Emergent BioSolutions Inc.
Form 10-Q
August 05, 2011

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

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

OR

o 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	14-1902018
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2273 Research Boulevard, Suite 400 Rockville, Maryland	20850
(Address of Principal Executive Offices)	(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. þ Yes o 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).
þ Yes o 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):

o Large accelerated filer þ Accelerated filer o Non-accelerated filer o 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). o Yes þ No

As of July 29, 2011, the registrant had 35,850,658 shares of common stock outstanding.

Emergent BioSolutions Inc.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This quarterly report on Form 10-Q and the documents incorporated by reference herein contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended, that involve substantial risks and uncertainties. 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. The words “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “plan,” “predict,” “project,” “will,” “wou expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words.

These forward-looking statements include, among other things, statements about:

- our ability to perform under our contracts with the U.S. government related to BioThrax® (Anthrax Vaccine Adsorbed), our FDA-approved anthrax vaccine, including the timing of deliveries;
- our plans for future sales of BioThrax, including our ability to obtain new contracts or modifications to existing contracts with the U.S. government;
- our plans to pursue label expansions and other improvements for BioThrax;
- our ability to perform under our development contract with the U.S. government for our product candidate PreviThraxTM (Recombinant Protective Antigen Anthrax Vaccine, Purified);
- 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 plans to expand our manufacturing facilities and capabilities;
- the rate and degree of market acceptance of our products and product candidates;
- the success of preclinical studies and clinical trials of our product candidates and post-approval clinical utility of our products;
- our ongoing and planned development programs, preclinical studies and clinical trials;
- our ability to identify and acquire or in-license products and product candidates that satisfy our selection criteria;
- our ability to successfully integrate and develop the products or product candidates, programs, operations and personnel of any entities or businesses that we acquire;
- the potential benefits of our existing collaborations and our ability to selectively enter into additional collaborative arrangements;
- the timing of and our ability to obtain and maintain regulatory approvals for our products and product candidates;
- our commercialization, marketing and manufacturing capabilities and strategy;
- our intellectual property portfolio; and
- our estimates regarding expenses, future revenues, capital requirements and needs for additional financing.

We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements, and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements we make. We have included important factors in the cautionary statements included in this quarterly report, particularly in the “Risk Factors” section, that we believe could cause actual results or events to differ materially from the forward-looking statements that we make. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make.

You should read this quarterly report, including the documents that we have incorporated by reference herein or filed as exhibits hereto, completely and with the understanding that our actual future results may be materially different from what we expect. We disclaim any obligation to update any forward-looking statements.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	June 30, 2011	December 31, 2010
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	$122,094	$169,019
Investments	5,048	2,029
Accounts receivable	47,263	39,326
Inventories	17,262	12,722
Deferred tax assets, net	7,082	2,638
Income tax receivable, net	17,136	8,728
Restricted cash	217	217
Prepaid expenses and other current assets	7,742	8,814
Total current assets	223,844	243,493
Property, plant and equipment, net	172,481	152,701
In-process research and development	51,400	51,400
Goodwill	5,029	5,029
Assets held for sale	12,548	12,741
Deferred tax assets, net	27,970	33,757
Other assets	712	1,198
Total assets	$493,984	$500,319
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$32,182	$25,409
Accrued expenses and other current liabilities	1,200	1,309
Accrued compensation	13,823	23,975
Contingent value rights, current portion	9,734	-
Long-term indebtedness, current portion	10,229	17,187
Deferred revenue, current portion	5,336	7,839
Total current liabilities	72,504	75,719
Contingent value rights, net of current portion	6,206	14,532
Long-term indebtedness, net of current portion	29,074	30,239
Deferred revenue, net of current portion	2,953	4,386
Other liabilities	2,017	1,882
Total liabilities	112,754	126,758
Commitments and contingencies	-	-

Stockholders’ equity:		
Preferred stock, $0.001 par value; 15,000,000 shares authorized, 0 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	-	-
Common stock, $0.001 par value; 100,000,000 shares authorized, 35,850,658 and 35,011,423 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	36	35
Additional paid-in capital	213,320	197,689
Accumulated other comprehensive loss	(2,771)	(2,110)
Retained earnings	166,663	173,850
Total Emergent BioSolutions Inc. stockholders' equity	377,248	369,464
Noncontrolling interest in subsidiaries	3,982	4,097
Total stockholders’ equity	381,230	373,561
Total liabilities and stockholders’ equity	$493,984	$500,319

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,	
	2011	2010	2011	2010
	(Unaudited)		(Unaudited)	
Revenues:				
Product sales	$71,479	$55,872	$77,076	$94,725
Contracts and grants	16,662	6,266	29,598	14,213
Total revenues	88,141	62,138	106,674	108,938
Operating expenses:				
Cost of product sales	16,069	11,076	17,137	18,584
Research and development	31,481	18,602	66,240	38,524
Selling, general and administrative	20,384	17,649	38,596	33,841
Income (loss) from operations	20,207	14,811	(15,299)	17,989
Other income (expense):				
Interest income	24	376	59	764
Interest expense	(6)	(2)	(6)	(7)
Other income (expense), net	(39)	6	(40)	(2)
Total other income (expense)	(21)	380	13	755
Income (loss) before provision for (benefit from) income taxes	20,186	15,191	(15,286)	18,744
Provision for (benefit from) income taxes	7,663	5,757	(4,636)	7,392
Net income (loss)	12,523	9,434	(10,650)	11,352
Net loss attributable to noncontrolling interests	1,687	374	3,463	979
Net income (loss) attributable to Emergent BioSolutions Inc.	$14,210	$9,808	$(7,187)	$12,331
Earnings per share - basic	$0.40	$0.32	$(0.20)	$0.40
Earnings per share - diluted	$0.39	$0.31	$(0.20)	$0.39
Weighted-average number of shares - basic	35,619,514	31,097,445	35,400,906	30,989,308
Weighted-average number of shares - diluted	36,667,452	31,900,000	35,400,906	31,666,976

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

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

	Six Months Ended June 30,	
	2011	2010
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	$(10,650)	$11,352
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Stock-based compensation expense	5,150	3,363
Depreciation and amortization	4,514	2,646
Deferred income taxes	3,129	3,437
Non-cash development expenses from variable interest entities	3,348	185
Impairment of long-lived assets	193	1,029
Change in fair value of contingent value rights	1,408	-
Excess tax benefits from stock-based compensation	(1,786)	(709)
Other	43	(29)
Changes in operating assets and liabilities:		
Accounts receivable	(7,937)	9,107
Inventories	(4,540)	(3,595)
Income taxes	(8,408)	(6,214)
Prepaid expenses and other assets	1,557	159
Accounts payable	(766)	4,151
Accrued expenses and other liabilities	26	(329)
Accrued compensation	(10,152)	(3,346)
Deferred revenue	(3,936)	(14)
Net cash (used in) provided by operating activities	(28,807)	21,193
Cash flows from investing activities:		
Purchases of property, plant and equipment	(16,795)	(8,631)
Proceeds from maturity of investments	2,250	-
Purchase of investments	(5,269)	-
Net cash used in investing activities	(19,814)	(8,631)
Cash flows from financing activities:		
Proceeds from borrowing on line of credit	-	15,000
Issuance of common stock subject to exercise of stock options	8,695	2,784
Principal payments on long-term indebtedness and line of credit	(8,123)	(31,621)
Excess tax benefits from stock-based compensation	1,786	709
Net cash provided by (used in) financing activities	2,358	(13,128)
Effect of exchange rate changes on cash and cash equivalents	(662)	(165)
Net increase (decrease) in cash and cash equivalents	(46,925)	(731)
Cash and cash equivalents at beginning of period	169,019	102,924
Cash and cash equivalents at end of period	$122,094	$102,193

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 of the Securities and Exchange Commission. 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, 2010, as filed with the Securities and Exchange Commission.

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, 2011, results of operations for the three and six month periods ended June 30, 2011 and 2010, and cash flows for the six month periods ended June 30, 2011 and 2010. Interim results are not necessarily indicative of results that may be expected for any other interim period or for an entire year.

Earnings per share

Basic net income (loss) per share of common stock excludes dilution for potential common stock issuances and is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted net income (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except share and per share data)	2011	2010	2011	2010
Numerator:				
Net income (loss)	$14,210	$9,808	$(7,187)	$12,331
Denominator:				
Weighted-average number of shares—basic	35,619,514	31,097,445	35,400,906	30,989,308
Dilutive securities—equity awards	1,047,938	802,555	-	677,668
Weighted-average number of shares—diluted	36,667,452	31,900,000	35,400,906	31,666,976
Earnings per share-basic	$0.40	$0.32	$(0.20)	$0.40

Earnings per share-diluted	$0.39	$0.31	$(0.20)	$0.39

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 month periods ended June 30, 2011 and 2010, approximately 719,000 and 2.0 million options, respectively, along with 2.1 million options for the six month period ended June 30, 2011 were excluded from the calculation. These options were excluded because the exercise prices were in excess of the average per share closing price.

For the six month period ended June 30, 2011, approximately 4.0 million shares were excluded form the calculation of diluted earnings per share because the net loss attributable to Emergent BioSolutions Inc. would make these awards antidilutive.

Accounting for stock-based compensation

As of June 30, 2011, the Company has two stock-based employee compensation plans, the Amended and Restated Emergent BioSolutions Inc. 2006 Stock Incentive Plan (the "2006 Plan") and the Emergent BioSolutions Employee Stock Option Plan (the "2004 Plan" and together with the 2006 Plan, the "Emergent Plans"). The Company has granted options to purchase shares of common stock under the Emergent Plans, and has granted restricted stock units under the 2006 Plan.

The Company determines the fair value of restricted stock units using the closing market price of the Company's common stock on the day prior to the date of grant. The Company utilizes the Black-Scholes valuation model for estimating the fair value of all stock options granted. The fair value of each option is estimated on the date of grant. Set forth below are the assumptions used in valuing the stock options granted and a discussion of the Company's methodology for developing each of the assumptions used:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Expected dividend yield	0%	0%	0%	0%
Expected volatility	60%	55%	60%	55%
Risk-free interest rate	0.93%-0.97%	1.24%-1.36%	0.93%-1.04%	1.24%-1.46%
Expected average life of options	3.7 years	3.8 years	3.4 years	3.4 years

- Expected dividend yield — the Company does not pay regular dividends on its common stock and does not anticipate paying any dividends in the foreseeable future.
- Expected volatility — a measure of the amount by which a financial variable, such as share price, has fluctuated (historical volatility) or is expected to fluctuate (implied volatility) during a period. The Company analyzed its own historical volatility to estimate expected volatility over the same period as the expected average life of the options.
- Risk-free interest rate — the range of U.S. Treasury rates with a term that most closely resembles the expected life of the option as of the date on which the option is granted.
- Expected average life of options — the period of time that options granted are expected to remain outstanding, based primarily on the Company's expectation of optionee exercise behavior subsequent to vesting of options.

Comprehensive income (loss)

Comprehensive income (loss) is comprised of net income (loss) attributable to Emergent BioSolutions Inc. and other changes in equity that are excluded from net income (loss) attributable to Emergent BioSolutions Inc. The Company includes gains and losses on intercompany transactions with foreign subsidiaries that are considered to be long-term investments and translation gains and losses incurred when converting its subsidiaries' financial statements from their

functional currency to the U.S. dollar in accumulated other comprehensive income (loss). Comprehensive income for the three months ended June 30, 2011 was $14.2 million. Comprehensive loss for the six months ended June 30, 2011 was $7.8 million. Comprehensive income for the three and six months ended June 30, 2010 was $9.4 million and $12.2 million, respectively.

2. Inventories

Inventories consist of the following:

(in thousands)	June 30, 2011	December 31, 2010
Raw materials and supplies	$ 2,171	$ 2,311
Work-in-process	11,872	7,917
Finished goods	3,219	2,494
Total inventories	$ 17,262	$ 12,722

3. Fair value measurements

The Company measures and records cash equivalents and investment securities considered available-for-sale at fair value in the accompanying financial statements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability, an exit price, in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value include:

Level 1 — Observable inputs for identical assets or liabilities such as quoted prices in active markets;
Level 2 — Inputs other than quoted prices in active markets that are either directly or indirectly observable; and
Level 3 — Unobservable inputs in which little or no market data exists, which are therefore developed by the Company using estimates and assumptions that reflect those that a market participant would use.

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

	At June 30, 2011			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investment in money market funds (1)	$82,897	$-	$-	$82,897
U.S. Treasury securities (2)	-	5,048	-	5,048
Total assets	$82,897	$5,048	$-	$87,945
Liabilities:				
Contingent value rights	$-	$-	$15,940	$15,940
Total liabilities	$-	$-	$15,940	$15,940

	At December 31, 2010			
(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				
Investment in money market funds (1)	$102,360	$-	$-	$102,360
U.S. Treasury securities (2)	-	2,029	-	2,029
Total assets	$102,360	$2,029	$-	$104,389

Liabilities:				
Contingent value rights	$-	$-	$14,532	$14,532
Total liabilities	$-	$-	$14,532	$14,532

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

The fair value of U.S. Treasury securities (Level 2) is obtained from an independent pricing service and is based on recent sales of similar securities and other observable market data.

The fair value of the Contingent Value Right ("CVR") obligations is based on management's assessment of certain development and collaboration milestones, which are inputs that have no observable market (Level 3). The obligation is measured using a discounted cash flow model. For the six months ended June 30, 2011, the changes in the fair value of the CVR obligations resulted from an adjustment to the discount rates and a update to the estimated timing of achievement for certain development milestones. For the three and six months ended June 30, 2011, the Company recorded charges to adjust the CVRs to fair value of $827,000 and $1.4 million, respectively. These charges are classified in the Company's statement of operations as research and development expense within the Company's biosciences segment.

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) for the six months ended June 30, 2011. There were no Level 3 assets or liabilities at June 30, 2010.

(in thousands)	
Balance at January 1, 2010	$-
Fair value of CVRs issued	14,532
Expense (income) included in earnings	-
Purchases, sales, issuances and settlements	-
Transfers in/(out) of Level 3	-
Balance at December 31, 2010	$14,532
Expense (income) included in earnings	1,408
Purchases, sales, issuances and settlements	-
Transfers in/(out) of Level 3	-
Balance at June 30, 2011	$15,940

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, 2011 and December 31, 2010, the Company had no assets or liabilities that were measured at fair value on a nonrecurring basis.

The carrying amounts of the Company's short-term financial instruments, which include cash, accounts receivable and accounts payable, approximate their fair values due to their short maturities. The fair value of the Company's long-term indebtedness is estimated based on the quoted prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. Both the carrying value and fair value of long-term indebtedness at June 30, 2011 was $46.6 million. The carrying value and fair value of long-term indebtedness was $49.1 million and $49.0 million, respectively, at June 30, 2010.

4. Investments

The Company invests in a variety of highly liquid investment-grade securities. The following is a summary of the Company's available for sale securities:

	At June 30, 2011			
(in thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
U.S. Treasury securities	$5,045	$3	$-	$5,048

	At December 31, 2010			
(in thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
U.S. Treasury securities	$2,030	$-	$1	$2,029

5. Stock options and restricted stock units

As of June 30, 2011, the Company has two stock-based employee compensation plans, the 2006 Plan and the 2004 Plan. The Company has granted options to purchase shares of common stock under the Emergent Plans and has granted restricted stock units under the 2006 Plan. The Emergent Plans have both incentive and non-qualified stock option features. The Company no longer grants equity awards under the 2004 Plan.

As of June 30, 2011, an aggregate of 8,678,826 shares of common stock are authorized for issuance under the 2006 Plan, of which a total of 2,066,728 shares of common stock remain available for future awards to be made to plan participants. Awards of restricted stock units are counted against the maximum aggregate number of shares of common stock available for issuance under the 2006 Plan as one and one-half (1.5) 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 287,700. The exercise price of each option must be not less than 100% of the fair market value of the shares underlying such option on the date of grant. Awards granted under the 2006 Plan have a contractual life of no more than 10 years. The terms and conditions of equity awards (such as price, vesting schedule, term and number of shares) under the Emergent Plans are determined by the Company's compensation committee, which administers the Emergent Plans. Each equity award granted under the Emergent Plans vests as specified in the relevant agreement and no option can be exercised after ten years from the date of grant.

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

	2006 Plan		2004 Plan		
	Number of Shares	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2010	3,397,915	$ 14.31	67,541	$ 9.80	$32,023,466
Granted	803,027	23.97	-	-	
Exercised	(741,222)	11.63	(14,385)	13.26	
Forfeited	(115,091)	17.73	-	-	
Outstanding at June 30, 2011	3,344,629	$ 17.14	53,156	$ 8.86	$19,982,072
Exercisable at June 30, 2011	1,552,664	$ 13.73	53,156	$ 8.86	$14,417,769

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
Outstanding at December 31, 2010	395,555	$ 16.09	$9,279,720

Granted	401,523		23.99	
Vested	(120,561	)	15.91	
Forfeited	(28,065	)	18.61	
Outstanding at June 30, 2011	648,452	$	20.90	$14,622,593

6. Litigation

Patent Oppositions. The Company's live attenuated modified vaccinia Ankara virus ("MVA") platform technology, which has the potential to be used as a viral vector for delivery of certain vaccine antigens for different disease-causing organisms, is based in part on rights to certain MVA-related materials and technology that the Company acquired from the Bavarian State Ministry of the Environment and Public Health. From 2006 to 2008, the Company filed patent oppositions in the European Patent Office against four of Bavarian Nordic's patents covering certain aspects of MVA technology. In each of the four pending opposition proceedings, the subject patents have also been opposed by one or more additional parties, including Sanofi Pasteur, Transgene, Baxter, Virbac, and Innogenetics. The Company and the other opponents have alleged that the opposed patents should be revoked for failure to fulfill one or more of the patentability requirements of the European Patent Convention, such as the requirements for novelty and inventive step. In each opposition, a single hearing was held before the Opposition Division of the European Patent Office, in which each opponent presented oral argument and Bavarian Nordic presented rebuttal arguments. The first of these hearings, which occurred in June 2010, resulted in the Bavarian Nordic patent under consideration being maintained but narrowed in scope. Hearings in two of the other pending oppositions occurred in October 2010. Bavarian Nordic introduced amended patent claims into the record, which claims were upheld strictly and expressly conditioned on such claims being interpreted within a narrowly-defined scope. The Company timely filed its Appeal Briefs for each of these Oppositions. The Opposition Division held its hearing for the fourth pending opposition in January 2011. As for the previous Oppositions, Bavarian Nordic introduced amended patent claims into the record, and the Opposition Division upheld the amended claims, which are narrower in scope than the originally granted claims. The Company submitted a Notice of Appeal on June 7, 2011. An Appeal Brief is due on August 18, 2011. The Company routinely monitors the grant of further Bavarian Nordic European patents to determine whether any additional oppositions should be filed.

Class-action litigation related to Trubion Pharmaceuticals acquisition. On August 17, 2010, two class action lawsuits were filed in the Superior Court of Washington, King County (the "State Court"), against Trubion Pharmaceuticals, Inc. ("Trubion"), its board of directors, and the Company (collectively, the "Defendants"), alleging in summary that, in connection with the proposed merger of Trubion with a subsidiary of the Company (the "Acquisition"), the members of the Trubion board of directors breached their fiduciary duties by conducting an unfair sale process and agreeing to an unfair price. Both complaints also claim that Trubion and the Company aided and abetted the Trubion board of directors in its breach of fiduciary duties. On September 9, 2010, the actions were consolidated (the "State Action"). On October 1, 2010, the plaintiffs in the State Action served on the Defendants a consolidated amended class action complaint (the "Amended Complaint"). The Amended Complaint alleges, among other things and in addition to the matters alleged in the initial complaints, that the Defendants omitted material information from the Proxy Statement/Prospectus.

On October 4, 2010, a class action lawsuit was filed in the U.S. District Court for the Western District of Washington against the Defendants (the "Federal Action" and, collectively with the State Action, the "Actions"), which made allegations related to the Acquisition that are substantially similar to those matters alleged in the Amended Complaint and includes additional allegations regarding purported violations of the federal securities laws and sought substantially similar relief.

On October 8, 2010, the Defendants reached agreement in principle with the plaintiffs in the Actions regarding the settlement of the Actions. The terms of the settlement contemplated by that agreement in principle require that Trubion and the Company make certain additional disclosures related to the Acquisition, as set forth in the Company's Current Report on Form 8-K filed on October 8, 2010. The parties also agreed that the plaintiffs in the Actions may

seek attorneys' fees and costs in an aggregate amount up to $475,000, to be paid by Trubion if such fees and costs are approved by the State Court. There will be no other payment by Trubion, any of the members of the Trubion board of directors or the Company to the plaintiffs or their respective counsels in connection with the settlement and dismissal of the Actions. The agreement in principle further contemplates that the parties will enter into a stipulation of settlement, which will be subject to customary conditions, including State Court approval following notice to Trubion's shareholders. The Actions were stayed pending approval of the settlement of the State Action by the State Court, after which the State Action and all claims asserted therein will be dismissed with prejudice and counsel for the plaintiff in the Federal Action will take all necessary steps to dismiss the Federal Action and all claims asserted therein with prejudice. On April 26, 2011, the State Court entered an order granting preliminary approval of the settlement and requiring that notice of the settlement and preliminary approval be mailed to class members by May 17, 2011. The order also provided that all class members wishing to be excluded from the settlement of the Actions give notice by June 21, 2011. At the subsequent scheduled hearing on July 29, 2011, the State Court determined that the settlement was fair, reasonable and adequate to the class members, approved the settlement in all respects and entered a Final Judgement and Order of Dismissal and Prejudice.

Other. From time to time, the Company is involved in product liability claims and other litigation considered normal in the nature of its business. The Company does not believe that any such proceedings would have a material adverse effect on the results of its operations.

7. Segment information

For financial reporting purposes, the Company reports financial information for two business segments: biodefense and biosciences. In the biodefense segment, the Company develops, manufactures and commercializes vaccines and antibody therapies for use against biological agents that are potential weapons of bioterrorism or biowarfare. Revenues in this segment relate primarily to the Company's FDA-licensed product, BioThrax® (Anthrax Vaccine Absorbed). In the biosciences segment, the Company develops vaccines, antibody therapies and technology platforms for use against infectious diseases, oncology, autoimmune and inflammatory disorders and other medical conditions that have resulted in significant unmet or underserved public health needs. 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 product candidates or activities that are not classified as biodefense or biosciences. The assets in this segment consist primarily of cash. For the three and six months ended June 30, 2010, the Company reclassified its business segments to conform with the current period presentation.

	Reportable Segments			
(in thousands)	Biodefense	Biosciences	All Other	Total
Three Months Ended June 30, 2011				
External revenue	$83,685	$4,456	$-	$88,141
Net income (loss) attributable to Emergent BioSolutions Inc.	36,902	(20,580)	(2,112)	14,210
Assets	217,057	121,209	155,718	493,984
Three Months Ended June 30, 2010				
External revenue	$62,138	$-	$-	$62,138
Net income (loss) attributable to Emergent BioSolutions Inc.	22,524	(10,958)	(1,758)	9,808
Assets	208,004	42,102	95,642	345,748

	Reportable Segments			
(in thousands)	Biodefense	Biosciences	All Other	Total
Six Months Ended June 30, 2011				
External revenue	$99,185	$7,489	$-	$106,674
Net income (loss) attributable to Emergent BioSolutions Inc.	30,810	(35,705)	(2,292)	(7,187)
Assets	217,057	121,209	155,718	493,984
Six Months Ended June 30, 2010				

External revenue	$108,938	$-	$-	$108,938
Net income (loss) attributable to Emergent BioSolutions Inc.	35,909	(20,564)	(3,014)	12,331
Assets	208,004	42,102	95,642	345,748

8. Related party transactions

The Company entered into an agreement in February 2009 with an entity controlled by family members of the Company's Chief Executive Officer to market and sell BioThrax. The agreement was effective as of November 2008 and requires payment based on a percentage of net sales of biodefense products of 17.5% in Saudi Arabia and 15% in Qatar and United Arab Emirates, and reimbursement of certain expenses. No payments under this agreement have been triggered during the six months ended June 30, 2011.

The Company entered into a severance agreement in April 2010 with the Company's former Senior Vice President, Legal Affairs and General Counsel, whose employment with the Company terminated in March 2010. Severance payments and other benefits under the agreement are substantially identical to those provided under the provisions of the Company's Severance Plan and Termination Protection Program. One-half of the amounts payable under the severance agreement was paid in September 2010, with the remaining amounts paid in six equal monthly installments concluding in March 2011.

The Company entered into a consulting agreement in September 2010 with an entity controlled by the Company's former Senior Vice President Corporate Affairs, who is also a family member of the Company's Chief Executive Officer. The agreement provides for consulting services in connection with special projects as assigned by the Company's President. During the six months ended June 30, 2011, the Company paid approximately $30,000 for services rendered under this agreement, of which $10,000 remained in accounts payable at June 30, 2011.

The Company has entered into a consulting agreement with a member of the Company's Board of Directors. For each of the six month periods ended June 30, 2011 and 2010, the Company paid approximately $90,000 under this agreement for strategic consultation and project support for the Company's marketing and communications group, of which no balance remained unpaid in accounts payable at June 30, 2011.

9. Variable interest entities

In July 2008, the Company entered into a collaboration with the University of Oxford ("Oxford") and certain University of Oxford researchers to conduct clinical trials in the advancement of a vaccine product candidate for tuberculosis, resulting in the formation of the Oxford-Emergent Tuberculosis Consortium ("OETC"). The Company has a 51% equity interest in OETC and controls the OETC Board of Directors. In addition, the Company has certain funding and service obligations related to its investment. The Company has evaluated its variable interests in OETC and has determined that it is the primary beneficiary as it has the ability to direct the activities of OETC and will absorb the majority of expected losses. Accordingly, the Company consolidates the entity. As of June 30, 2011 and 2010, respectively, assets of $394,000 and $355,000 and liabilities of $910,000 and $337,000 related to OETC are included within the Company's consolidated balance sheet. During the three and six months ended June 30, 2011, OETC incurred net losses of $3.2 million and $6.8 million, respectively, of which $1.6 million and $3.4 million, respectively, is included in the Company's consolidated statement of operations. During the three and six months ended June 30, 2010, OETC incurred net losses of $763,000 and $2.0 million, respectively, of which $389,000 and $1.0 million, respectively, is included in the Company's consolidated statement of operations.

In conjunction with the establishment of OETC, the Company granted a put option to Oxford and the Oxford researchers whereby the Company may be required to acquire all of the OETC shares held by Oxford and the Oxford researchers at fair market value of the underlying shares. This put option is contingent upon the satisfaction of a number of conditions that must exist or occur subsequent to the granting by the European Commission of marketing authorization for the OETC-sponsored vaccine product candidate for tuberculosis. The Company accounts for the put

option in accordance with the accounting provisions related to derivatives and distinguishing liabilities from equity. In accordance with these provisions, the Company has determined that the put option has a de minimis fair value as of June 30, 2011.

In July 2010, the Company entered into a collaboration with Temasek Life Sciences Ventures Pte Limited to advance the development of monoclonal products for worldwide prophylaxis or treatment of infection caused by existing or anticipated future pandemic influenza strains via a hemagglutinin-based medical countermeasure, resulting in the formation of EPIC Bio Pte Limited ("EPIC"). The Company has a 60% equity interest in EPIC and controls the EPIC Board of Directors. The Company has evaluated its variable interests in EPIC and has determined that it is the primary beneficiary as it has the ability to direct the activities of EPIC and will absorb the majority of expected losses. Accordingly, the Company consolidates the entity. As of June 30, 2011, assets of $1.9 million and liabilities of $741,000 related to EPIC are included within the Company's consolidated balance sheet. During the three and six months ended June 30, 2011, EPIC incurred net losses of $352,000 and $375,000, respectively, of which $211,000 and $225,000, respectively, is included in the Company's consolidated statement of operations.

The following is a summary of the stockholders' equity attributable to the Company and the noncontrolling interests:

(in thousands)	Emergent BioSolutions Inc.	Noncontrolling Interests	Total
Stockholders' equity at December 31, 2010	$ 369,464	$ 4,097	$373,561
Non-cash development expenses from variable interest entities	-	3,348	3,348
Net loss	(7,187)	(3,463)	(10,650)
Other	14,971	-	14,971
Stockholders' equity at June 30, 2011	$ 377,248	$ 3,982	$381,230

10. Restructuring

In November 2010, the Company adopted a plan to restructure and reprioritize the operations of Emergent Product Development UK Limited ("EPDU"). The Company has made estimates and judgments regarding the amount and timing of this restructuring expense and liability, including current and future period termination benefits and other exit costs to be incurred when related actions take place. The Company has also assessed the recoverability of certain long-lived assets employed in the business and in certain instances shortened the expected useful life of the assets based on changes in their expected use. When the Company determines that the useful lives of assets are shorter than it had originally estimated, the Company records additional depreciation to reflect the assets' new shorter useful lives. Severance and other related costs and asset-related charges are reflected within the Company's consolidated statement of income as a component of selling, general and administrative expense within the Company's biosciences segment. Actual results may differ from these estimates.

The Company has substantially completed this restructuring in the first half of 2011. The costs of the restructuring are detailed below:

(in thousands)	Incurred in 2011	Inception to Date Costs Incurred	Total Expected to be Incurred
Termination benefits	$438	$2,856	$2,900
Contract termination costs	2,153	2,803	2,550
Other costs	90	350	350
Total	$2,681	$6,009	$5,800

In July 2011, the Company received a refund of previously paid contract termination costs. This refund lowered our total expected cost to be incurred.

The following is a summary of the activity for the liabilities related to the EPDU restructuring:

(in thousands)	Termination Benefits	Lease Termination Costs	Total
Balance at December 31, 2010	$ 2,418	$ 650	$ 3,068
Expenses incurred	438	2,153	2,591
Amount paid	(2,714)	(2,571)	(5,285)
Balance at June 30, 2011	$ 142	$ 232	$ 374

11. Assets held for sale

The Company currently owns two buildings in Frederick, Maryland that it determined in 2009 would not be placed into service. Accordingly, the Company committed to a plan to sell the buildings, along with associated improvements. These buildings are classified on the Company's balance sheets as assets held for sale. Assets held for sale are recorded at the lower of the carrying amount or fair market value less costs to sell, and are no longer depreciated once classified as held for sale. The Company recorded the assets held for sale at fair market value, based on factors that include recent purchase offers less estimated selling costs. The Company recorded an impairment charge of $193,000 for each of the three and six months ended June 30, 2011. The Company recorded impairment charges of $448,000 and $1.0 million, respectively, for the three and six months ended June 30, 2010. This charge was classified in the Company's statement of operations as selling, general and administrative expense within the Company's biosciences segment. The Company continues to actively seek to sell these buildings.

12. Asset Purchase Agreement

In May 2011, the Company and TenX BioPharma, Inc. ("TenX") entered into an asset purchase agreement in which the Company acquired all assets and rights related to the Zanolimumab product candidate and related technology from TenX. The Company paid approximately $3.1 million in conjunction with the closing of this acquisition, and has recorded this amount in the Company's statement of operations as research and development expense in the Company's biosciences segment. The asset purchase agreement also contemplates additional milestone payments and specified percentages of future net sales.

13. Subsequent events

On July 29, 2011, the Company entered into a loan agreement and related agreements with PNC Bank ("PNC"), under which PNC provided the Company with a construction loan of up to $30.0 million primarily to fund the ongoing build-out of the Company's Baltimore facility. A portion of the loan was also used to repay the Company's original loan with HSBC Bank ("HSBC") to finance a portion of the purchase price of the facility. Under the loan agreement, PNC will make advances to the Company of up to $30.0 million through July 2012 based on periodic requests from the Company. The Company has drawn $17.8 million on the loan to date, of which $6.2 million was used to repay the HSBC loan.

On August 3, 2011, the Company entered into a separate loan agreement with PNC to provide the Company with an equipment loan of $12.0 million to fund equipment purchases at the Baltimore facility. Under the equipment loan agreement, PNC will make advances to the Company of up to $12.0 million through August 2012 based on periodic requests from the Company. To date, the Company has not requested any advances under this loan agreement.

The Company has evaluated subsequent events through the time of filing these financial statements.

ITEM 2. MANAGMENT'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, include forward-looking statements that involve risks and uncertainties. You should review the “Special Note Regarding Forward-Looking Statements” and the “Risk Factors” sections of this quarterly report 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

We are a biopharmaceutical company focused on protecting and enhancing life by developing and manufacturing vaccines and antibody therapeutics that are supplied to healthcare providers and purchasers for use in preventing and treating disease. For financial reporting purposes, we operate in two business segments, biodefense and biosciences.

Our biodefense segment focuses on vaccines and antibody therapies for use against biological agents that are potential weapons of bioterrorism or biowarfare. Our products and product candidates in this segment are focused on anthrax. We manufacture and market BioThrax® (Anthrax Vaccine Adsorbed), the only vaccine licensed by the U.S. Food and Drug Administration, or FDA, for the prevention of anthrax infection. In addition to BioThrax, we are developing PreviThraxTM (Recombinant Protective Antigen Anthrax Vaccine, Purified), Anthrivig TM (Human Anthrax Immunoglobulin), Thravixa TM (Fully Human Anthrax Monoclonal Antibody) and NuThrax TM (Anthrax Vaccine Absorbed with CPG 7909 Adjuvant). Operations in this segment include biologics manufacturing, regulatory and quality affairs, marketing and sales in support of BioThrax and product development of our investigational product candidates.

Our biosciences segment is directed to commercial opportunities. Our programs in this segment target oncology, including B-cell malignancies of chronic lymphocytic leukemia, or CLL, and non-Hodgkin’s lymphoma, or NHL; autoimmune and inflammatory disorders, or AIID, including rheumatoid arthritis, or RA, and systemic lupus erythematosus, or SLE; as well as other infectious diseases such as tuberculosis and influenza. Additionally, through our recent acquisition of certain assets of TenX BioPharma, Inc., or TenX, we acquired a clinical stage product candidate targeted at cutaneous T-cell lymphoma, or CTCL, and peripheral T-cell lymphoma, or PTCL. Our programs in this segment include clinical and preclinical stage investigational product candidates. Operations in this segment include product development in support of our investigational product candidates, and manufacturing and related infrastructure initiatives in support of our technology platforms.

Our biodefense segment has generated net income for each of the last five fiscal years. Over this timeframe, our biosciences segment has generated revenue through development contracts and grant funding, but none of our biosciences product candidates have received marketing approval and, therefore, our biosciences segment 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 substantially all of our product sales revenues from BioThrax sales to the U.S. government. We are currently a party to a contract with the U.S. Department of Health and Human Services, or HHS, to supply doses of

BioThrax for placement into the Strategic National Stockpile, or SNS. We expect for the foreseeable future to continue to derive substantially all of our product sales revenues from our sales of BioThrax to the U.S. government. Our total revenues from BioThrax sales were $77.1 million and $94.7 million, respectively, for the six months ended June 30, 2011 and 2010. We are focused on increasing sales of BioThrax to U.S. government customers, expanding the market for BioThrax to other customers domestically and internationally and pursuing label expansions and improvements for BioThrax.

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. We have received funding for the following development programs:

§ BioThrax post-exposure prophylaxis;
§ NuThrax;
§ Large-scale manufacturing for BioThrax;
§ PreviThrax;
§ Anthrivig;
§ Thravixa;
§ Double mutant recombinant protective antigen anthrax vaccine; and
§ Recombinant botulinum vaccine.

Additionally, our tuberculosis vaccine product candidate is indirectly supported by grant funding provided to the University of Oxford by the Wellcome Trust and Aeras Global Tuberculosis Vaccine Foundation. Our TRU-016 product candidate is being funded via our collaboration with Abbott Laboratories, or Abbott, in which we and Abbott share all funding responsibilities equally. Our SBI-087 product candidate is substantially funded by Pfizer Inc., or Pfizer.

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

Manufacturing Infrastructure

We conduct our primary vaccine manufacturing operations at a multi-building campus on approximately 12.5 acres in Lansing, Michigan. To augment our existing manufacturing capabilities, we have constructed Building 55, a 50,000 square foot large-scale manufacturing facility on our Lansing campus. In July 2010, we entered into an agreement with the Biomedical Advanced Research and Development Authority, or BARDA, to finalize development of and obtain regulatory approval for large-scale manufacturing of BioThrax in Building 55. This agreement provides for funding from BARDA of up to approximately $107 million over a five-year contract term, including a two-year base period of performance valued at approximately $55 million.

In November 2009, we purchased a building in Baltimore, Maryland for product development and manufacturing purposes, and have begun renovation, improvement and equipment acquisitions at this facility. During the third quarter of 2011, we entered into two loan agreements with PNC Bank totaling up to $42.0 million to fund these renovations, improvements and equipment acquisitions. Our specific plans for this facility will be contingent on the progress of our existing development programs and the outcome of our efforts to acquire new product candidates.

Critical Accounting Policies and Estimates

There have been no significant changes to our Critical Accounting Policies and Estimates during the six months ended June 30, 2011. Refer to the Critical Accounting Policies and Estimates section in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission.

Financial Operations Overview

Revenues

On September 30, 2008, we entered into an agreement with HHS to supply up to 14.5 million doses of BioThrax for placement into the SNS. This agreement was amended in July 2010 to, among other things, allow us to accelerate the delivery of BioThrax doses into the SNS by approximately three months. In April 2011, we entered into a modification to this contract to supply an additional 3.4 million doses at a value of up to $101 million. The term of the modified agreement is from September 30, 2008 through September 30, 2011. The total purchase price of the modified contract for 17.9 million doses is approximately $500 million. Through June 30, 2011, we have delivered approximately 14.3 million doses under this agreement. We have agreed to provide all shipping services related to delivery of doses into the SNS over the term of the agreement, for which HHS has agreed to pay us approximately $2.3 million. We recognize revenue under the agreement upon acceptance of each delivery of BioThrax doses to the SNS.

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

Product Candidate/Manufacturing	Funding Source	Award Date	Amount (Up to)	Performance Period
Anthrivig	NIAID	9/2007	$9.5 million	9/2007 — 12/2011
Recombinant botulinum vaccine	NIAID	6/2008	$1.8 million	6/2008 — 5/2012
NuThrax	NIAID	7/2008	$2.8 million	7/2008 — 6/2013
Thravixa	NIAID/BARDA	9/2008	$24.3 million	9/2008 — 8/2012
NuThrax	NIAID/BARDA	9/2008	$24.4 million	9/2008 — 7/2012
Double mutant recombinant protective antigen anthrax vaccine	NIAID	9/2009	$4.9 million	9/2009 — 8/2012
Large-scale manufacturing for BioThrax	BARDA	7/2010	$107.0 million	7/2010 — 7/2015
NuThrax	NIAID	7/2010	$28.7 million	8/2010 — 8/2014
PreviThrax	BARDA	9/2010	$186.6 million	9/2010 — 9/2015

Our revenue, operating results and profitability have varied, and we expect that they will continue to vary on a quarterly basis, primarily due to the timing of our fulfilling orders for BioThrax and work done under new and existing contracts and grants.

Cost of Product Sales

The primary expense that we incur to deliver BioThrax to our customers is manufacturing cost, which consist of primarily fixed costs. These fixed manufacturing costs consist of facilities, utilities and personnel-related expenses for indirect manufacturing support staff. Variable manufacturing costs for BioThrax consist primarily of costs for materials, direct labor and contract filling operations.

We determine the cost of product sales for doses sold during a reporting period based on the average manufacturing cost per dose in the period those doses were manufactured. We calculate the average manufacturing cost per dose in the period of manufacture by dividing the actual costs of manufacturing in such period by the number of units produced in that period. In addition to the fixed and variable manufacturing costs described above, the average

manufacturing cost per dose depends on the efficiency of the manufacturing process, utilization of available manufacturing capacity and the production yield for the period of production.

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, preclinical and analytical testing, independently monitoring our clinical trials and acquiring 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 believe that significant investment in product development is a competitive necessity and plan to continue these investments in order to be in a position to realize the potential of our product candidates. We expect that spending for our product pipeline will increase as our product development activities continue based on ongoing advancement of our product candidates, and as we prepare for regulatory submissions and other regulatory activities. We expect that the magnitude of any increase in our research and development spending will be dependent upon such factors as the results from our ongoing preclinical studies and clinical trials, continued participation of our third-party collaborators, the size, structure and duration of any follow-on clinical programs that we may initiate, 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 with BioThrax conducted by the Centers for Disease Control and Prevention, or CDC.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and other related costs for personnel serving the executive, sales and marketing, business development, finance, accounting, information technology, legal and human resource functions. Other costs include facility costs not otherwise included in cost of product sales or research and development expense and professional fees for legal and accounting services. We currently market and sell BioThrax directly to the U.S. government with a small, targeted marketing and sales group. As we seek to broaden the market for BioThrax and if we receive marketing approval for additional products, we expect that we will increase our spending for marketing and sales activities.

Results of Operations

Quarter Ended June 30, 2011 Compared to Quarter Ended June 30, 2010

Revenues

Product sales revenues increased by $15.6 million, or 28%, to $71.5 million for the three months ended June 30, 2011 from $55.9 million for the three months ended June 30, 2010. This increase in product sales revenues was primarily due to a 25% increase in the number of doses of BioThrax delivered. Product sales revenues for the three months ended June 30, 2011 consisted of BioThrax sales to HHS of $70.7 million and aggregate international and other sales of $738,000. Product sales revenues for the three months ended June 30, 2010 consisted of BioThrax sales to HHS of $53.5 million and aggregate international and other sales of $2.3 million.

Contracts and grants revenues increased by $10.4 million, or 166%, to $16.7 million for the three months ended June 30, 2011 from $6.3 million for the three months ended June 30, 2010. The increase in contracts and grants revenue was primarily due to revenues from our contract from BARDA for large-scale manufacturing for BioThrax and our collaborations with Abbott and Pfizer, along with increased activity and associated revenue from our development contracts with NIAID and BARDA for NuThrax and PreviThrax. Contracts and grants revenues for the three months ended June 30, 2011 consisted of $12.1 million in development contract and grant revenue from NIAID and BARDA and $4.5 million from Abbott and Pfizer. All contracts and grants revenues for the three months ended June 30, 2010 were from NIAID and BARDA.

Cost of Product Sales

Cost of product sales increased by $5.0 million, or 45%, to $16.1 million for the three months ended June 30, 2011 from $11.1 million for the three months ended June 30, 2010. This increase was primarily attributable to the 25% increase in the number of BioThrax doses sold coupled with an increase in the cost per dose sold associated with decreased production yield in the period in which the doses were produced.

Research and Development Expense

Research and development expenses increased by $12.9 million, or 69%, to $31.5 million for the three months ended June 30, 2011 from $18.6 million for the three months ended June 30, 2010. This increase primarily reflects higher contract service and personnel-related costs, and includes increased expenses of $12.4 million for product candidates and technology platform development activities that are categorized in the biosciences segment, increased expenses of $170,000 for product candidates that are categorized in the biodefense segment, and increased expenses of $330,000 in other research and development, which are in support of central research and development activities. For the three months ended June 30, 2011 and 2010, we incurred research and development expenses net of development contract and grant revenues along with the net loss attributable to noncontrolling interests of $13.1 million and $12.0 million, respectively.

The spending on biodefense product candidates, detailed in the table below, was primarily attributable to the timing of development efforts on various programs as we completed various studies and prepared for subsequent studies and trials. The increase in spending for NuThrax was due to assay development and the conduct of clinical trial activities. The increase in spending for our large-scale manufacturing for BioThrax program was primarily due to characterization assay development and manufacturing that increased subsequent to the associated development contract award in July 2010. The increase in spending for BioThrax related programs was related to clinical and non-clinical studies to support applications for marketing approval of these programs. The increase in spending for PreviThrax was primarily due to formulation stability studies and process development subsequent to the associated development contract awarded in September 2010. The decrease in spending for Anthrivig was primarily due to the timing of clinical studies and animal model development. The decrease in spending for Thravixa was primarily due to the timing of manufacturing and pilot studies. The decrease in spending for our other biodefense activities was primarily due to decreased spending associated with our double mutant recombinant protective antigen anthrax vaccine due primarily to reduced funding by the U.S. government for this product candidate. As such, we expect that spending for our double mutant recombinant protective antigen anthrax vaccine will decrease in the future.

The increase in spending on biosciences product candidates, detailed in the table below, was primarily attributable to the timing of development efforts and the acquisition of certain biosciences product candidates. The increase in spending for our tuberculosis vaccine product candidate is related to the costs incurred for the continued conduct of a Phase IIb clinical trial along with process development and manufacturing activities. The increase in spending for our TRU-016, DRACO and XI product candidates, acquired as a result of our October 2010 acquisition of Trubion and its development programs for product candidates to treat certain autoimmune diseases and oncology, is primarily related to clinical studies and manufacturing costs. The spending for our Zanolimumab product candidate was for upfront and milestone payments related to the May 2011 acquisition of certain assets of TenX. The spending for our influenza

vaccine product candidate is related to process and analytical development. The decrease in spending for Typhella was primarily due to the substantial completion of manufacturing and clinical studies. We have significantly reduced ongoing spending with regard to Typhella while we investigate options to sell or outlicense the related technology, and expect that future spending will be reduced. The increase in spending for our other biosciences activities was primarily due to increased spending associated with development of platform technologies along with preclinical product candidates as a result of our acquisition of Trubion.

The spending for other research and development activities was primarily attributable to central research and development activities.

Our principal research and development expenses for the three months ended June 30, 2011 and 2010 are shown in the following table:

	Three Months Ended June 30,	
(in thousands)	2011	2010
Biodefense:		
NuThrax	$3,083	$2,352
Large-scale manufacturing for BioThrax	2,855	1,880
BioThrax related programs	1,626	1,249
PreviThrax	3,042	600
Anthrivig	386	2,294
Thravixa	947	2,339
Other biodefense	546	1,601
Total biodefense	12,485	12,315
Biosciences:		
Tuberculosis vaccine	3,932	2,068
TRU-016	3,450	-
DRACO	1,985	-
X1	915	-
Zanolimumab	3,149	-
Influenza vaccine	692	826
Typhella	262	639
Other biosciences	3,255	1,728
Total biosciences	17,640	5,261
Other	1,356	1,026
Total	$31,481	$18,602

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by $2.7 million, or 15%, to $20.4 million for the three months ended June 30, 2011 from $17.6 million for the three months ended June 30, 2010. This increase is primarily due to approximately $2.2 million in restructuring charges related to our UK operations. The majority of the expense is attributable to the biodefense segment, in which selling, general and administrative expenses increased by $479,000, or 4%, to $13.1 million for the three months ended June 30, 2011 from $12.6 million for the three months ended June 30, 2010. Selling, general and administrative expenses related to our biosciences segment increased by $2.3 million, or 45%, to $7.3 million for the three months ended June 30, 2011 from $5.0 million for the three months ended June 30, 2010, reflecting the charge for the UK restructuring.

Total Other Income (Expense)

Total other income (expense) decreased by $401,000, or 106%, to net other expense of $21,000 for the three months ended June 30, 2011 from net other income of $380,000 for the three months ended June 30, 2010. The decrease was due primarily to 2010 interest income related to the note receivable from Protein Sciences Corporation, which was settled in October 2010.

Income Taxes

Provision for income taxes increased by $1.9 million, or 33%, to $7.7 million for the three months ended June 30, 2011 from $5.8 million for the three months ended June 30, 2010. The estimated effective tax rate for the three months ended June 30, 2011 and 2010 was 35% and 37%, respectively. The increase in the provision for income taxes was primarily due to the increase in our income before provision for income taxes plus the loss attributable to noncontrolling interest of $6.3 million.

Net Loss Attributable to Noncontrolling Interests

Net loss attributable to noncontrolling interests increased by $1.3 million to $1.7 million for the three months ended June 30, 2011 from $374,000 for the three months ended June 30, 2010. The loss was primarily a result of clinical and development activities and related expenses incurred by our joint venture with the University of Oxford. These amounts primarily represent the portion of the loss incurred by the joint venture for the three months ended June 30, 2011 and 2010, respectively, that is attributable to the University of Oxford.

Six Months Ended June 30, 2011 Compared to Six Months Ended June 30, 2010

Revenues

Product sales revenues decreased by $17.7 million, or 19%, to $77.1 million for the six months ended June 30, 2010 from $94.7 million for the six months ended June 30, 2010. This decrease in product sales revenues was primarily due to a 22% decrease in the number of doses of BioThrax delivered due to the redeployment of our potency testing capacity from BioThrax release testing to qualification of replacement reference standards and other development testing during the first quarter 2011. Product sales revenues for the six months ended June 30, 2011 consisted of BioThrax sales to HHS of $75.8 million and aggregate international and other sales of $1.3 million. Product sales revenues for the six months ended June 30, 2010 consisted of BioThrax sales to HHS of $92.4 million and aggregate international and other sales of $2.4 million.

Contracts and grants revenues increased by $15.4 million, or 108%, to $29.6 million for the six months ended June 30, 2011 from $14.2 million for the six months ended June 30, 2010. The increase in contracts and grants was primarily due to revenues from our contract with BARDA for large-scale manufacturing for BioThrax and our collaborations with Abbott and Pfizer, along with increased activity and associated revenue from our development contracts with NIAID and BARDA for NuThrax and PreviThrax. Contracts and grants revenues for the six months ended June 30, 2011 consisted of $22.0 million in development contract and grant revenue from NIAID and BARDA and $7.5 million from Abbott and Pfizer. Contracts and grants revenues for the six months ended June 30, 2010 consisted of $13.5 million in development contract and grant revenue from NIAID and BARDA and $750,000 from a milestone payment related to the 2008 sale of technology rights and related materials and documentation pertaining to our Pertussis technology.

Cost of Product Sales

Cost of product sales decreased by $1.4 million, or 8%, to $17.1 million for the six months ended June 30, 2011 from $18.6 million for the six months ended June 30, 2010. This decrease was attributable to a 22% decrease in the number of doses of BioThrax delivered partially offset by an increase in the cost per dose sold associated with decreased production yield in the period in which the doses were produced.

Research and Development Expense

Research and development expenses increased by $27.7 million, or 72%, to $66.2 million for the six months ended June 30, 2011 from $38.5 million for the six months ended June 30, 2010. This increase primarily reflects higher contract service and personnel-related costs, and includes increased expenses of $26.0 million for product candidates and technology platform development activities that are categorized in the biosciences segment, increased expenses of $1.1 million for product candidates categorized in the biodefense segment, and increased expenses of $664,000 in other research and development, which are in support of central research and development activities. For the six months ended June 30, 2011 and 2010, we incurred research and development expenses net of development contract and grant revenues along with the net loss attributable to noncontrolling interests of $33.2 million and $23.3 million, respectively.

The increase in spending on biodefense product candidates, detailed in the table below, was primarily attributable to the timing of development efforts on various programs as we completed various studies and prepared for subsequent studies and trials. The increase in spending for NuThrax was due to manufacturing, assay development and the conduct of clinical trial activities. The increase in spending for our large-scale manufacturing for BioThrax program was primarily due to characterization assay development and manufacturing that increased subsequent to the associated development contract award in July 2010. The increase in spending for BioThrax related programs was related to clinical and non-clinical studies to support applications for marketing approval of these programs. The increase in spending for PreviThrax was primarily due to formulation stability studies and potency assay qualification subsequent to the associated development contract awarded in September 2010. The decrease in spending for Anthrivig was primarily due to the timing of clinical studies and animal model development. The decrease in spending for Thravixa was primarily due to the timing of manufacturing and pilot studies. The decrease in spending for our other biodefense activities was primarily due to decreased spending associated with our double mutant recombinant protective antigen anthrax vaccine due primarily to reduced funding by the U.S. government for this product candidate. As such, we expect that spending for our double mutant recombinant protective antigen anthrax vaccine will decrease in the future.

The increase in spending on biosciences product candidates, detailed in the table below, was primarily attributable to the timing of development efforts and the acquisition of certain biosciences product candidates. The increase in spending for our tuberculosis vaccine product candidate is related to the costs incurred for the continued conduct of a Phase IIb clinical trial along with process development and manufacturing activities. The increase in spending for our TRU-016, DRACO and XI product candidates, which is a result of our October 2010 acquisition of Trubion and its development programs for product candidates to treat certain autoimmune diseases and oncology, is primarily related to clinical studies and manufacturing costs. The spending for our Zanolimumab product candidate was for upfront and milestone payments related to the May 2011 acquisition of certain assets of TenX. The spending for our influenza vaccine product candidate is related to process and analytical development. The decrease in spending for Typhella was primarily due to the substantial completion of manufacturing and clinical studies. We have significantly reduced ongoing spending with regard to Typhella while we investigate options to sell or outlicense the related technology, and expect that future spending will be reduced. The increase in spending for our other biosciences activities was primarily due to increased spending associated with development of platform technologies along with preclinical product candidates as a result of our acquisition of Trubion.

Our principal research and development expenses for the six months ended June 30, 2011 and 2010 are shown in the following table:

	Six Months Ended June 30,	
(in thousands)	2011	2010
Biodefense:		

NuThrax	$6,722	$4,552
Large-scale manufacturing for BioThrax	6,100	3,414
BioThrax related programs	3,769	3,353
PreviThrax	5,924	1,450
Anthrivig	1,005	3,890
Thravixa	2,225	5,823
Other biodefense	1,487	3,684
Total biodefense	27,232	26,166
Biosciences:		
Tuberculosis vaccine	9,836	4,322
TRU-016	8,475	-
DRACO	3,946	-
X1	1,822	-
Zanolimumab	3,149	-
Influenza vaccine	1,462	1,589
Typhella	1,102	1,237
Other biosciences	6,602	3,260
Total biosciences	36,394	10,408
Other	2,614	1,950
Total	$66,240	$38,524

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by $4.8 million, or 14%, to $38.6 million for the six months ended June 30, 2011 from $33.8 million for the six months ended June 30, 2010. This increase is primarily due to approximately $2.2 million in restructuring charges related to our UK operations and increased personnel and professional services to support growth of the business. The majority of the expense is attributable to the biodefense segment, in which selling, general and administrative expenses increased by $2.3 million, or 9%, to $27.2 million for the six months ended June 30, 2011 from $24.8 million for the six months ended June 30, 2010. Selling, general and administrative expenses related to our biosciences segment, increased by $2.4 million, or 27%, to $11.4 million for the six months ended June 30, 2011 from $9.0 million for the six months ended June 30, 2010, reflecting the charge for the UK restructuring.

Total Other Income (Expense)

Total other income decreased by $742,000, or 98%, to $13,000 for the six months ended June 30, 2011 from $755,000 for the six months ended June 30, 2010. The decrease was due primarily to 2010 interest income related to the note receivable from Protein Sciences Corporation, which was settled in October 2010.

Income Taxes

Provision for (benefit from) income taxes decreased by $12.0 million, or 163%, to a benefit from income taxes of $4.6 million for the six months ended June 30, 2011 from a provision for income taxes of $7.4 million for the six months ended June 30, 2010. The estimated annual effective tax rate for the six months ended June 30, 2011 and 2010 was 39% and 37%¸ respectively. The decrease in income taxes is primarily due to a $31.5 million decrease in our income before provision for income taxes and the loss attributable to noncontrolling interests.

Net Loss Attributable to Noncontrolling Interest

Net loss attributable to noncontrolling interest increased by $2.5 million to $3.5 for the six months ended June 30, 2011 from $979,000 for the six months ended June 30, 2010. The increase resulted from the timing of clinical and

development activities and related expenses incurred by our joint venture with the University of Oxford. These amounts represent the portion of the loss incurred by the joint venture for the six months ended June 30, 2011 and 2010, respectively, that is attributable to the University of Oxford.

Liquidity and Capital Resources

Sources of Liquidity

We have funded our cash requirements from inception through June 30, 2011 principally with a combination of revenues from BioThrax product sales, debt financings and facilities and equipment leases, development funding from government entities and non-government and philanthropic organizations, the net proceeds from our initial public offering and from the sale of our common stock upon exercise of stock options. We have operated profitably for each of the five years ended December 31, 2010.

As of June 30, 2011, we had cash, cash equivalents and investments of $127.1 million. Additionally, at June 30, 2011 our accounts receivable balance was $47.3 million.

Cash Flows

The following table provides information regarding our cash flows for the six months ended June 30, 2011 and 2010:

	Six Months Ended June 30,	
(in thousands)	2011	2010
Net cash provided by (used in):		
Operating activities(1)	$(29,469)	$21,028
Investing activities	(19,814)	(8,631)
Financing activities	2,358	(13,128)
Total net cash provided by (used in)	$(46,925)	$(731)

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

Net cash used in operating activities of $29.5 million for the six months ended June 30, 2011 was principally due to our net loss attributable to Emergent BioSolutions Inc. of $7.2 million, a $4.5 million increase in inventory related to the timing of BioThrax shipments, a net decrease in income taxes of $5.3 million related to timing differences, a decrease in accrued compensation of $10.2 million primarily due to the payment of the 2010 bonuses, an increase in accounts receivable of $7.9 million due to the timing of collection of amounts billed primarily to HHS, partially offset by non-cash charges of $5.2 million for stock-based compensation, $4.5 million for depreciation and amortization, and $3.3 million for development expenses primarily from our joint venture with the University of Oxford.

Net cash provided by operating activities of $21.0 million for the six months ended June 30, 2010 was due principally to net income attributable to Emergent BioSolutions Inc. of $12.3 million along with non-cash charges of $3.4 million for stock compensation, $2.6 million for depreciation and amortization and $1.0 million related to the impairment of our Frederick facilities.

Net cash used in investing activities for the six months ended June 30, 2011 was $19.8 million, primarily due to capital expenditures of $16.8 million related to the construction and related costs for our facility in Baltimore, Maryland, and infrastructure investments and other equipment, along with the purchase of U.S. Treasury securities of $5.3 million partially offset by proceeds from the maturity of U.S. Treasury securities of $2.3 million.

Net cash used in investing activities for the six months ended June 30, 2010 of $8.6 million resulted principally from the construction and related costs for our manufacturing facility in Lansing, Michigan and infrastructure investments and other equipment.

Net cash provided by financing activities of $2.4 million for the six months ended June 30, 2011 resulted primarily from $8.7 million in proceeds from stock option exercises and $1.8 million related to excess tax benefits from the exercise of stock options, partially offset by $8.1 million in principal payments on indebtedness.

Net cash used in financing activities of $13.1 million for the six months ended June 30, 2010 resulted primarily from $31.6 million in principal payments on indebtedness, including $30.0 million in payments on our revolving line of credit with Fifth Third Bank, partially offset by $15.0 million in proceeds from borrowings under our revolving line of credit with Fifth Third Bank, $2.8 million in proceeds from stock option exercises and $709,000 related to excess tax benefits from the exercise of stock options.

Debt Financing

As of June 30, 2011, we had $39.3 million principal amount of debt outstanding, comprised primarily of the following:

- $2.5 million outstanding under a loan from the Department of Business and Economic Development of the State of Maryland used to finance eligible costs incurred to purchase our first facility in Frederick, Maryland;
- $5.4 million outstanding under a mortgage loan from PNC Bank used to finance the remaining portion of the purchase price for our first Frederick facility;
- $20.5 million outstanding under a term loan from HSBC Realty Credit Corporation used to finance a portion of the costs of our facility expansion in Lansing, Michigan;
- $6.3 million outstanding under a mortgage loan from HSBC Realty Credit Corporation used to finance a portion of the purchase price of our facility in Baltimore, Maryland, the balance of which was repaid in July 2011; and
- $4.6 million outstanding under a mortgage loan from HSBC Realty Credit Corporation used to finance a portion of the purchase price of our facility in Gaithersburg, Maryland.

In April 2011, we repaid the remaining $6.5 million due under the mortgage loan from HSBC Realty Credit Corporation that was used to finance a portion of the purchase price for our second facility at the Frederick site.

On June 1, 2011, our revolving line of credit with Fifth Third Bank expired. There were no outstanding principal amounts owed as of teh date of the expiration.

On July 29, 2011, we entered into a loan agreement and related agreements with PNC Bank, or PNC, under which PNC provided us with a construction loan of up to $30.0 million primarily to fund the ongoing build-out of the our Baltimore facility. A portion of the loan was also used to repay the Company’s original loan with HSBC Bank to finance a portion of the purchase price of the facility. Under the loan agreement, PNC will make advances to the Company of up to $30.0 million through July 2012 based on periodic requests from us.

On August 3, 2011, we entered into a separate loan agreement with PNC to provide us with an equipment loan of $12.0 million to fund equipment purchases at the Baltimore facility. Under the equipment loan agreement, PNC will make advances to us of up to $12.0 million through August 2012 based on periodic requests from us.

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 BioThrax product sales, collaboration funding, development contract and grant funding, and any lines of credit we may establish from time to time.. There are numerous risks and

uncertainties associated with BioThrax product sales and with the development and commercialization of our product candidates. We may seek additional external debt financing to provide additional financial flexibility. Our future capital requirements will depend on many factors, including:

- the level and timing of BioThrax product sales and cost of product sales;
- our ability to obtain funding from government entities and non-government and philanthropic organizations for our development programs;
- the level of participation of collaborative partners in our development programs;
- the acquisition of new facilities, and capital improvements to new or existing facilities;
- the timing of, and the costs involved in, completion of qualification and validation activities related to Building 55, our large-scale manufacturing facility in Lansing, Michigan, the build out of our new facility in Baltimore, Maryland, and any other new facilities;
- the scope, progress, results and costs of our preclinical and clinical development activities;
- the costs, timing and outcome of regulatory review of our product candidates;
- the number of, and development requirements for, other product candidates that we may pursue;
- §