

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q

(Mark One)

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

**For the quarterly period ended June 30, 2014**

**OR**

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

**For the transition period from to**

**Commission file number: 001-33137**  
**EMERGENT BIOSOLUTIONS INC.**  
*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**  
*(State or Other Jurisdiction of  
Incorporation or Organization)*

**14-1902018**  
*(I.R.S. Employer  
Identification No.)*

**2273 Research Boulevard, Suite 400**  
**Rockville, Maryland**  
*(Address of Principal Executive Offices)*

**20850**  
*(Zip Code)*

**(301) 795-1800**  
*(Registrant's Telephone Number, Including Area Code)*

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company  
(Do not check if a smaller reporting company)

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

As of July 31, 2014, the registrant had 37,477,213 shares of common stock outstanding.

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**Emergent BioSolutions Inc.**  
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BioThrax® (Anthrax Vaccine Adsorbed), RSDL® (KBDO individual use skin decontamination packet), BAT™ [Botulism Antitoxin Heptavalent (A,B,C,D,E,F,G)-Equine], HepaGam B® (Hepatitis B Immune Globulin Intravenous (Human)), VARIZIG® (Varicella Zoster Immune Globulin (Human)), WinRho® SDF [Rh<sub>0</sub> (D) Immune Globulin Intravenous (Human)], NuThrax™ (anthrax vaccine adsorbed with CPG 7909 adjuvant), PreviThrax™ (recombinant protective antigen anthrax vaccine, purified) and any and all Emergent BioSolutions Inc. brands, products, services and feature names, logos and slogans are trademarks or registered trademarks of Emergent BioSolutions Inc. or its subsidiaries in the United States or other countries. episil® (oral liquid) is a trademark of Camurus AB. All rights reserved. All other brands, products, services and feature names or trademarks are the property of their respective owners.

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical fact, including statements regarding our strategy, future operations, future financial position, future revenues, projected costs, prospects, plans and objectives of management, are forward-looking statements. We generally identify forward-looking statements by using words like "believes," "expects," "anticipates," "intends," "plans," "forecasts," "estimates" and similar expressions in conjunction with, among other things, discussions of financial performance or financial condition, growth strategy, product sales, manufacturing capabilities, product development, regulatory approvals or expenditures. These forward-looking statements are based on our current intentions, beliefs and expectations regarding future events. We cannot guarantee that any forward-looking statement will be accurate. You should realize that if underlying assumptions prove inaccurate or unknown risks or uncertainties materialize, actual results could differ materially from our expectations. You are, therefore, cautioned not to place undue reliance on any forward-looking statement. Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, we do not undertake to update any forward-looking statement to reflect new information, events or circumstances.

There are a number of important factors that could cause our actual results to differ materially from those indicated by such forward-looking statements, including, among others:

- appropriations for the procurement of BioThrax<sup>®</sup> (Anthrax Vaccine Adsorbed), our FDA-approved anthrax vaccine;
- our ability to successfully integrate our acquisitions of Cangene Corporation and the Healthcare Protective Products Division of Bracco Diagnostics Inc., which we recently acquired, and realize the benefits of these acquisitions;
- our ability to perform under our contracts with the U.S. government related to BioThrax, including the timing of deliveries;
- our ability to obtain new BioThrax sales contracts or modifications to existing contracts;
- the availability of funding for our U.S. government grants and contracts;
- our ability to successfully execute our growth strategy and achieve our financial and operational goals;
- our ability to successfully integrate and develop the products or product candidates, programs, operations and personnel of any entities or businesses that we acquire;
- our ability to perform under our contract with the U.S. government to develop and obtain regulatory approval for large-scale manufacturing of BioThrax in Building 55, our large-scale vaccine manufacturing facility in Lansing, Michigan;
- our ability to identify and acquire companies or in-license products or late-stage product candidates that satisfy our selection criteria;
- whether anticipated synergies and benefits from an acquisition or in-license are realized within expected time periods or at all;
- our ability to selectively enter into collaboration arrangements;
- our ability to obtain and maintain intellectual property protection for our products and product candidates;
- our ability and plans to expand our manufacturing facilities and capabilities;
- our ability to meet operating and financial restrictions placed on us and our subsidiaries under our senior secured credit facility;
- the rate and degree of market acceptance and clinical utility of our products;
- the success of our ongoing and planned development programs, non-clinical activities and clinical trials of our product candidates;
- the timing of and our ability to obtain and maintain regulatory approvals for our product candidates;
- our commercialization, marketing and manufacturing capabilities and strategy; and
- our estimates regarding expenses, future revenues, capital requirements and needs for additional financing.

The foregoing sets forth many, but not all, of the factors that could cause actual results to differ from our expectations in any forward-looking statement. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of any such factor on the business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. You should consider this cautionary statement, the risk factors identified in the section entitled "Risk Factors" in this quarterly report on Form 10-Q and the risk factors identified in our other periodic reports filed with the Securities and Exchange Commission when evaluating our forward-looking statements.

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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. FINANCIAL STATEMENTS**

**Emergent BioSolutions Inc. and Subsidiaries**  
**Consolidated Balance Sheets**  
(in thousands, except share and per share data)

	<b>June 30, 2014</b>	<b>December 31,</b>
	<b>(unaudited)</b>	<b>2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 168,130	\$ 179,338
Accounts receivable	78,270	60,587
Inventories	66,030	14,643
Income tax receivable, net	16,674	5,651
Prepaid expenses and other current assets	16,345	12,896
Total current assets	<u>345,449</u>	<u>273,115</u>
Property, plant and equipment, net	302,455	264,240
In-process research and development	50,300	41,800
Intangible assets, net	66,678	30,148
Goodwill	47,188	13,954
Deferred tax assets- long-term, net	16,411	-
Other assets	8,768	3,373
Total assets	<u>\$ 837,249</u>	<u>\$ 626,630</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 36,968	\$ 27,521
Accrued expenses and other current liabilities	2,957	1,252
Accrued compensation	23,044	24,615
Contingent purchase consideration, current portion	3,813	1,341
Provisions for chargebacks	4,224	-
Deferred tax liability-current portion, net	88	88
Deferred revenue, current portion	5,333	1,834
Total current liabilities	<u>76,427</u>	<u>56,651</u>
Contingent purchase consideration, net of current portion	19,193	15,278
Long-term indebtedness, net of current portion	251,000	62,000
Deferred tax liability long-term, net	-	1,419
Deferred revenue, net of current portion	1,632	-
Other liabilities	1,230	2,117
Total liabilities	<u>349,482</u>	<u>137,465</u>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 15,000,000 shares authorized, 0 shares issued and outstanding at June 30, 2014 and December 31, 2013, respectively	-	-
Common stock, \$0.001 par value; 100,000,000 shares authorized, 37,885,227 shares issued and 37,472,274 shares outstanding at June 30, 2014; 37,036,996 shares issued and 36,624,043 shares outstanding at December 31, 2013	38	37
Treasury stock, at cost, 412,953 common shares at both June 30, 2014 and December 31, 2013	(6,119)	(6,119)
Additional paid-in capital	260,778	247,637
Accumulated other comprehensive loss	(3,251)	(3,465)
Retained earnings	236,321	251,528
Total Emergent BioSolutions Inc. stockholders' equity	<u>487,767</u>	<u>489,618</u>
Noncontrolling interest in subsidiaries	-	(453)
Total stockholders' equity	<u>487,767</u>	<u>489,165</u>
Total liabilities and stockholders' equity	<u>\$ 837,249</u>	<u>\$ 626,630</u>

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

**Emergent BioSolutions Inc. and Subsidiaries**  
**Consolidated Statements of Operations**  
(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)		(Unaudited)	
<b>Revenues:</b>				
Product sales	\$ 78,269	\$ 65,596	\$ 114,036	\$ 95,955
Contract manufacturing	9,187	-	11,913	-
Contracts and grants	22,869	16,840	38,260	29,581
<b>Total revenues</b>	<b>110,325</b>	<b>82,436</b>	<b>164,209</b>	<b>125,536</b>
<b>Operating expense:</b>				
Cost of product sales and contract manufacturing	34,507	16,945	53,504	22,643
Research and development	37,401	30,278	67,657	61,002
Selling, general and administrative	30,555	20,501	60,644	40,529
<b>Income (loss) from operations</b>	<b>7,862</b>	<b>14,712</b>	<b>(17,596)</b>	<b>1,362</b>
<b>Other income (expense):</b>				
Interest income	31	10	71	33
Interest expense	(1,721)	(3)	(5,256)	(14)
Other income (expense), net	1,322	18	1,834	35
<b>Total other income (expense)</b>	<b>(368)</b>	<b>25</b>	<b>(3,351)</b>	<b>54</b>
<b>Income (loss) before provision for (benefit from) income taxes</b>	<b>7,494</b>	<b>14,737</b>	<b>(20,947)</b>	<b>1,416</b>
Provision for (benefit from) income taxes	2,465	4,381	(5,740)	(135)
<b>Net income (loss)</b>	<b>5,029</b>	<b>10,356</b>	<b>(15,207)</b>	<b>1,551</b>
Net loss attributable to noncontrolling interest	-	128	-	871
<b>Net income (loss) attributable to Emergent BioSolutions Inc.</b>	<b>\$ 5,029</b>	<b>\$ 10,484</b>	<b>\$ (15,207)</b>	<b>\$ 2,422</b>
<b>Income (loss) per share - basic</b>	<b>\$ 0.13</b>	<b>\$ 0.29</b>	<b>\$ (0.41)</b>	<b>\$ 0.07</b>
<b>Income (loss) per share - diluted</b>	<b>\$ 0.13</b>	<b>\$ 0.29</b>	<b>\$ (0.41)</b>	<b>\$ 0.07</b>
<b>Weighted-average number of shares - basic</b>	<b>37,416,554</b>	<b>36,144,063</b>	<b>37,137,015</b>	<b>36,056,297</b>
<b>Weighted-average number of shares - diluted</b>	<b>38,333,425</b>	<b>36,527,014</b>	<b>37,137,015</b>	<b>36,247,773</b>

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

**Emergent BioSolutions Inc. and Subsidiaries**  
**Consolidated Statements of Comprehensive Income (Loss)**  
(in thousands)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
	<u>(Unaudited)</u>		<u>(Unaudited)</u>	
<b>Net income (loss) attributable to Emergent BioSolutions Inc.</b>	\$ 5,029	\$ 10,484	\$ (15,207)	\$ 2,422
Foreign currency translations, net of tax	139	246	214	616
<b>Comprehensive income (loss)</b>	<u>\$ 5,168</u>	<u>\$ 10,730</u>	<u>\$ (14,993)</u>	<u>\$ 3,038</u>

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

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**Emergent BioSolutions Inc. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
(in thousands)

	<b>Six Months Ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(Unaudited)</b>	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (15,207)	\$ 1,551
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Stock-based compensation expense	6,015	5,718
Depreciation and amortization	15,294	8,372
Deferred income taxes	(5,199)	(135)
Non-cash development expenses from joint venture	-	(347)
Change in fair value of contingent obligations	1,630	-
Write off of debt issuance costs	1,831	-
Excess tax benefits from stock-based compensation	(5,179)	(1,757)
Other	499	(10)
Changes in operating assets and liabilities:		
Accounts receivable	2,274	41,674
Inventories	1,232	(3,421)
Income taxes	(5,184)	(7,999)
Prepaid expenses and other assets	(567)	(1,734)
Accounts payable	(10,357)	(6,199)
Accrued expenses and other liabilities	(644)	(619)
Accrued compensation	(3,902)	(7,130)
Provision for chargebacks	284	-
Deferred revenue	(1,246)	238
Net cash provided by (used in) operating activities	<u>(18,426)</u>	<u>28,202</u>
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(9,400)	(14,123)
Acquisition of Cangene Corporation, net of acquired cash	(178,167)	-
Net cash used in investing activities	<u>(187,567)</u>	<u>(14,123)</u>
<b>Cash flows from financing activities:</b>		
Proceeds from convertible debenture, net of debt issuance costs	241,654	-
Proceeds from other long-term debt obligations	1,000	-
Issuance of common stock subject to exercise of stock options	9,969	933
Excess tax benefits from stock-based compensation	5,179	1,757
Principal payments on long-term indebtedness	(62,000)	(2,235)
Contingent obligation payments	(1,019)	-
Net cash provided by financing activities	<u>194,783</u>	<u>455</u>
Effect of exchange rate changes on cash and cash equivalents	2	43
Net increase (decrease) in cash and cash equivalents	(11,208)	14,577
Cash and cash equivalents at beginning of period	179,338	141,666
Cash and cash equivalents at end of period	<u>\$ 168,130</u>	<u>\$ 156,243</u>

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

**EMERGENT BIOSOLUTIONS INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**1. Summary of significant accounting policies**

**Basis of presentation and consolidation**

The accompanying unaudited consolidated financial statements include the accounts of Emergent BioSolutions Inc. (the "Company" or "Emergent") and its wholly-owned and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

The unaudited consolidated financial statements included herein have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X issued by the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC.

In the opinion of the Company's management, any adjustments contained in the accompanying unaudited consolidated financial statements are of a normal recurring nature, and are necessary to present fairly the financial position of the Company as of June 30, 2014; the results of operations and comprehensive income (loss) for the three and six months ended June 30, 2014 and 2013; and cash flows for the six months ended June 30, 2014 and 2013. Interim results are not necessarily indicative of results that may be expected for any other interim period or for an entire year.

There have been no significant changes to the Company's summary of significant accounting policies, contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC, during the six months ended June 30, 2014, except for additions to the Company's accounting policies for revenue recognition and inventories related to the Cangene Corporation ("Cangene") acquisition (see Note 2).

**Revenue recognition**

The Company recognizes revenues from product sales if four basic criteria have been met:

- there is persuasive evidence of an arrangement;
- delivery has occurred or title has passed to the Company's customer;
- the fee is fixed or determinable; and
- collectability is reasonably assured.

All revenues from product sales are recorded net of applicable allowances for sales returns, rebates, special promotional programs, and discounts. The Company estimates allowances for deductions from revenue using a combination of information received from third parties including market data, inventory reports from major wholesalers, historical information and analysis. These estimates are subject to the inherent limitations of estimates that rely on third party data, as certain third-party information may itself rely on estimates and reflect other limitations. Provisions for estimated rebates and other allowances, such as discounts and promotional and other credits, are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and contract terms, and actual discounts offered. Management believes that such provisions are determinable because of the limited number of assumptions involved and the consistency of historical experience.

The Company markets and sells its Biosciences products through commercial wholesalers (direct customers) who purchase the products at a price referred to as the wholesale acquisition cost ("WAC"). Additionally, the Company enters into agreements with indirect customers for a contracted price that is less than the WAC. The indirect customers, such as group-purchasing organizations, physician practice-management groups and hospitals, purchase the Company's products from the wholesalers. Under these agreements with the wholesalers, the Company guarantees that it will credit them for the difference between the WAC and the indirect customers' contracted price. This credit is referred to as a chargeback. Wholesalers provide detailed information regarding indirect customer purchases as part of the justification for their credit request. Once received by the Company, these requests are standardized and tracked within a software system that adjudicates and reconciles all indirect claims coming from wholesalers. The database with these claims is used for historical trending and estimating future indirect sales, which are used to estimate accruals. Adjustments to these provisions are made periodically to reflect new facts and circumstances that may indicate that historical experience may not be indicative of current and/or future results. The Company makes subjective judgments primarily based on its evaluation of current market conditions and trade inventory levels related to the products. This evaluation may result in an increase or decrease in the experience rate that is applied to current and future sales, or as an adjustment to past sales, or both. The Company estimates allowances for revenue-reducing obligations such as rebates, special promotional programs, and discounts, using a combination of historical trends, contractual obligations and information received from third parties. The accuracy of these estimates is dependent upon the inherent limitations of extrapolating estimates from historical trends and upon the quality of the third-party information.

**Inventories**

Inventories are stated at the lower of cost or market with cost being determined using a standard cost method, which approximates average cost. Average cost consists primarily of material, labor and manufacturing overhead expenses (which includes fixed production-overhead costs) and includes the services and products of third party suppliers. The Company analyzes its inventory levels quarterly and writes down, in the applicable period, inventory that has become obsolete, inventory that has a cost basis in excess of its expected net realizable value and inventory in excess of expected customer demand. The Company also writes off, in the applicable period, the costs related to expired inventory. Costs of purchased inventories are recorded using weighted-average costing. The Company determines normal capacity for each production facility and allocates fixed production-overhead costs on that basis. Any excess, unallocated fixed production-overhead costs are expensed as incurred.

**2. Acquisitions**

**Cangene Corporation**

On February 21, 2014, the Company acquired 100% of the voting interest of Cangene for \$3.24 per share in cash (on a fully-diluted basis), which



represents a total purchase price of \$221.8 million. This transaction was accounted for by the Company under the acquisition method of accounting, with the Company as the acquirer. Under the acquisition method of accounting, the assets and liabilities of Cangene were recorded as of the acquisition date, at their respective fair values, and combined with those of the Company. This acquisition diversifies the product portfolio of the Company's Biodefense and Biosciences divisions and expands the Company's manufacturing capabilities.

The table below summarizes the preliminary allocation of the purchase price based upon estimated fair values of assets acquired and liabilities assumed at February 21, 2014. As of the date of this filing, the valuation of acquired intangible assets, inventory, deferred taxes, property plant and equipment, employee related liabilities and other fair value adjustments are not complete as the Company is obtaining and analyzing additional information related to the aforementioned items. As such, the purchase price allocation is subject to change.

(in thousands)	February 21, 2014
Fair value of tangible assets acquired and liabilities assumed:	
Cash	\$ 43,631
Accounts receivable	19,940
Inventory (i)	52,619
Prepaid expenses and other assets	2,375
Property, plant and equipment	40,264
Deferred taxes, net	18,371
Income tax receivable	2,940
Accounts payable and accrued liabilities	(22,916)
Provision for chargebacks	(3,940)
Contingent purchase consideration	(5,776)
Deferred revenue	(6,378)
Total fair value of tangible assets acquired and liabilities assumed	141,130
Acquired in-process research and development	8,500
Acquired intangible assets	40,400
Goodwill	31,770
Total purchase price	\$ 221,800

(i) Acquired inventory reflects a \$6.2 million adjustment to record inventory at fair value, referred to as a step-up adjustment. The \$6.2 million step-up was estimated to be amortized through cost of product sales and contract manufacturing over the next five years based on estimated inventory turnover, which will increase cost of product sales and contract manufacturing during such period.

The table below summarizes the preliminary estimated fair value of intangible assets acquired and the estimated amortization periods:

(in thousands)	Amount	Amortization Period in years
Corporate Trade Name	\$ 2,800	5.0
Marketed Products	8,300	10.0
Licensed Products	3,300	7.0
Biodefense Products	20,400	12.0
Contract Manufacturing	5,600	8.0
Total identified intangible assets	\$ 40,400	

The Company determined the estimated fair value of the intangible assets using the income approach, which is based on the present value of future cash flows. The fair value measurements are based on significant unobservable inputs that are developed by the Company using estimates and assumptions of the respective market and market penetration of the Company's products.

A substantial portion of the assets acquired from Cangene consisted of intangible assets. The Marketed Products intangible asset includes WinRho<sup>®</sup> SDF [Rho(D) Immune Globulin Intravenous (Human)] and VARIZIG<sup>®</sup> (Varicella Zoster Immune Globulin (Human)). The Licensed Products intangible asset includes HepaGam B<sup>®</sup> (Hepatitis B Immune Globulin Intravenous (Human)) and episil<sup>®</sup> (oral liquid). The Biodefense intangible asset includes BAT<sup>™</sup> [Botulism Antitoxin Heptavalent (A, B, C, D, E, F, G)-Equine], AIGIV (Anthrax Immune Globulin Intravenous (Human)) and VIGIV (Vaccinia Immune Globulin Intravenous (Human)). The Contract Manufacturing intangible asset is primarily related to contract manufacturing in Baltimore, Maryland.

The Company estimated the fair value of the Marketed, Licensed and Biodefense Product intangible assets using the income approach with a present value discount rate of 15%, which is based on the estimated weighted-average cost of capital for companies with profiles substantially similar to that of Cangene. This is comparable to the estimated internal rate of return for the acquisition and represents the rate that market participants would use to value these intangible assets. The projected cash flows from these Marketed, Licensed and Biodefense Product intangible assets were based on key assumptions including: estimates of revenues and operating profits; the life of the potential commercialized product and associated risks; and risks related to the viability of and potential alternative treatments in any future target markets.

The Company estimated the fair value of the Contract Manufacturing intangible asset using the income approach with a present value discount rate of 15%, which is based on the estimated weighted-average cost of capital for companies with profiles substantially similar to that of Cangene. This is comparable to the estimated internal rate of return for the acquisition and represents the rate that market participants would use to value this intangible asset. The projected cash flows from the Contract Manufacturing intangible asset was based on key assumptions including: estimates of revenues and operating profits; and viability of attaining/maintaining future third-party manufacturing relationships with the Company's customers.

The Company estimated the fair value of the Corporate Trade Name intangible asset using the relief of royalty method with a present value discount rate of 15%, which is based on the estimated weighted-average cost of capital for companies with profiles substantially similar to that of Cangene. This is comparable to the estimated internal rate of return for the acquisition and represents the rate that market participants would use to value this intangible asset.

The weighted average amortization period of the intangible assets is 118 months. For the three and six months ended June 30, 2014, the Company recorded amortization expense of \$1.1 million and \$1.5 million, respectively, for intangible assets acquired from Cangene, which has been recorded in cost of product sales and contract manufacturing. Amortization expense of \$691,000 and \$928,000, respectively, was recorded within the Biosciences segment for the three and six months ended June 30, 2014. Amortization expense of \$389,000 and \$602,000, respectively, was recorded within the Biodefense segment for the three and six months ended June 30, 2014.

The intangible asset associated with in-process research and development ("IPR&D") acquired from Cangene is the IXINITY product candidate. Management determined that the estimated acquisition-date fair value of intangible assets related to IPR&D was \$8.5 million. The estimated fair value was determined using the income approach, which discounts expected future cash flows to present value. The Company estimated the fair value using a present value discount rate of 16%, which is based on the estimated weighted-average cost of capital for companies with profiles substantially similar to that of Cangene. This is comparable to the estimated internal rate of return for the acquisition and represents the rate that market participants would use to value the IPR&D. The projected cash flows for IXINITY was based on key assumptions including: estimates of revenues and operating profits related to IXINITY, considering its stage of development on the acquisition date; the time and resources needed to complete the development and approval of the product candidate; the life of the potential commercialized product and associated risks, including the inherent difficulties and uncertainties in developing a product candidate such as obtaining marketing approval from the FDA and other regulatory agencies; and risks related to the viability of and potential alternative treatments in any future target markets. IPR&D assets are considered to be indefinite-lived until the completion or abandonment of the associated research and development efforts (see Note 5).

The Company recorded approximately \$31.8 million in goodwill related to the Cangene acquisition, representing the purchase price paid in the acquisition that was in excess of the fair value of the tangible and intangible assets acquired. None of the goodwill generated from the Cangene acquisition is expected to be deductible for tax purposes.

The Company has incurred transaction costs related to the Cangene acquisition of approximately \$3.7 million for the six months ended June 30, 2014, which has been recorded in selling, general and administrative expenses within the Company's Biosciences segment. The Company has incurred to date a total of \$7.0 million in transaction costs associated with the Cangene acquisition through June 30, 2014, of which \$3.3 million was incurred in 2013.

The following pro forma information is presented as if the acquisition had occurred on January 1, 2013, and combines the historical results of operations of the Company and Cangene for the six month periods ended June 30, 2014 and 2013.

(in thousands)	June 30,	
	2014	2013
Pro forma revenue	\$ 191,688	\$ 191,700
Pro forma net loss	\$ (17,782)	\$ (3,838)

#### Healthcare Protective Products Division

On August 1, 2013, the Company acquired substantially all of the assets and liabilities of Health Protective Products Division ("HPPD"), a division of Bracco Diagnostics Inc. ("Bracco"), for \$25.9 million in cash along with contingent purchase consideration obligations to Bracco. The assets and liabilities acquired include HPPD's product, RSDL, and a majority of the customer and distributor agreements associated with RSDL along with \$1.5 million of manufacturing equipment. In addition, the Company assumed a \$1.5 million liability associated with the Canadian Technology Development Fund. The acquisition diversifies the product portfolio of the Biodefense segment by adding product sales from RSDL.

The contingent purchase consideration obligation due to Bracco is based on a percentage of RSDL net sales, ranging from 5-10%, for the period August 1, 2013 through July 31, 2028. At August 1, 2013, the contingent purchase consideration obligation was recorded at a fair value of \$16.2 million. The Level 3 fair value of this obligation is based on management's assessment of the potential future realization of the contingent purchase consideration payments. This assessment is based on inputs that have no observable market. The obligation is measured using the income approach (a discounted cash flow model).

The total purchase price is summarized below:

(in thousands)	
Amount of cash paid to Bracco Diagnostics Inc.	\$ 25,873
Fair value of contingent purchase consideration at date of acquisition	16,232
Total purchase price	<u>\$ 42,105</u>

The table below summarizes the allocation of the purchase price based upon fair values of assets acquired and liabilities assumed at August 1, 2013.

(in thousands)	
Acquired intangible assets	\$ 32,099
Goodwill	9,916
Acquired equipment	1,543
Other	11
Assumed liabilities	(1,464)
Total purchase price	<u>\$ 42,105</u>

A substantial portion of the assets acquired from Bracco consisted of intangible assets associated with the RSDL product. As of the date of acquisition, the Company recorded intangible assets of approximately \$28.6 million related to RSDL, which is being amortized over 8 years, and \$3.5 million related to a manufacturing agreement with Bracco, which is being amortized over 3 years. For the three and six months ended June 30, 2014, the

Company recorded \$1.2 million and \$2.3 million, respectively, amortization expense for intangible assets acquired from Bracco which was recorded in cost of product sales and contract manufacturing within the Company's Biodefense segment. The weighted average remaining amortization period for the intangible assets is 80 months.

The Company recorded approximately \$9.9 million in goodwill related to the HPPD acquisition representing the purchase price paid in the acquisition in excess of the fair value of the tangible and intangible assets acquired. This goodwill is included in the Company's biodefense segment. None of the goodwill generated from the HPPD acquisition is expected to be deductible for tax purposes.

The Company has determined the historical results of HPPD were not significant to the Company's results of operations, and as such no proforma disclosures have been presented.

### 3. Fair value measurements

The following table represents the Company's fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis:

(in thousands)	At June 30, 2014			
	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment in money market funds (1)	\$ 57,108	\$ -	\$ -	\$ 57,108
Total assets	<u>\$ 57,108</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 57,108</u>
<b>Liabilities:</b>				
Contingent purchase consideration	\$ -	\$ -	\$ 23,006	\$ 23,006
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 23,006</u>	<u>\$ 23,006</u>
<b>At December 31, 2013</b>				
(in thousands)	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Investment in money market funds (1)	\$ 37,701	\$ -	\$ -	\$ 37,701
Total assets	<u>\$ 37,701</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 37,701</u>
<b>Liabilities:</b>				
Contingent purchase consideration	\$ -	\$ -	\$ 16,619	\$ 16,619
Total liabilities	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 16,619</u>	<u>\$ 16,619</u>

(1) Included in cash and cash equivalents in accompanying consolidated balance sheets.

For the periods ended June 30, 2014 and 2013, the Company did not have any transfers between Level 1 and Level 2 assets or liabilities.

The fair value of contingent purchase consideration obligations are based on management's assessment of changes as a result of adjustments to the discount rates and updates in the assumed and actual achievement of net sales for future RSDL, HepaGam B and episil®, which are inputs that have no observable market (Level 3). For the three and six months ended June 30, 2014, the contingent purchase consideration obligation increased by \$1.2 million and \$1.6 million, respectively, primarily due to an adjustment to the actual and expected timing of RSDL, HepaGam B and episil® sales. This increase resulted in a charge that is classified in the Company's statement of operations as cost of product sales and contract manufacturing.

The following table is a reconciliation of the beginning and ending balance of the liabilities measured at fair value using significant unobservable inputs (Level 3) during the six months ended June 30, 2014.

(in thousands)	
Balance at December 31, 2013	\$ 16,619
Expense (income) included in earnings	1,630
Settlements	(1,019)
Purchases, sales and issuances	5,776
Transfers in/(out) of Level 3	-
Balance at June 30, 2014	<u>\$ 23,006</u>

Separate disclosure is required for assets and liabilities measured at fair value on a recurring basis, as documented above, from those measured at fair value on a nonrecurring basis. As of June 30, 2014, the Company had no assets or liabilities that were measured at fair value on a nonrecurring basis except for the assets acquired and liabilities assumed as part of the Cangene acquisition (See Note 2). As of June 30, 2013, the Company had no assets or liabilities that were measured at fair value on a nonrecurring basis.

### 4. Inventories

Inventories consist of the following:

(in thousands)	June 30, 2014	December 31, 2013
Raw materials and supplies	\$ 15,033	\$ 2,656
Work-in-process	32,962	9,819
Finished goods	18,035	2,168
Total inventories	<u>\$ 66,030</u>	<u>\$ 14,643</u>

## 5. Intangible assets, in-process research and development and goodwill

As of June 30, 2014, the Company had \$50.3 million of IPR&D assets, which are included in the Biosciences business segment. This includes \$41.8 million related to the Company's oltuzumab product candidate and \$8.5 million related to the Company's IXINITY product candidate. On July 29, 2014, the U.S. Food and Drug Administration ("FDA") issued a complete response letter for the New Drug Application ("NDA") of IXINITY. The complete response letter requested additional analyses of data from completed studies and noted deficiencies in the chemistry, manufacturing, and controls section of the license application, all of which must be resolved before approval can be granted by FDA. The Company determined that the FDA's response to its NDA is a potential indicator of impairment of the related IXINITY IPR&D asset. However, the Company has not yet completed its interim impairment assessment. The Company has determined the potential range of impairment could be from zero to the carrying value of the IXINITY IPR&D asset.

Intangible assets consist of the following:

(in thousands)	RSDL	Manufacturing Agreement	Corporate Tradename	Marketed Products	Licensed Products	Biodefense Products	Contract Manufacturing	Total
<b>Cost basis</b>								
Balance at December 31, 2013	\$ 28,621	\$ 3,478	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 32,099
Additions	-	-	2,800	8,300	3,300	20,400	5,600	40,400
Balance at June 30, 2014	\$ 28,621	\$ 3,478	\$ 2,800	\$ 8,300	\$ 3,300	\$ 20,400	\$ 5,600	\$ 72,499
<b>Accumulated amortization</b>								
Balance at December 31, 2013	\$ (1,468)	\$ (483)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ (1,951)
Amortization	(1,760)	(580)	(198)	(365)	(117)	(602)	(248)	(3,870)
Balance at June 30, 2014	\$ (3,228)	\$ (1,063)	\$ (198)	\$ (365)	\$ (117)	\$ (602)	\$ (248)	\$ (5,821)
Net book value at June 30, 2014	\$ 25,393	\$ 2,415	\$ 2,602	\$ 7,935	\$ 3,183	\$ 19,798	\$ 5,352	\$ 66,678

The following table is a reconciliation of goodwill:

(in thousands)	Total
<b>Cost basis</b>	
Balance at December 31, 2013	\$ 13,954
Additions	33,234
Balance at June 30, 2014	\$ 47,188

## 6. Long-term debt

On January 29, 2014, the Company issued \$250.0 million aggregate principal amount of 2.875% Convertible Senior Notes due 2021 (the "Notes"). The Notes bear interest at a rate of 2.875% per year, payable semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2014. The Notes mature on January 15, 2021, unless earlier purchased by the Company, redeemed or converted. The conversion rate is equal to 30.8821 shares of common stock per \$1,000 principal amount of notes (which is equivalent to an initial conversion price of approximately \$32.38 per share of common stock). The conversion rate is subject to adjustment upon the occurrence of certain specified events but will not be adjusted for accrued and unpaid interest. The Company incurred approximately \$8.3 million in debt issuance costs associated with the Notes, which has been capitalized on the consolidated balance sheets and is being amortized over seven years, using the effective interest method.

On December 11, 2013, the Company entered into a senior secured credit agreement (the "Credit Agreement") with three lending financial institutions (the "Lenders"), led by Bank of America, N.A., as administrative agent. The Credit Agreement originally provided for a revolving credit facility of up to \$100 million through December 11, 2018 (or such earlier date required by the terms of the Credit Agreement) and a term loan facility of up to \$125 million to be drawn in full, if at all, on or prior to March 31, 2014. In connection with the Credit Agreement, the Company borrowed \$62.0 million under the revolving credit facility primarily to repay obligations under existing loan agreements. On January 29, 2014, in connection with the Company's issuance of the Notes, the unused \$125 million term loan portion of the Credit Agreement terminated automatically in accordance with the terms of the Credit Agreement. In addition, following the closing of the Notes offering, the Company repaid the \$62.0 million outstanding indebtedness under the revolving credit facility, which restored the full \$100 million revolving credit capacity under this facility. In addition, during the six months ended June 30, 2014, the Company expensed \$1.8 million of debt issuance cost associated with the term loan facility. As of June 30, 2014, no amounts were drawn under the revolving credit facility.

The Company's payment obligations under the Credit Agreement are secured by a lien on substantially all of the Company's assets, including the stock of all of the Company's subsidiaries, and the assets of the subsidiary guarantors, including mortgages over certain of their real properties, including the Company's large-scale vaccine manufacturing facility in Lansing, Michigan and the Company's product development and manufacturing facility in Baltimore, Maryland.

The Credit Agreement, as amended, contains affirmative and negative covenants customary for financings of this type. Negative covenants in the Credit Agreement limit the Company's ability to, among other things: incur indebtedness (other than the issuance of the Notes) and liens; dispose of assets; make investments including loans, advances or guarantees; and enter into certain mergers or similar transactions. The Credit Agreement also contains financial covenants, tested quarterly and in connection with any triggering events under the Credit Agreement that include the maintenance of: (1) a minimum consolidated debt service coverage ratio of 2.50 to 1.00, (2) a maximum consolidated leverage ratio for the period ending on or prior to September 30, 2014 of 4.00 to 1.00, for the measurement period ending December 31, 2014 of 3.75 to 1.00, and thereafter of 3.50 to 1.00, (3) a maximum consolidated senior leverage ratio of 2.00 to 1.00 (when no term loan is outstanding) and (4) a minimum liquidity requirement of \$50 million. Upon the occurrence and continuance of an event of default under the Credit Agreement, the commitments of the lenders to make loans under the Credit Agreement may be terminated

and the Company's payment obligations under the Credit Agreement may be accelerated. The events of default under the Credit Agreement include, among others, subject in some cases to specified cure periods: payment defaults; inaccuracy of representations and warranties in any material respect; defaults in the observance or performance of covenants; bankruptcy and insolvency related defaults; the entry of a final judgment in excess of a threshold amount; change of control; and the invalidity of loan documents relating to the Credit Agreement.

## 7. Equity awards

As of June 30, 2014, the Company had two stock-based employee compensation plans, the Third Amended and Restated Emergent BioSolutions Inc. 2006 Stock Incentive Plan (the "2006 Plan") and the Emergent BioSolutions Employee Stock Option Plan (the "2004 Plan") (together, the "Emergent Plans").

On May 22, 2014, the Company's shareholders approved an amendment to the 2006 Plan, which increased the number of shares of common stock available for issuance under plan awards by 4,000,000. As part of this amendment, awards of restricted stock units after May 22, 2014 are counted against the maximum aggregate number of shares of common stock available for issuance under the 2006 Plan as 2.3 shares of common stock for every one restricted stock unit granted. The maximum number of shares subject to awards that may be granted per year under the 2006 Plan to a single participant is 1,000,000.

The following is a summary of stock option award activity under the Emergent Plans:

	2006 Plan		2004 Plan		Aggregate Intrinsic Value
	Number of Shares	Weighted- Average Exercise Price	Number of Shares	Weighted- Average Exercise Price	
Outstanding at December 31, 2013	3,639,995	\$ 17.01	53,156	\$ 8.86	\$ 23,148,738
Granted	1,099,271	27.55	-	-	-
Exercised	(596,955)	13.63	-	-	-
Forfeited	(57,867)	18.47	-	-	-
Outstanding at June 30, 2014	4,084,444	\$ 19.87	53,156	\$ 8.86	\$ 17,771,557
Exercisable at June 30, 2014	2,128,797	\$ 17.72	53,156	\$ 8.86	\$ 11,617,808

The following is a summary of restricted stock unit award activity under the 2006 Plan:

	Number of Shares	Weighted- Average Grant Price	Aggregate Intrinsic Value
Granted	549,637	27.55	-
Vested	(331,864)	26.95	-
Forfeited	(28,034)	18.15	-
Outstanding at June 30, 2014	982,365	\$ 22.52	\$ 22,063,918

## 8. Variable interest entities

In July 2008, the Company entered into a collaboration with the University of Oxford ("Oxford") and certain Oxford researchers to advance a vaccine product candidate for tuberculosis, resulting in the formation of the Oxford-Emergent Tuberculosis Consortium ("OETC"). The Company liquidated OETC during the six month period ending June 30, 2014. In addition, the Company recorded an adjustment related to noncontrolling interest of \$453,000 due to the liquidation. This expense was recorded as selling, general and administrative expense within the Company's Biosciences segment.

## 9. Earnings per share

For the three and six month periods ended June 30, 2014 and 2013, basic earnings per share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period.

For the three and six month periods ended June 30, 2014, diluted earnings per share is computed using the if-converted method by dividing the adjusted net income (loss) by the weighted average number of shares of common stock outstanding during the period. The adjusted net income (loss) is adjusted for interest expense and amortization of debt issuance cost, both net of tax, associated with the Company's Notes. The weighted average number of shares-diluted is adjusted for the potential dilutive effect of the exercise of stock options and the vesting of restricted stock units along with the assumption of the conversion of the convertible obligations, at the beginning of the period.

For the three and six months ended June 30, 2013, diluted earnings per share is computed using the treasury method by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period, adjusted for the potential dilutive effect of other securities if such securities were converted or exercised.

The following table presents the calculation of basic and diluted net income (loss) per share:

(in thousands, except share and per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Numerator:				
Net income (loss)	\$ 5,029	\$ 10,484	\$ (15,207)	\$ 2,422
Interest expense applicable to convertible debt, net of tax	-	-	-	-
Amortization of debt issuance costs, net of tax	-	-	-	-
Adjusted net income (loss)	\$ 5,029	\$ 10,484	\$ (15,207)	\$ 2,422

Denominator:					
Weighted-average number of shares—basic		37,416,554	36,144,063	37,137,015	36,056,297
Dilutive securities—equity awards		916,871	382,951	-	191,476
Dilutive securities—convertible debt		-	-	-	-
Weighted-average number of shares—diluted		38,333,425	36,527,014	37,137,015	36,247,773
Income (loss) per share-basic	\$	0.13	\$ 0.29	\$ (0.41)	\$ 0.07
Income (loss) per share-diluted	\$	0.13	\$ 0.29	\$ (0.41)	\$ 0.07

For the three months ended June 30, 2014 there were no adjustments to adjusted net income (loss) or dilutive securities associated with the Company's Notes as such adjustments would have been anti-dilutive. For the six months ended June 30, 2014, outstanding stock options to purchase approximately 5,100,000.0 million shares of common stock, along with 8.1 million shares related to the Company's convertible debt, were excluded from the calculation of diluted earnings per share because of the adjusted net loss incurred for the six months ended June 30, 2014 would make these awards anti-dilutive.

Stock options with exercise prices in excess of the average per share closing price during the period are not considered in the calculation of fully diluted earnings per share. For the three months ended June 30, 2014, approximately 1.5 million were excluded from the calculation of diluted earnings per share. For the three and six month periods ended June 30, 2013, approximately 3.5 million and 2.7 million stock options were excluded from the calculation of diluted earnings per share.

## 10. Segment information

For financial reporting purposes, the Company reports financial information for two business segments: Biodefense and Biosciences. The Company's two business segments, or divisions, engage in business activities for which discrete financial information and allocation resources are reviewed by the chief operating decision maker. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. The Company's reportable segments are business units that offer different products and product candidates and are managed separately because they manufacture and develop distinct products with different manufacturing and development processes, along with having separate and distinct sales and marketing processes.

The Biodefense division is a specialty biopharmaceutical business focused on countermeasures that address Chemical, Biological, Radiological and Nuclear ("CBRN") threats and consists of two business units: vaccines and therapeutics, and medical devices. Revenues in this segment are primarily from sales of the Company's FDA-licensed product, BioThrax® (Anthrax Vaccine Adsorbed), to the U.S. government. The Biosciences division is directed to commercial opportunities and primarily targets hematology/oncology, transplantation and infectious diseases, and consists of two business units, therapeutics and vaccines. The "All Other" segment relates to the general operating costs of the Company and includes costs of the centralized services departments, which are not allocated to the other segments, as well as spending on activities that are not classified as Biodefense or Biosciences.

(in thousands)	Reportable Segments			
	Biodefense	Biosciences	All Other	Total
<b>Three Months Ended June 30, 2014</b>				
External revenue	\$ 91,103	\$ 19,222	\$ -	\$ 110,325
Net income (loss)	22,416	(15,001)	(2,386)	5,029
<b>Three Months Ended June 30, 2013</b>				
External revenue	\$ 82,402	\$ 34	\$ -	\$ 82,436
Net income (loss)	24,996	(14,156)	(356)	10,484
<b>Six Months Ended June 30, 2014</b>				
External revenue	\$ 138,542	\$ 25,667	\$ -	\$ 164,209
Net income (loss)	23,828	(34,510)	(4,525)	(15,207)
<b>Six Months Ended June 30, 2013</b>				
External revenue	\$ 124,561	\$ 975	\$ -	\$ 125,536
Net income (loss)	29,606	(25,528)	(1,656)	2,422

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes and other financial information included elsewhere in this quarterly report on Form 10-Q. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report on Form 10-Q, including information with respect to our plans and strategy for our business and financing, includes forward-looking statements that involve risks and uncertainties. You should review the "Special Note Regarding Forward-Looking Statements" and "Risk Factors" sections of this quarterly report on Form 10-Q for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

### Overview

#### Product Portfolio

Emergent BioSolutions Inc. is a specialty biopharmaceutical company seeking to protect and enhance life by offering specialized products to healthcare providers and governments for use in addressing medical needs and emerging health threats. We have two operating divisions: Biodefense and Biosciences. For financial reporting purposes, we operate in two business segments that correspond to these two divisions.

On February 21, 2014, we acquired Cangene Corporation, or Cangene, for approximately \$222 million. As part of the acquisition, we received the following revenue-generating products: BAT™ [Botulism Antitoxin Heptavalent (A, B, C, D, E, F, G)-Equine], AIGIV (Anthrax Immune Globulin Intravenous (Human)) and VIGIV (Vaccinia Immune Globulin Intravenous (Human)) in the Biodefense segment; and WinRho® SDF [Rh<sub>0</sub>(D) Immune Globulin Intravenous (Human)], HepaGam B® (Hepatitis B Immune Globulin Intravenous (Human)), VARIZIG® (Varicella Zoster Immune Globulin (Human)) and episil® in the Biosciences segment.

Our Biodefense division is a specialty biopharmaceutical business focused on countermeasures (vaccines, therapeutics and medical devices) that address Chemical, Biological, Radiological and Nuclear, or CBRN, threats. The U.S. government is the primary purchaser of our Biodefense products, and often provides us with substantial funding for the development of our Biodefense product candidates. Our Biodefense product portfolio consists of five revenue-generating products, including BioThrax® (Anthrax Vaccine Adsorbed), the only vaccine approved by the U.S. Food and Drug Administration, or the FDA, for the prevention of anthrax disease, RSDL® (KBDO individual use skin decontamination packet), BAT, AIGIV and VIGIV, and various investigational stage product candidates. Operations that support this division include manufacturing, medical affairs, regulatory affairs, quality assurance, quality control, international sales and marketing, and domestic government affairs in support of our marketed products, as well as product development and manufacturing infrastructure in support of our investigational stage product candidates.

Our Biosciences division is a specialty biopharmaceutical business focused on therapeutics and vaccines in hematology/oncology, transplantation and infectious disease. Our Biosciences portfolio consists of four revenue-generating products, including WinRho, HepaGam B, VARIZIG, and episil®, as well as various investigational stage product candidates and a contract manufacturing services business, which we acquired in our recent acquisition of Cangene. Operations that support this division include manufacturing, quality, regulatory, medical affairs, and sales and marketing in support of our marketed products, as well as additional product development capabilities in support of our investigational stage product candidates.

Our Biodefense segment has generated net income for each of the last five fiscal years. Over this same time frame, our Biosciences segment has generated revenue through development contracts and collaborative funding, but has not generated any product sales revenues. As a result, our Biosciences segment has incurred a net loss for each of the last five fiscal years.

### ***Product Sales***

We have derived the majority of our historical product sales revenues from BioThrax sales to the U.S. government. We are currently a party to a contract with the Centers for Disease Control and Prevention, or CDC, an operating division of the U.S. Department of Health and Human Services, or HHS, to supply up to 44.75 million doses of BioThrax for placement into the Strategic National Stockpile, or SNS, over a five-year period ending September 30, 2016. We expect to continue to derive a majority of product sales revenues from our sales of BioThrax to the U.S. government. Our total revenues from BioThrax sales were \$92.0 million and \$96.0 million for the six months ended June 30, 2014 and 2013, respectively. We are focused on the following:

- increasing sales for our Biodefense products to U.S. government customers; and
- expanding the market for our product portfolio to other customers domestically and internationally.

### ***Contract Manufacturing***

We provide contract manufacturing services, including biopharmaceutical product development and filling services for injectable and other sterile products, as well as process design, technology transfer, manufacturing validation, laboratory support, aseptic filling, lyophilization and accelerated and ongoing stability studies. We produce finished units of commercial drugs for a variety of customers ranging from small biopharmaceutical companies to major multinationals. We are focused on increasing services to third party biopharmaceutical companies, both domestically and internationally.

### ***Contracts and Grants***

We seek to advance development of our product candidates through external funding arrangements. We may slow down development programs or place them on hold during periods that are not covered by external funding. In addition, we perform certain ongoing product-related services for which we receive funding. We have received funding from the U.S. government for the following programs:

- BioThrax as a post-exposure prophylaxis, or PEP;
- NuThrax;
- Large-scale manufacturing for BioThrax;
- PreviThrax;
- BAT;
- AIGIV; and
- VIGIV.

We continue to actively pursue additional government sponsored development contracts and grants and commercial collaborative relationships. We also encourage both governmental and non-governmental agencies and philanthropic organizations to provide funding for non-clinical activities and to conduct clinical studies of our product candidates.

### **Financial Operations Overview**

#### ***Revenues***

We entered into a contract with the CDC effective as of September 30, 2011 to supply up to 44.75 million doses of BioThrax to the CDC over a five-year period. The period of performance under the award is from September 30, 2011 through September 30, 2016. The maximum amount that could be paid to us under the contract is up to \$1.25 billion, subject to availability of funding by the U.S. government. To date, the U.S. government has committed approximately \$704 million for the procurement of BioThrax doses under this contract. Through June 30, 2014, we have delivered and, upon CDC acceptance, recognized revenue on approximately 21 million doses, representing approximately \$570 million in revenue under this contract.

We have received contract and grant funding from the CDC, National Institute of Allergy and Infectious Diseases, or NIAID, and the Biomedical Advanced Research and Development Authority, or BARDA, for the following development programs:

<b>Development Programs</b>	<b>Funding Source</b>	<b>Award Date</b>	<b>Performance Period</b>
Post-Exposure Prophylaxis indication for BioThrax	BARDA	9/2007	9/2007 — 3/2016
Large-scale manufacturing for BioThrax	BARDA	7/2010	7/2010 — 7/2016
NuThrax	NIAID	7/2010	8/2010 — 4/2015
PreviThrax	BARDA	9/2010	9/2010 — 9/2015
CIADM	BARDA	6/2012	6/2012 — 6/2037

BAT	CDC	1/2003	1/2003 — 1/2015
BAT	BARDA	5/2006	5/2006 — 5/2026
AIGIV	BARDA	9/2005	9/2005 — 4/2021
AIGIV	BARDA	9/2002	9/2002 — 12/2015
AIGIV	BARDA	9/2013	9/2013 — 9/2018
VIGIV	CDC	8/2012	8/2012 — 12/2015

Our revenue, operating results and profitability have varied, and we expect they will continue to vary on a quarterly basis, primarily due to the timing of sales of our products and the timing of reimbursement under our contracts and grants.

### ***Cost of Product Sales***

The primary expense that we incur to deliver our vaccines and therapeutics to our customers is manufacturing cost, consisting of fixed and variable costs. Variable manufacturing costs consist primarily of costs for materials and personnel-related expenses for direct and indirect manufacturing support staff, contract manufacturing and filling operations, and sales-based royalties. Fixed manufacturing costs include facilities, utilities and amortization of intangible assets. We determine the cost of product sales for products sold during a reporting period based on the average manufacturing cost per unit in the period those units were manufactured. In addition to the fixed and variable manufacturing costs described above, the cost of product sales depends on utilization of available manufacturing capacity.

The primary expense that we incur to deliver our medical device, RSDL, to our customers is the cost per unit of production from our third-party contract manufacturer. Other associated expenses include sales-based royalties, amortization of intangible assets, shipping, logistics and the cost of support functions.

### ***Research and Development Expenses***

We expense research and development costs as incurred. Our research and development expenses consist primarily of:

- personnel-related expenses;
- fees to professional service providers for, among other things, analytical testing, independent monitoring or other administration of our non-clinical studies and clinical trials; and obtaining and evaluating data from our clinical trials and non-clinical studies;
- costs of contract manufacturing services for clinical trial material;
- costs of materials used in clinical trials and research and development;
- depreciation of capital assets used to develop our products; and
- operating costs, such as the operating costs of facilities and the legal costs of pursuing patent protection of our intellectual property.

We intend to focus our product development efforts on promising late-stage candidates that we believe satisfy well-defined criteria and seek to utilize collaborations or non-dilutive funding. We plan to seek funding for development activities from external sources and third parties, such as governments and non-governmental organizations, including commercial partners. We expect that our research and development spending will be dependent upon such factors as the results from our clinical trials, the availability of reimbursement of research and development spending, the number of product candidates under development, the size, structure and duration of any follow-on clinical programs that we may initiate, the costs associated with manufacturing our product candidates on a large-scale basis for later stage clinical trials, and our ability to use or rely on data generated by government agencies, such as studies involving BioThrax conducted by the CDC.

### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses consist primarily of personnel-related costs and professional fees in support of our executive, sales and marketing, business development, government affairs, finance, accounting, information technology, legal and human resource functions. Other costs include facility costs not otherwise included in cost of product sales and contract manufacturing or research and development expense.

### ***In-process Research and Development***

The intangible asset associated with in-process research and development, or IPR&D, acquired from Cangene, is the IXINITY product candidate. As part of the preliminary purchase price allocation with respect to the Cangene acquisition, management determined that the estimated acquisition date fair value related to IPR&D was \$8.5 million. The estimated fair value was determined using the income approach, which discounts expected future cash flows to present value. We estimated the fair value using a present value discount rate of 16%, which is based on the estimated weighted-average cost of capital for companies with profiles substantially similar to that of Cangene. This is comparable to the estimated internal rate of return for the acquisition and represents the rate that market participants would use to value the IPR&D. The projected cash flows from the IPR&D projects were based on key assumptions, including: estimates of revenues and operating profits related to each project considering its stage of development on the acquisition date; the time and resources needed to complete the development and approval of the product candidate; the life of the potential commercialized product and associated risks, including the inherent difficulties and uncertainties in developing a product candidate such as obtaining marketing approval from the FDA and other regulatory agencies; and risks related to the viability of and potential alternative treatments in any future target markets. IPR&D assets will be considered to be indefinite-lived until the completion or abandonment of the associated research and development efforts.

On July 29, 2014, the U.S. Food and Drug Administration ("FDA") issued a complete response letter for the New Drug Application ("NDA") of IXINITY. The complete response letter requested additional analyses of data from completed studies and noted deficiencies in the chemistry, manufacturing, and controls section of the license application, all of which must be resolved before approval can be granted by FDA. We determined the FDA's response to our NDA is a potential indicator of impairment of the related IXINITY IPR&D asset. However, we have not yet completed our interim impairment assessment. We have determined the potential range of impairment could be from zero to the carrying value of the IXINITY IPR&D asset.

### ***Inventory Step-up***

As part of the preliminary purchase price allocation with respect to the Cangene acquisition, management determined that acquired inventory includes a \$6.2 million adjustment to record inventory at fair value, referred to as a step-up adjustment. The \$6.2 million step-up was estimated to be amortized through cost of product sales and contract manufacturing over the next five years based on estimated inventory turnover, which will increase costs of product sales and contract manufacturing during such period.



## **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on our financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. During the six months ended June 30, 2014, there have been no significant changes to our summary of significant accounting policies, contained in the our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the Securities and Exchange Commission, or SEC, except for additions to our accounting policy for revenue recognition related to the Cangene acquisition.

### **Revenue Recognition**

We recognize revenues from product sales if four basic criteria have been met:

- there is persuasive evidence of an arrangement;
- delivery has occurred or title has passed to our customer;
- the fee is fixed or determinable; and
- collectibility is reasonably assured.

All revenues from product sales are recorded net of applicable allowances for sales returns, rebates, special promotional programs, and discounts. We estimate allowances for deductions from revenue using a combination of information received from third parties including market data, inventory reports from major wholesalers, historical information and analysis. These estimates are subject to the inherent limitations of estimates that rely on third-party data, as certain third-party information may itself rely on estimates and reflect other limitations. Provisions for estimated rebates and other allowances, such as discounts and promotional and other credits, are estimated based on historical payment experience, historical relationship to revenues, estimated customer inventory levels and contract terms, and actual discounts offered. Management believes that such provisions are determinable because of the limited number of assumptions involved and the consistency of historical experience.

We market and sell our Biosciences products through commercial wholesalers (direct customers) who purchase the products at a price referred to as the wholesale acquisition cost, or WAC. Additionally, we enter into agreements with indirect customers for a contracted price that is less than the WAC. The indirect customers, such as group-purchasing organizations, physician practice-management groups and hospitals, purchase the Company's products from the wholesalers. Under these agreements with the wholesalers, we guarantee that it will credit them for the difference between the WAC and the indirect customers' contracted price. This credit is referred to as a chargeback. Wholesalers provide detailed information regarding indirect customer purchases as part of the justification for their credit request. Once received by us, these requests are standardized and tracked within a software system that adjudicates and reconciles all indirect claims coming from wholesalers. The database with these claims is used for historical trending and estimating future indirect sales, which are used to estimate accruals. Adjustments to these provisions are made periodically to reflect new facts and circumstances that may indicate that historical experience may not be indicative of current and/or future results. We make subjective judgments primarily based on its evaluation of current market conditions and trade inventory levels related to the products. This evaluation may result in an increase or decrease in the experience rate that is applied to current and future sales, or as an adjustment to past sales, or both. We estimate allowances for revenue-reducing obligations such as rebates, special promotional programs, and discounts, using a combination of historical trends, contractual obligations and information received from third parties. The accuracy of these estimates is dependent upon the inherent limitations of extrapolating estimates from historical trends and upon the quality of the third-party information.

## **Results of Operations**

### ***Three Months ended June 30, 2014 Compared to Three Months ended June 30, 2013***

#### ***Revenues***

Product sales revenues increased by \$12.7 million, or 19%, to \$78.3 million for the three months ended June 30, 2014 from \$65.6 million for the three months ended June 30, 2013. Product sales revenue included:

- BioThrax - \$67.5 million for the three months ended June 30, 2014 as compared to \$65.6 million for the three months ended June 30, 2013;
- RSDL (acquired in August 2013) - \$1.5 million for the three months ended June 30, 2014;
- WinRho (acquired in February 2014) - \$6.3 million for the three months ended June 30, 2014;
- HepaGam (acquired in February 2014) - \$2.2 million for the three months ended June 30, 2014; and
- Other products (acquired in February 2014) - \$770,000 for the three months ended June 30, 2014.

BioThrax product sales revenues during the three months ended June 30, 2014 consisted of sales to the CDC of \$65.7 million and aggregate international and other sales of \$1.8 million. Product sales revenues during the three months ended June 30, 2013 consisted of BioThrax sales to the CDC of \$65.6 million and aggregate international and other sales of \$28,000.

Contract manufacturing (which we acquired in February 2014) revenue was \$9.2 million for the three months ended June 30, 2014. Contract manufacturing revenues primarily consists of contract services to third parties.

Contracts and grants revenues increased by \$6.0 million, or 36%, to \$22.9 million for the three months ended June 30, 2014 from \$16.8 million for the three months ended June 30, 2013. The increase in contracts and grants revenues was primarily due to the following:

- development funding of \$6.3 million for BAT (acquired in February 2014);
- development funding of \$4.5 million for AIG (acquired in February 2014); and
- increased revenue of \$1.6 million for NuThrax, due to the timing of clinical trial activities.

These increases were partially offset by:

- decreased revenue of \$4.8 million from 2013 related to the establishment of our CIADM, primarily due to a license fee milestone achieved in 2013; and

- decreased revenue of \$2.8 million under our development contracts for PreviThrax and large scale manufacturing of BioThrax, primarily due to the timing of development efforts.

#### **Cost of Product Sales and Contract Manufacturing**

Cost of product sales and contract manufacturing increased by \$17.6 million, or 104%, to \$34.5 million for the three months ended June 30, 2014 from \$16.9 million for the three months ended June 30, 2013. The increase was primarily attributable to the following:

- RSDL (acquired in August 2013) - \$3.1 million for the three months ended June 30, 2014; and
- product and contract manufacturing costs associated with revenues acquired as part of the Cangene acquisition (acquired in February 2014) - \$14.4 million for the three months ended June 30, 2014.

#### **Research and Development Expenses**

Research and development expenses increased by \$7.1 million, or 24%, to \$37.4 million for the three months ended June 30, 2014 from \$30.3 million for the three months ended June 30, 2013. This increase primarily reflects higher contract service costs, and includes increased expenses of \$3.6 million for product candidates and manufacturing development categorized in the Biodefense segment, increased expenses of \$2.2 million for product candidates and technology platform development activities categorized in the Biosciences segment and increased expenses of \$1.3 million in other research and development, which are in support of central research and development activities. Net of development contract and grant reimbursements along with the net loss attributable to noncontrolling interests, we incurred research and development expenses of \$14.5 million and \$13.3 million, during the three months ended June 30, 2014 and 2013, respectively.

Our principal research and development expenses for the three months ended June 30, 2014 and 2013 are shown in the following table:

(in thousands)	Three Months ended June 30,	
	2014	2013
<b>Biodefense:</b>		
Large-scale manufacturing for BioThrax	\$ 4,250	\$ 4,004
BioThrax related programs	2,055	2,764
PreviThrax	2,506	3,791
NuThrax	2,148	2,084
Botulinum antitoxin	3,017	-
Anthrax immune globulin	3,391	-
Pandemic influenza (1)	-	2,500
Other Biodefense	3,192	1,805
Total Biodefense	20,559	16,948
<b>Biosciences:</b>		
ES414 (formerly T-Scorp)	3,373	1,833
IXinity	2,915	-
otlertuzumab (formerly TRU-016)	1,950	7,022
Tuberculosis vaccine	-	279
Other Biosciences	6,122	2,986
Total Biosciences	14,360	12,120
Other	2,482	1,210
<b>Total</b>	<b>\$ 37,401</b>	<b>\$ 30,278</b>

The spending for our large-scale manufacturing for BioThrax was primarily due to the timing of manufacturing development activities. The decrease in spending for BioThrax related programs was primarily related to the timing of clinical studies to support applications for label expansion for BioThrax. The decrease in spending for PreviThrax was primarily due to the timing of non-clinical studies. The spending for NuThrax was primarily for clinical trial activities. The spending for our Botulinum Antitoxin program (which we acquired from Cangene) was primarily due to plasma collection services and stability testing. The spending for our Anthrax Immune Globulin program (which we acquired from Cangene) was due to plasma collection services. The decrease in spending for pandemic influenza was related to a license fee for the rights to manufacture and sell pandemic influenza products during 2013. The increase in spending for our other Biodefense activities was primarily due to increased spending related to manufacturing development.

The increase in spending for our ES414 (formerly T-Scorp) product candidate was primarily due to manufacturing development. The spending for our IXINITY product candidate in 2014 was primarily for clinical trial activities. The decrease in spending for our otlertuzumab (formerly TRU-016) product candidate was primarily related to the timing of clinical trial activities. The spending for our tuberculosis vaccine product candidate during 2013 was for manufacturing development activities. The increase in spending for our other Biosciences activities was primarily due to increased costs associated with the development of platform technologies along with costs associated with programs acquired in our acquisition of Cangene.

The spending for other research and development activities was primarily due to centralized research and development activities attributable to product candidates.

#### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased by \$10.1 million, or 49%, to \$30.6 million for the three months ended June 30, 2014 from \$20.5 million for the three months ended June 30, 2013. This increase includes additional post-acquisition selling, general and administrative costs of \$7.2 million associated with the operations of Cangene and in support of RSDL.

Selling, general and administrative expenses attributable to the Biodefense segment increased by \$2.6 million, or 18%, to \$17.4 million during the three months ended June 30, 2014 from \$14.8 million during the three months ended June 30, 2013. Selling, general and administrative expenses related to our Biosciences segment increased by \$7.5 million, or 130%, to \$13.2 million for the three months ended June 30, 2014 from \$5.7 million for the three months ended June 30, 2013.

### ***Total Other Income (Expense)***

Total net other income (expense) decreased by \$393,000 to a net other expense of \$368,000 for the three months ended June 30, 2014, from a net other income of \$25,000 for the three months ended June 30, 2013. The decrease was primarily due to interest expense from our 2.875% Convertible Senior Notes due 2021, or the Notes, of \$1.3 million that was not capitalized in 2014 and \$381,000 of loan fee amortization expense associated with the Notes and our revolver loan facility, partially offset by \$1.4 million in rental income.

### ***Income Taxes***

Provision for income taxes decreased by \$1.9 million, or 44%, to \$2.5 million for the three months ended June 30, 2014 from \$4.4 million for the three months ended June 30, 2013. The decrease in the provision for income taxes is primarily due to the \$7.4 million decrease in our income before provision for income taxes and the net loss attributable to noncontrolling interest.

### ***Net Loss Attributable to Noncontrolling Interest***

Net loss attributable to noncontrolling interest decreased to \$0 during the three months ended June 30, 2014 from \$128,000 for three months ended June 30, 2013. The decrease resulted from the liquidation of the Oxford Emergent Tuberculosis Consortium in 2014.

### ***Six months ended June 30, 2014 Compared to Six ended June 30, 2013***

#### ***Revenues***

Product sales revenues increased by \$18.1 million, or 19%, to \$114.0 million for the six months ended June 30, 2014 from \$96.0 million for the six months ended June 30, 2013. Product revenue included:

- BioThrax - \$92.0 million for 2014 as compared to \$96.0 million for 2013;
- RSDL (acquired in August 2013) - \$9.0 million for 2014;
- WinRho (acquired in February 2014) - \$8.0 million for 2014;
- HepaGam (acquired in February 2014) - \$3.5 million for 2014; and
- Other products (acquired in February 2014) - \$1.5 million for 2014.

The decrease in BioThrax sales was primarily due to a 7% decrease in the number of doses of BioThrax delivered, attributable to the timing of deliveries to the SNS. BioThrax product sales revenues during the six months ended June 30, 2014 consisted of sales to the CDC of \$90.1 million and aggregate international and other sales of \$1.9 million. Product sales revenues during the three months ended June 30, 2013 consisted of BioThrax sales to the CDC of \$94.9 million and aggregate international and other sales of \$1.1 million.

Contract manufacturing revenue was \$11.9 million for the six months ended June 30, 2014. Contract manufacturing revenues primarily consists of contract services to third parties.

Contracts and grants revenues increased by \$8.7 million, or 29%, to \$38.3 million for the six months ended June 30, 2014 from \$29.6 million for the six months ended June 30, 2013. The increase in contracts and grants revenues was primarily due to the following:

- development funding of \$9.4 million for BAT (which we acquired in February 2014);
- development funding of \$5.3 million for AIG (which we acquired in February 2014);
- a payment of \$1.9 million received in 2014 for our PEP indication for BioThrax related to the progress of development activities; and
- increased revenue of \$1.4 million for NuThrax, due to the timing of clinical trial activities.

These increases were partially offset by;

- decreased revenue related to the establishment of our CIADM of \$3.7 million, primarily due to a license fee milestone achieved in 2013; and
- decreased revenue of \$6.3 million under our development contracts for PreviThrax and large scale manufacturing of BioThrax, primarily due to the timing of development efforts.

### ***Cost of Product Sales and Contract Manufacturing***

Cost of product sales and contract manufacturing increased by \$30.9 million, or 136%, to \$53.5 million for the six months ended June 30, 2014 from \$22.6 million for the six months ended June 30, 2013. The increase was primarily attributable to the following:

- RSDL (acquired in August 2013) - \$7.6 million for the six months ended June 30, 2014; and
- product and contract manufacturing costs associated with revenues acquired as part of the Cangene acquisition (acquired in February 2014) - \$21.3 million for the six months ended June 30, 2014.

### ***Research and Development Expenses***

Research and development expenses increased by \$6.7 million, or 11%, to \$67.7 million for the six months ended June 30, 2014 from \$61.0 million for the six months ended June 30, 2013. This increase primarily reflects higher contract service costs, and includes increased expenses of \$3.6 million for product candidates and manufacturing development categorized in the Biodefense segment, increased expenses of \$2.0 million for product candidates and technology platform development activities categorized in the Biosciences segment, and increased expenses of \$1.1 million in other research and development, which are in support of central research and development activities. Net of development contract and grant reimbursements along with the net loss attributable to noncontrolling interests, we incurred research and development expenses of \$29.4 million and \$30.6 million, during the six months ended June 30, 2014 and 2013, respectively.

Our principal research and development expenses during the six months ended June 30, 2014 and 2013 are shown in the following table:

(in thousands)	Six Months ended June 30,	
	2014	2013
<b>Biodefense:</b>		
Large-scale manufacturing for BioThrax	\$ 7,739	\$ 8,730
BioThrax related programs	4,379	5,557
PreviThrax	5,034	8,030
NuThrax	4,555	4,332
Botulinum antitoxin	3,663	-
Anthrax immune globulin	4,091	-
Pandemic influenza	-	2,500
Other Biodefense	6,754	3,492
Total Biodefense	<u>36,215</u>	<u>32,641</u>
<b>Biosciences:</b>		
ES414 (formerly T-Scorp)	7,871	3,865
IXINITY	4,162	-
otlertuzumab (formerly TRU-016)	5,195	11,649
Tuberculosis vaccine	-	4,185
Other Biosciences	9,959	5,523
Total Biosciences	<u>27,187</u>	<u>25,222</u>
Other	4,255	3,139
<b>Total</b>	<u>\$ 67,657</u>	<u>\$ 61,002</u>

The decrease in spending for our large-scale manufacturing for BioThrax was primarily due to the timing of manufacturing development activities. The decrease in spending for BioThrax related programs was primarily related to the timing of clinical studies to support applications for label expansion for BioThrax. The decrease in spending for PreviThrax was primarily due to the timing of stability and non-clinical studies. The spending for NuThrax was primarily due to clinical trial activities. The spending for our Botulinum Antitoxin program (which we acquired from Cangene) was primarily due to plasma collection services and stability testing. The spending for our Anthrax Immune Globulin program (which we acquired from Cangene) was due to plasma collection services. The decrease in spending for pandemic influenza was related to a license fee for the rights to manufacture and sell pandemic influenza products during 2013. The increase in spending for our other Biodefense activities was primarily due to increased spending related to manufacturing development.

The increase in spending for our ES414 (formerly T-Scorp) product candidate was primarily due to manufacturing development. The spending for our IXINITY product candidate in 2014 was primarily for clinical trial activities. The decrease in spending for our otlertuzumab (formerly TRU-016) product candidate was primarily related to the timing of clinical trial activities. The spending for our tuberculosis vaccine product candidate during 2013 was for manufacturing development activities. The increase in spending for our other Biosciences activities was primarily due to increased costs associated with the development of platform technologies along with costs associated with programs acquired in our acquisition of Cangene.

The spending for other research and development activities was primarily due to centralized research and development activities not attributable to product candidates.

#### ***Selling, General and Administrative Expenses***

Selling, general and administrative expenses increased by \$20.1 million, or 50%, to \$60.6 million for the six months ended June 30, 2014 from \$40.5 million for the six months ended June 30, 2013. This increase included increased spending for professional services of \$5.0 million associated with the acquisition and integration of Cangene, which we acquired in February 2014, along with additional post-acquisition selling, general and administrative costs of \$11.1 million associated with the operations of Cangene and in support of RSDL.

Selling, general and administrative expenses attributable to the Biodefense segment increased by \$5.5 million, or 19%, to \$34.3 million during the six months ended June 30, 2014 from \$28.7 million during the six months ended June 30, 2013. The increase in Biodefense selling, general and administrative expense was primarily due to post acquisition costs associated with our acquisitions of RSDL and Cangene. Selling, general and administrative expenses related to our Biosciences segment increased by \$14.6 million, or 124%, to \$26.4 million during the six months ended June 30, 2014 from \$11.8 million during the six months ended June 30, 2013. The increase in the Biosciences selling, general and administrative expense was due to professional services to support due diligence along with other acquisition-related activities and post-acquisition operations associated with our acquisition of Cangene.

#### ***Total Other Income (Expense)***

Total net other income (expense) decreased by \$3.4 million to a net other expense of \$3.4 million for the six months ended June 30, 2014, from a net other income of \$54,000 for the six months ended June 30, 2013. The decrease was primarily due to interest expense from our Notes of \$2.8 million that was not capitalized in 2014, \$1.8 million of costs associated with the termination of our \$125 million term loan facility and \$699,000 of loan fee amortization expense associated with Notes and our revolver loan facility, partially offset by \$1.9 million in rental income.

#### ***Income Taxes***

Provision for (benefit from) income taxes increased by \$5.6 million to a benefit from income taxes of \$5.7 million for the six months ended June 30, 2014 from a provision for income taxes of \$135,000 for the six months ended June 30, 2013. The increase in the benefit from income taxes was primarily due to the \$23.2 million increase in our loss before provision for income taxes and the loss attributable to noncontrolling interests. The estimated effective annual tax rate for the six months ended June 30, 2014 and 2013 was approximately 26% and 30%, respectively. The reduction in the estimated effective tax rate was primarily due to an increase in tax credits associated with research and development activities. The provision for (benefit from) income taxes for the six months ended June 30, 2013 includes a one-time discrete reduction in tax expense of approximately \$823,000 associated with the 2012 research and development tax credit that was recorded in 2013 due to the legislation extending the credit not being signed into law until January 2013.

## Net Loss Attributable to Noncontrolling Interest

Net loss attributable to noncontrolling interest decreased to \$0 for the six months ended June 30, 2014 from \$871,000 for for the six months ended June 30, 2013. The decrease resulted from the liquidation of our noncontrolling interest in the Oxford Emergent Tuberculosis Consortium during the six months ended June 30, 2014.

## Liquidity and Capital Resources

### Sources of Liquidity

We have funded our cash requirements from inception through June 30, 2014 principally with a combination of revenues from BioThrax product sales, debt financings, development funding from government entities and non-government and philanthropic organizations and collaborative partners, the net proceeds from our initial public offering and the sale of our common stock upon exercise of stock options. We have operated profitably for each of the five years ended December 31, 2013.

As of June 30, 2014, we had cash and cash equivalents of \$168.1 million. Additionally, at June 30, 2014, our accounts receivable balance was \$78.3 million.

### Cash Flows

The following table provides information regarding our cash flows for the six months ended June 30, 2014 and 2013:

(in thousands)	Six Months ended June 30,	
	2014	2013
Net cash provided by (used in):		
Operating activities(1)	\$ (18,424)	\$ 28,245
Investing activities	(187,567)	(14,123)
Financing activities	194,783	455
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>\$ (11,208)</b>	<b>\$ 14,577</b>

(1) Includes the effect of exchange rates on cash and cash equivalents.

Net cash used in operating activities of \$18.4 million for the six months ended June 30, 2014 was primarily due to our net loss attributable to Emergent BioSolutions Inc. of \$15.2 million, a decrease in income taxes of \$10.4 million related to timing differences, and a decrease in accounts payable of \$10.4 million, primarily due to acquisition related activities, partially offset by a non-cash charge of \$15.3 million for depreciation and amortization.

Net cash provided by operating activities of \$28.2 million for the six months ended June 30, 2013 was principally due to a decrease in accounts receivable of \$41.7 million related to the timing of collection of amounts billed primarily to the CDC, non-cash charges of \$5.7 million for stock-based compensation and \$8.4 million for depreciation and amortization, partially offset by a decrease in net income taxes of \$8.1 million related to timing differences and a decrease in accrued compensation of \$7.1 million primarily related to the payment of 2012 bonuses.

Net cash used in investing activities of \$187.6 million for the six months ended June 30, 2014 was primarily due to the acquisition of Cangene for \$178.2 million, which is net of \$43.6 million of acquired cash, and capital expenditures of \$9.4 million for infrastructure and equipment investments.

Net cash used in investing activities of \$14.1 million for the six months ended June 30, 2013 was primarily due to capital expenditures, and includes construction and renovation of facilities at our Lansing, Michigan campus, and costs of other infrastructure and equipment investments.

Net cash provided by financing activities of \$194.8 million for the six months ended June 30, 2014 was primarily due to proceeds from our convertible debenture of \$250.0 million, of which \$241.7 million (net of \$8.3 million of transaction costs) was from our Notes, \$10.0 million in proceeds from the issuance of common stock pursuant to employee equity plans and \$5.2 million in excess tax benefits from the exercise of stock options, partially offset by a principal payment on indebtedness of \$62.0 million under our revolving credit facility.

Net cash provided by financing activities of \$455,000 for the six months ended June 30, 2013 was primarily due to \$1.8 million in excess tax benefits from the exercise of stock options and \$933,000 in proceeds from employee equity plans, partially offset by principal payments on indebtedness of \$2.2 million.

### Contractual Obligations

The following table summarizes our contractual obligations at June 30, 2014:

(in thousands)	Payments due by period				
	Total	Less than 1 year	1 to 3 Years	4 to 5 Years	More than 5 years
<b>Contractual obligations:</b>					
Convertible debt	\$ 250,000	\$ -	\$ -	\$ -	\$ 250,000
Long-term indebtedness including current portion	1,000	-	-	-	1,000
Operating lease obligations	3,816	2,880	866	70	-
<b>Total contractual obligations</b>	<b>\$ 254,816</b>	<b>\$ 2,880</b>	<b>\$ 866</b>	<b>\$ 70</b>	<b>\$ 251,000</b>

There are a number of uncertainties that we face in the development of new product candidates that prevent us from making a reasonable estimate of the cash obligations under our license agreements. Because of these uncertainties, the preceding table excludes contingent contractual payments that we may become obligated to make under such agreements. These agreements typically provide for the payment of milestone fees upon achievement of specified research, development and commercialization milestones, such as the commencement of clinical trials, the receipt of funding awards, the receipt of regulatory approvals, and the achievement of sales milestones. The amount of contingent contractual milestone payments that we may become obligated to make is

variable based on the actual achievement and timing of the applicable milestones and the characteristics of any products or product candidates that are developed, including factors such as number of products or product candidates developed, type and number of components of each product or product candidate, ownership of the various components and the specific markets affected, and the aggregate payments could be as much as approximately \$118 million. The success of our efforts to commercialize our product candidates depends on many factors, including those set forth in "*Risk Factors—Our business depends on our success in developing and commercializing our product candidates. If we are unable to commercialize these product candidates, or experience significant delays or unanticipated costs in doing so, our business would be materially affected.*" and is highly uncertain. Even if these efforts are successful, the timing of success is highly unpredictable and variable. The same is true for any contingent contractual royalty payments that we may be obligated to make upon successful commercialization of these product candidates or for products we have acquired. We do not expect that any such payments would have an adverse effect on our financial position, operations and capital resources because, if payable, we expect that the benefits associated with the achievement of the relevant milestones or the achievement of revenue would offset the burden of making these payments. Deferred income taxes and liabilities for unrecognized income tax benefits are excluded from the above table since they are not contractually fixed as to timing and amount.

### ***Debt Financing***

On January 29, 2014, we issued \$250.0 million aggregate principal amount of Notes. The Notes bear interest at a rate of 2.875% per year, payable semi-annually in arrears on January 15 and July 15 of each year, commencing July 15, 2014. The Notes mature on January 15, 2021, unless earlier purchased by us, redeemed or converted. The conversion rate is equal to 30.8821 shares of common stock per \$1,000 principal amount of notes, which is equivalent to an initial conversion price of approximately \$32.38 per share of common stock. The conversion rate is subject to adjustment upon the occurrence of certain specified events but will not be adjusted for accrued and unpaid interest.

On December 11, 2013, we entered into a senior secured credit agreement, or the Credit Agreement, with three lending financial institutions, or the Lenders, led by Bank of America, N.A., as administrative agent. The Credit Agreement originally provided for a revolving credit facility of up to \$100.0 million through December 11, 2018, or such earlier date required by the terms of the Credit Agreement, and a term loan facility of up to \$125.0 million that was to be drawn in full, if at all, on or prior to June 30, 2014. On January 29, 2014, in connection with our issuance of the Notes, the unused \$125 million term loan portion of our Credit Agreement terminated automatically in accordance with its terms. As of June 30, 2014, there was no outstanding balance under the revolving credit facility.

Our payment obligations under the Credit Agreement are secured by a lien on substantially all of our assets, including the stock of all of our subsidiaries, and the assets of the subsidiary guarantors, including mortgages over certain of their real properties, including our large-scale vaccine manufacturing facility in Lansing, Michigan and our biodefense facility in Baltimore, Maryland.

The Credit Agreement, as amended, contains affirmative and negative covenants customary for financing of this type. Negative covenants in the Credit Agreement, among other things: limit our ability to incur indebtedness and liens; dispose of assets; make investments including loans, advances or guarantees; and enter into certain mergers or similar transactions. The Credit Agreement also contains financial covenants, tested quarterly and in connection with any triggering events under the Credit Agreement that include the maintenance of: (1) a minimum consolidated debt service coverage ratio of 2.50 to 1.00, (2) a maximum consolidated leverage ratio for the measurements period ending on or prior to September 30, 2014 of 4.00 to 1.00, for the measurement period ending December 31, 2014 of 3.75 to 1.00, and thereafter of 3.50 to 1.00, (3) a maximum consolidated senior leverage ratio of 2.00 to 1.00 (when no term loan is outstanding) and (4) a minimum liquidity requirement of \$50.0 million. Upon the occurrence and continuance of an event of default under the Credit Agreement, the commitments of the lenders to make loans under the Credit Agreement may be terminated and our payment obligations under the Credit Agreement may be accelerated. The events of default under the Credit Agreement include, among others, subject in some cases to specified cure periods: payment defaults; inaccuracy of representations and warranties in any material respect; defaults in the observance or performance of covenants; bankruptcy and insolvency related defaults; the entry of a final judgment in excess of a threshold amount; change of control; and the invalidity of loan documents relating to the Credit Agreement.

### ***Funding Requirements***

We expect to continue to fund our anticipated operating expenses, capital expenditures and debt service requirements from existing cash and cash equivalents, revenues from product sales, development contract and grant funding, and our revolving credit facility and any other lines of credit we may establish from time to time. There are numerous risks and uncertainties associated with product sales and with the development and commercialization of our product candidates. We may seek additional external financing to provide additional financial flexibility. Our future capital requirements will depend on many factors, including:

- the level, timing and cost of product sales;
- the extent to which we acquire or invest in and integrate companies, businesses, products or technologies;
- the acquisition of new facilities and capital improvements to new or existing facilities;
- the payment obligations under our indebtedness;
- the scope, progress, results and costs of our development activities;
- our ability to obtain funding from collaborative partners, government entities and non-governmental organizations for our development programs;
- the costs of commercialization activities, including product marketing, sales and distribution; and
- the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other patent-related costs.

If our capital resources are insufficient to meet our future capital requirements, we will need to finance our cash needs through public or private equity or debt offerings, bank loans or collaboration and licensing arrangements. We have an effective shelf registration statement on file with the SEC that allows us to issue up to an aggregate of \$180 million of equity, debt and certain other types of securities through one or more future offerings. If we raise funds by issuing equity securities, our stockholders may experience dilution. Public or bank debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures, pursuing acquisition opportunities or declaring dividends. If we raise funds through collaboration and licensing arrangements with third parties, it may be necessary to relinquish valuable rights to our technologies or product candidates or grant licenses on terms that may not be favorable to us.

We are not restricted under the terms of the indenture governing the Notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that could have the effect of diminishing our ability to make payments on our indebtedness.

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

Our exposure to market risk is currently confined to our cash and cash equivalents and our long-term indebtedness. We currently do not hedge interest rate exposure or foreign currency exchange exposure, and the movement of foreign currency exchange rates could have an adverse or positive impact on our results of operations. We have not used derivative financial instruments for speculation or trading purposes. Because of the short-term maturities of our cash and cash equivalents, we believe that an increase in market rates would likely not have a significant impact on the realized value of our investments, but any increase in market rates would likely increase the interest expense associated with our debt.

#### **ITEM 4. CONTROLS AND PROCEDURES**

##### **Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2014. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2014, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

##### **Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting (as defined in Rule 13a-15(f)) identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act has occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management's assessment and conclusion of the effectiveness of disclosure controls and procedures and internal controls over financial reporting did not include the internal controls related to the operations acquired in the acquisition of the Healthcare Protective Products Division, or HPPD, from Bracco Diagnostics Inc., in August 2013 or the acquisition of Cangene Corporation, or Cangene, in February 2014. Included in our consolidated financial statements related to the operations of HPPD and Cangene are total assets and net assets of \$296.0 million and \$63.7 million, respectively, as of June 30, 2014 and \$49.2 million and \$7.2 million, respectively, of revenues and net loss for the six months ended June 30, 2014 for HPPD and, in the case of Cangene for the period since acquisition through June 30, 2014.

#### **PART II. OTHER INFORMATION**

##### **ITEM 1. LEGAL PROCEEDINGS**

Not applicable.

##### **ITEM 1A. RISK FACTORS**

*You should carefully consider, among other matters, the following risk factors in addition to the other information in this Quarterly Report on Form 10-Q when evaluating our business because these risk factors may have a significant impact on our business, financial condition, operating results or cash flow. If any of the risks described below or in subsequent reports we file with the SEC actually occur, they may materially harm our business, financial condition, operating results or cash flow. Additional risks and uncertainties that we have not yet identified or that we presently consider to be immaterial may also materially harm our business, financial condition, operating results or cash flow.*

##### **GOVERNMENT CONTRACTING RISKS**

***We derive the majority of our revenue from sales of BioThrax to our principal customer, the U.S. government. If the U.S. government's demand for BioThrax is reduced, our business, financial condition, operating results and cash flow could be materially harmed.***

We have derived and expect for the foreseeable future to derive the majority of our revenue from sales to the U.S. government of BioThrax, our FDA-approved anthrax vaccine. We are currently party to a contract with the Centers for Disease Control and Prevention, or CDC, for the supply of up to 44.75 million doses of BioThrax for placement into the Strategic National Stockpile, or SNS, over a five-year period ending in September 2016.

The procurement of doses of BioThrax by the CDC is subject to the availability of funding. Our existing contract with the CDC does not guarantee that funding for the procurement of doses will be made available. If the SNS priorities change, funding to procure doses of BioThrax may be limited or not available at all, and our business, financial condition and operating results would be materially harmed. The success of our business and our operating results for the foreseeable future are significantly dependent on funding for the procurement of BioThrax and the terms of our BioThrax sales to the U.S. government, including the price per dose, the number of doses and the timing of deliveries.

***Our U.S. government contracts require ongoing funding decisions by the U.S. government. Reduced or discontinued funding of these contracts, including funding implications of the federal budget sequestration provisions, could cause our business, financial condition, operating results and cash flow to suffer materially.***

Our principal customer for BioThrax, BAT, AIGIV, VIGIV and RSDL is the U.S. government. We anticipate that the U.S. government will also be a principal customer for other biodefense products that we successfully acquire or develop. Additionally, a significant portion of our revenue comes from U.S. government development contracts and grants. Over its lifetime, a U.S. government program may be implemented through the award of many different individual contracts and subcontracts. The funding for government programs is subject to Congressional appropriations, generally made on a fiscal year basis, even for programs designed to continue for several years. These appropriations can be subject to political considerations and stringent budgetary constraints. For example, sales of BioThrax supplied under our multi-year procurement contract with the CDC are subject to available funding, mostly from annual appropriations. Additionally, our government-funded development contracts typically give the U.S. government the right, exercisable in its sole

discretion, to extend these contracts for successive option periods following a base period of performance. The value of the services to be performed during these option periods may constitute the majority of the total value of the underlying contract. For example, the development contract we were awarded in September 2010 for development of PreviThrax consists of a base period of performance and exercised option periods valued at approximately \$84.5 million with remaining option periods valued at approximately \$25.8 million. If levels of government expenditures and authorizations for biodefense decrease or shift to programs in areas where we do not offer products or are not developing product candidates, or if the U.S. government otherwise declines to exercise its options under our contracts, our business, revenues and operating results would suffer.

In August 2011, Congress enacted the Budget Control Act of 2011, or BCA, committing the U.S. government to significantly reduce the federal deficit over ten years. The BCA contains provisions commonly referred to as "sequestration" which call for substantial, unspecified automatic federal spending cuts that may continue for a period of ten years. Legislation has been enacted suspending the federal debt ceiling until March 16, 2015. We cannot predict the ultimate outcome of the budget process or federal debt ceiling negotiations or whether such efforts will result in significant funding delays, cancellation of orders or possible default on obligations by the U.S. government, any of which may adversely impact our business and results of operations.

***The government contracting process is typically a competitive bidding process and involves risks and requirements that are not present in commercial contracting.***

We expect that a significant portion of our near-term business will be under government contracts and grants, which may be awarded through competitive bidding. Competitive bidding for government contracts presents a number of risks and requirements, some of which are not typically present in the commercial contracting process, including:

- the commitment of substantial time and attention of management and key employees to the preparation of bids and proposals for contracts that may not be awarded to us;
- the need to accurately estimate the resources and cost structure that will be required to perform any contract that we might be awarded;
- the possibility that we may be ineligible to respond to a request for proposal issued by the government;
- the submission by third parties of protests to our responses to requests for proposal that could result in delays or withdrawals of those requests for proposal; and
- in the event our competitors protest or challenge contract or grant awards made to us pursuant to competitive bidding, the potential that we may incur expenses or delays, and that any such protest or challenge would result in the resubmission of bids based on modified specifications, or in the termination, reduction or modification of the awarded contract.

The U.S. government may choose not to award us future contracts for the development and supply of our Biodefense products and product candidates that we are developing, and may instead award such contracts to our competitors. If we are unable to win particular contracts, we may not be able to operate in the market for products that are provided under those contracts for a number of years. Additionally, if we are unable to consistently win new contract awards over an extended period, or if we fail to anticipate all of the costs or resources that will be required to secure and, if applicable, perform such contract awards, our growth strategy and our business, financial condition and operating results could be materially and adversely affected.

***Laws and regulations affecting government contracts make it more costly and difficult for us to successfully conduct our business. Failure to comply with these laws could result in significant civil and criminal penalties and materially damage our relationship with the U.S. government.***

We must comply with numerous laws and regulations relating to the procurement, formation, administration and performance of government contracts. Among the most significant government contracting regulations that affect the business of our Biodefense division are:

- the Federal Acquisition Regulation, or FAR, and agency-specific regulations supplemental to the FAR, which comprehensively regulate the procurement, formation, administration and performance of government contracts;
- business ethics and public integrity obligations, which govern conflicts of interest and the hiring of former government employees, restrict the granting of gratuities and funding of lobbying activities and incorporate other requirements such as the Anti-Kickback Act, the Procurement Integrity Act, the False Claims Act and the Foreign Corrupt Practices Act;
- export and import control laws and regulations; and
- laws, regulations and executive orders restricting the use and dissemination of information classified for national security purposes and the exportation of certain products and technical data.

U.S. government agencies routinely audit and investigate government contractors for compliance with applicable laws and standards. If we are audited and such audit were to uncover improper or illegal activities, we could be subject to civil and criminal penalties, administrative sanctions, including suspension or debarment from government contracting and significant reputational harm.

***The amount we are paid under our fixed price government contracts is based on estimates we have made of the time, resources and expenses required for us to perform those contracts. If our actual costs exceed our estimates, we may not be able to earn an adequate return or may incur a loss under these contracts, which could harm our operating results and materially reduce our net income.***

Some of our current contracts with the U.S. Health & Human Services, or HHS, and the Department of Defense, or DoD, for the procurement of our Biodefense products are fixed price contracts. We expect that our potential future contracts with the U.S. government for our Biodefense products also may be fixed price contracts. Under a fixed price contract, we are required to deliver our products at a fixed price regardless of the actual costs we incur. Estimating costs that are related to performance in accordance with contract specifications is difficult, particularly where the period of performance is over several years. Our failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed price contract could reduce the profitability of such a contract or cause a loss, which could harm our operating results and materially reduce our net income.

***Unfavorable provisions in government contracts, some of which may be customary, may subject our business to material limitations, restrictions and uncertainties and may have a material adverse impact on our financial condition and operating results.***

Government contracts customarily contain provisions that give the U.S. government substantial rights and remedies, many of which are not typically found in commercial contracts, including provisions that allow the U.S. government to:

- terminate existing contracts, in whole or in part, for any reason or no reason;
- unilaterally reduce or modify contracts or subcontracts, including by imposing equitable price adjustments;
- cancel multi-year contracts and related orders, if funds for contract performance for any subsequent year become unavailable;



- decline, in whole or in part, to exercise an option to purchase product under a contract or renew a contract;
- claim rights to facilities or to products, including intellectual property, developed under the contract;
- require repayment of contract funds spent on construction of facilities in the event of contract default;
- take actions that result in a longer development timeline than expected;
- direct the course of a development program in a manner not chosen by the government contractor;
- suspend or debar the contractor from doing business with the government or a specific government agency;
- pursue civil or criminal remedies under acts such as the False Claims Act and False Statements Act; and
- control or prohibit the export of products.

Generally, government contracts, including our contract for procurement of BioThrax, contain provisions permitting unilateral termination or modification, in whole or in part, at the U.S. government's convenience. Under general principles of government contracting law, if the U.S. government terminates a contract for convenience, the government contractor may recover only its incurred or committed costs, settlement expenses and profit on work completed prior to the termination. If the U.S. government terminates a contract for default, the government contractor is entitled to recover costs incurred and associated profits on accepted items only and may be liable for excess costs incurred by the government in procuring undelivered items from another source. Our CDC contract for the procurement of BioThrax is, and our future U.S. government procurement and development contracts are likely to be, terminable at the U.S. government's convenience with these potential consequences.

Our U.S. government contracts grant the U.S. government the right to use technologies developed by us under the government contract or the right to share data related to our technologies, for or on behalf of the U.S. government. Under our U.S. government contracts, we might not be able to prohibit third parties, including our competitors, from accessing such technology or data, including intellectual property, in providing products and services to the U.S. government.

## COMMERCIALIZATION RISKS

***We face substantial competition, which may result in others developing or commercializing products before or more successfully than we do.***

The development and commercialization of new biopharmaceutical products is highly competitive and subject to rapid technological advances. We may face future competition with respect to our products, any products that we acquire, our current product candidates and any products we may seek to develop or commercialize in the future from other biopharmaceutical companies and governments, universities and other non-profit research organizations, who are increasingly aware of the commercial value of their research. Our competitors may develop products that are safer, more effective, more convenient or less costly than any products that we may develop or market. Our competitors may devote greater resources to market or sell their products, adapt more quickly to new technologies and scientific advances, initiate or withstand substantial price competition more successfully than we can, or more effectively negotiate third-party licensing and collaborative arrangements.

There are a number of companies with biodefense products or product candidates competing with us for both U.S. government procurement and development resources. For example, in terms of additional procurement of licensed countermeasures, HHS awarded a development and SNS procurement contract to GlaxoSmithKline plc for ABThrax (raxibacumab), an anthrax monoclonal antibody therapeutic.

We believe that our most significant competitors in the hematology/oncology and transplantation markets include: Amgen Inc., Baxter International Inc., CSL Behring, a subsidiary of CSL Limited, GlaxoSmithKline plc, Grifols USA LLC and Biotest Pharmaceuticals Corporation, a subsidiary of Biotest AG.

Any reduction in demand for our products as a result of a competing product could lead to reduced revenues, reduced margins, reduced levels of profitability and loss of market share for our products. These competitive pressures could adversely affect our business and operating results.

***We rely on third parties to distribute some of our products and those third parties may not perform.***

A portion of our revenues from product sales is derived from sales through exclusive distributors in Canada and international markets. For example, in Canada, only two distributors have rights to our WinRho SDF, HepaGam B and VARIZIG products. As a result, we rely on the sales and marketing strength of these distributors and the distribution channels through which they operate for a portion of our revenues. We may not be able to retain these distribution relationships indefinitely and these distributors may not adequately support the sales, marketing and distribution efforts of our products in these significant markets. If third parties do not successfully carry out their contractual duties in maximizing the commercial potential of our products, or if there is a delay or interruption in the distribution of our products, it could negatively impact our revenue from sales of such products.

***The commercial success of our Biosciences products will depend upon the degree of market acceptance by the government, physicians, patients, healthcare payors and others in the medical community.***

Our Biosciences products may not gain or maintain market acceptance by potential government customers, physicians, patients, third-party payors and others in the medical community.

In particular, the success of our Biosciences products, including our hyperimmune specialty products, will depend upon, among other things, their acceptance by physicians, patients, third-party payors and other members of the medical community as a therapeutic and cost-effective alternative to competing products and treatments.

If any of our products do not achieve and maintain an adequate level of acceptance, we may not generate material revenues from sales of these products. The degree of market acceptance of our products will depend on a number of factors, including:

- our ability to provide acceptable evidence of safety and efficacy;
- the prevalence and severity of any side effects;
- availability, relative cost and relative efficacy of alternative and competing treatments;
- the ability to offer our products for sale at competitive prices;
- the relative convenience and ease of administration;
- the willingness of the target patient population to try new products and of physicians to prescribe these products;
- the strength of marketing and distribution support;
- publicity concerning our products or competing products and treatments; and
- the sufficiency of coverage or reimbursement by third parties.

If our products and product candidates do not become widely accepted by potential government customers, physicians, patients, third-party payors and other members of the medical community, our business, financial condition and operating results could be materially and adversely affected.

***Changes in health care systems and payer reimbursement policies could result in a decline in our potential sales and a reduction in our expected revenue from our products.***

The revenues and profitability of biopharmaceutical companies like ours may be affected by the continuing efforts of government and third-party payers to contain or reduce the costs of health care through various means. For example, in certain foreign markets, pricing or profitability of therapeutic and other pharmaceutical products is subject to governmental control. In the United States, there have been, and we expect that there will continue to be, a number of federal and state proposals to implement similar governmental control. Recent U.S. legislation, rules and regulations instituted significant changes to the U.S. healthcare system that could have a material adverse effect on our business, financial condition and profitability. We cannot predict what effects, if any, this legislation might have on our company and our products as this legislation is implemented over the next few years, nor can we predict whether additional legislative or regulatory proposals may be adopted.

In addition, in the U.S. and elsewhere, sales of therapeutic and other pharmaceutical products depend, in part, on the availability of reimbursement from third-party payers, such as government and private insurance plans. Third-party payers are increasingly challenging the prices charged for medical products and services. Third-party payers may limit access to biopharmaceutical products through the use of prior authorizations and step therapy. Any reimbursement granted may not be maintained, or limits on reimbursement available from third parties may reduce the demand for or negatively affect the price and profitability of those products. Payers may pursue aggressive cost cutting initiatives such as comparing the effectiveness, benefits and costs of similar treatments, which could result in lower reimbursement. Policies that decrease reimbursement would likely have a material adverse effect on our business, financial condition and results of operations. Our ability to successfully commercialize our products and product candidates and the demand for our products depend, in part, on the extent to which reimbursement and access is available from such third-party payers.

***Our biologic products may face risks of competition from biosimilar manufacturers.***

Competition for BioThrax, WinRho SDF, BAT, AIGIV, HepaGam B, VARIZIG and VIGIV, or our "Biologic Products," may be affected by follow-on biologics, which are also referred to as "biosimilars," in the U.S. and other jurisdictions. Regulatory and legislative activity in the U.S. and other countries may make it easier for generic drug manufacturers to manufacture and sell biological drugs similar or identical to our Biologic Products, which might affect the profitability or commercial viability of our Biologic Products. Under the Biologics Price Competition and Innovation Act of 2010, the FDA cannot approve a biosimilar application until the 12-year exclusivity period for the innovator biologic has expired. Regulators in the European Union and in other foreign jurisdictions have already approved biosimilars, although the European Medicines Agency has expressly excluded blood or plasma-derived products and their recombinant alternatives from the biosimilar pathway for a period of time. Vaccine and allergen products are considered on a case-by-case basis. The specific regulatory framework for this new approval pathway, whether the FDA will permit biosimilars for blood products and vaccines, and the extent to which an approved biosimilar would be substituted for the innovator biologic are not yet clear and will depend on many factors that are currently unknown. If a biosimilar version of one of our Biologic Products were approved, it could have a material adverse effect on the sales and gross profits of the affected Biologic Product and adversely affect our business and operating results.

***Political or social factors may delay or impair our ability to market our products and may require us to spend significant management time and financial resources to address these issues.***

Products developed to treat diseases caused by or to combat CBRN (Chemical, Biological, Radiological and Nuclear) threats are subject to changing political and social environments. The political responses and social awareness of the risks of biowarfare and bioterrorism attacks on military personnel or civilians may vary over time. Changes in the leadership of prominent terrorist networks could result in a public perception that the risk of bioterrorism is reduced. This perception, as well as political or social pressures, could delay or cause resistance to bringing our products to market or limit pricing or purchases of our products, any of which could negatively affect our revenues.

In addition, substantial delays or cancellations of purchases could result from protests or challenges from third parties. Lawsuits brought against us by third parties or activists, even if not successful, could require us to spend significant management time and financial resources defending the related litigation and could potentially damage the public's perception of us and our products. Any publicity campaigns or other negative publicity may adversely affect the degree of market acceptance of our Biodefense products and thereby limit the demand for our Biodefense products, which would adversely affect our revenues.

## **REGULATORY AND COMPLIANCE RISKS**

***Our long term success depends, in part, upon our ability to develop, receive regulatory approval for and commercialize product candidates and, if we are not successful, our business and operating results may suffer.***

Our product candidates and the activities associated with their development, including testing, manufacture, recordkeeping, storage and approval, are subject to comprehensive regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in other countries. Except under limited circumstances related to certain government sales, failure to obtain regulatory approval for a product candidate will prevent us from commercializing the product candidate. We have limited experience in preparing, filing and prosecuting the applications necessary to gain regulatory approvals and expect to rely on third-party contract research organizations and consultants to assist us in this process.

In the United States, to obtain approval from the FDA to market any of our future biologic products, we will be required to submit a biologics license application, or BLA, to the FDA. Ordinarily, the FDA requires a sponsor to support a BLA with substantial evidence of the product's safety and efficacy in treating the targeted indication based on data derived from adequate and well-controlled clinical trials, including Phase III safety and efficacy trials conducted in patients with the disease or condition being targeted.

However, NuThrax and PreviThrax are subject to a different regulatory approval pathway. Specifically, because humans are rarely exposed to anthrax toxins under natural conditions, and cannot be intentionally exposed, statistically significant efficacy for these product candidates cannot be demonstrated in humans. Instead, efficacy must be demonstrated, in part, by utilizing animal models before they can be approved for marketing. This is known as the FDA's "Animal Rule." We cannot guarantee that the FDA will permit us to proceed with licensure of NuThrax, PreviThrax or any Biodefense product candidates under the Animal Rule. Even if we are able to proceed pursuant to the Animal Rule, the FDA may decide that our data are insufficient to support approval and require additional preclinical, clinical or other studies, refuse to approve our products, or place restrictions on our ability to commercialize those products. Furthermore, products approved under the Animal Rule are subject to certain additional post-marketing requirements. For

example, to the extent feasible and ethical, manufacturers of products approved pursuant to the Animal Rule must conduct post-marketing studies, such as field studies, to verify and describe the drug's clinical benefit and to assess its safety when used as indicated. We cannot guarantee that we will be able to meet this regulatory requirement even if one or more of our product candidates is approved under the Animal Rule.

The process of obtaining these regulatory approvals is expensive, often takes many years if approval is obtained at all, and can vary substantially based upon the type, complexity and novelty of the product candidate involved. Changes in the regulatory approval process during the development period, changes in or the enactment of additional statutes or regulations, or changes in the regulatory review for a submitted product application, may cause delays in the approval or rejection of an application.

The FDA has substantial discretion in the approval process and may refuse to accept any application or may decide that our data are insufficient to support approval and require additional preclinical, clinical or other studies. In addition, varying interpretations of the data obtained from preclinical and clinical testing could delay, limit or prevent regulatory approval of a product candidate.

***Even after regulatory approval is received, if we fail to comply with regulatory requirements, or if we experience unanticipated problems with our approved products, they could be subject to restrictions, penalties or withdrawal from the market.***

Any vaccine, therapeutic product or medical device for which we obtain marketing approval, along with the manufacturing processes, post-approval clinical data, labeling, advertising and promotional activities for such product will be subject to continual requirements of and review by the FDA and other regulatory bodies. Our approved products are subject to these requirements and ongoing review. These requirements include submissions of safety and other post-marketing information and reports, registration requirements, current good manufacturing practices, or cGMP, requirements relating to quality control, quality assurance, restrictions on advertising and promotion, import and export restrictions and recordkeeping requirements. In addition, various state laws require that companies that manufacture and/or distribute drug products within the state obtain and maintain a manufacturer or distributor license, as appropriate. Because of the breadth of these laws, it is possible that some of our business activities could be subject to challenge under one or more of such laws.

The FDA enforces its cGMP and other requirements through periodic unannounced inspections of manufacturing facilities. The FDA is authorized to inspect domestic manufacturing facilities without prior notice at reasonable times and in a reasonable manner. The FDA conducts periodic inspections of our facilities. For example, our Lansing facility was inspected most recently in November 2013. Following each of these inspections, the FDA has issued inspectional observations, some of which were significant, but all of which are being addressed through corrective actions. If, in connection with any future inspection, the FDA finds that we are not in substantial compliance with cGMP requirements, or if the FDA is not satisfied with the corrective actions we take, the FDA may undertake enforcement action against us, which may include:

- warning letters and other communications;
- product seizure or withdrawal of the product from the market;
- restrictions on the marketing or manufacturing of a product;
- suspension or withdrawal of regulatory approvals or refusal to approve pending applications or supplements to approved applications;
- fines or disgorgement of profits or revenue; and
- injunctions or the imposition of civil or criminal penalties.

Similar action may be taken against us upon our failure to comply with regulatory requirements, or later discovery of previously unknown problems with our products or manufacturing processes. Even if regulatory approval of a product is granted, the approval may be subject to limitations on the indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for costly post-marketing testing and surveillance to monitor the safety or efficacy of the product. If we experience any of these post-approval events, our business, financial condition and operating results could be materially and adversely affected.

***Failure to obtain or maintain regulatory approval in international jurisdictions could prevent us from marketing our products abroad and could limit the growth of our business.***

We currently sell and intend to sell our products outside the United States. To market our products in the European Union and many other foreign jurisdictions, we may need to obtain separate regulatory approvals and comply with numerous and varying regulatory requirements. Approval by the FDA does not ensure approval by foreign regulatory authorities. The approval procedures in foreign jurisdictions can vary widely and can involve additional clinical trials and data review. We and our collaborators may not be able to obtain foreign regulatory approvals on a timely basis, if at all, and therefore we may be unable to commercialize our products internationally.

***Our international operations increase our risk of exposure to potential claims of bribery and corruption.***

As we expand our commercialization activities outside of the United States, we are subject to an increased risk of inadvertently conducting activities in a manner that violates the U.S. Foreign Corrupt Practices Act, or FCPA, the U.K. Bribery Act, Canada's Corruption of Foreign Public Officials Act, or other similar foreign laws, which prohibit corporations and individuals from paying, offering to pay, or authorizing the payment of anything of value to any foreign government official, government staff member, political party, or political candidate in an attempt to obtain or retain business or to otherwise influence a person working in an official capacity. In the course of establishing and expanding our commercial operations and seeking regulatory approvals outside of the United States, we will need to establish and expand business relationships with various third parties and will interact more frequently with foreign officials, including regulatory authorities and physicians employed by state-run healthcare institutions who may be deemed to be foreign officials under the FCPA or similar foreign laws. If our business practices outside the United States are found to be in violation of the FCPA or similar foreign laws, we and our senior management may be subject to significant civil and criminal penalties, potential debarment from public procurement and reputational damage, which could have a material adverse effect on our business, financial condition, results of operations and growth prospects.

## **MANUFACTURING RISKS**

***Our biologic products and product candidates are complex to manufacture and ship, which could cause us to experience delays in product manufacturing or development and resulting delays in revenues.***

BioThrax, WinRho SDF, BAT, AIGIV, HepaGam B, VARIZIG, VIGIV and all of our current product candidates, are biologics. Manufacturing biologic products, especially in large quantities, is complex. The products must be made consistently and in compliance with a clearly defined manufacturing process. Problems may arise during manufacturing for a variety of reasons, including problems with raw materials, equipment malfunction and

failure to follow specific protocols and procedures. In addition, slight deviations anywhere in the manufacturing process, including obtaining materials, maintaining master seed or cell banks and preventing genetic drift, seed or cell growth, fermentation, filtration, filling, labeling, packaging, storage and shipping, and quality control testing, may result in lot failures or manufacturing shut-down, delays in the release of lots, product recalls, spoilage or regulatory action. Such deviations may require us to revise manufacturing processes or change manufacturers. Additionally, as our equipment ages, it will need to be replaced. Replacement of equipment has the potential to introduce variations in the manufacturing process that may result in lot failures or manufacturing shut-down, delay in the release of lots, product recalls, spoilage or regulatory action. Success rates can also vary dramatically at different stages of the manufacturing process, which can reduce yields and increase costs. From time to time, we may experience deviations in the manufacturing process that may take significant time and resources to resolve and, if unresolved, may affect manufacturing output and could cause us to fail to satisfy customer orders or contractual commitments, lead to a termination of one or more of our contracts, lead to delays in our clinical trials, result in litigation or regulatory action against us or cause the FDA to cease releasing product until the deviations are explained and corrected, any of which could be costly to us, damage our reputation and negatively impact our business.

FDA approval is required for the release of each lot of BioThrax. We will not be able to sell any lots that fail to satisfy the release testing specifications. For example, we must provide the FDA with the results of certain tests, including potency tests, before lots are released for sale. Potency testing of each lot of BioThrax is performed against a qualified control lot that we maintain. We have one mechanism for conducting this potency testing that is reliant on a unique animal strain for which we currently have no alternative. We continually monitor the status of our control lot and periodically produce and qualify a new control lot to replace the existing control lot. If we are not able to produce and qualify a new control lot or otherwise satisfy the FDA's requirements for release of BioThrax, our ability to sell BioThrax would be impaired until such time as we become able to meet the FDA's requirements, which would significantly impact our revenues, require us to utilize our cash balances to help fund our ongoing operations and otherwise harm our business.

We are contractually required to ship our biologic products at a prescribed temperature range and variations from that temperature range could result in loss of product and could significantly impact our revenues. Delays, lot failures, shipping deviations, spoilage or other loss during shipping could cause us to fail to satisfy customer orders or contractual commitments, lead to a termination of one or more of our contracts, lead to delays in potential clinical trials or result in litigation or regulatory action against us, any of which could be costly to us and otherwise harm our business.

***We are in the process of expanding our manufacturing facilities. Delays in completing our facilities, or delays or failures in obtaining regulatory approvals for our new manufacturing facilities, could limit our ability to expand our revenues.***

We have constructed Building 55, a large-scale manufacturing facility on our Lansing, Michigan campus for which we received a development contract from BARDA in July 2010 for scale-up, qualification and validation to manufacture BioThrax. Additionally, in 2009, we acquired a facility in Baltimore, Maryland, which we intend to utilize for certain product development or manufacturing projects, including projects performed under a separate development contract from BARDA to establish a Center for Innovation in Advanced Development and Manufacturing. The process for qualifying and validating these facilities may result in unanticipated delays and may cost more than expected due to a number of factors, including regulatory requirements. The costs and time required to comply with cGMP regulations or similar foreign regulatory requirements for sales of our products may be significant. In addition, if we experience delays, we may be in breach of the obligations under our government-funded development contracts. We have experienced such delays in the past and may experience further delays in the future. If our facility licensure activities are delayed, we may not be able to utilize Building 55 to increase our production of BioThrax or manufacture product candidates in our Baltimore facility, which could significantly impact our future revenues.

***Currently, only Building 12, our manufacturing facility in Lansing, Michigan has regulatory approval to manufacture BioThrax. A significant interruption of the ability of this facility to manufacture BioThrax would reduce our revenues and materially harm our business, financial condition, operating results and cash flow.***

We currently rely on our manufacturing facility at a single location in Lansing, Michigan, Building 12, for the production of BioThrax. Any interruption in manufacturing operations at this location could result in our inability to satisfy the product demand of the U.S. government or other BioThrax customers. A number of factors could cause interruptions, including:

- equipment malfunctions or failures;
- technology malfunctions;
- cyber-attacks;
- work stoppages or slow-downs;
- protests, including by animal rights activists
- damage to or destruction of the facility; or
- product tampering.

Providers of bioterrorism countermeasures could be subject to an increased risk of terrorist activities. The U.S. government has designated both our Lansing, Michigan and our Biodefense Baltimore facility as facilities requiring additional security. Although, we continually evaluate and update security measures, there can be no assurance that any additional security measures would protect our facilities from terrorist efforts determined to disrupt our manufacturing activities.

The factors listed above could also cause disruptions at our other facilities, including our manufacturing facility in Winnipeg, Manitoba, Canada. Any such disruption, damage, or destruction of these facilities could impede our ability to manufacture our Biologic Products and our product candidates, result in losses and delays, including delay in the performance of our contractual obligations or delay in our clinical trials, any of which could be costly to us and materially harm our business, financial condition and operating results.

***If we are unable to obtain supplies for the manufacture of BioThrax or our other products and product candidates in sufficient quantities and at an acceptable cost, our ability to manufacture BioThrax or to develop and commercialize our other products and product candidates could be impaired, which could harm our revenues, lead to a termination of one or more of our contracts, lead to delays in clinical trials or otherwise harm our business.***

We depend on certain single-source suppliers for materials and services necessary for the manufacture of BioThrax and our other products and product candidates. For example, we rely on a single-source supplier to provide us with Alhydrogel in sufficient quantities to meet our needs to manufacture BioThrax and NuThrax. We also rely on single-source suppliers for the sponge applicator device and the active ingredient used to make RSDL and the specialty plasma in our hyperimmune specialty plasma products. A disruption in the availability of such materials or services from these suppliers could require us to qualify and validate alternative suppliers. If we are unable to locate or establish alternative suppliers, our ability to manufacture our products and product candidates could be adversely affected and could harm our revenues, cause us to fail to satisfy contractual commitments, lead to a termination of one or more of our contracts or lead to delays in our clinical trials, any of which could be costly to us and otherwise harm our business, financial condition

and operating results.

***We are currently dependent on third-party manufacturers for the manufacture of RSDL and episil®. Certain of our third-party manufacturers currently constitute the sole source supplier for these products, and we have and will continue to have limited control over the manufacturing process and costs of these products.***

Third-party manufacturers currently supply a significant amount of RSDL and episil® pursuant to contractual arrangements. Certain manufacturers currently constitute the sole source for RSDL and episil®. For example, E-Z-EM Canada Inc. (dba Therapex) is our sole source manufacturer for RSDL. Because of contractual restraints and the lead-time necessary to obtain FDA approval of a new manufacturer, replacement of any of these manufacturers may be expensive and time consuming and may cause interruptions in our supply of these products to our customers.

We have a limited ability to control the manufacturing process or costs related to the third-party manufacture of our products. Increases in the prices we pay our manufacturers, interruptions in the supply of our products or lapses in quality could adversely impact our margins, profitability and cash flows. We are reliant on our third-party manufacturers to maintain the facilities at which they manufacture our products in compliance with all FDA and other applicable regulatory requirements. If these manufacturers fail to maintain compliance with FDA or other applicable regulatory requirements, they could be ordered to cease manufacturing, which could have a materially adverse impact on our revenues and operating results.

We may be forced to consider entering into additional manufacturing arrangements with other third-party manufacturers. In each case, we will incur significant costs and time in obtaining the regulatory approvals for these third-party facilities and in taking the necessary steps to prepare these third parties for the manufacture of our products.

***Our operations, including our use of hazardous materials, chemicals, bacteria and viruses, require us to comply with regulatory requirements and expose us to significant potential liabilities.***

Our operations involve the use of hazardous materials, including chemicals, bacteria, viruses and radioactive materials, and may produce dangerous waste products. Accordingly, we, along with the third parties that conduct clinical trials on and manufacture our products and product candidates on our behalf are subject to federal, state, local and foreign laws and regulations that govern the use, manufacture, distribution, storage, handling, exposure, disposal and recordkeeping with respect to these materials. Under the Federal Select Agent Program, pursuant to the Public Health Security and Bioterrorism Preparedness and Response Act, we are required to register with and be inspected by the CDC and the Animal and Plant Health Inspection Service if we have in our possession, or if we use or transfer select biological agents or toxins that could pose a threat to public health and safety, to animal or plant health or to animal or plant products. This legislation requires stringent safeguards and security measures for these select agents and toxins, including controlled access and the screening of entities and personnel and establishes a comprehensive national database of registered entities. We are also subject to a variety of environmental and occupational health and safety laws. Compliance with current or future laws and regulations can require significant costs and we could be subject to substantial fines and penalties in the event of noncompliance. In addition, the risk of contamination or injury from these materials cannot be completely eliminated. In such event, we could be held liable for substantial civil damages or costs associated with the cleanup of hazardous materials. From time to time, we have been involved in remediation activities and may be so involved in the future. Any related cost or liability might not be fully covered by insurance, could exceed our resources and could have a material adverse effect on our business. In addition to complying with environmental and occupational health and safety laws, we must comply with special regulations relating to biosafety administered by the CDC, HHS, U.S. Department of Agriculture and the DoD, as well as regulatory authorities in Canada.

## **PRODUCT DEVELOPMENT RISKS**

***Our business depends on our success in developing and commercializing our product candidates. If we are unable to commercialize these product candidates, or experience significant delays or unanticipated costs in doing so, our business would be materially and adversely affected.***

We have invested significant efforts and financial resources in the development of our vaccines and therapeutic product candidates and the acquisition of additional product candidates. In addition to our product sales, our ability to generate revenue is dependent on the success of our development programs, on the U.S. government's interest in providing development funding for or procuring certain of our Biodefense Division product candidates, on the interest of non-governmental organizations and other commercial entities in providing grant funding for development of certain of our Biosciences Division product candidates and on the commercial viability of our acquired or developed product candidates. The commercial success of our product candidates will depend on many factors, including accomplishing the following in an economical manner:

- successful development, formulation and cGMP scale-up of biological manufacturing that meets FDA requirements;
- successful completion of clinical or non-clinical development, including toxicology studies and studies in approved animal models;
- receipt of marketing approvals from the FDA and equivalent foreign regulatory authorities;
- establishment of commercial manufacturing processes and product supply of our own or arrangements with contract manufacturers;
- establishment and training of a commercial sales force for the product, whether alone or in collaboration with others;
- successful registration and maintenance of patent and/or other proprietary protection for our commercial products; and
- acceptance of the product by potential government customers, physicians, patients, healthcare payors and others in the medical community.

If we are delayed or prevented from developing or commercializing a product candidate in a profitable manner, or if doing so requires us to incur significant unanticipated costs, our growth could be materially and adversely affected.

***Clinical trials of product candidates are expensive and time-consuming, and their outcome is uncertain. We must invest substantial amounts of time and financial resources in these trials, which may not yield viable products.***

Before obtaining regulatory approval for the sale of our product candidates, we and our collaborative partners must conduct extensive preclinical studies and clinical trials to establish proof of concept and demonstrate the safety and efficacy of our product candidates. Preclinical and clinical testing is expensive, difficult to design and implement, can take many years to complete and is uncertain as to outcome. Success in preclinical testing and early clinical trials does not ensure that later clinical trials or animal efficacy studies will be successful, and interim results of a clinical trial or animal efficacy study do not necessarily predict final results. An unexpected result in one or more of our clinical trials can occur at any stage of testing.

For certain of our Biodefense product candidates, we expect to rely on the Animal Rule to obtain approval. The Animal Rule permits, in certain limited circumstances, the use of animal efficacy studies, together with human clinical safety and immunogenicity trials, to support an application for marketing approval. For a product approved under the Animal Rule, certain additional post-marketing requirements apply. For example, to the extent feasible

and ethical, applicants must conduct post-marketing studies, such as field studies, to verify and describe the drug's clinical benefit and to assess its safety when used as indicated. We have limited experience in the application of these rules to the product candidates that we are developing. It is possible that results from these animal efficacy studies may not be predictive of the actual efficacy of our product candidates in humans. Under the Project BioShield Act of 2004, the Secretary of HHS can contract to purchase countermeasures for the SNS prior to FDA approval of the countermeasure in specified circumstances. Project BioShield also allows the FDA commissioner to authorize the emergency use of medical products that have not yet been approved by the FDA under an Emergency Use Authorization, or EUA. If our Biodefense product candidates are not selected under this Project BioShield authority, they generally will have to be approved by the FDA through traditional regulatory mechanisms.

We may experience unforeseen events or issues during, or as a result of, preclinical testing, clinical trials or animal efficacy studies. These issues and events could delay or prevent our ability to receive regulatory approval for a product candidate and include, among others:

- our inability to manufacture sufficient quantities of materials for use in trials;
- the unavailability or variability in the number and types of subjects for each study;
- safety issues or inconclusive or incomplete testing, trial or study results;
- lack of efficacy of product candidates during the trials;
- government or regulatory restrictions or delays; and
- greater than anticipated costs of trials.

For example, in February 2013, we announced results of a Phase IIb clinical trial evaluating the safety and efficacy of MVA85A in preventing tuberculosis in infants, which indicated that a single dose of MVA85A was not sufficient to confer statistically significant protection against tuberculosis in infants. As a consequence of these results, we ceased further development work on MVA85A.

***We depend on third parties to conduct our clinical and non-clinical trials. If these third parties do not perform as contractually required or as we expect, we may not be able to obtain regulatory approval for or commercialize our product candidates and, as a result, our business may suffer.***

We do not have the ability to independently conduct the clinical and non-clinical trials required to obtain regulatory approval for our product candidates. We depend on third parties, such as independent clinical investigators, contract research organizations and other third-party service providers to conduct the clinical and non-clinical trials of our product candidates and expect to continue to do so. We rely heavily on these third parties for successful execution of our clinical and non-clinical trials, but do not exercise day-to-day control over their activities. Our reliance on these service providers does not relieve us of our regulatory responsibilities, including ensuring that our trials are conducted in accordance with good clinical practice regulations and the plan and protocols contained in the relevant regulatory application. In addition, these organizations may not complete these activities on our anticipated or desired timeframe. We also may experience unexpected cost increases that are beyond our control. Problems with the timeliness or quality of the work of a contract research organization may lead us to seek to terminate the relationship and use an alternative service provider, which may prove difficult, costly and result in a delay of our trials. Any delay in or inability to complete our trials could delay or prevent the development, approval and commercialization of our product candidates.

In certain cases, government entities and non-government organizations conduct studies of our product candidates, and we may seek to rely on these studies in applying for marketing approval for certain of our product candidates. These government entities and non-government organizations have no obligation or commitment to us to conduct or complete any of these studies or clinical trials and may choose to discontinue these development efforts at any time. Furthermore, government entities depend on annual Congressional appropriations to fund their development efforts.

If we are unable to obtain any necessary third-party services on acceptable terms or if these service providers do not successfully carry out their contractual duties or meet expected deadlines, our efforts to obtain regulatory approvals for our product candidates may be delayed or prevented.

***We may fail to select or capitalize on the most scientifically, clinically or commercially promising or profitable product candidates.***

We continue to evaluate our business strategy and, as a result, may modify our strategy in the future. In this regard, we may, from time to time, focus our product development efforts on different product candidates or may delay or halt the development of various product candidates. For example, in February 2013, as a consequence of clinical trial results, we ceased further development work on MVA85A, our tuberculosis vaccine candidate. As a result of changes in our strategy, we may change or refocus our existing product development, commercialization and manufacturing activities. This could require changes in our facilities and our personnel. Any product development changes that we implement may not be successful. In particular, we may fail to select or capitalize on the most scientifically, clinically or commercially promising or profitable product candidates. Our decisions to allocate our research and development, management and financial resources toward particular product candidates or therapeutic areas may not lead to the development of viable commercial products and may divert resources from better opportunities. Similarly, our decisions to delay or terminate product development programs may also prove to be incorrect and could cause us to miss valuable opportunities.

## **INTELLECTUAL PROPERTY RISKS**

***If we are unable to protect our proprietary rights, our business could be harmed.***

Our success, particularly with respect to the Biosciences portion of our business, will depend, in large part, on our ability to obtain and maintain protection in the U.S. and other countries for the intellectual property covering or incorporated into our technology, products and product candidates. Obtaining and maintaining this protection is very costly. The patentability of technology in the field of vaccines, therapeutics and medical devices generally is highly uncertain and involves complex legal and scientific questions.

We may not be able to obtain additional issued patents relating to our technology or products. Even if issued, patents may inadvertently lapse or be challenged, narrowed, invalidated or circumvented, which could limit our ability to stop competitors from marketing similar products or limit the duration of patent protection we may have for our products. We have in the past, and may in the future, abandon the prosecution and/or maintenance of a family of patent applications in the ordinary course of business. If these patent rights are later determined to be valuable or necessary to our business, our competitive position may be adversely affected. Changes in patent laws or administrative patent office rules or changes in interpretations of patent laws in the U.S. and in other countries may diminish the value of our intellectual property or narrow the scope of our patent protection, or result in costly defensive measures.

The cost of litigation to uphold the validity of patents to prevent infringement or to otherwise protect or enforce our proprietary rights could be substantial, and from time to time our patents are subject to opposition proceedings. Some of our competitors may be better able to sustain the costs of complex patent litigation because they may have substantially greater financial resources. Intellectual property lawsuits are expensive and unpredictable and

would consume management's time and attention and other resources, even if the outcome were successful. In addition, there is a risk that a court would decide that our patents are not valid and that we do not have the right to stop the other party from using the inventions covered by or incorporating them. There is also a risk that, even if the validity of a patent were upheld, a court would refuse to stop the other party from using the invention(s), including on the grounds that its activities do not infringe the patent. If any of these events were to occur, our business, financial condition and operating results could be materially and adversely affected.

Our collaborators and licensors may not adequately protect our intellectual property rights. These third parties may have the first right to maintain or defend our intellectual property rights and, although we may have the right to assume the maintenance and defense of our intellectual property rights if these third parties do not do so, our ability to maintain and defend our intellectual property rights may be compromised by the acts or omissions of these third parties. For example, we license an oligonucleotide adjuvant, CPG 7909, for use in NuThrax from Pfizer. One of the licensed U.S. patents related to CPG 7909 has been revoked by the U.S. Patent and Trademark Office, as a result of a patent interference between Pfizer and a third party.

We also will rely on current and future trademarks to establish and maintain recognized brands. If we fail to acquire and protect such trademarks, our ability to market and sell our products, and therefore our business, financial condition and operating results, could be materially and adversely affected.

***Third parties may choose to file patent infringement claims against us; defending ourselves from such allegations would be costly, time-consuming, distracting to management and could be materially adverse to our business.***

Our development and commercialization activities, as well as any product candidates or products resulting from these activities, may infringe or be claimed to infringe patents and other intellectual property rights of third parties under which we do not hold sufficient licenses or other rights. Additionally, third parties may be successful in obtaining patent protection for technologies that cover development and commercialization activities in which we are already engaged. Third parties may own or control these patents and intellectual property rights in the U.S. and abroad. These third parties may have substantially greater financial resources than us and could bring claims against us that would cause us to incur substantial expenses to defend against these claims and, if successful against us, could cause us to pay substantial damages. Further, if a patent infringement or other similar suit were brought against us, we could be forced to stop or delay development, manufacturing or sales of the product or product candidate that is the subject of the suit. Intellectual property litigation in the biopharmaceutical industry is common, and we expect this trend to continue.

As a result of patent infringement or other similar claims, or to avoid potential claims, we may choose or be required to seek a license from the third party and be required to pay license fees or royalties or both. These licenses may not be available on acceptable terms, or at all. Even if we were able to obtain a license, the rights may be non-exclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be prevented from commercializing a product, or be forced to cease some aspect of our business operations, if, as a result of actual or threatened patent infringement claims, we are unable to enter into licenses on acceptable terms, if at all, or if an injunction is granted against us, which could harm our business significantly.

***If we fail to comply with our obligations in our intellectual property licenses with third parties, we could lose license rights that are important to our business.***

We are a party to a number of license agreements and expect to enter into additional license agreements in the future. Our existing licenses impose, and we expect future licenses will impose, various diligence, milestone payment, royalty, insurance and other obligations on us. If we fail to comply with these obligations, the licensor may have the right to terminate the license and/or sue us for breach, in which event we might not be able to market any product that is covered by the licensed patents and may be subject to damages.

***If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected.***

In addition to patented technology, we rely upon unpatented proprietary technology, processes and know-how, particularly as to our proprietary manufacturing processes. Because we do not have patent protection for any of our current products, our only intellectual property protection for these products, other than trademarks, is confidentiality regarding our manufacturing capability and specialty know-how, such as techniques, processes and unique starting materials. However, these types of trade secrets can be difficult to protect. We seek to protect this confidential information, in part, through agreements with our employees, consultants and third parties as well as confidentiality policies and audits, although these may not be successful in protecting our trade secrets and confidential information.

These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known, including through a potential cyber security breach, or may be independently developed by competitors. If we are unable to protect the confidentiality of our proprietary information and know-how, competitors may be able to use this information to develop products that compete with our products, which could adversely impact our business.

## **RISKS RELATED TO STRATEGIC ACQUISITIONS AND COLLABORATIONS**

***Our strategy of generating growth through acquisitions may not be successful.***

Our business strategy includes growing our business through acquisition and in-licensing transactions. We may not be successful in identifying, effectively evaluating, acquiring or in-licensing, and developing and commercializing additional products on favorable terms, or at all. Competition for attractive product opportunities is intense and may require us to devote substantial resources, both managerial and financial, to an acquisition opportunity. A number of more established companies are also pursuing strategies to acquire or in-license products in the vaccine and therapeutic field. These companies may have a competitive advantage over us due to their size, cash resources and greater clinical development and commercialization capabilities.

Acquisition efforts can consume significant management attention and require substantial expenditures, which could detract from our other programs. In addition, we may devote significant resources to potential acquisitions that are never completed. Even if we are successful in acquiring a product or company, it may not result in a successfully developed or commercialized product or, even if an acquired product is commercialized, competing products or technologies could render a product noncompetitive, uneconomical or obsolete. Moreover, the cost of acquiring other companies or in-licensing products could be substantial, and in order to acquire companies or new products, we may need to incur substantial debt or issue dilutive securities. For example, in part to fund our acquisition of Cangene Corporation, we issued \$250 million of senior convertible notes in January 2014. If we are unsuccessful in our efforts to acquire other companies or in-license and develop additional products, or if we acquire or in-license unproductive assets, it could have a material adverse effect on the growth of our business.

***Our failure to successfully integrate acquired assets into our operations, including our recent acquisitions of Cangene Corporation and the Healthcare Protective Products Division from Bracco Diagnostics Inc., could adversely affect our business.***

We may not be able to integrate any acquired business successfully, including our recent acquisitions of Cangene Corporation and the Healthcare Protective Products Division from Bracco Diagnostics Inc., or operate any acquired business profitably. In addition, cost synergies, if achieved at all, may be less than we expect, or may take greater time to achieve than we anticipate.

Issues that could delay or prevent successful integration or cost synergies of an acquired business include, among others:

- retaining existing customers and attracting new customers;
- retaining key employees;
- diversion of management attention and resources;
- conforming internal controls, policies and procedures, business cultures and compensation programs;
- consolidating corporate and administrative infrastructures;
- consolidating sales and marketing operations;
- identifying and eliminating redundant and underperforming operations and assets;
- assumption of known and unknown liabilities;
- coordinating geographically dispersed organizations; and
- managing tax costs or inefficiencies associated with integrating operations.

If we are unable to successfully integrate the Cangene acquisition, the Healthcare Protective Products Division from Bracco Diagnostics Inc. or future acquisitions with our existing businesses, we may not obtain the advantages that the acquisitions were intended to create, which may materially adversely affect our business and our ability to develop and introduce new products.

***We may not be successful in establishing and maintaining collaborations to leverage our capabilities to develop and commercialize our product candidates.***

For each of our product candidates, including otlertuzumab (Humanized Anti-CD37 therapeutic) (formerly known as TRU-016), we plan to evaluate the merits of entering into collaboration arrangements with leading biopharmaceutical companies or non-governmental organizations. We expect to selectively pursue collaboration arrangements with collaborators that have particular technology, expertise or resources for the development or commercialization of our product candidates or for accessing particular markets. We face, and will continue to face, significant competition in seeking appropriate partners for our product candidates. If we are unable to identify partners whose capabilities complement and integrate well with ours and reach collaboration arrangements with such partners on acceptable terms, or if the arrangements we establish are unproductive for us, we may fail to meet our business objectives for the particular product candidate.

Any collaboration that we enter into may not be successful and the success of our collaboration arrangements will depend heavily on the efforts and activities of our collaborators. It is likely that our collaborators will have significant discretion in determining the efforts and resources that they will apply to these collaborations.

The risks that we are subject to in any of our collaborations include the following, among others:

- our collaborators may not commit adequate resources to the development, marketing and distribution of any collaboration products, limiting our potential revenues from these products;
- our collaborators may experience financial difficulties and may therefore be unable to meet their commitments to us;
- our collaborators may pursue a competing product candidate developed either independently or in collaboration with others, including our competitors; and
- our collaborators may terminate our relationship.

For example, our previous collaborative partner Pfizer Inc. terminated its collaboration with us for the development of SBI-087 following a portfolio reprioritization process in 2012. As a result, we experienced a charge of \$9.6 million in 2012 attributable to impairment of our SBI-087 in-process research and development asset. Similarly, our previous collaborative partner Abbott Laboratories terminated its collaboration with us for the development of otlertuzumab (formerly TRU-016) following a similar portfolio reprioritization process.

Failure of any of our future collaborative partners to perform as expected could place us at a competitive disadvantage and adversely affect us financially, including delay and increased costs of development, loss of market opportunities, lower than expected revenues and impairment of the value of the related product candidate.

## **FINANCIAL RISKS**

***Servicing our debt requires a significant amount of cash, and we may not have sufficient cash flow from our operations to pay our substantial debt.***

As of July 31, 2014, our total consolidated indebtedness was \$251 million, including \$250 million of our obligations under our senior convertible notes. Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the senior convertible notes, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not continue to generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

***Our current indebtedness and any additional debt financing may restrict the operation of our business and limit the cash available for investment in our business operations.***

In addition to our current debt, we also have a senior secured revolving credit facility with available capacity of up to \$100 million effective until December 11, 2018 (or such earlier date to the extent required by the terms of this facility). We may seek additional debt financing to support our ongoing



activities or to provide additional financial flexibility. Debt financing could have significant adverse consequences for our business, including:

- requiring us to dedicate a substantial portion of any cash flow from operations to payment on our debt, which would reduce the amounts available to fund other corporate initiatives;
- increasing the amount of interest that we have to pay on debt with variable interest rates, if market rates of interest increase;
- subjecting us, as under our senior secured revolving credit facility, to restrictive covenants that may reduce our ability to take certain corporate actions, acquire companies, products or technology, or obtain further debt financing;
- requiring us to pledge our assets as collateral, which could limit our ability to obtain additional debt financing;
- limiting our flexibility in planning for, or reacting to, general adverse economic and industry conditions; and
- placing us at a competitive disadvantage compared to our competitors that have less debt, better debt servicing options or stronger debt servicing capacity.

We may not have sufficient funds or be able to obtain additional financing to pay the amounts due under our indebtedness. In addition, failure to comply with the covenants under our debt instruments could result in an event of default under those instruments. An event of default could result in the acceleration of amounts due under a particular debt instrument and a cross default and acceleration under other debt instruments, and we may not have sufficient funds or be able to obtain additional financing to make any accelerated payments. Under these circumstances, our lenders could seek to enforce security interests, if any, in our assets securing our indebtedness.

***We may require significant additional funding and may be unable to raise capital when needed or on acceptable terms, which would harm our business, results of operations and financial condition.***

We may require significant additional funding to acquire other companies or products, in-license and develop additional products, enhance our manufacturing capacity, support commercial marketing activities or otherwise provide additional financial flexibility. We may also require additional funding to support our ongoing operations in the event that our ability to sell BioThrax to the U.S. government is interrupted for an extended period of time, reducing our BioThrax revenues and decreasing our cash balances.

As of June 30, 2014, we had approximately \$246.4 million of cash, cash equivalents and accounts receivable. Our future capital requirements will depend on many factors, including, among others:

- the level, timing and cost of product sales;
- the extent to which we acquire or invest in companies, businesses, products or technologies;
- the acquisition of new facilities and capital improvements to new or existing facilities;
- the payment obligations under our indebtedness;
- the scope, progress, results and costs of our development activities;
- our ability to obtain funding from collaborative partners, government entities and non-governmental organizations for our development programs; and
- the costs of commercialization activities, including product marketing, sales and distribution.

If our capital resources are insufficient to meet our future capital requirements, we will need to finance our cash needs through public or private equity or debt offerings, bank loans or collaboration and licensing arrangements. We have an effective shelf registration statement on file with the Securities and Exchange Commission, effective until June 2015 that allows us to issue up to an aggregate of \$180 million of equity, debt and certain other types of securities through one or more future offerings. If we raise funds by issuing equity securities, our stockholders may experience dilution. Public or bank debt financing, if available, may involve agreements that include covenants, like those contained in our senior secured revolving credit facility, limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures, pursuing acquisition opportunities or declaring dividends. If we raise funds through collaboration and licensing arrangements with third parties, it may be necessary to relinquish valuable rights to our technologies or product candidates or grant licenses on terms that may not be favorable to us. We are not restricted under the terms of the indenture governing our senior convertible notes from incurring additional debt, securing existing or future debt, recapitalizing our debt or taking a number of other actions that could have the effect of diminishing our ability to make payments on our indebtedness.

Current economic conditions may make it difficult to obtain financing on attractive terms, or at all. If financing is unavailable or lost, our business, results of operations and financial condition would be adversely affected and we could be forced to delay, reduce the scope of or eliminate many of our planned activities.

***We may not maintain profitability in future periods or on a consistent basis.***

Although we have been profitable for each of the last five fiscal years, we have not been profitable for every quarter during that time. For example, we incurred a net loss in the first quarters of 2014, 2013 and 2012. Our profitability has been substantially dependent on BioThrax product sales, which historically have fluctuated significantly from quarter to quarter, and we expect that they will continue to fluctuate significantly based primarily on the timing of our fulfillment of orders from the U.S. government. Additionally, our profitability may be adversely affected as we progress through various stages of ongoing or planned clinical trials for our product candidates. We may not be able to achieve consistent profitability on a quarterly basis or sustain or increase profitability on an annual basis.

## **OTHER BUSINESS RISKS**

***We face product liability exposure, which could cause us to incur substantial liabilities and negatively affect our business, financial condition and results of operations.***

We face an inherent risk of product liability exposure related to the sale of our products, any other products that we successfully acquire or develop and the testing of our product candidates in clinical trials.

One measure of protection against such lawsuits is coverage under the Public Readiness and Emergency Preparedness Act, or PREP Act, which was signed into law in December 2005. The PREP Act creates immunity for manufacturers of biodefense countermeasures when the Secretary of HHS issues a declaration for their manufacture, administration or use. A PREP Act declaration is meant to provide immunity from all claims under federal or state law for loss arising out of the administration or use of a covered countermeasure. The Secretary of HHS has issued PREP Act declarations identifying BioThrax, BAT, AIGIV and VIGIV as covered countermeasures. Manufacturers are not entitled to protection under the PREP Act in cases of willful misconduct. We cannot

predict whether the Secretary of HHS will renew the declarations when they expire, whether Congress will fund the relevant PREP Act compensation programs, or whether the necessary prerequisites for immunity would be triggered with respect to our products or product candidates

Additionally, BioThrax and RSDL are certified anti-terrorism products covered under the protections of the Support Anti-Terrorism by Fostering Effective Technology Act of 2002, or SAFETY Act. The SAFETY Act creates product liability limitations for qualifying anti-terrorism technologies for claims arising from or related to an act of terrorism. Although we are entitled to the benefits of the SAFETY Act for BioThrax and RSDL, the SAFETY Act may not provide adequate protection from claims made against us.

If we cannot successfully defend ourselves against future claims that our products or product candidates caused injuries and if we are not entitled to indemnity by the U.S. government, or the U.S. government does not honor its obligations to us under the PREP Act or SAFETY Act, or if the indemnification under the PREP Act and SAFETY Act is not adequate to cover all claims, we may incur substantial liabilities. Regardless of merit or eventual outcome, product liability claims may result in:

- decreased demand or withdrawal of a product;
- injury to our reputation;
- withdrawal of clinical trial participants;
- costs to defend the related litigation;
- substantial monetary awards to trial participants or patients;
- loss of revenue; and
- an inability to commercialize products that we may develop.

The amount of insurance that we currently hold may not be adequate to cover all liabilities that may occur. Further product liability insurance may be difficult and expensive to obtain. We may not be able to maintain insurance coverage at a reasonable cost and we may not be able to obtain insurance coverage that will be adequate to satisfy all potential liabilities. For example, we may not have sufficient insurance against potential liabilities associated with a possible large scale deployment of BioThrax as a countermeasure to a bioterrorism threat. We rely on PREP Act protection for BioThrax, BAT, AIGIV and VIGIV and SAFETY Act protection for BioThrax and RSDL in addition to our insurance coverage to help mitigate our product liability exposure for these products. Claims or losses in excess of our product liability insurance coverage could have a material adverse effect on our business, financial condition and results of operations.

***We may incur losses associated with foreign currency fluctuations.***

With our acquisition of Cangene Corporation, we expect to incur a significant Canadian-dollar denominated expense in our Canadian operations. Our net income may be materially affected directly by exchange-rate fluctuations as net income from Canadian operations is translated into U.S. dollars for reporting purposes.

***We rely significantly on information technology systems and any failure, inadequacy, interruption or security lapse of that technology, including any cyber security incidents, could harm our ability to operate our business effectively or result in data leakage of proprietary and confidential business and employee information.***

Our business is increasingly dependent on critical, complex and interdependent information technology systems, including Internet-based systems, to support business processes as well as internal and external communications. The size and complexity of our computer systems make them potentially vulnerable to interruption, invasion, computer viruses, destruction, malicious intrusion and additional related disruptions which may result in the impairment of production and key business processes.

In addition, our systems are potentially vulnerable to data security breaches—whether by employee error, malfeasance or other disruption—which may expose sensitive data to unauthorized persons. Such data security breaches could lead to the loss of trade secrets or other intellectual property, or could lead to the public exposure of personal information, including sensitive personal information, of our employees, clinical trial patients, customers and others.

A significant business disruption or a breach in security resulting in misappropriation, theft or sabotage with respect to our proprietary and confidential business and employee information could result in financial, legal, business or reputational harm to us, any of which could adversely affect our business, financial condition and operating results.

***Our success is dependent on our continued ability to attract, motivate and retain key personnel. If we fail to attract or retain key personnel, we may be unable to maintain or expand our business.***

Because of the specialized scientific nature of our business, our ability to develop products and to compete with our current and future competitors largely depends upon our ability to attract, retain and motivate highly qualified managerial and key scientific and technical personnel. If we lose the services of one or more of the principal members of senior management or other key employees, our ability to implement our business strategy could be materially harmed. We face intense competition for qualified employees from biopharmaceutical companies, research organizations and academic institutions. Attracting, retaining or replacing these personnel on acceptable terms may be difficult and time-consuming given the high demand in our industry for similar personnel. We believe part of being able to attract, motivate and retain personnel is our ability to offer a competitive compensation package, including equity incentive awards. If we cannot offer a competitive compensation package or otherwise attract and retain the qualified personnel necessary for the continued development of our business, we may not be able to maintain our operations or grow our business.

## **RISKS RELATED TO OWNERSHIP OF OUR COMMON STOCK**

***Fuad El-Hibri, executive chairman of our Board of Directors, has significant influence over us through his significant beneficial ownership of our common stock, including an ability to significantly influence the election of the members of our Board of Directors, or delay or prevent a change of control of us.***

Mr. El-Hibri has the ability to significantly influence the election of the members of our Board of Directors due to his significant beneficial ownership of our common stock. As of July 31, 2014, Mr. El-Hibri was the beneficial owner of approximately 16% of our outstanding common stock. Because of Mr. El-Hibri's significant beneficial ownership of our common stock, Mr. El-Hibri also has the ability to delay or prevent a change of control of us that may be favored by other directors or stockholders and otherwise exercise substantial control over all corporate actions requiring board or stockholder approval, including any amendment of our certificate of incorporation or by-laws. The control by Mr. El-Hibri may prevent other stockholders from influencing significant corporate decisions. In addition, Mr. El-Hibri's significant beneficial ownership of our shares could present the potential for a conflict

of interest.

***Provisions in our certificate of incorporation and by-laws and under Delaware law may discourage acquisition proposals, delay a change in control or prevent transactions that stockholders may consider favorable.***

Provisions of our certificate of incorporation and by-laws may discourage, delay or prevent a merger, acquisition or other changes in control that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares. These provisions may also prevent or frustrate attempts by our stockholders to replace or remove our management.

These provisions include:

- the classification of our directors;
- limitations on changing the number of directors then in office;
- limitations on the removal of directors;
- limitations on filling vacancies on the board;
- limitations on the removal and appointment of the chairman of our Board of Directors;
- advance notice requirements for stockholder nominations of candidates for election to the Board of Directors and other proposals;
- the inability of stockholders to act by written consent;
- the inability of stockholders to call special meetings; and
- the ability of our Board of Directors to designate the terms of and issue a new series of preferred stock without stockholder approval.

The affirmative vote of holders of our capital stock representing at least 75% of the voting power of all outstanding stock entitled to vote is required to amend or repeal the above provisions of our certificate of incorporation. The affirmative vote of either a majority of the directors present at a meeting of our Board of Directors or holders of our capital stock representing at least 75% of the voting power of all outstanding stock entitled to vote is required to amend or repeal our by-laws.

In addition, Section 203 of the General Corporation Law of Delaware prohibits a corporation from engaging in a business combination with an interested stockholder, generally a person which together with its affiliates owns or within the last three years has owned 15% or more of the corporation's voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Accordingly, Section 203 may discourage, delay or prevent a change in control of us.

***Our stockholder rights plan could prevent a change in control of us in instances in which some stockholders may believe a change in control is in their best interests.***

Under our stockholder rights plan, we issue to each of our stockholders one preferred stock purchase right for each outstanding share of our common stock. Each right, when exercisable, will entitle its holder to purchase from us a unit consisting of one one-thousandth of a share of series A junior participating preferred stock at a purchase price of \$150 in cash, subject to adjustments.

Our stockholder rights plan is intended to protect stockholders in the event of an unfair or coercive offer to acquire us and to provide our Board of Directors with adequate time to evaluate unsolicited offers. The rights plan may have anti-takeover effects. The rights plan will cause substantial dilution to a person or group that attempts to acquire us on terms that our Board of Directors does not believe are in our best interests or those of our stockholders and may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares.

***Our stock price is volatile and purchasers of our common stock could incur substantial losses.***

Our stock price has been, and is likely to continue to be, volatile. The market price of our common stock could fluctuate significantly for many reasons, including in response to the risks described in this "Risk Factors" section, or for reasons unrelated to our operations, such as reports by industry analysts, investor perceptions or negative announcements by our customers, competitors or suppliers regarding their own performance, as well as industry conditions and general financial, economic and political instability. From November 15, 2006, when our common stock first began trading on the New York Stock Exchange, through July 31, 2014, our common stock has traded as high as \$28.48 per share and as low as \$4.40 per share. The stock market in general and the market for biopharmaceutical companies in particular have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. The market price of our common stock may be influenced by many factors, including, among others:

- decisions and procurement policies by the U.S. government affecting BioThrax;
- the success of competitive products or technologies;
- results of clinical and non-clinical trials of our product candidates;
- announcements of acquisitions, collaborations, financings or other transactions by us;
- public concern as to the safety of our products;
- termination or delay of a development program;
- the recruitment or departure of key personnel;
- variations in our product revenue and profitability; and
- the other factors described in this "Risk Factors" section.

***Because we have no current intention to pay dividends in the foreseeable future, investors will benefit from an investment in our common stock only if it appreciates in value.***

We currently do not anticipate paying dividends on our common stock in the foreseeable future. Our senior secured credit facility and any future debt agreements that we enter into may limit our ability to pay dividends. As a result, capital appreciation, if any, of our common stock will be the sole source of gain for our stockholders for the foreseeable future.

***A significant portion of our shares may be sold into the market at any time. This could cause the market price of our common stock to drop significantly.***

Sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales or the perception in the market that the holders of a large number of shares intend to sell shares could reduce the market price of our common stock. Moreover, holders of an aggregate of

approximately 6 million shares of our common stock outstanding as of July 31, 2014, have the right to require us to register these shares of common stock under specified circumstances. In 2012, the SEC declared effective our shelf registration statement that included registration of up to 3 million of these shares to be sold by these holders from time to time.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

**Recent Sales of Unregistered Securities**

Not applicable.

**Use of Proceeds**

Not applicable.

**Purchases of Equity Securities**

Not applicable.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

Not applicable.

**ITEM 6. EXHIBITS**

The exhibits required to be filed by Item 601 of Regulation S-K are listed in the Exhibit Index immediately preceding the exhibits hereto.

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**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.

**EMERGENT BIOSOLUTIONS INC.**

By: /s/ Daniel J. Abdun-Nabi  
Daniel J. Abdun-Nabi  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 7, 2014

By: /s/ Robert G. Kramer  
Robert G. Kramer  
Chief Financial Officer and Treasurer  
(Principal Financial and Accounting Officer)

Date: August 7, 2014

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## EXHIBIT INDEX

Exhibit Number	Description
10	Third Amended and Restated Emergent BioSolutions Inc. 2006 Stock Incentive Plan (incorporated by reference to Appendix A to the Company's definitive proxy statement on Schedule 14A filed with the Securities and Exchange Commission on April 7, 2014).
12#	Ratio of Earnings to Fixed Charges.
31.1#	Certification of the Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a).
31.2#	Certification of the Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a).
32.1#	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2#	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Presentation Linkbase Document

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language):

- (i) Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014 and June 30, 2013;
- (ii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2014 and 2013;
- (iii) Condensed Consolidated Balance Sheets at June 30, 2014 and December 31, 2013;
- (iv) Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013; and
- (v) Notes to Consolidated Financial Statements.

In Accordance with Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed filed for purposes of Section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.

#Filed herewith.

(in thousands)	Ratio of Earnings to Fixed Charges					
	Period Ended	Year Ended December 31,				
	June 30, 2014	2013	2012	2011	2010	2009
Pretax income (loss) from continuing operations (1)	\$ (20,947)	\$ 37,446	\$ 38,849	\$ 77,880	\$ 46,110	\$ 32,737
Fixed charges						
Interest expensed	3,814	2,177	1,719	1,778	1,797	3,032
Debt issuance cost	2,531	67	135	113	159	54
Total fixed charges (2)	6,345	2,244	1,854	1,891	1,956	3,086
Noncontrolling interest in pretax income (3)	-	5,381	6,906	4,514	4,599	724
Capitalized interest (4)	1,050	2,171	1,713	1,796	1,790	3,023
Earnings ((1) + (2) -(3) -(4))	(15,652)	32,138	32,084	73,461	41,677	32,076
Fixed charges	6,345	2,244	1,854	1,891	1,956	3,086
Ratio of earnings to fixed charges	(2.5)	14.3	17.3	38.8	21.3	10.4

## CERTIFICATION

I, Daniel J. Abdun-Nabi certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Emergent BioSolutions Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information, and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2014

/s/DANIEL J. ABDUN-NABI

Daniel J. Abdun-Nabi  
Chief Executive Officer



## CERTIFICATION

I, Robert G. Kramer certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Emergent BioSolutions Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information, and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 7, 2014

/s/ROBERT G. KRAMER  
Robert G. Kramer  
Chief Financial Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Emergent BioSolutions Inc. (the "Company") for the period ended June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Daniel Abdun-Nabi, Chief Executive Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 7, 2014

/s/DANIEL J. ABDUN-NABI  
Daniel J. Abdun-Nabi  
Chief Executive Officer

CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of Emergent BioSolutions Inc. (the "Company") for the period ended June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned, Robert Kramer, Chief Financial Officer of the Company, hereby certifies, pursuant to 18 U.S.C. Section 1350, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 7, 2014

/s/ROBERT G. KRAMER

Robert G. Kramer  
Chief Financial Officer

