investment in the notes.

ADDITIONAL INFORMATION ABOUT THE NOTES

No interest or dividends: The notes will not pay interest or dividends.

No listing: The notes will not be listed on any securities exchange.

No redemption: The notes will not be subject to any redemption right.

Purchase at amount other than Face Amount: The amount we will pay you on the Stated Maturity Date for your notes will not be adjusted based on the issue price you pay for your notes, so if you acquire notes at a premium (or discount) to the Face Amount and hold them to the Stated Maturity Date, it could affect your investment in a number of ways. The return on your investment in such notes will be lower (or higher) than it would have been had you purchased the notes at the Face Amount. Also, the Buffer Level would not offer the same measure of protection to your investment as would be the case if you had purchased the notes at the Face Amount. Additionally, the Cap Level would be triggered at a lower (or higher) percentage return than indicated below, relative to your initial investment. See "Risk Factors—If You Purchase Your Notes At A Premium To The Face Amount, The Return On Your Investment Will Be Lower Than The Return On Notes Purchased At The Face Amount, And The Impact Of Certain Key Terms Of The Notes Will Be Negatively Affected" beginning on page 10 of this document.

Use of proceeds and hedging: The proceeds from the sale of the notes will be used by us for general corporate purposes. We will receive, in aggregate, $1,000 per note issued. The costs of the notes borne by you and described on page 2 comprise the cost of issuing, structuring and hedging the notes.

On or prior to the Trade Date, we will hedge our anticipated exposure in connection with the notes, by entering into hedging transactions with our affiliates and/or third party dealers. We expect our hedging counterparties to take positions in stocks of the Underlier, futures and options contracts on the Underlier, and any component stocks of the Underlier listed on major securities markets or positions in any other available securities or instruments that they may wish to use in connection with such hedging. Such purchase activity could increase the level of the Underlier on the Trade Date, and therefore increase the level at or above which the Underlier must close on the Determination Date so that investors do not suffer a loss on their initial investment in the notes. In addition, through our affiliates, we are likely to modify our hedge position throughout the term of the notes, including on the Determination Date, by purchasing and selling the stocks constituting the Underlier, futures or options contracts on the Underlier or its component stocks listed on major securities markets or positions in any other available securities or instruments that we may wish to use in connection with such hedging activities. As a result, these entities may be unwinding or adjusting hedge positions during the term of the notes, and the hedging strategy may involve greater and more frequent dynamic adjustments to the hedge as the Determination Date approaches. We cannot give any assurance that our hedging activities will not affect the level of the Underlier, and, therefore, adversely affect the value of the notes

or the payment you will receive at maturity, if any. For further information on our use of proceeds and hedging, see "Use of Proceeds and Hedging" in the accompanying product supplement.

Benefit Plan Investor Considerations: Each fiduciary of a pension, profit-sharing or other employee benefit plan subject to Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (a "Plan"), should consider the fiduciary standards of ERISA in the context of the Plan's particular circumstances before authorizing an investment in the notes. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the Plan.

In addition, we and certain of our affiliates, including MS & Co., may each be considered a "party in interest" within the meaning of ERISA, or a "disqualified person" within the meaning of the Internal Revenue Code of 1986, as amended (the "Code"), with respect to many Plans, as well as many individual retirement accounts and Keogh plans (such accounts and plans, together with other plans, accounts and arrangements subject to Section 4975 of the Code, also "Plans"). ERISA Section 406 and Code Section 4975 generally prohibit transactions between Plans and parties in interest or disqualified persons. Prohibited transactions within the meaning of ERISA or the Code would likely arise, for example, if the notes are acquired by or with the assets of a Plan with respect to which MS & Co. or any of its affiliates is a service provider or other party in interest, unless the notes are acquired pursuant to an exemption from

the “prohibited transaction” rules. A violation of these “prohibited transaction” rules could result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for those persons, unless exemptive relief is available under an applicable statutory or administrative exemption.

The U.S. Department of Labor has issued five prohibited transaction class exemptions (“PTCEs”) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the notes. Those class exemptions are PTCE 96-23 (for certain transactions determined by in-house asset managers), PTCE 95-60 (for certain transactions involving insurance company general accounts), PTCE 91-38 (for certain transactions involving bank collective investment funds), PTCE 90-1 (for certain transactions involving insurance company separate accounts) and PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers). In addition, ERISA Section 408(b)(17) and Section 4975(d)(20) of the Code provide an exemption for the purchase and sale of securities and the related lending transactions, provided that neither the Issuer of the notes nor any of its affiliates has or exercises any discretionary authority or control or renders any investment advice with respect to the assets of the Plan involved in the transaction and provided further that the Plan pays no more, and receives no less, than “adequate consideration” in connection with the transaction (the so-called “service provider” exemption). There can be no assurance that any of these class or statutory exemptions will be available with respect to transactions involving the notes.

Because we may be considered a party in interest with respect to many Plans, the notes may not be purchased, held or disposed of by any Plan, any entity whose underlying assets include “plan assets” by reason of any Plan’s investment in the entity (a “Plan Asset Entity”) or any person investing “plan assets” of any Plan, unless such purchase, holding or disposition is eligible for exemptive relief, including relief available under PTCEs 96-23, 95-60, 91-38, 90-1, 84-14 or the service provider exemption or such purchase, holding or disposition is otherwise not prohibiht" style="margin:0in 0in .0001pt;text-align:right;">

Operating expenses:

Research and development (1)

	859
General and administrative (1)	
	4,768
	1,835
Restructuring	
	(3
)	
	(2
)	
	4,873
	2,692
Loss from operations	

(3,873

)

(2,642

)

Interest income

34

124

Net loss

$

(3,839

)

$

(2,518

)

Net loss per share basic and diluted

$

(0.13

)

$

(0.09

)

Weighted average common shares outstanding basic and diluted

30,230

27,145

(1) Non-cash stock-based compensation expense included in these amounts are as follows:

Research and development	$	$ 44
General and administrative	623	257

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

Table of Contents

EXACT SCIENCES CORPORATION

Condensed Consolidated Statements of Cash Flows

(Amounts in thousands - unaudited)

	Three Months Ended March 31,	
	2009	**2008**
Cash flows from operating activities:		
Net loss	$ (3,839)	$ (2,518)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of fixed assets	12	59
Amortization and write-offs of patents	95	34
Stock-based compensation	623	301
Amortization of deferred license fees	(993)	(338)
Changes in assets and liabilities:		
Prepaid expenses and other current assets	(500)	(178)
Accounts payable	(649)	30
Accrued expenses	(264)	(743)
Third party royalty obligation	(1,485)	300
Net cash used in operating activities	(7,000)	(3,053)
Cash flows from investing activities:		
Purchases of marketable securities	(16,947)	(2,466)
Maturities of marketable securities		5,080
Purchases of property and equipment	(9)	
Increase in patent costs and other assets		(54)
Net cash (used in) provided by investing activities	(16,956)	2,560
Cash flows from financing activities:		
Proceeds from Genzyme Collaboration, License and Purchase Agreement	16,650	
Proceeds from sale of common stock to Genzyme	6,000	
Proceeds from exercise of common stock options and stock purchase plan	14	6
Payment to repurchase stock options	(50)	
Net cash provided by financing activities	22,614	6
Net decrease in cash and cash equivalents	(1,342)	(487)
Cash and cash equivalents, beginning of period	4,937	4,486
Cash and cash equivalents, end of period	$ 3,595	$ 3,999

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

Table of Contents

EXACT SCIENCES CORPORATION

Notes to Condensed Consolidated Financial Statements

(Unaudited)

(1) ORGANIZATION AND BASIS OF PRESENTATION

Organization

EXACT Sciences Corporation (the Company) was incorporated in February 1995. The Company s purpose is to improve quality of life through the development of innovative diagnostics. The mission of the company is to save lives by launching an FDA-cleared, patient friendly colon cancer test that detects both pre-cancer and cancer. Effective April 2, 2009 the Company s board of directors appointed Kevin T. Conroy as president and chief executive, and Maneesh K. Arora as senior vice president and chief financial officer. Both Conroy and Arora bring significant experience with molecular diagnostics and managing complex clinical trials to their new roles at the Company. They were most recently president and chief executive, and chief financial officer, respectively, of Third Wave Technologies Inc. Third Wave, a NASDAQ-traded molecular diagnostics company which was acquired last year by Hologic Inc. for $582 million.

The American Cancer Society estimates that 80-90 million people in the United States are eligible for colorectal cancer screening. The company will approach this market opportunity by remaining focused on key priorities. The company s priorities for 2009 are: 1) product development, 2) clinical trial planning and 3) creating a performance culture at Exact.

As more fully described in Note 3 below, the Company entered into a strategic transaction with Genzyme Corporation (the Genzyme Strategic Transaction) on January 27, 2009, pursuant to which Genzyme acquired certain intellectual property assets related to the fields of prenatal and reproductive health and licensed certain intellectual property outside the fields of colorectal cancer screening and stool-based DNA detection. Genzyme also purchased 3.0 million shares of the Company s common stock. Pursuant to the strategic transaction, EXACT retained worldwide rights to its colorectal cancer screening and stool-based DNA testing intellectual property, and will receive a share of Genzyme s sublicensing income derived from the purchased intellectual property outside the fields of prenatal and reproductive health.

The Genzyme Strategic Transaction provides for the Company to receive up to $24.5 million in cash in total. On January 27, 2009, the Company received $16.65 million, with an additional $1.85 million to be received over the next 18 months, contingent upon the non-occurrence of certain events, in exchange for the sale and license of certain of the Company s intellectual property assets, including those relating to reproductive and prenatal health. In addition, at closing, Genzyme purchased 3.0 million shares of EXACT common stock at $2.00 per share for an aggregate purchase price of $6.0 million.

The Company has licensed certain of its technologies, including improvements to such technologies, on an exclusive basis through December 2010 to Laboratory Corporation of America® Holdings (LabCorp®) for use in a commercial testing service for the detection of colorectal cancer developed by LabCorp. The Company has devoted the majority of its efforts to date on research and development and commercialization support of its colorectal cancer detection technologies.

The Company expects that cash, cash equivalents and marketable securities on hand at March 31, 2009 will be sufficient to fund its current operations for at least the next twelve months, based on current operating plans. The projection is based on the Company s currently anticipated cost structure and operating assumptions and does not provide for the full funding of the development of the Company s stool-based DNA technology and related FDA submission and commercialization efforts or other programs and initiatives. The Company does not expect that product royalty payments or milestone payments from LabCorp will materially supplement its liquidity position in the next twelve months, if at all. Since the Company has no current sources of material ongoing revenue, it believes that it will need to raise additional capital to complete the development, FDA submission for clearance or approval, and commercialization of its technologies, including an FDA-approved in vitro diagnostic test for stool-based DNA colorectal cancer screening. If the Company is unable to obtain sufficient additional funds to enable it to fund its operations through the completion of the development of such a test, the submission to the FDA for clearance or approval of the test, and commercialization of the test, the Company s results of operations and financial condition would be materially adversely affected and it may be required to delay such efforts and otherwise scale back operations. Even if the Company successfully raises sufficient funds to continue its operations to fund the development, FDA submission, and commercialization of its technology, including an FDA-approved in vitro diagnostic test for stool-based DNA colorectal cancer screening, the Company cannot assure you that its business will ever generate sufficient cash flow from operations to become profitable.

Basis of Presentation

The accompanying condensed consolidated financial statements of the Company are unaudited and have been prepared on a basis substantially consistent with the Company s audited financial statements. These condensed consolidated financial statements assume that the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities and commitments in the normal course of business, and, in the opinion of management, include all normal and recurring adjustments which are necessary to present fairly the results of operations for the reported periods. These condensed consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and follow the requirements of the Securities and Exchange Commission (SEC) for interim reporting.

The results of the Company s operations for any interim period are not necessarily indicative of the results of the Company s operations for any other interim period or for a full fiscal year.

Table of Contents

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company s wholly-owned subsidiary, EXACT Sciences Securities Corporation, a Massachusetts securities corporation. All significant intercompany transactions and balances have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly-liquid investments with maturities of 90 days or less at the time of acquisition to be cash equivalents. Cash equivalents primarily consist of money market funds.

Restricted Cash

At March 31, 2009 and December 31, 2008, $0.6 million of the Company s cash has been pledged as collateral for an outstanding letter of credit in connection with the lease for the Company s corporate headquarters.

Marketable Securities

The Company accounts for its investments in marketable securities in accordance with Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Marketable equity securities and debt securities not classified as held-to-maturity are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses, net of tax, reported in other comprehensive income. The amortized cost of debt securities in this category is

adjusted for amortization of premiums and accretion of discounts to maturity computed under the effective interest method. Such amortization is included in investment income. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in investment income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in investment income.

At March 31, 2009, the Company s investments were comprised of fixed income investments and all were deemed available-for-sale. At December 31, 2008, the Company held no marketable securities. The objectives of the Company s investment strategy are to provide liquidity and safety of principal while striving to achieve the highest rate of return consistent with these two objectives. The Company s investment policy limits investments to certain types of instruments issued by institutions with investment grade credit ratings and places restrictions on maturities and concentration by type and issuer. There were no realized gains or losses on the sale of available-for-sale securities during the three months ended March 31, 2009 and 2008.

Patent Costs

Patent costs, which have historically consisted of related legal fees, are capitalized as incurred and are amortized beginning when patents are approved over an estimated useful life of five years. Capitalized patent costs are expensed upon disapproval, upon a decision by the Company to no longer pursue the patent or when the related intellectual property is either sold or deemed to be no longer of value to the Company. In connection with the Genzyme Strategic Transaction, the Company sold its then-remaining capitalized intellectual property to Genzyme on January 27, 2009, and accordingly, wrote off the remaining unamortized capitalized patent costs at that time.

The following table summarizes activity with respect to the Company s capitalized patents for the three months ended March 31, 2009 and 2008. Amounts included in the table are in thousands.

Table of Contents

	Three Months Ended	
	March 31, 2009	March 31, 2008
Patents, net of accumulated amortization, Beginning of period	$ 95	$ 432
Patent costs capitalized		54
Amortization of patents		(34)
Write-offs of patents	(95)	
Patents, net of accumulated amortization, End of period	**$**	$ 452

Net Loss Per Share

Basic and diluted net loss per share is presented in conformity with SFAS No. 128, *Earnings per Share* (SFAS No. 128), for all periods presented. In accordance with SFAS No. 128, basic net loss per common share was determined by dividing net loss applicable to common stockholders by the weighted average common shares outstanding during the period. Basic and diluted net loss per share are the same because all outstanding common stock equivalents have been excluded, as they are anti-dilutive.

The following potentially issuable common shares were not included in the computation of diluted net loss per share because they would have an anti-dilutive effect due to net losses for each period:

	March 31,	
(In thousands)	**2009**	**2008**
Shares issuable upon exercise of stock options	6,636	4,433
Shares issuable upon exercise of outstanding warrants		1,000
	6,636	5,433

In conjunction with its strategic alliance with LabCorp, in June 2002, the Company issued to LabCorp a warrant (the LabCorp Warrant) to purchase 1,000,000 shares of its common stock, exercisable over a three-year period at an exercise price of $16.09 per share. At the time of issuance, the LabCorp Warrant had an expiration date of June 26, 2005. On June 24, 2005, the Company extended the expiration date of the LabCorp Warrant to August 13, 2008, which was the expiration date of the exclusive period at the time of the extension. On August 13, 2008, the LabCorp Warrant expired unexercised.

Accounting for Stock-Based Compensation

The Company accounts for share-based payments to employees in accordance with SFAS No. 123(R), *Share-Based Payment* (SFAS No. 123(R)), which requires all share-based payments to employees, including grants of employee stock options and shares purchased under an employee stock purchase plan (if certain parameters are not met), to be recognized in the financial statements based on their fair values. Share-based payment transactions with parties other than employees are accounted for in accordance with EITF 96-18, *Accounting for Equity*

Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.

Revenue Recognition

License fees. License fees for the licensing of product rights on initiation of strategic agreements are recorded as deferred revenue upon receipt and recognized as revenue on a straight-line basis over the license period. On June 27, 2007, the Company entered into an amendment to its exclusive license agreement with LabCorp (the Second Amendment) that, among other modifications to the terms of the license, extended the exclusive license period from August 2008 to December 2010, subject to carve-outs for certain named organizations. Accordingly, the Company amortizes the remaining deferred revenue balance resulting from its license agreement with LabCorp at the time of the Second Amendment ($4.7 million) on a straight-line basis over the remaining exclusive license period, which ends in December 2010.

As more fully described in Note 3 below, in connection with the Genzyme Strategic Transaction, the Company received an up-front payment of $16.65 million on January 27, 2009 in exchange for the assignment and licensing of certain intellectual property to

Table of Contents

Genzyme. Pursuant to the provisions of SEC Staff Accounting Bulletin No. 104 and EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables*, which govern revenue recognition, the Company s on-going performance obligations to Genzyme under the Collaboration, License and Purchase Agreement (the CLP Agreement), as described below, including its obligation to deliver certain intellectual property improvements to Genzyme during the initial five-year collaboration period, were deemed to be undelivered elements of the CLP Agreement on the date of closing. Accordingly, the Company deferred the initial $16.65 million in cash received at closing and will amortize that up-front payment on a straight line basis into the License Fee Revenue line item in its statements of operations over the initial five-year collaboration period ending in January 2014. Receipt of any holdback amounts, as defined below, will similarly be deferred and amortized on a straight line basis into the License Fee Revenue line item in the Company s statements of operations over the remaining term of the collaboration at the time of receipt.

In addition, Genzyme paid $2.00 per share for the 3,000,000 million shares of common stock purchased from the Company on January 27, 2009, representing a premium of $0.51 per share above the closing price of the Company s common stock on that date of $1.49 per share. Under FASB Technical Bulletin No. 85-6, *Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt,* (FTB No. 85-6), the aggregate premium paid by Genzyme over the closing price of the Company s common stock on the date of the transaction of $1.53 million is deemed to be a part of the total consideration for the CLP Agreement. Accordingly, the Company deferred the aggregate $1.53 million premium and will amortize that amount on a straight line basis into the License Fee Revenue line item in its statements of operations over the initial five-year collaboration period ending in January 2014. The Company recognized approximately $0.7 million in license fee revenue in connection with the amortization of the up-front payments from Genzyme during the quarter ended March 31, 2009.

Product royalty fees. The Company has licensed certain of its technologies, including improvements to such technologies, on an exclusive basis through December 2010 to LabCorp. LabCorp developed and commercially offered PreGen-Plus, a non-invasive stool-based DNA colorectal cancer screening service for the average-risk population based on the Company s Version 1 technology, from August 2003 through June 2008. In June 2008, LabCorp stopped offering PreGen-Plus. On July 14, 2008, LabCorp began to commercially offer ColoSure, its next generation non-invasive, stool-based DNA testing service for the detection of colorectal cancer in the average-risk population, which is based on certain of the Company s intellectual property. The Company will be entitled to the same royalty and milestone structure on any sales of ColoSure as it was entitled to on sales of PreGen-Plus.

Prior to the effective date of the Second Amendment, the Company s product royalty fees were based on a specified contractual percentage of LabCorp s cash receipts from performing PreGen-Plus tests. Accordingly, the Company recorded product royalty fees based on this specified percentage of LabCorp s cash receipts, as reported to the Company each month by LabCorp. Subsequent to the effective date of the Second Amendment, the Company s product royalty fees are based on a specified contractual percentage of LabCorp s net revenues from sales of PreGen-Plus through June 1, 2008, when LabCorp stopped offering PreGen-Plus, and from sales of ColoSure from and after July 2008. Accordingly, subsequent to the effective date of the Second Amendment, the Company records product royalty fees based on the specified contractual percentage of LabCorp s net revenues from its sales of such colorectal cancer screening tests, as reported to the Company each month by LabCorp. The current royalty rate is 15%, subject to an increase to 17% in the event that LabCorp achieves a specified significant threshold of annual net revenues from the sales of such colorectal cancer screening tests.

Additionally, pursuant to the Second Amendment, the Company is potentially obligated to reimburse LabCorp for certain third-party royalty payments, as described in Note 5 below. To the extent the Company incurs liabilities in connection with this provision of the Second Amendment, the accretion of such liabilities will be recorded as a reduction in the product royalty fee line item in the Company s condensed consolidated statements of operations.

Product revenue. Product revenue from the sale of certain components of the Company s Effipure technology to LabCorp was recognized upon transfer of the components provided that title passed, the price was fixed or determinable and collection of the receivable was probable. LabCorp has indicated that Effipure is not used as a component in LabCorp s ColoSure offering and the Company therefore does not expect to record product revenue in connection with Effipure sales in future periods.

Other revenue. Revenue from milestone and other performance-based payments is recognized as revenue when the milestone or performance is achieved and collection of the receivable is estimable and probable.

Comprehensive Loss

SFAS No. 130, *Reporting Comprehensive Income*, establishes presentation and disclosure requirements for comprehensive income (loss). Comprehensive loss consists of net loss and the change in unrealized gains and losses on marketable securities. Comprehensive loss for the three months ended March 31, 2009 and 2008 was as follows:

	Three Months Ended March 31,	
(In thousands)	**2009**	**2008**
Net loss	$ (3,839)	$ (2,518)
Unrealized gain on marketable securities	71	1
Comprehensive loss	$ (3,768)	$ (2,517)

Table of Contents

(3) GENZYME STRATEGIC TRANSACTION

Transaction summary

On January 27, 2009, the Company entered into a Collaboration, License and Purchase Agreement (the CLP Agreement) with Genzyme Corporation (Genzyme). Pursuant to the CLP Agreement, the Company (i) assigned to Genzyme all of its intellectual property applicable to the fields of prenatal and reproductive health (the Transferred Intellectual Property), (ii) granted Genzyme an irrevocable, perpetual, exclusive, worldwide, fully-paid, royalty-free license to use and sublicense all of the Company s remaining intellectual property (the Retained Intellectual Property) in the fields of prenatal and reproductive health (the Genzyme Core Field), and (iii) granted Genzyme an irrevocable, perpetual, non-exclusive, worldwide, fully-paid, royalty-free license to use and sublicense the Retained Intellectual Property in all fields other than the Genzyme Core Field and other than colorectal cancer detection and stool-based disease protection (the Company Field). Following the Genzyme Transaction, EXACT retains rights in its intellectual property to pursue only the fields of colorectal cancer detection and stool-based detection of any disease or condition. Further, subject to the terms of the JHU Amendment (defined below), the Company assigned to Genzyme its rights under the license agreement between the Company and The Johns Hopkins University (JHU) dated March 25, 2003, as amended (the JHU Agreement) (collectively, with the licenses and assignment described herein, the Sale Transaction). The CLP Agreement also provides for the formation of a joint advisory committee to assist both parties in the achievement of product development and regulatory goals. The collaboration period under the CLP Agreement may be terminated upon certain events. Additional termination rights concerning the collaboration period arise after five years.

Under the CLP Agreement, the Company retained ownership of intellectual property rights other than the Transferred Intellectual Property. In addition, with respect to the Transferred Intellectual Property, Genzyme granted the Company an irrevocable, perpetual, exclusive, worldwide, fully-paid, royalty-free license to use and sublicense such intellectual property in the Company Field. The parties also granted to each other a perpetual (subject to termination for uncured material breaches), exclusive, worldwide, fully-paid, royalty-free license to use and sublicense any improvements Genzyme or the Company makes to the Transferred Intellectual Property that is applicable to the Company Field (in the case of the Company as licensee) or all fields other than the Company Field (the Genzyme Field) (in the case of Genzyme as licensee). Further, the parties granted to each other a perpetual (subject to termination for uncured material breaches), exclusive, worldwide, fully-paid, royalty-free license to use and sublicense intellectual property jointly developed pursuant to the collaboration between the parties (the Joint Technology). The license to the Joint Technology granted by the Company to Genzyme is exclusive in the Genzyme Field and the license to the Joint Technology granted by Genzyme to the Company is exclusive in the Company Field. The Company also granted to Genzyme an exclusive option to obtain an exclusive license, in the Genzyme Core Field, to certain technology that the Company may develop or acquire that has applicability in the Genzyme Core Field. The CLP Agreement contains representations, warranties and covenants with respect to the Sale Transaction and provides, under certain circumstances, for the Company and Genzyme to indemnify each other for breaches of their respective representations, warranties and covenants.

As part of the Sale Transaction, the Company entered into an Assignment, Sublicense, Consent and Eighth Amendment to License Agreement with Genzyme and JHU (the JHU Amendment) on January 27, 2009, whereby the Company assigned its rights under the JHU Agreement to Genzyme. Pursuant to the JHU Amendment, Genzyme sublicensed to the Company the intellectual property subject to the JHU Agreement for colorectal cancer detection and stool-based disease detection, including the BEAMing technology for the detection of colorectal cancer. Under the JHU Amendment, the Company and Genzyme will share in the royalty and annual payment obligations to JHU. The JHU Amendment also modified the minimum annual license fee due to JHU under the JHU Agreement. The JHU Agreement terminates upon the later of 20 years from the effective date of the JHU Agreement and the expiration of the last to expire of the patents for the licensed technology, or upon certain uncured defaults of JHU or Genzyme. Pursuant to the JHU Amendment, the sublicense to the Company terminates upon certain uncured defaults of the Company. The JHU Amendment also provides that, in the event the JHU Agreement terminates upon an uncured default of Genzyme, if the Company is in good standing under the JHU Agreement at such time, the sublicense to the Company will become a direct license from JHU to the Company.

Also as part of the Sale Transaction, the Company entered into an Amended and Restated License Agreement (the Restated License) with Genzyme on January 27, 2009, which amends and restates the License Agreement between the parties dated March 25,

Table of Contents

1999, effective as of January 27, 2009. Pursuant to the Restated License, Genzyme granted to the Company a non-exclusive license to use technology related to the use of certain genes, specifically APC and p53, and methodologies related thereto. In exchange for the license, which continues until the expiration of the last to expire licensed patent, the Company has agreed to pay Genzyme royalties based on net revenues received from performing tests that incorporate the licensed technology and sales of reagents and diagnostic test kits that incorporate the licensed technology, as well as certain minimum royalties, milestone payments and maintenance fees.

Pursuant to the Sale Transaction, Genzyme agreed to pay an aggregate of $18.5 million to the Company, of which $16.65 million was paid at closing and $1.85 million (the Holdback Amount) is subject to a holdback by Genzyme to satisfy certain potential indemnification obligations of the Company. Subject to the terms and conditions of the CLP Agreement, one-half of the Holdback Amount will be released to the Company in 12 months and one-half will be released in 18 months. Genzyme also agreed to pay a double-digit royalty to the Company on income received by Genzyme as a result of any licenses or sublicenses to third parties of the Transferred Intellectual Property or the Retained Intellectual Property in any field other than the Genzyme Core Field or the Company Field.

In addition, the Company entered into a Common Stock Subscription Agreement with Genzyme (the Purchase Agreement) on January 27, 2009, which provided for the private issuance and sale to Genzyme of 3,000,000 shares (the Shares) of the Company s common stock, $0.01 par value per share (Common Stock), at a per share price of $2.00, for an aggregate purchase price of $6.0 million.

Pursuant to the Purchase Agreement, Genzyme has the right until December 31, 2010 to participate in certain future private offerings of equity securities by the Company up to the amount necessary to maintain Genzyme s pro-rata percentage ownership of the Company, at a price per share equal to the greater of $2.00 or the closing price of the Common Stock on the Company s trading market on the day prior to the date that the Company notifies Genzyme of its right to purchase additional shares. This right is subject to certain customary exclusions, including issuances to employees pursuant to a stock plan, issuances in connection with a change of control transaction and issuances in connection with strategic partnerships. Under the Purchase Agreement, Genzyme also has the right to include the Shares on a registration statement filed by the Company or, under certain circumstances, cause the Company to file a registration statement covering the resale of the Shares by Genzyme with the Securities and Exchange Commission.

Pursuant to the provisions of SEC Staff Accounting Bulletin No. 104 and EITF No. 00-21, which govern revenue recognition, the Company s on-going performance obligations to Genzyme under the CLP, including the obligation to deliver certain intellectual property improvements to Genzyme during the initial five year collaboration period, were deemed to be undelivered elements of the CLP Agreement on the date of closing. Accordingly, the Company deferred the initial $16.65 million in cash received at closing and will amortize that up-front payment on a straight line basis into the License Fee Revenue line item in its statements of operations over the initial five year collaboration period. Receipt of any Holdback Amounts will similarly be deferred and amortized on a straight line basis into the License Fee Revenue line item in the Company s statements of operations over the remaining term of the collaboration at the time of receipt.

In addition, Genzyme paid $2.00 per share for the 3,000,000 million shares of common stock purchased on January 27, 2009, representing a premium of $0.51 per share above the closing price of the Company s common stock on that date of $1.49 per share. Under FTB No. 85-6 the aggregate premium paid by Genzyme over the closing price of the Company s common stock on the date of the transaction of $1.53 million is included as a part of the total consideration for the CLP. Accordingly, the Company deferred the aggregate $1.53 million premium and will amortize that amount on a straight line basis into the License Fee Revenue line item in the Company s statements of operations over the initial five-year collaboration period. The Company recognized approximately $0.7 million in license fee revenue in connection with the amortization of the up-front payments from Genzyme during the quarter ended March 31, 2009.

(4) CHANGES IN SENIOR MANAGEMENT AND EMPLOYMENT AGREEMENTS

Former Chief Executive Officer and Former Chief Financial Officer

Effective April 2, 2009, Jeffrey R. Luber resigned as the Company s President and Chief Executive Officer and member of the Company s Board of Directors, and Charles R. Carelli, Jr. resigned as the Company s Chief Financial Officer. Mr. Carelli remained employed by the Company as a non-executive employee through April 30, 2009.

In connection with their departure, Messrs. Luber and Carelli were entitled to receive severance benefits pursuant to their previously disclosed retention agreements, including salary continuation of $472,500 and $287,500, which is equal to eighteen months and fifteen months, respectively, of their base salaries as of the date of termination. On March 31, 2009, the Company entered into release agreements with Messrs. Luber and Carelli that provided, in exchange for a general release in favor of the Company, for the accelerated payment of the salary continuation obligations on March 31, 2009. In addition, the release agreements also provided for

Table of Contents

the repurchase by the Company of options held by Messrs. Luber and Carelli for an aggregate of 895,000 shares of common stock, in lieu of accelerated vesting and an extension of the option exercise period arising from the prior retention agreements. The Company paid Messrs. Luber and Carelli approximately $39,000 and $11,000, respectively, to repurchase Mr. Luber s options to purchase 620,000 shares and Mr. Carelli s options to purchase 275,000 shares. The purchase price of the outstanding options represented a 75 percent discount from the estimated fair value of the vested options as of March 31, 2009 and was recorded as a reduction to additional paid-in-capital. Messrs. Luber and Carelli retained the balance of their existing options, the vesting of which accelerated by nine months.

In connection with the repurchase of options from Messrs. Luber and Carelli, the Company recorded non-cash stock-based compensation charges of approximately $0.2 million in its condensed consolidated financial statements in the quarter ended March 31, 2009 in accordance with the provisions of SFAS No. 123(R). In addition, the Company recorded non-cash stock-based compensation charges of approximately $60,000 in its condensed consolidated financial statements during the quarter ended March 31, 2009 in accordance with the provisions of SFAS No. 123(R) in connection with changes in vesting and period of exercise for options being retained by Messrs. Luber and Carelli.

A summary of options repurchased on March 31, 2009 from Mr. Luber and options retained subsequent to Mr. Luber s termination is below.

Options Repurchased

Option Grant Date	Grant Price	Number of Securities Underlying Unexercised Options As of March 31, 2009 Exercisable	Unexercisable	Total Options Repurchased
11/18/2002	$ 14.33	50,000		50,000
2/11/2004	$ 7.72	80,000		80,000
12/23/2004	$ 3.61	60,000		60,000
2/17/2005	$ 4.22	20,000		20,000
2/16/2006	$ 2.61	55,000		55,000
4/11/2006	$ 3.07	29,166	834	30,000
2/15/2007	$ 2.77	52,083	22,917	75,000
9/4/2007	$ 2.90	125,000	125,000	250,000
		471,249	148,751	620,000

Options Retained

Option Grant Date	Grant Price	Number of Options Retained	Expiration Date
2/21/2008	$ 1.83	80,207	1/2/2011

A summary of options repurchased on March 31, 2009 from Mr. Carelli and options retained subsequent to Mr. Carelli s termination is below.

Options Repurchased

Option Grant Date	Grant Price	Number of Securities Underlying Unexercised Options As of March 31, 2009 Exercisable	Unexercisable	Total Options Repurchased
11/9/2004	$ 3.28	20,000		20,000
7/29/2005	$ 2.65	27,499	2,501	30,000
2/16/2006	$ 2.61	25,000		25,000
4/11/2006	$ 3.07	24,305	695	25,000
2/15/2007	$ 2.77	52,083	22,917	75,000
9/4/2007	$ 2.90	50,000	50,000	100,000
		198,887	76,113	275,000

Options Retained

Option Grant Date	Grant Price	Number of Options Retained	Expiration Date
2/21/2008	$ 1.83	43,124	1/31/2011

Table of Contents

New Chief Executive Officer and Chief Financial Officer

On March 18, 2009, the Company s Board of Directors appointed Kevin T. Conroy as President and Chief Executive Officer of the Company, effective April 2, 2009. Also on March 18, 2009, based on the recommendation of the Corporate Governance and Nominating Committee, the Board of Directors elected Mr. Conroy to the Board. In connection with his appointment, Mr. Conroy entered into an employment agreement with the Company on March 18, 2009 (the Conroy Agreement). Under the terms of the Conroy Agreement, Mr. Conroy serves as President and Chief Executive Officer of the Company at a base salary of $340,000 and is eligible to earn up to 50% of his base salary in annual bonuses, with the exact amount of any such bonus to be determined by the Compensation Committee. Pursuant to the Conroy Agreement, Mr. Conroy was granted options to purchase 2.5 million shares of the common stock of the Company, par value $0.01 per share (the Common Stock), at a price per share of $0.83, which is equal to the closing price of the Common Stock on the NASDAQ Capital Market on March 18, 2009. Twenty-five percent (25%) of the shares underlying the stock options become exercisable on the one-year anniversary of the date of grant, with the remainder vesting quarterly over the subsequent three years.

Mr. Conroy s employment with the Company continues until terminated in accordance with the Conroy Agreement. Mr. Conroy may terminate his employment with the Company without good reason (as defined in the Conroy Agreement) upon 30 business days written notice to the Company and with good reason at any time within ninety (90) days after the occurrence of an event constituting good reason. The Company may terminate Mr. Conroy s employment, with or without cause (as defined in the Conroy Agreement), upon written notice to Mr. Conroy. In the event of termination by the Company without cause or by Mr. Conroy for good reason, then Mr. Conroy will receive (i) salary continuation for a period of eighteen (18) months at his then-current base salary, (ii) any accrued but unpaid base salary as of the termination date, (iii) any accrued but unpaid bonus (including any performance-based bonus), (iv) twelve months accelerated vesting of any unvested equity awards, and (v) the right to exercise any vested equity awards until the earlier of two (2) years from the date of termination or the date such equity award expires.

In the event of termination by the Company without cause or by Mr. Conroy for good reason, within twelve (12) months before, or if Mr. Conroy remains employed with the Company on the effective date of, a Change of Control (as defined in the Conroy Agreement), Mr. Conroy will receive a lump-sum payment equal to twenty-four (24) months (which period will be reduced under certain circumstances) of his then-current base salary. Upon a Change of Control and subject to Mr. Conroy s agreement to remain employed by the Company (or any successor), if requested, for a period of at least six (6) months following such Change of Control at his then current base salary, all of Mr. Conroy s outstanding stock options would become fully vested and exercisable. The foregoing change of control payments shall be subject to increase to cover any excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended. The Conroy Agreement also provides that Mr. Conroy will participate in a long-term incentive plan to be developed by the Company pursuant to which he will be eligible for a cash payment upon certain changes of control of the Company.

The Conroy Agreement prohibits Mr. Conroy from engaging in certain activities involving competition with the Company for an 18-month period following termination of his employment with the Company.

On March 18, 2009, the Company s Board of Directors appointed Maneesh Arora as Senior Vice President and Chief Financial Officer of the Company, effective April 2, 2009. In connection with his appointment, Mr. Arora entered into an employment agreement with the Company on March 18, 2009 (the Arora Agreement). Under the terms of the Arora Agreement, Mr. Arora serves as Senior Vice President and Chief Financial Officer of the Company at a base salary of $240,000 and is eligible to earn up to 40% of his base salary in annual bonuses, with the exact amount of any such bonus to be determined by the Compensation Committee. Pursuant to the Arora Agreement, Mr. Arora was granted options to purchase 1.25 million shares of Common Stock, at a price per share of $0.83, which is equal to the closing price of the Common Stock on the NASDAQ Capital Market on March 18, 2009. Twenty-five percent (25%) of the shares underlying the stock options become exercisable on the one-year anniversary of the date of grant, with the remainder vesting quarterly over the subsequent three years.

Mr. Arora s employment with the Company continues until terminated in accordance with the Arora Agreement. Mr. Arora may terminate his employment with the Company without good reason (as defined in the Arora Agreement) upon 30 business days written notice to the Company and with good reason at any time within ninety (90) days after the occurrence of an event constituting good reason. The Company may terminate Mr. Arora s employment, with or without cause (as defined in the Arora Agreement),

Table of Contents

upon written notice to Mr. Arora. In the event of termination by the Company without cause or by Mr. Arora for good reason, then Mr. Arora will receive (i) salary continuation for a period of fifteen (15) months at his then-current base salary, (ii) any accrued but unpaid base salary as of the termination date, (iii) any accrued but unpaid bonus (including any performance-based bonus), (iv) twelve months accelerated vesting of any unvested equity awards, and (v) the right to exercise any vested equity awards until the earlier of two (2) years from the date of termination or the date such equity award expires.

In the event of termination by the Company without cause or by Mr. Arora for good reason, within twelve (12) months before, or if Mr. Arora remains employed with the Company on the effective date of, a Change of Control (as defined in the Arora Agreement), Mr. Arora will receive a lump-sum payment equal to eighteen (18) months (which period will be reduced under certain circumstances) of his then-current base salary. Upon a Change of Control and subject to Mr. Arora s agreement to remain employed by the Company (or any successor), if requested, for a period of at least six (6) months following such Change of Control at his then current base salary, all of Mr. Arora s outstanding stock options would become fully vested and exercisable. The Arora Agreement also provides that Mr. Arora will participate in a long-term incentive plan to be developed by the Company pursuant to which he will be eligible for a cash payment upon certain changes of control of the Company.

The Arora Agreement prohibits Mr. Arora from engaging in certain activities involving competition with the Company for an 18-month period following termination of his employment with the Company.

(5) CONTINGENCIES

Third Party Royalty Obligation

Pursuant to the terms of the Second Amendment to the Company s license agreement with LabCorp, the Company is obligated to reimburse LabCorp for certain third-party royalty payments if LabCorp s third-party royalty rate is greater than a specified royalty rate during the measuring period, as outlined in the table below. During the quarter ended March 31, 2009, the Company paid LabCorp approximately $1.5 million related to its obligation for the first measurement period, which ended on December 31, 2008. The Company s future obligation to pay LabCorp pursuant to this provision of the Second Amendment is based on LabCorp s sales volumes of colorectal cancer screening tests using the Company s technology during two separate measurement periods, as defined below. A significant increase in such sales volumes during either measurement period, as compared to historical PreGen-Plus sales volumes, could reduce the Company s potential obligation during such measurement period, while test volumes consistent with historical PreGen-Plus sales levels could result in aggregate future payments to LabCorp totaling up to $2.0 million during the remaining measurement periods. Until LabCorp s sales of colorectal cancer screening tests using the Company s technology increase to a level that would reduce this potential maximum obligation, if ever, the Company intends to record its estimated obligation under this provision of the Second Amendment as a reduction in the product royalty fee line item in its consolidated statements of operations, in accordance with EITF No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*. Based on sales volumes of PreGen-Plus through June 1, 2008 (when LabCorp ceased selling this service) and anticipated sales volumes of ColoSure, as of March 31, 2009, the Company had accrued a total of $1.97 million related to the total potential $2.0 million remaining obligation to LabCorp. The Company recorded charges of $2.25 million and $1.2 million during the years ended December 31, 2008 and 2007, respectively, in connection with this third-party royalty obligation. These charges were recorded under the caption Product royalty fees in the Company s consolidated statements of operations. Future increases in this obligation, to the extent necessary, will continue to be recorded as charges to the product royalty revenue line item of the Company s consolidated statements of operations. Amounts included in the table are in thousands.

	Potential	**Potential**

Measurement period Start Date	Measurement period End Date	Payment Due Date for Measurement Period	Minimum Third Party Royalty Obligation During Measurement Period	Maximum Third Party Royalty Obligation During Measurement Period
January 1, 2009	December 31, 2009	January 30, 2010	$	$ 1,000
January 1, 2010	December 31, 2010	January 30, 2011		1,000
			$	$ 2,000

Table of Contents

(6) RESTRUCTURING

2008 Restructuring

On July 16, 2008, the Company implemented certain cost reduction initiatives, including the suspension of the clinical validation study for its Version 2 technology and the elimination of eight positions, or 67% of the Company s workforce (the 2008 Restructuring), in connection with the Company s revised corporate strategy of reducing costs to better preserve existing cash.

In connection with the 2008 Restructuring, the Company recorded restructuring charges of approximately $0.5 million during the three months ended September 30, 2008, including $0.3 million in one-time termination benefits arising under retention and severance agreements with each of the terminated employees and $0.2 million resulting from the write-off of leasehold improvements abandoned by the Company in connection with the reduction in force. The Company s decision to eliminate 67% of its workforce was deemed to be an impairment indicator under SFAS No. 144. As a result of performing the impairment evaluations, non-cash asset impairment charges of $0.3 million were recorded to adjust the carrying value of the related leasehold improvements to their net realizable value.

In addition, in connection with the 2008 Restructuring, the Company accelerated the vesting of 15,523 shares under terminated employees previously unvested stock options, with a weighted average exercise price of $2.65 per share, and extended the expiration date of all the terminated employees outstanding options as of their date of termination, covering an aggregate of 181,828 shares with a weighted average exercise price of $4.50 per share, through August 1, 2009. Pursuant to the measurement provisions of SFAS No. 123(R), the Company recorded one-time non-cash stock-based compensation charges of approximately $3,000 in the Restructuring line item of the Company s condensed consolidated statements of operations during the quarter ended September 30, 2008.

During the fourth quarter of 2008, the Company entered into a sublease agreement (the 2008 Sublease Agreement) with QTEROS, Inc. (QTEROS) to sublease to QTEROS approximately 25,537 square feet of rentable area in the Company s corporate headquarters. The term of the 2008 Sublease Agreement, which commenced on December 9, 2008, is 20 months with a base rent of $625,657 per year. Pursuant to the 2008 Sublease Agreement, QTEROS has no rights to renew or extend the 2008 Sublease Agreement. Under the terms of the 2008 Sublease Agreement, QTEROS is required to pay its pro rata share of any increases in building operating expenses and real estate taxes and to provide a security deposit in the form of an irrevocable, standby letter of credit from a national commercial bank reasonably acceptable to the Company in the amount of approximately $52,000 naming the Company as beneficiary. The 2008 Sublease Agreement provides for the Company s employees to continue to occupy approximately 1,100 square feet in the premises subleased to QTEROS. The Company believes that such 1,100 square feet are adequate to meet our space requirements with respect to administrative needs. The Company believes that the development of an FDA-approved product for colorectal cancer screening will require that it lease additional space. In this regard, the Company is currently exploring additional space in Madison, Wisconsin.

In connection with the 2008 Sublease Agreement, the Company also recorded the following restructuring charges during the fourth quarter of 2008 (included opposite the caption Facility consolidation costs in the table below): approximately $0.1 million in future cash payments related to the difference between the Company s committed lease payments and the estimated sublease rental income under the 2008 Sublease Agreement; approximately $0.1 million in one time real estate transaction and laboratory decommissioning fees; and approximately $0.1 million of non-cash charges related to the write-off of leasehold improvements abandoned by the Company in connection with the 2008 Sublease Agreement. These charges were offset by cash receipts of approximately $0.3 million received in connection with sales of fully depreciated fixed assets upon commencement of the 2008 Sublease Agreement. During the quarter ended March 31, 2009, certain of the cost estimates related to the 2008 Restructuring were adjusted, resulting in a credit of approximately $3,000 to the restructuring line item in the Company s

condensed consolidated statements of operations.

Amounts remaining in the 2008 Restructuring accrual at March 31, 2009, which are expected to be paid out in cash through July 2010, are recorded under the caption Accrued expenses in the Company s consolidated balance sheets. The following table summarizes changes made to the restructuring accrual during the three months ended March 31, 2009 relating to the 2008 Restructuring. Amounts included in the table are in thousands.

Type of Liability	Balance, December 31, 2008	Charges	Cash Payments	Balance, March 31, 2009
Employee separation costs	$ 16	$ (2)	$ (14)	$
Facility consolidation costs	165	(1)	(43)	121
Total	$ 181	$ (3)	$ (57)	$ 121

Table of Contents

2007 Restructuring

During the third quarter of 2007, in connection with the Third Amendment to the LabCorp agreement, the Company notified six employees of their termination from the Company (the 2007 Restructuring). The 2007 Restructuring was principally designed to eliminate the Company s sales and marketing functions to reduce costs and help preserve the Company s cash resources. In connection with the 2007 Restructuring, the Company recorded restructuring charges of approximately $0.8 million during the three months ended September 30, 2007, primarily related to one-time termination benefits arising under retention and severance agreements with each of the terminated employees.

Restructuring charges recorded during the third quarter of 2007 of $0.8 million included $0.6 million in severance and related benefit costs which were paid in cash through May 2008, and $0.2 million in non-cash stock-based compensation charges associated with extending the period of exercise for vested stock option awards for terminated employees.

During the fourth quarter of 2007, the Company entered into a sublease agreement (the 2007 Sublease Agreement) with INTRINSIX Corporation to sublease to INTRINSIX approximately 11,834 square feet of rentable area in the Company s corporate headquarters. The term of the 2007 Sublease Agreement, which commenced on December 15, 2007, is 32 months with a base rent of $266,265 per year. Pursuant to the 2007 Sublease Agreement, INTRINSIX has no rights to renew or extend the 2007 Sublease Agreement. Under the terms of the 2007 Sublease Agreement, INTRINSIX was required to provide a security deposit of $35,000 and is required to pay its pro rata share of any building operating expenses and real estate taxes.

In connection with the 2007 Sublease Agreement, the Company recorded restructuring charges of approximately $0.4 million during the fourth quarter of 2007, which consist of approximately $0.3 million in future cash payments related to the difference between the Company s committed lease payments and the estimated sublease rental income under the 2007 Sublease Agreement and approximately $0.1 million of non-cash charges related to the write-off of leasehold improvements abandoned by the Company in connection with the Sublease Agreement. The Company s decision to enter into the 2007 Sublease Agreement was deemed to be an impairment indicator under SFAS No. 144. As a result of performing the impairment evaluations, asset impairment charges of $0.1 million were recorded to adjust the carrying value of the related leasehold improvements to their net realizable value. Facility consolidation costs also include one time real estate transaction fees in connection with the Sublease Agreement.

Amounts remaining in the 2007 Restructuring accrual at March 31, 2009, which are expected to be paid out through July 2010, are recorded under the caption Accrued expenses in the Company s condensed consolidated balance sheets. The following table summarizes the 2007 Restructuring activities during the quarter ended March 31, 2009. Amounts included in the table are in thousands.

Type of Liability	Balance, December 31, 2008	Charges	Cash Payments	Balance, March 31, 2009
Employee separation costs	$	$	$	$
Facility consolidation costs	161		(23)	138
Total	$ 161	$	$ (23)	$ 138

(7) STOCK-BASED COMPENSATION

Stock-Based Compensation Plans

The Company maintains the 1995 Stock Option Plan (1995 Option Plan), the 2000 Stock Option and Incentive Plan (2000 Option Plan) and the 2000 Employee Stock Purchase Plan. Note 8 to the Company s consolidated financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2008, which has been filed with the SEC, includes a description of the Company s stock-based compensation plans.

Stock-Based Compensation Expense

The Company recorded $0.6 million in stock-based compensation during the three months ended March 31, 2009 in connection with the amortization of restricted common stock awards and stock options granted to employees, non-employee directors and non-employee consultants as well as certain stock option modifications discussed below. The Company recorded $0.3 million in stock-based compensation during the three months ended March 31, 2008 in connection with the amortization of awards of common stock, restricted common stock and stock options granted to employees, non-employee directors and non-employee consultants, as well as stock-based compensation expense related to the Company s 2008 401(k) match.

Table of Contents

Determining Fair Value

Valuation and Amortization Method - The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model based on the assumptions in the table below. The estimated fair value of employee stock options is amortized to expense using the straight-line method over the vesting period.

Expected Term - The Company uses the simplified calculation of expected life, described in the SEC s Staff Accounting Bulletins 107 and 110, as the Company does not currently have sufficient historical exercise data on which to base an estimate of expected term. Using this method, the expected life is determined using the average of the vesting period and the contractual life of the stock options granted.

Expected Volatility - Expected volatility is based on the Company s historical volatility from the time of its initial public offering in January 2001 through the measurement date of the awards.

Risk-Free Interest Rate - The Company bases the risk-free interest rate used in the Black-Scholes valuation method on the implied yield currently available on U.S. Treasury zero-coupon issues with an equivalent remaining term.

Forfeitures - As required by SFAS No. 123(R), the Company records share-based compensation expense only for those awards that are expected to vest. The Company does not need to estimate forfeitures for awards prior to 2009 because all such share based awards vest monthly.

The fair value of each option award is estimated on the date of grant using the Black-Scholes option-pricing model based on the assumptions in the following table.

	Three Months Ended March 31,	
	2009	**2008**
Option Plan Shares		
Risk-free interest rates	1.76%	2.80%
Expected term (in years)	6	6
Expected volatility	85%	70%
Dividend yield	0%	0%
Weighted average fair value per share of options granted during the period	$ 0.60	$ 1.17

Stock Option Activity

A summary of stock option activity under the 1995 Option Plan and the 2000 Option Plan during the three months ended March 31, 2009 is as follows:

Options (Aggregate intrinsic value in thousands)	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (1)
Outstanding, January 1, 2009	3,703,899	$ 3.99	4.9	
Granted	4,053,790	$ 0.77		
Exercised	(51,349)	$ 0.27		
Cancelled or redeemed	(1,070,818)	$ 4.30		
Outstanding, March 31, 2009	6,635,522	$ 2.00	7.7	$ 2,190
Exercisable, March 31, 2009	2,067,765	$ 4.59	2.9	$ 27
Vested and expected to vest, March 31, 2009	6,479,478	$ 1.96	7.5	$ 2,190

Table of Contents

(1) The aggregate intrinsic value of options outstanding, as well as options vested and expected to vest, at March 31, 2009 is calculated as the difference between the exercise price of the underlying options and the market price of the Company s common stock for the 4,289,790 options that had exercise prices that were lower than the $1.25 market price of the Company s common stock at March 31, 2009. The aggregate intrinsic value of options exercisable at March 31, 2009 is calculated as the difference between the exercise price of the underlying options and the market price of the Company s common stock for the 50,307 options that had exercise prices that were lower than the $1.25 market price of our common stock at March 31, 2009.

The table above includes outstanding restricted stock awards of 458,790 shares as of March 31, 2009. The Company granted 288,790 shares of common stock pursuant to restricted stock awards during the quarter ended March 31, 2009. There were 15,000 common stock awards that vested and were no longer subject to restriction during the quarter ended March 31, 2009.

As of March 31, 2009, there was $2.6 million of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all equity compensation plans. Total unrecognized compensation cost will be adjusted for future changes in forfeitures. The Company expects to recognize that cost over a weighted average period of 2.4 years.

(8) FAIR VALUE MEASUREMENTS

In September 2006, the FASB issued Statement No. 157, *Accounting for Fair Value Measurements* (SFAS No. 157). SFAS No. 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements are separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The Company adopted SFAS No. 157 on January 1, 2008 and it did not have any impact on its consolidated results of operations, financial position or cash flows.

SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs. Observable inputs are inputs that reflect the assumptions that market participants would use in pricing the asset or liability developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances.

The three levels of the fair value hierarchy established by SFAS No. 157 in order of priority are as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Pricing inputs other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 Unobservable inputs that reflect the Company s assumptions about the assumptions that market participants would use in pricing the asset or liability. Unobservable inputs shall be used to measure fair value to the extent that observable inputs are not available.

In accordance with the disclosure provisions of SFAS No. 157, the following table presents the Company s fair value measurements as of March 31, 2009 along with the level within the fair value hierarchy prescribed by SFAS No. 157 in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3). Cash and cash equivalents are recorded at cost, which approximates fair value. Amounts in the table are in thousands.

Table of Contents

Description	Fair Value at March 31, 2009	Fair Value Measurement at March 31, 2009 Using: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available-for-Sale				
Marketable Securities	$ 17,018	$	$ 17,018	$
Total	$ 17,018	$	$ 17,018	$

(9) NEW ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157. SFAS No. 157 establishes a common definition for fair value to be applied under GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. Issued in February 2008, FASB Staff Position No. SFAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, removed leasing transactions accounted for under FASB Statement No. 13, *Accounting for Leases*, and related guidance from the scope of SFAS No. 157. Issued in February 2008, FASB Staff Position No. SFAS 157-2, *Effective Date of FASB Statement No. 157*, deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The adoption of FASB Staff Position No. SFAS 157-2 did not have a material effect on the Company s consolidated financial statements.

In December 2007, the FASB ratified the consensus reached by the EITF on EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* (EITF 07-1). EITF 07-1 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF 07-1 clarified the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to EITF Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*. EITF 07-1 became effective for the Company beginning on January 1, 2009. The implementation of EITF 07-1 did not have a material effect on the Company s consolidated financial statements.

(10) SUBSEQUENT EVENT

NASDAQ Compliance

On March 6, 2009, the Company received notice from The NASDAQ Stock Market LLC (NASDAQ) that it was not in compliance with NASDAQ Marketplace Rule 4310(c)(3) (the Rule), which requires an issuer to maintain a minimum $35 million market value of its listed securities for continued listing on The NASDAQ Capital Market. NASDAQ also noted that the Company was not in compliance with either of the other alternatives for compliance with the Rule, which require minimum stockholders equity of $2,500,000 or net income from continuing operations of $500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years, respectively. The Company was provided a period of 90 calendar days, or until June 4, 2009, to regain compliance with the Rule. On April 2, 2009, the Company received a determination from NASDAQ indicating that the Company had evidenced compliance with the Rule for continued listing on The NASDAQ Capital Market.

19

Table of Contents

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

The following discussion of the financial condition and results of operations of EXACT Sciences Corporation should be read in conjunction with the condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q and the audited financial statements and notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008, which has been filed with the Securities and Exchange Commission, or SEC.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities and Exchange Act of 1934, as amended, that are intended to be covered by the safe harbor created by those sections. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies and expectations, can generally be identified by the use of forward-looking terms such as believe, expect, may, will, should, could, seek, i estimate, anticipate or other comparable terms. Forward-looking statements in this Quarterly Report on Form 10-Q may address the following subjects among others: statements regarding the sufficiency of our capital resources, expected operating losses, expected license fee revenues, expected research and development expenses, expected general and administrative expenses and our expectations concerning our business strategy. Forward-looking statements involve inherent risks and uncertainties which could cause actual results to differ materially from those in the forward-looking statements, as a result of various factors including those risks and uncertainties described in the Risk Factors and in Management s Discussion and Analysis of Financial Condition and Results of Operations sections of this report and our Annual Report on Form 10-K for the year ended December 31, 2008. We urge you to consider those risks and uncertainties in evaluating our forward-looking statements. We caution readers not to place undue reliance upon any such forward-looking statements, which speak only as of the date made. Except as otherwise required by the federal securities laws, we disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained herein (or elsewhere) to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Overview

EXACT Sciences Corporation is a molecular diagnostics company focused on colorectal cancer. Our non-invasive stool-based DNA (sDNA) screening technology includes proprietary and patented methods that isolate and analyze human DNA present in stool to screen for the presence of colorectal pre-cancer and cancer. We believe that our proprietary methods and technologies have several advantages over other screening options that may ultimately lead to decreased mortality associated with colorectal cancer, which is the third leading cause of cancer death overall, the second leading cause of death from cancers that affect both men and women, and the leading cause of cancer death among non-smokers in the United States.

Currently, we license certain of our colorectal cancer screening technologies on an exclusive basis in the U.S. and Canada through December 2010 to Laboratory Corporation of America® Holdings, or LabCorp®. LabCorp has developed and commercially offers a non-invasive stool-based DNA (sDNA) colorectal cancer screening service for the average-risk population, which is based on certain of our technologies.

Our primary goal is to become the market leader for a patient-friendly diagnostic screening product for the early detection of colorectal pre-cancer and cancer. Our strategic roadmap to achieve this goal includes the following key components:

- develop and refine our non-invasive sDNA colorectal pre-cancer and cancer screening test;
- advance our product through U.S. Food and Drug Administration, or FDA, clinical trials;
- secure insurance coverage and reimbursement for our product; and
- commercialize an FDA-cleared product that detects colorectal pre-cancer and cancer.

We believe obtaining FDA approval is critical to building broad demand and successful commercialization for our sDNA colorectal cancer screening technologies. In 2009, we intend to focus on further refining our product design to demonstrate the clinical superiority of the test to detect pre-cancer and adenomas while balancing its product attributes to enable ease of commercialization and widespread laboratory adoption. Additionally, we intend to finalize plans for clinical trials in 2009 with the goal of confirming our trial protocols with the FDA.

Table of Contents

We have generated limited operating revenues since inception and, as of March 31, 2009, we had an accumulated deficit of approximately $176.3 million. Losses have historically resulted from costs incurred in conjunction with research, development and clinical study initiatives; salaries and benefits associated with the hiring of personnel; the initiation of marketing programs; and prior to August 31, 2007, the build-out of our sales infrastructure to support the commercialization of SDNA screening. We expect to continue to incur losses for the next several years, and it is possible we may never achieve profitability.

Recent Developments

New Senior Management Team

Effective April 2, 2009, Jeffrey R. Luber resigned as our President, Chief Executive Officer and member of our board of directors and Charles R. Carelli, Jr. resigned as our Chief Financial Officer.

On March 18, 2009, our board of directors appointed Kevin T. Conroy as President and Chief Executive Officer, effective April 2, 2009. Also on March 18, 2009, based on the recommendation of our corporate governance and nominating committee, the board of directors appointed Mr. Conroy to fill a vacancy on our board. Our board of directors also appointed Maneesh Arora as our Senior Vice President and Chief Financial Officer, effective April 2, 2009.

Genzyme Strategic Transaction

In January 2009, we completed a strategic transaction with Genzyme Corporation, pursuant to which we assigned to Genzyme all of our intellectual property applicable to the fields of prenatal and reproductive health and granted Genzyme an irrevocable, perpetual, exclusive, worldwide, fully-paid, royalty-free license to use and sublicense all of our remaining intellectual property in all fields other than colorectal cancer detection and stool-based disease detection. We retained our rights in both the assigned and licensed intellectual property in the fields colorectal cancer detection and stool-based disease detection. We and Genzyme also agreed to form a joint advisory committee to assist Genzyme in the achievement of product development goals related to the purchased intellectual property and to assist us with our regulatory goals.

Genzyme agreed to pay us an aggregate of $18.5 million, of which $16.65 million was paid at closing and $1.85 million is subject to a holdback by Genzyme to satisfy certain of our potential indemnification obligations. Subject to terms of the strategic agreement, one-half of the holdback amount will be released to us in 12 months and one-half will be released in 18 months. Genzyme also agreed to pay a double-digit royalty to us on income received by Genzyme as a result of any licenses or sublicenses to third parties of the assigned or licensed intellectual property in any field other than prenatal and reproductive health or colorectal cancer detection and stool-based disease detection.

In addition, we sold to Genzyme 3,000,000 shares of our common stock at a per share price of $2.00, for a total purchase price of $6.0 million.

Messrs. Luber and Carelli Severance

In connection with their departures in March 2009, Messrs. Luber and Carelli were entitled to receive severance benefits pursuant to their existing retention agreements, including salary continuation of $472,500 and $287,500, which is equal to eighteen months and fifteen months, respectively, of their base salaries as of the date of termination. On March 31, 2009, we entered into release agreements with Messrs. Luber and Carelli that provided, in exchange for a general release in favor of us, for the accelerated payment of the salary continuation obligations on March 31, 2009. In addition, the release agreements also provided for the repurchase by us of certain options held by Messrs. Luber and Carelli for an aggregate of 895,000 shares of common stock, in lieu of accelerated vesting and an extension of the option exercise period arising from their retention agreements. We paid Messrs. Luber and Carelli approximately $39,000 and $11,000, respectively, to repurchase Mr. Luber s options to purchase 620,000 shares and Mr. Carelli s options to purchase 275,000 shares. The purchase price of the outstanding options represented a 75 percent discount from the estimated fair value of the vested options as of March 31, 2009. Messrs. Luber and Carelli retained options to purchase 80,207 and 43,124 shares at an exercise price of $1.83, following the termination of their employment, respectively.

Compliance with NASDAQ Listing Requirements

On March 6, 2009, we received notice from The NASDAQ Stock Market LLC, or NASDAQ, that we were not in compliance with NASDAQ Marketplace Rule 4310(c)(3), or the Rule, which requires an issuer to maintain a minimum $35 million market value of its listed securities for continued listing on The NASDAQ Capital Market. NASDAQ also noted that we were not in compliance with either of the other alternatives for compliance with the Rule, which require minimum stockholders equity of $2,500,000 or net

Table of Contents

income from continuing operations of $500,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years, respectively. On April 2, 2009, we received a determination from NASDAQ indicating that we had evidenced compliance with the Rule for continued listing on The NASDAQ Capital Market.

Significant Accounting Policies

This management s discussion and analysis of our financial condition and results of operations is based on our 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 us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported revenues and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and judgments, including those related to revenue recognition and intangible assets. We base our estimates on historical experience and on various other factors that are believed to be appropriate under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The notes to our consolidated financial statements included in our annual report on Form 10-K for the year ended December 31, 2008 include a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. As described below, we believe that that the following accounting policies and judgments are critical to fully understand and evaluate our reported financial results.

Revenue Recognition.

License fees. License fees for the licensing of product rights on initiation of strategic agreements are recorded as deferred revenue upon receipt and recognized as revenue on a straight-line basis over the license period. On June 27, 2007, we entered into an amendment to our exclusive license agreement with LabCorp, or the Second Amendment, that, among other modifications to the terms of the license, extended the exclusive license period from August 2008 to December 2010, subject to carve-outs for certain named organizations. Accordingly, we are amortizing the remaining deferred revenue balance resulting from our license agreement with LabCorp at the time of the Second Amendment ($4.7 million) on a straight-line basis over the remaining exclusive license period, which ends in December 2010.

As more fully described under the heading Genzyme Strategic Transaction above, in connection with the Genzyme strategic transaction, we received an up-front payment of $16.65 million on January 27, 2009 in exchange for the assignment and licensing of certain of our intellectual property to Genzyme. Pursuant to the provisions of SEC Staff Accounting Bulletin No. 104 and EITF No. 00-21, which govern revenue recognition, our on-going performance obligations to Genzyme under the Collaboration, License and Purchase Agreement, or the CLP Agreement, including our obligation to deliver certain intellectual property improvements to Genzyme during the initial five year collaboration period, were deemed to be undelivered elements of the CLP Agreement on the date of closing. Accordingly, we deferred the initial $16.65 million in cash received at closing and are amortizing that up-front payment on a straight line basis into the License Fee Revenue line item in our statements of operations over the initial five-year collaboration period ending in January 2014. Receipt of any holdback amounts will similarly be deferred and amortized on a straight line basis into the License Fee Revenue line item in our statements of operations over the remaining term of the collaboration at the time of receipt.

In addition, Genzyme paid $2.00 per share for the 3.0 million shares purchased from us on January 27, 2009, representing a premium of $0.51 per share above the closing price of the Company s common stock on that date of $1.49 per share. Under FASB Technical Bulletin No. 85-6, the aggregate premium paid by Genzyme over the closing price of our common stock on the date of the transaction of $1.53 million was deemed to be a part of the total consideration for the CLP Agreement. Accordingly, we deferred the aggregate $1.53 million premium and will amortize that amount on a straight line basis into the License Fee Revenue line item in our statements of operations over the initial five year collaboration period ending in January 2014. We recognized approximately $0.7 million in license fee revenue in connection with the amortization of the up-front payments from Genzyme during the quarter ended March 31, 2009.

Product royalty fees. We have licensed certain of our technologies, including improvements to such technologies, on an exclusive basis through December 2010 to LabCorp. LabCorp developed and commercially offered PreGen-Plus, a non-invasive sDNA colorectal cancer screening service for the average-risk population based on our Version 1 technology, from August 2003 through June 2008. In June 2008, LabCorp stopped offering PreGen-Plus. On July 14, 2008, LabCorp began to commercially offer ColoSure, its next generation non-invasive, sDNA testing service for the detection of colorectal cancer in the average-risk population, which is based on certain of our intellectual property. We are entitled to the same royalty and milestone structure on any sales of ColoSure as we were entitled to on sales of PreGen-Plus.

Table of Contents

Prior to the effective date of the Second Amendment, our product royalty fees were based on a specified contractual percentage of LabCorp s cash receipts from performing PreGen-Plus tests. Accordingly, we recorded product royalty fees based on this specified percentage of LabCorp s cash receipts, as reported to us each month by LabCorp. Subsequent to the effective date of the Second Amendment, our product royalty fees are based on a specified contractual percentage of LabCorp s net revenues from sales of PreGen-Plus through June 1, 2008, when LabCorp stopped offering PreGen-Plus, and from sales of ColoSure from and after July 2008. Accordingly, subsequent to the effective date of the Second Amendment, we record product royalty fees based on the specified contractual percentage of LabCorp s net revenues from its sales of such colorectal cancer screening tests, as reported to us each month by LabCorp. The current royalty rate is 15%, subject to an increase to 17% in the event that LabCorp achieves a specified significant threshold of annual net revenues from the sales of such colorectal cancer screening tests.

Additionally, as described below under the heading Cririca Accounting Estimate Third Party Royalty Obligation, pursuant to the Second Amendment, we are potentially obligated to reimburse LabCorp for certain third-party royalty payments. To the extent we incur liabilities in connection with this provision of the Second Amendment, the accretion of such liabilities will be recorded as a reduction in the product royalty fee line item in our statements of operations.

Other revenue. Revenue from milestone and other performance-based payments is recognized as revenue when the milestone or performance is achieved and collection of the receivable is estimable and probable.

Patent Costs. Patent costs, which have historically consisted of related legal fees, are capitalized as incurred and are amortized beginning when patents are approved over an estimated useful life of five years. Capitalized patent costs are expensed upon disapproval, upon a decision by us to no longer pursue the patent or when the related intellectual property is either sold or deemed to be no longer of value to us. In connection with the Genzyme transaction, we sold our then-remaining capitalized intellectual property to Genzyme on January 27, 2009, and accordingly, we wrote-off the remaining unamortized capitalized patent costs at that time.

We apply SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets and for Long-Lived Assets*, or SFAS No. 144, which requires that we continually evaluate whether events or circumstances have occurred that indicate that the estimated remaining useful life of long-lived assets and certain identifiable intangibles and goodwill may warrant revision or that the carrying value of these assets may be impaired.

Stock-Based Compensation. We adopted SFAS No. 123(R) effective January 1, 2006 using the modified prospective transition method. SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options and shares purchased under an employee stock purchase plan (if certain parameters are not met), to be recognized in the financial statements based on their fair values. SFAS No. 123(R) did not change the accounting guidance for share-based payment transactions with parties other than employees provided in SFAS No. 123, as originally issued and EITF 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. Prior to January 1, 2006, we accounted for stock-based compensation under the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*.

Critical Accounting Estimate - Third Party Royalty Obligation

Pursuant to the terms of the Second Amendment to our license agreement with LabCorp, we are obligated to reimburse LabCorp for certain third-party royalty payments if LabCorp s third-party royalty rate is greater than a specified royalty rate during the measuring period, as outlined in the table below. During the quarter ended March 31, 2009, we paid LabCorp approximately $1.5 million related to our obligation for the first measurement period, which ended on December 31, 2008. Our future obligation to pay LabCorp pursuant to this provision of the Second Amendment is based on LabCorp s sales volumes of colorectal cancer screening tests using our technology during two separate measurement periods, as defined below. A significant increase in such sales volumes during either measurement period, as compared to historical PreGen-Plus sales volumes, could reduce our potential obligation during such measurement period, while test volumes consistent with historical PreGen-Plus sales levels could result in aggregate future payments to LabCorp totaling up to $2.0 million during the remaining measurement periods. Until LabCorp s sales of colorectal cancer screening tests using our technology increase to a level that would reduce this potential maximum obligation, if ever, we intend to record our estimated obligation under this provision of the Second Amendment as a reduction in the product royalty fee line item in our statements of operations, in accordance with EITF No. 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products).* Based on sales volumes of PreGen-Plus through June 1, 2008 (when LabCorp ceased selling this service) and anticipated sales volumes of ColoSure, as of March 31, 2009, we had accrued a total of $1.97 million related to the total potential $2.0 million remaining obligation to LabCorp. Amounts included in the table are in thousands.

Table of Contents

Measurement period Start Date	Measurement period End Date	Payment Due Date for Measurement Period	Potential Minimum Third Party Royalty Obligation During Measurement Period	Potential Maximum Third Party Royalty Obligation During Measurement Period
January 1, 2009	December 31, 2009	January 30, 2010	$	$ 1,000
January 1, 2010	December 31, 2010	January 30, 2011		1,000
			$	$ 2,000

Recent Accounting Pronouncements

In September 2006, the FASB issued Statement No. 157, *Accounting for Fair Value Measurements*, or SFAS No. 157. SFAS No. 157 establishes a common definition for fair value to be applied under GAAP requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. Issued in February 2008, FASB Staff Position No. SFAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13*, removed leasing transactions accounted for under FASB Statement No. 13, *Accounting for Leases*, and related guidance from the scope of SFAS No. 157. Issued in February 2008, FASB Staff Position No. SFAS 157-2, *Effective Date of FASB Statement No. 157*, deferred the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. The adoption of FASB Staff Position No. SFAS 157-2 did not have a material effect on our consolidated financial statements.

In November 2007, the FASB issued EITF Issue No. 07-1, *Accounting for Collaborative Arrangements,* or EITF 07-1, which defines collaborative arrangements and establishes reporting requirements for transactions between participants in a collaborative arrangement and between participants in the arrangement and third parties, including the appropriate income statement presentation and classification of, and the required disclosures related to, these arrangements. EITF 07-1 is effective January 1, 2009, to be applied retrospectively for collaborative arrangements existing as of the effective date. The adoption of EITF 07-1 did not have a material impact on our consolidated financial statements.

Results of Operations

Revenue. Net revenue is primarily composed of the amortization of up-front technology license fees associated with our amended license agreement with LabCorp and our collaboration, license and purchase agreement with Genzyme. The unamortized LabCorp up-front payment is being amortized on a straight-line basis over the remaining exclusive license period, which ends in December 2010. The unamortized Genzyme up-front payment is being amortized on a straight-line basis over the initial Genzyme collaboration period, or through January 2014. While we expect license fee revenue resulting from the amortization of the up-front license payment from LabCorp in 2009 to be consistent with amounts recorded in 2008, we expect that total license fee revenue for 2009 will be higher than amounts recorded in 2008 as a result of amortization of payments received from Genzyme in January 2009 in connection with the Genzyme strategic transaction.

Net revenue increased to $1.0 million for the quarter ended March 31, 2009, from $0.1 million for the same period in 2008. The increase in net revenue for the quarter ended March 31, 2009, when compared to the quarter ended March 31, 2008, was primarily due to an increase of approximately $0.7 million in license fee amortization as a direct result of the commencement of amortization of the upfront payment received from Genzyme in January 2009. In addition, product royalty revenues were higher in the quarter ended March 31, 2009 when compared to the quarter ended March 31, 2008 due to product royalty revenue charges of $0.3 million recorded in the quarter ended March 31, 2008. These

charges related to our third-party royalty reimbursement obligation to LabCorp, and resulted in negative product royalty revenue for the quarter ended March 31, 2008.

Research and development expenses. Research and development expenses decreased to $0.1 million for the three months ended March 31, 2009 from $0.9 million for the three months ended March 31, 2008. The decrease was primarily the result of the continuing effect of the cost reduction plans undertaken in 2007 and 2008. Research and development costs for the quarter ended March 31, 2009 were primarily comprised of external licensing costs and rent.

As a result of the activities anticipated in support of our objectives toward developing an FDA-approved in vitro diagnostic test, we expect research and development costs in 2009 to be higher than 2008 levels.

Table of Contents

General and administrative expenses. General and administrative expenses increased to $4.8 million for the quarter ended March 31, 2009, compared to $1.8 million for the same period in 2008. This increase was primarily the result of $1.9 million in transaction costs related to the Genzyme strategic transaction in January 2009, including legal, audit, and investment banking fees as well as approximately $0.8 million in retention bonus payments made to employees pursuant to board-approved retention agreements. Non-cash stock-based compensation expense included in general and administrative expense in the quarter ended March 31, 2009 also increased by $0.4 million compared to the same period in 2008 primarily as a result of $0.3 million in non-cash charges recorded in the first quarter of 2009 in connection with the option modifications made pursuant to separation and release agreements with Messrs. Luber and Carelli described elsewhere in this report. These increases were partially offset by a decrease in professional fees related to on-going operations of $0.2 million in the first quarter of 2009 compared to the prior year period.

We expect general and administrative expenses in 2009 to be higher than 2008 levels, primarily as a result of professional fees in connection with the Genzyme strategic transaction and the transition of our senior management team as described above.

Interest income. Primarily as a result of less favorable interest rates on investments held, interest income decreased to $34,000 for the three months ended March 31, 2009 from $0.1 million for the same period in 2008.

Liquidity and Capital Resources

We have financed our operations since inception primarily through private and public offerings of our equity securities, cash received from LabCorp in connection with our license agreement, and cash received in January 2009 from Genzyme in connection with the Genzyme strategic transaction described above. As of March 31, 2009, we had approximately $3.6 million in unrestricted cash and cash equivalents, $0.6 million in restricted cash, which has been pledged as collateral for an outstanding letter of credit in connection with the lease for our Marlborough, Massachusetts facility, and approximately $17.0 million in investments in marketable securities. All of our investments in marketable securities are comprised of fixed income investments and all are deemed available-for-sale.

Net cash used in operating activities was $7.0 million for the quarter ended March 31, 2009 as compared to $3.1 million for the quarter ended March 31, 2008. The principal use of cash in operating activities for the three months ended March 31, 2009 and 2008 was to fund our net loss. The increase in net cash used in operating activities for quarter ended March 31, 2009 as compared to the same period in 2008, was primarily due to the payment of the $1.5 million to LabCorp to satisfy our third party royalty obligation for 2008, one-time transaction payments for professional fees in connection with the Genzyme strategic transaction of approximately $1.1 million, one time retention bonus payments to employees pursuant to board-approved retention payments of approximately $0.8 million, and one-time severance payments of approximately $0.8 million to former executives, each as described elsewhere in this report. Cash flows from operations can vary significantly due to various factors, including changes in our operations, prepaid expenses, accounts payable and accrued expenses.

Net cash used in investing activities was $17.0 million for the quarter ended March 31, 2009 and represented the investment of a portion of the funds received in January 2009 from the Genzyme strategic transaction. Net cash provided by investing activities was $2.6 million for the three months ended March 31, 2008 and primarily resulted from the maturity of marketable securities. Purchases of property and equipment were not material during the quarters ended March 31, 2009 and 2008. As a result of the cash received in January 2009 in connection with the Genzyme strategic transaction, and based on our plans for further development of our sDNA technology for colorectal cancer detection, we expect that purchases of property and equipment during 2009 will be higher than amounts invested in 2008.

Net cash provided by financing activities was $22.6 million for the quarter ended March 31, 2009 and was comprised primarily of the receipt of cash in connection with the Genzyme strategic transaction. We also paid $50,000 to repurchase outstanding options from former executives as described elsewhere in this report.

We expect that cash, cash equivalents and marketable securities on hand at March 31, 2009 will be sufficient to fund our current operations for at least the next twelve months, based on current operating plans. This projection is based on our currently anticipated cost structure and operating assumptions and does not provide for the full funding of our current strategic plan, the centerpiece of which is the commercialization of our sDNA technology through completion of the development an FDA-approved in vitro diagnostic test for sDNA colorectal pre-cancer and cancer screening. We do not expect that product royalty payments or milestone payments from LabCorp will materially supplement our liquidity position in the next twelve months, if at all. Since we have no current sources of material ongoing revenue, we believe that we will need to raise additional capital to complete our strategic plan. If we are unable to obtain sufficient additional funds to enable us to fund our operations through the completion of such plan, our results of operations and financial condition would be materially adversely affected and we may be required to delay the implementation of our plan and otherwise scale back operations. Even if we successfully raise sufficient funds to continue the implementation of our strategic plan, we cannot assure you that our business will ever generate sufficient cash flow from operations to become profitable.

Table of Contents

The table below reflects our estimated fixed obligations and commitments as of March 31, 2009:

			Payments Due by Period		
Description	**Total**	**Less Than One Year**	**1 - 3 Years**	**3 - 5 Years**	**More Than 5 Years**
			(in Thousands)		
Obligations under license and collaborative agreements	$ 4,144	$ 1,221	$ 1,360	$ 342	$ 1,221
Operating lease obligations	1,367	1,023	344		
Severance obligations	75	75			
Purchase obligations	152	152			
Total	$ 5,738	$ 2,471	$ 1,704	$ 342	$ 1,221

Obligations under license and collaboration agreements represent on-going commitments under various research collaborations and licensing agreements. This category includes a potential obligation to reimburse LabCorp for a certain third-party royalty, up to a remaining aggregate maximum of $2.0 million, during two defined measurement periods between January 1, 2009 and December 31, 2010. Although payment of this potential obligation is dependent upon LabCorp s sales levels of ColoSure during the measurement periods, the total remaining potential $2.0 million obligation has been included in the table above based on historical sales levels of PreGen-Plus and current sales levels of ColoSure as of March 31, 2009. Commitments under license agreements generally expire concurrent with the expiration of the intellectual property licensed from the third party. Operating leases reflect remaining obligations associated with leased facilities in Marlborough, Massachusetts. Purchase obligations primarily represent historical amounts owed in connection with our operations. Severance obligations represent remaining commitments to former personnel, including our former Chief Executive Officer and former Chief Financial Officer.

Off-Balance Sheet Arrangements

As of March 31, 2009, we had no off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our exposure to market risk is principally confined to our cash, cash equivalents and marketable securities. We invest our cash, cash equivalents and marketable securities in securities of the U.S. government and its agencies and in investment-grade, highly liquid investments consisting of commercial paper, bank certificates of deposit and corporate bonds, all of which are currently invested in the U.S. and are classified as available-for-sale. We place our cash equivalents and marketable securities with high-quality financial institutions, limit the amount of credit exposure to any one institution and have established investment guidelines relative to diversification and maturities designed to maintain safety and liquidity.

Based on a hypothetical ten percent adverse movement in interest rates, the potential losses in future earnings, fair value of risk-sensitive financial instruments, and cash flows are immaterial, although the actual effects may differ materially from the hypothetical analysis.

Item 4T. Controls And Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15b promulgated under the Exchange Act of 1934, as amended. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that, as of March 31, 2009, our disclosure controls and procedures were effective in enabling us to record, process, summarize and report information required to be included in our periodic SEC filings within the required time period. Our disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the periodic reports filed with the SEC is accumulated and communicated to our management, including our principal executive, financial and accounting officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

During the fiscal quarter covered by this report, there have been no significant changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

Part II - Other Information

Item 1A. Risk Factors

Factors That May Affect Future Results

We operate in a rapidly changing environment that involves a number of risks that could materially affect our business, financial condition or future results, some of which are beyond our control. In addition to the other information set forth in this report, the risks and uncertainties that we believe are most important for you to consider are discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. There are no material changes to the risk factors described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the foregoing risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer.

Table of Contents

Item 6. Exhibits

Exhibit Number	Description
3.1	Amended and Restated By-Laws of the Registrant, as amended.
10.1**	Collaboration, License and Purchase Agreement between Genzyme Corporation and the Registrant, dated January 27, 2009 (previously filed as Exhibit 10.1 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.2**	Assignment, Sublicense, Consent and Eighth Amendment to License Agreement among the Registrant, Genzyme Corporation and The Johns Hopkins University, dated January 27, 2009 (previously filed as Exhibit 10.2 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.3**	Amended and Restated License Agreement between Genzyme Corporation and the Registrant, dated January 27, 2009 (previously filed as Exhibit 10.3 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.4	Common Stock Subscription Agreement between the Registrant and Genzyme Corporation, dated January 27, 2009 (previously filed as Exhibit 10.4 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.5	Employment Agreement by and between Kevin T. Conroy and the Registrant, dated as of March 18, 2009 (previously filed as Exhibit 10.1 to our Report on Form 8-K filed on March 18, 2009, which is incorporated herein by reference).
10.6	Employment Agreement by and between Maneesh Arora and the Registrant, dated as of March 18, 2009 (previously filed as Exhibit 10.2 to our Report on Form 8-K filed on March 18, 2009, which is incorporated herein by reference).
10.7	Release Agreement between Jeffrey R. Luber and the Registrant, dated as of March 31, 2009 (previously filed as Exhibit 10.36 to our Annual Report on Form 10-K for the period ended December 31, 2008, which is incorporated herein by reference).
10.8	Release Agreement between Charles R. Carelli, Jr. and the Registrant, dated as of March 31, 2009 (previously filed as Exhibit 10.37 to our Annual Report on Form 10-K for the period ended December 31, 2008, which is incorporated herein by reference).
31.1	Certification Pursuant to Rule 13(a)-14(a) or Rule 15d-14(a) of Securities Exchange Act of 1934.
31.2	Certification Pursuant to Rule 13(a)-14(a) or Rule 15d-14(a) of Securities Exchange Act of 1934.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*** Confidential treatment has been requested for portions of this exhibit.*

Indicates a management contract or any compensatory plan, contract or arrangement.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

EXACT SCIENCES CORPORATION

Date: May 15, 2009

By: /s/ Kevin T. Conroy
Kevin T. Conroy

President and Chief Executive Officer
(Authorized Officer)

Date: May 15, 2009

By: /s/ Maneesh K. Arora
Maneesh K. Arora

Chief Financial Officer
(Authorized Officer and Principal Financial Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description
3.1	Amended and Restated By-Laws of the Registrant, as amended.
10.1**	Collaboration, License and Purchase Agreement between Genzyme Corporation and the Registrant, dated January 27, 2009 (previously filed as Exhibit 10.1 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.2**	Assignment, Sublicense, Consent and Eighth Amendment to License Agreement among the Registrant, Genzyme Corporation and The Johns Hopkins University, dated January 27, 2009 (previously filed as Exhibit 10.2 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.3**	Amended and Restated License Agreement between Genzyme Corporation and the Registrant, dated January 27, 2009 (previously filed as Exhibit 10.3 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.4	Common Stock Subscription Agreement between the Registrant and Genzyme Corporation, dated January 27, 2009 (previously filed as Exhibit 10.4 to our Report on Form 8-K filed on January 28, 2009, which is incorporated herein by reference).
10.5	Employment Agreement by and between Kevin T. Conroy and the Registrant, dated as of March 18, 2009 (previously filed as Exhibit 10.1 to our Report on Form 8-K filed on March 18, 2009, which is incorporated herein by reference).
10.6	Employment Agreement by and between Maneesh Arora and the Registrant, dated as of March 18, 2009 (previously filed as Exhibit 10.2 to our Report on Form 8-K filed on March 18, 2009, which is incorporated herein by reference).
10.7	Release Agreement between Jeffrey R. Luber and the Registrant, dated as of March 31, 2009 (previously filed as Exhibit 10.36 to our Annual Report on Form 10-K for the period ended December 31, 2008, which is incorporated herein by reference).
10.8	Release Agreement between Charles R. Carelli, Jr. and the Registrant, dated as of March 31, 2009 (previously filed as Exhibit 10.37 to our Annual Report on Form 10-K for the period ended December 31, 2008, which is incorporated herein by reference).
31.1	Certification Pursuant to Rule 13(a)-14(a) or Rule 15d-14(a) of Securities Exchange Act of 1934.
31.2	Certification Pursuant to Rule 13(a)-14(a) or Rule 15d-14(a) of Securities Exchange Act of 1934.
32.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

** *Confidential treatment has been requested for portions of this exhibit.*

 Indicates a management contract or any compensatory plan, contract or arrangement.