HERITAGE FINANCIAL CORP /WA/
Form 11-K
June 26, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 11-K

x **ANNUAL REPORT PURSUANT TO SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2011

OR

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

COMMISSION FILE NUMBER 000-29480

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

(Full title of the plan)

HERITAGE FINANCIAL CORPORATION

201 5TH AVENUE S.W.

OLYMPIA, WASHINGTON 98501-1114

(Name of issuer of the securities held pursuant to the plan and the address of its principal executive office)

REQUIRED INFORMATION

The Heritage Financial Corporation 401(k) Employee Stock Ownership Plan and Trust (the Plan) is subject to ERISA and elects to file Plan financial statements and schedules prepared in accordance with the financial reporting requirements of ERISA.

Furnished herewith are the financial statements and schedules of the Plan as of December 31, 2011 and 2010 and for the year ended December 31, 2011.

Table of Contents

FINANCIAL STATEMENTS AND EXHIBITS

(a) FINANCIAL STATEMENTS

Statements of Net Assets Available for Benefits as of December 31, 2011 and 2010

Statement of Changes in Net Assets Available for Benefits for the year ended December 31, 2011

Notes to Financial Statements

Form 5500, Schedule H, Line 4i Schedule of Assets (Held at End of Year)

(b) EXHIBIT

Exhibit 23 - Consent of Independent Registered Public Accounting Firm

Table of Contents

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

Financial Statements and Supplemental Schedules

December 31, 2011 and 2010

(Report of Independent Registered Public Accounting Firm)

Table of Contents

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

Table of Contents

	Page(s)
Report of Independent Registered Public Accounting Firm	1
Financial Statements:	
Statements of Net Assets Available for Benefits	2
Statement of Changes in Net Assets Available for Benefits	3
Notes to Financial Statements	4 14
Supplemental Schedules	
Schedule of Assets (Held at End of Year)	15
All other Schedules have been omitted as not applicable	

Table of Contents

Report of Independent Registered Public Accounting Firm

Audit and Finance Committee

Heritage Financial Corporation 401(k)

Employee Stock Ownership Plan and Trust

Olympia, Washington

We have audited the accompanying statements of net assets available for benefits of the Heritage Financial Corporation 401(k) Employee Stock Ownership Plan and Trust (the Plan) as of December 31, 2011 and 2010, and the related statement of changes in net assets available for benefits for the year ended December 31, 2011. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2011 and 2010, and the changes in net assets available for benefits for the year ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule H, line 4i Schedule of Assets (Held at End of Year) as of December 31, 2011 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedule is the responsibility of the Plan s management. The supplemental schedule has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

/s/ KPMG LLP
Seattle, Washington
June 26, 2012

Table of Contents

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

Statements of Net Assets Available for Benefits

December 31, 2011 and 2010

	2011	2010
Assets:		
Participant directed investments at fair value:		
Registered investment company funds	$ 13,327,996	$ 15,446,633
Stable value fund	3,327,319	
Heritage Financial Corporation common stock	4,666,670	5,197,701
Cash and cash equivalents	257,686	217,307
	21,579,671	20,861,641
Nonparticipant directed investments at fair value:		
Heritage Financial Corporation common stock	242,220	397,305
Total investments	21,821,891	21,258,946
Non-interest bearing cash	12,510	
Receivables:		
Employer contributions	581,740	369,653
Participant contributions		1,336
Notes receivable from participants	128,957	125,654
Total receivables	710,697	496,643
Total assets	22,545,098	21,755,589
Liabilities:		
Loan payable to Heritage Financial Corporation	161,196	297,420
Accounts payable and other	27,582	25,956
Excess deferrals		17,875
Total liabilities	188,778	341,251
Net assets reflecting investments at fair value	22,356,320	21,414,338
Adjustment from fair value to contract value for underlying fully benefit-responsive investment contracts	(84,468)	
Net assets available for benefits	$ 22,271,852	$ 21,414,338

See accompanying notes to financial statements.

Table of Contents

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

Statement of Changes in Net Assets Available for Benefits

Year ended December 31, 2011

Investment (loss) income:	
Net depreciation in fair value of investments	$ (1,123,943)
Interest	4,064
Dividends	352,129
Other	43,040
Net investment loss	(724,710)
Contributions:	
Participant salary deferrals	1,278,438
Employer	1,020,455
Participant rollover	234,892
ESOP loan payments	156,278
Total contributions	2,690,063
Total additions	1,965,353
Deductions:	
Benefits paid to participants	943,883
Administrative expenses	143,901
Interest expense	20,055
Total deductions	1,107,839
Net increase	857,514
Net assets available for benefits, beginning of year	21,414,338
Net assets available for benefits, end of year	$ 22,271,852

See accompanying notes to financial statements.

Table of Contents

HERITAGE FINANCIAL CORPORATION

401(k) EMPLOYEE STOCK OWNERSHIP PLAN AND TRUST

Notes to Financial Statements

December 31, 2011 and 2010

(1) Description of Plan

The following description of the Heritage Financial Corporation 401(k) Employee Stock Ownership Plan and Trust (the Plan) provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan s provisions.

(a) General

Heritage Financial Corporation (the Company) is a bank holding company with headquarters in Olympia, Washington.

The Plan is a qualified defined contribution plan established by the Company under the provisions of Section 401(a), Section 401(k) and Section 4975(e)(7) of the Internal Revenue Code (IRC) with salary reduction and employer stock ownership features for the benefit of eligible employees of the Company. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

The Plan is administered by the 401(k) Employee Stock Ownership Plan (KSOP) Committee, which consists of certain officers and employees of the Company. Wilmington Trust Company serves as the custodian, certain officers of the Company serve as Trustees of the Plan, and RBC Wealth Management serves as the investment advisor.

(b) Eligibility

Employees are eligible to participate in the Plan on the first of the month coincident with or following thirty days of service and attaining age eighteen.

(c) Contributions

Participants may elect to contribute up to the lesser of 100% of their eligible compensation or to certain limitations under the IRC. These limitations include a dollar limitation ($16,500 for 2011 and 2010) and discrimination testing limitations. Additionally, participants over the age of 50 at Plan year end may make catch-up contributions up to the applicable dollar limitation ($5,500 for 2011 and 2010). Participants may also contribute amounts representing distributions from other qualified plans.

The Company makes contributions to participant accounts as follows:

1) a matching contribution equal to 50% of the participant s contribution up to 6% of the participant s eligible compensation. Matching contributions are subject to discrimination limitations.

2) required profit sharing contribution of 2% of the participant s eligible compensation.

3) discretionary profit sharing contributions beyond the required 2% contribution.

4) discretionary Employee Stock Ownership Plan (ESOP) allocation of Company Stock, determined based on the current year ESOP loan principal and interest repayments. See Note 3 for additional discussion.

During 2011, the Company s discretionary profit sharing contribution totaled 1% of eligible compensation. The following provisions apply to contributions:

Participants are eligible for matching contributions upon participation in the Plan.

Non-ESOP Employer contributions to the Plan are invested as directed by the employee.

ESOP contributions are employer directed and initially invested in Heritage Financial Corporation common stock. Participants may elect to diversify these investments as permitted under the Plan.

Participants, who are not credited with at least 1,000 hours of service during the Plan year or are not employed on the last working day of a Plan year, are not eligible for an allocation of nonmatching Company profit sharing or ESOP contributions for that year except in the event of the participant s death, disability or retirement.

Table of Contents

During 2011, the Company met the minimum funding requirements as defined by ERISA.

(d) Participants Accounts

Each participant s account is credited with the participant s elective (401(k)) contributions and allocations of the Company s contributions (including Company stock attributable to repayments of the ESOP loan) and Plan earnings net of expenses. The benefit to which a participant is entitled is the benefit that can be provided from the participant s vested account. Participant accounts are valued daily based on quoted market prices.

(e) Vesting

Participants are always vested in their 401(k) contributions plus earnings thereon. Vesting in the Company s contributions plus earnings thereon is based on years of service. A participant s matching contribution and all other employer contributions are 100% vested after six years of service (or upon death or disability while employed, or retirement on or after normal retirement age), with 20% vesting at two years of service increasing by an additional 20% with each additional year of service.

(f) Investment Options

The Plan s ESOP component is designed to invest primarily in Company common stock in order to comply with Section 4975(e)(7) of the IRC and Income Tax Regulation 54.4975-11. Upon enrollment in the Plan, a participant may direct his or her 401(k) contributions in 1% increments among eleven registered investment company funds, one stable value fund, and the Company stock fund. Participants also have the option to invest in four different managed portfolio strategies.

Participants may change their investment elections and reallocate their investments on a daily basis (including with respect to Company stock). Contributions may be temporarily held as cash balances pending the execution of the investment according to the participant s direction.

(g) Payment of Benefits

No distributions from the Plan may be made until a participant retires, dies (in which case, payment shall be made to his or her beneficiary or, if none, to his or her legal representatives), becomes disabled or otherwise terminates employment with the Company. Participants aged 59 $^{1}/_{2}$ or older are eligible for in-service distributions. However, the participant has the right to defer receipt of his Plan accounts until he or she attains normal retirement age (age 65).

Distributions are made in cash, Company stock, or both, at the election of the participant, subject to the terms of the Plan.

Benefit distributions are based on the participant s vested account balance and may be distributed in a lump sum. If a participant s vested account balances exceed $1,000, a participant may elect to have the vested accounts distributed in installments over a period of not more than the participant s life expectancy, or through the purchase of an annuity. In the case of a married participant, certain accounts from a previously merged plan must be distributed in the form of a joint and survivor annuity with the participant s spouse as the joint annuitant, unless waived by the participant and consented to by the participant s spouse.

Under certain conditions, participants, while still employed by the Company, are permitted to withdraw in a single sum, the employee contribution portion of their account balance on account of hardship as defined in IRS regulations. If a hardship withdrawal is made, a participant s right to make 401(k) contributions to the Plan will be suspended for six months after the receipt of the hardship withdrawal. This will affect the participant s right to receive matching contributions but not other Company contributions. In addition, participants, while still employed by the Company, are permitted to withdraw all or a portion of their employee account balance after age 59 $^{1}/_{2}$. Rollover accounts may be withdrawn, all or part, once during each Plan Year regardless of the participant s age.

The Plan has the right to immediately distribute participant accounts upon termination of service for participants with balances not exceeding $1,000, as a lump sum distribution.

(h) Diversification

Participants may diversify their employer contributions daily among all of the investment options in the Plan from time to time, including the Company stock fund.

Table of Contents

(i) Voting and Dividend Rights

No participant shall have any voting or dividend rights or other rights of a stockholder prior to the time that shares are allocated to the participant.

Each participant is entitled to exercise voting rights attributable to the shares of Company stock allocated to his or her account and is notified by the trustee prior to the time that such rights are to be exercised.

(j) Forfeitures

Forfeitures may be used to pay reasonable and permitted administrative expenses, with the remainder used to reduce the Company s employer contribution obligation. Forfeitures used to reduce employer contributions during 2011 were $14,515.

(k) Notes Receivable from Participants

Participants may borrow, upon written application, any amount provided that the aggregate amount of all outstanding notes from the participant to the Plan, taking into account notes payable to any other qualified plan maintained by the employer, shall not exceed the lesser of $50,000 or 50% of the participant s vested account balance. Note terms shall not exceed five years, except for the purchase of a primary residence. The notes are collateralized by the balance in the participant s account and bear interest at a rate equal to the then current prime rate. Principal and interest is paid ratably through semi-monthly payroll deductions. The interest rates on outstanding notes as of December 31, 2011 were all 3.25% and the notes mature through September 2016. All notes were current and the Plan recorded no allowance for loan losses related to the outstanding notes receivable from participants as of December 31, 2011 or 2010.

(l) Administrative Expenses and Revenue Sharing Credits

Administrative expenses including trust, recordkeeping, audit, and investment fees are paid by the Plan. The Company may also pay certain administrative expenses incurred by the Plan.

The Plan earns revenue sharing credits from certain registered investment funds based on the invested balances. The credits may be used to pay reasonable and permitted administrative expenses. Credits used to pay Plan expenses during 2011 were $37,833.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

The accompanying financial statements have been prepared under the accrual method of accounting.

(b) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and changes therein, and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

(c) Risks and Uncertainties

The Plan allows participants to direct contributions into various registered investment company funds, a stable value fund, and Company stock. The underlying investment securities of these funds and the Company stock are exposed to various risks, including but not limited to interest rate, market, liquidity and credit risk. Due to the level of risk associated with certain underlying investment securities, the sensitivity of certain

fair value estimates to changes in valuation assumptions, and the level of uncertainty related to changes in the value of the funds, in particular the Company stock, it is likely that changes in the value of investment securities will occur in the near term and that such changes could materially affect participants account balances and the amounts reported in the statement of net assets available for benefits and the statement of changes in net assets available for benefits.

Participants should refer to Heritage Financial Corporation s annual and quarterly financial statements filed with the Securities and Exchange Commission (Form 10K and 10Q) regarding risks associated with Company stock.

(d) Investment Valuation and Income Recognition

The Plan s investments are stated at fair value as further described in Note 5.

Table of Contents

Purchases and sales of securities are recorded on a trade-date basis. Dividend income is accrued on the ex-dividend date. Interest income is recorded on the accrual basis. Realized gains and losses from security transactions are reported on the moving average method. Net appreciation (depreciation) in fair value of investments represents the change in fair value from one period to the next and realized gains and losses.

(e) Stable Value Fund

The Plan includes investments in fully-benefit responsive contracts as part of offering the Wells Fargo Stable Value Fund M (Fund) investment option to participants. The Fund is primarily comprised of investment contracts issued by financial companies including guaranteed investment contracts (GICs), separate account GICs (SICs), and security backed investment contracts. GICs are issued by insurance companies which guarantee the return of principal and stated rate of return for a specific period of time. GICs are backed by the general account of the insurance company. SICs are GICs issued by an insurance company and are maintained within a separate account. SICs are backed by segregated pool of assets. Security backed investment contracts are comprised of two components: investment contracts issued by a financial institution (i.e. wrap contracts) and underlying portfolios of fixed income securities (generally bonds) whose market prices fluctuate.

The Fund s contracts are carried at contract value in the participants account. Participant accounts are credited with interest at a fixed rate that is typically reset quarterly. The rate reset allows the contract value to converge with a fair value of the underlying portfolio over time, assuming the portfolio continues to earn the current yield for a period of time equal to the current portfolio duration. While there may be slight variations from one contract to another, the primary variables which could impact the future rates credited to participants include (1) the amount and timing of participant contributions, (2) transfers and withdrawals into/out of the contract, (3) the current yield of the assets underlying the contract, (4) the duration of the assets underlying the contract and (5) the existing difference between fair value of the securities and the contract value of the assets within the insurance contract.

To the extent that the underlying portfolio has unrealized and/or realized losses, an adjustment is made when reconciling from fair value to contract value under contract value accounting. As a result, the future rate credited to participants may be lower over time than the current market rates. Similarly, if the underlying portfolio generates unrealized and/or realized gains, an adjustment is made when reconciling from fair value to contract value and, in the future, the rate credited to participants may be higher than the current market rates. The contracts cannot credit an interest rate that is less than zero percent.

Each contract issuer specifies events which would limit the ability of the Plan to transact at contract value. Such events can include premature termination of the contracts by the Plan or Plan termination. The Company does not believe that occurrence of any such events is probable.

The contracts for the Fund limit the circumstances under which the issuer may unilaterally terminate the contract. The issuer may terminate the contract on short notice upon the Plan s loss of its qualified status, uncured material breaches of responsibilities, or material and adverse changes to the provisions of the Plan. If one of these events was to occur, the issuer could terminate the contracts at the fair value of the underlying securities. The Fund reserves the right to require twelve-month notice for withdrawal of assets from the Fund initiated by the Plan sponsor.

The average yield earned by the entire Fund for all fully benefit-responsive investment contracts, which is calculated by dividing the annualized earnings of all investments in the Fund (irrespective of the interest rate credited to participants in the Fund) by the fair value of all investments in the Fund, for 2011, was 1.56%. The average yield earned by the entire Fund, with an adjustment to reflect the actual interest rate credited to participants, for 2011, was 2.33%.

(f) Payment of Benefits

Benefits are recorded when paid. At December 31, 2011 and 2010, assets allocated to withdrawing participants totaled $1,500 and $10,158, respectively.

(g) Notes Receivable from Participants

Notes receivable from participants are stated at the outstanding balance of the loan plus accrued interest. Interest income is recorded on the accrual basis.

(h) Recently Adopted Accounting Standards

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2010-25, *Plan Accounting Defined Contribution Pension Plans (Topic 962), Reporting Loans to Participants by Defined Contribution*

Table of Contents

Pension Plans, a consensus of the FASB Emerging Issues Task Force (Update). This Update requires that participant loans be classified as notes receivable from participants, which are segregated from plan investments and measured at their unpaid principal balance plus any accrued but unpaid interest. This Update is effective for periods ending after December 15, 2010, with early adoption permitted, and requires retrospective application to all periods presented. ASU 2010-25 was adopted for the year ended December 31, 2010. The adoption had no effect on the Plan s Net Assets Available for Benefits.

(3) Leveraged ESOP Feature

The Plan purchased shares of the Company s stock using the proceeds of a loan from the Company and the Plan holds the stock in a trust established under the Plan. The loan is to be repaid over a period of 15 years funded by Company contributions to the trust fund. The Company stock acquired with the ESOP loan is held in an unallocated suspense account under the Plan pending repayment of the loan.

Under the ESOP feature of the Plan, the Company is obligated to make contributions to the Plan which, when aggregated with the Plan s dividends and interest earnings, equal the amount necessary to enable the Plan to make its regularly scheduled payments of principal and interest due on its term indebtedness to the Company. Each year, as the Plan makes payments of principal and interest, an appropriate percentage of stock is released from the suspense account in accordance with applicable regulations under the IRC, and allocated to participants, generally on a pro rata basis based on annual compensation.

The unallocated shares of Company stock collateralize the loan. The lender has no rights against shares once they are allocated under the Plan. Accordingly, the table below presents separately the assets and liabilities and changes therein pertaining to:

(a) accounts of employees with rights in allocated stock and

(b) stock not yet allocated to employees.

The Plan s ESOP assets are summarized as follows and represent a portion of the Heritage Financial Corporation common stock as presented on the Statement of Net Assets:

	2011		2010	
	Allocated	**Unallocated**	**Allocated**	**Unallocated**
Heritage Financial Corporation common stock, at fair value	$ 1,768,335	242,220	1,868,871	397,305
Cash and cash equivalents	32,982	7,303	663	
Pending transfers	116,280	(116,280)	128,446	(127,913)
Loan payable to Heritage Financial Corporation		(161,196)		(297,420)
Net ESOP assets (liabilities)	$ 1,917,597	(27,953)	1,997,890	(28,028)

Pending transfers represent shares of Company stock to be deposited to participants in Q1 of the following plan year. Upon transfer, the shares will be participant-directed.

Table of Contents

The ESOP component s change in net assets is summarized as follows:

	Year ended December 31, 2011	
	Allocated	**Unallocated**
Heritage Financial Corporation common stock:		
Net depreciation in fair value of investments	$ (190,961)	(27,171)
Interest and dividends	53,417	7,328
Loan payments		156,278
Shares released	116,280	(116,280)
Fund transfers/stock diversifications	(37,967)	
Distributions to participants	(21,152)	
Administrative expense		(25)
Interest expense		(20,055)
Net (decrease) increase	(80,383)	75
Net assets, beginning of year	1,997,980	(28,028)
Net assets, end of year	$ 1,917,597	(27,953)

In January 1998, the Plan borrowed $1,323,000 from the Company to purchase shares of the Company s stock. The loan matures January 2013 and is repaid in monthly installments of $13,023 primarily from the Company s contributions. Interest is accrued at a rate of 8.5% per annum.

ONT SIZE="1"> 2,942 26,867 29,809

Depreciation and amortization

651 529 536 1,716

Segment operating income (loss)

(4,744) 9,608 (16,818) (11,954)

Nine months ended Mar. 31, 2007:

Revenues

8,631 103,017 111,648

Depreciation and amortization

1,975 1,715 1,846 5,536

Segment operating income (loss)

(15,568) 44,285 (64,178) (35,461)

Nine months ended Mar. 31, 2006:

Revenues

10,466 71,788 82,254

Depreciation and amortization

1,947 1,577 1,527 5,051

Segment operating income (loss)

(11,005) 23,527 (44,130) (31,608)

(in thousands)	Three Months Ended Mar. 31, 2007	2006	Nine Months Ended Mar. 31, 2007	2006
Total operating loss for reportable segments	$ (9,092)	$ (11,954)	$ (35,461)	$ (31,608)
Interest income	3,123	2,407	8,298	4,867
Other	32	(24)	5	(24)
Net loss	$ (5,937)	$ (9,571)	$ (27,158)	$ (26,765)

(6) Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159 (SFAS 159) *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company s adoption of SFAS 159 is not expected to have a material effect on our consolidated financial position or results of operations.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) *Accounting for Income Tax Uncertainties*. FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authority. FIN 48 provides guidance on the de-recognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 is not expected to have a material effect on the Company s consolidated financial position or results of operations.

Table of Contents

(7) Public Offering of Common Stock

In February 2007, the Company received $105.3 million in net proceeds from an underwritten public offering of three million shares of common stock pursuant to the Company s outstanding shelf registration on Form S-3 (Registration No. 333-123914). The Company has approximately $43.4 million of securities available for sale under the shelf registration statement.

Table of Contents

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

We are a leading biotechnology company focused on the development and marketing of novel therapeutic and molecular diagnostic products. We employ a number of proprietary technologies that permit us to understand the genetic basis of human disease and the role that genes and their related proteins play in the onset and progression of disease. We use this information to guide the development of new healthcare products that will treat major diseases and assess a person s risk of disease later in life.

We believe that the future of medicine lies in the creation of new classes of drugs that treat the underlying cause, not just the symptoms, of disease and that may be useful in disease prevention. By understanding the genetic basis of disease, we believe we will be able to develop drugs that are safer and more efficacious. In addition, we believe that advances in the emerging field of molecular diagnostics will improve our ability to determine which patients are subject to a greater risk of developing these diseases and who therefore would benefit from preventive therapies.

Understanding the cause of disease at the molecular level can be very useful in determining how best to treat the disease. Historically, technologies used to discover pharmaceutical products that treat the symptoms of diseases have been less effective against complex diseases that arise through a combination of genetic and environmental factors, such as cancer and Alzheimer s disease. In order to treat complex diseases effectively, it is imperative to understand how the body uses its genetic information, how the disruption of important biological pathways can lead to disease, and how drugs can be developed to prevent, modify, or halt disease progression. As we learn more about the genetic basis of disease, we believe that we will be able to develop drugs that are more effective and have fewer side effects.

Our molecular diagnostic business encompasses efforts in both predictive medicine and personalized medicine. Predictive medicine analyzes genes and their mutations to assess an individual s risk for developing disease later in life. Personalized medicine analyzes genes and their mutations to assess a patient s risk of disease progression, disease recurrence, and drug response and toxicity. To date we have launched four commercial molecular diagnostic products. We market these products through our own 140-person sales force in the United States and we have entered into marketing collaborations with other organizations in selected foreign countries. Molecular diagnostic revenue was $38.0 million and $103.0 million for the three and nine months ended March 31, 2007, respectively, representing increases of 41% and 44% over revenues of $26.9 million and $71.8 million for the same periods in the prior year. Our current commercial molecular diagnostic products are described below:

BRACAnalysis®: molecular diagnostic product for breast and ovarian cancer. BRACAnalysis is a comprehensive analysis of the BRCA1 and BRCA2 genes for assessing a woman s risk for breast and ovarian cancer. A woman who tests positive with the BRACAnalysis test has an 82% risk of developing breast cancer during her lifetime and up to a 54% risk of developing ovarian cancer. BRACAnalysis provides important information that we believe will help the patient and her physician make better informed lifestyle, surveillance, preventive medication and treatment decisions. As published in the *Journal of the National Cancer Institute*, researchers have shown that pre-symptomatic individuals who have a high risk of developing breast cancer can reduce their risk by approximately 50% with appropriate preventive therapies. Additionally, as published in the *New England Journal of Medicine*, researchers have shown that pre-symptomatic individuals who carry gene mutations can lower their risk of developing ovarian cancer by approximately 60% with appropriate preventive therapies.

COLARIS®: molecular diagnostic product for colon cancer and uterine cancer. COLARIS is a comprehensive analysis of the MLH1 and MSH2 genes for determining a person s risk of developing colon cancer or uterine cancer. Individuals who carry a deleterious mutation in one of the two colon cancer genes in the COLARIS test have a greater than 80% lifetime risk of developing colon cancer and women have a 60% lifetime chance of developing uterine cancer.

Table of Contents

Highly effective preventive measures include colonoscopy and the removal of precancerous polyps. Through proper application of screening and polyp removal, colon cancer is a preventable disease.

COLARIS AP®: molecular diagnostic product for colon cancer. COLARIS AP detects mutations in the APC and MYH genes, which cause a colon polyp-forming syndrome known as Familial Adenomatous Polyposis (FAP) and a more common variation of the syndrome known as attenuated FAP. Individuals who carry a deleterious mutation in the APC or MYH gene may have a greater than 90% lifetime risk of developing colon cancer. Effective preventive measures include colonoscopy and the removal of pre-cancerous polyps and prophylactic surgery.

MELARIS®: molecular diagnostic product for melanoma. MELARIS analyzes mutations in the p16 gene to determine genetic susceptibility to malignant melanoma, a deadly form of skin cancer. Individuals who test positive for MELARIS have a 75-fold increased risk of developing melanoma during their lifetimes as compared to the general population. MELARIS, which assesses a person s risk of developing melanoma, provides important information that we believe will be useful in the surveillance and prevention of melanoma. Melanoma can be prevented through appropriate screening and a specific threshold of action for mutation carriers, in which pre-cancerous lesions are removed before cancer can develop.

Myriad researchers have made important discoveries in the fields of cancer, Alzheimer s disease, and infectious diseases such as AIDS. These discoveries point to novel disease pathways that we believe may pave the way for the development of new classes of drugs. We intend to develop and, subject to regulatory approval, market our therapeutic products in the area of cancer, Alzheimer s disease and viral disease.

We currently have four proprietary drug candidates in six human clinical trials, and a number of other promising drug candidates are in late-stage preclinical development. Our most advanced drug development programs are described below:

Flurizan (tarenflurbil): drug candidate for Alzheimer s disease. Flurizan, our lead therapeutic candidate for the treatment of Alzheimer s disease, is the first in a new class of drug candidates known as Selective Amyloid Beta Lowering Agents, or SALAs. We have initiated two Phase 3 clinical trials in patients with mild Alzheimer s disease. The first Phase 3 trial is a two-arm study (800 mg twice daily and placebo) which has completed enrollment of 1,684 patients in 130 centers in the United States and is designed to assess the ability of Flurizan to reduce the rate of cognitive decline and decline in activities of daily living over an 18-month period. The second Phase 3 trial is also a two-arm study (800 mg twice daily and placebo) which has completed enrollment of 840 patients in 100 centers in Europe, Canada and the United States. This study is also designed to assess the ability of Flurizan to reduce the rate of cognitive decline and decline in overall function, such as judgment, problem-solving, behavior, and orientation over an 18-month period.

Azixa : drug candidate for solid cancer tumors and brain metastases. Azixa is a novel, small-molecule tubulin inhibitor that has recently begun two Phase 2 human clinical trials. The first Phase 2 trial is designed to determine the safety profile of Azixa and the extent of its ability to improve the survival of patients with glioblastoma multiforme, the most common form of primary brain cancer. The trial will compare the survival of patients treated with Azixa to those treated with oxaliplatin, a chemotherapy drug, and to those treated with Azixa plus oxaliplatin. The second Phase 2 trial is designed to determine the safety profile of Azixa and the extent of its ability to improve the overall survival of patients with melanoma skin cancer with brain metastases. The trial will compare the survival of patients treated with Azixa to those treated with temozolomide, a chemotherapy drug, or the combination of Azixa plus temozolomide.

Table of Contents

MPC-2130: drug candidate for blood cancers. Our drug candidate MPC-2130, a novel apoptosis inducing small molecule, is in Phase 1 clinical testing. The study is designed to evaluate the safety and pharmacokinetic profile of MPC-2130 in patients with hematologic cancers as well as refractory cancers that have progressed despite previous chemotherapy. In preclinical studies, MPC-2130 demonstrated cancer cell killing activity in ovarian cancer and prostate cancer as well as two lymphoma cell lines, Burkitt s lymphoma and T-cell lymphoma. In addition, MPC-2130 was not subject to multiple drug resistance and was able to cross the blood-brain barrier.

MPC-0920: drug candidate for thrombosis. We have initiated a Phase 1 human clinical trial for our drug candidate MPC-0920, an orally available direct thrombin inhibitor. The study uses an escalating dose regimen designed to evaluate the safety, pharmacokinetic, and pharmacodymanic profile of MPC-0920 in healthy volunteers. MPC-0920 has demonstrated characteristics that may offer improvements over traditional anticoagulants, which have limitations such as non-selectivity, inability to effect thrombin-bound fibrin, and drug and food interactions.

MPI-49839: drug candidate for AIDS. MPI-49839, an orally available viral maturation inhibitor, is in late-stage preclinical development for the treatment of AIDS. As published in the scientific journal *Cell* in October 2001, our scientists and their collaborators discovered the viral budding and maturation mechanism in HIV and other viruses. This discovery led to the development of MPI-49839, which is one of a new class of drug candidates for the treatment of AIDS. MPI-49839 has demonstrated strong anti-HIV activity and has been shown to be active against many of the drug resistant strains of HIV. MPI-49839 is in late-stage preclinical development in preparation for human clinical testing in the future.

We have also entered into strategic partnerships and collaborative relationships to discover genes and proteins associated with human disease, elucidate protein networks and disease pathways, screen small molecule libraries against drug target assays, develop novel drug candidates, and sequence the genome of entire organisms. We are currently undertaking collaborative research and development work with a number of organizations, including Abbott Laboratories, Instituto Agrario di San Michele all Adigea and various entities within the National Institutes of Health. These collaborations allow us to further develop and utilize our technologies and to generate revenue.

We have devoted substantially all of our resources to undertaking our drug discovery and development programs, operating our molecular diagnostic business, and continuing our research and development efforts. We have three reportable operating segments: (1) research, (2) molecular diagnostics, and (3) drug development. See Note 5 Segment and Related Information in the notes to our condensed consolidated financial statements (unaudited) for information regarding these operating segments. Our revenues have consisted primarily of sales of molecular diagnostic products and research payments. We have yet to attain profitability and, for the three and nine months ended March 31, 2007, we had net losses of $5.9 million and $27.2 million, respectively. As of March 31, 2007 we had an accumulated deficit of $244.6 million.

We expect to incur losses for at least the next several years, primarily due to the expansion of our drug discovery and development efforts, the initiation and continuing conduct of human clinical trials, the launch of new molecular diagnostic products, the continuation of our internal research and development programs, and the expansion of our facilities. Additionally, we expect to incur substantial sales, marketing and other expenses in connection with building our pharmaceutical and molecular diagnostic businesses. We expect that losses will fluctuate from quarter to quarter and that such fluctuations may be substantial.

Table of Contents

Critical Accounting Policies

Critical accounting policies are those policies which are both important to the portrayal of a company s financial condition and results and require management s most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Our critical accounting policies are as follows:

- revenue recognition;
- allowance for doubtful accounts; and
- share-based payment expense.

Revenue Recognition. Molecular diagnostic revenue includes revenue from the sale of molecular diagnostic products and related marketing agreements. Molecular diagnostic revenue is recognized upon completion of the test or analysis and communication of results and when collectibility is reasonably assured.

Research revenue includes revenue from research agreements, milestone payments, and technology licensing agreements. In applying the principles of Staff Accounting Bulletin 104 to research and technology license agreements we consider the terms and conditions of each agreement separately to arrive at a proportional performance methodology of recognizing revenue. Such methodologies involve recognizing revenue on a straight-line basis over the term of the agreement, on a basis of costs incurred relative to the total estimated contract costs, or on the basis of contractually defined output measures such as units delivered. We make adjustments, if necessary, to the estimates used in our calculations as work progresses and we gain experience. The principal costs under these agreements are for personnel expenses to conduct research and development but also include costs for materials and other direct and indirect items necessary to complete the research under these agreements. Actual results may vary from our estimates. Payments received on uncompleted long-term contracts may be greater than or less than incurred costs and estimated earnings and have been recorded as other receivables or deferred revenues in the accompanying consolidated balance sheets. We recognize revenue from milestone payments as agreed-upon events representing the achievement of substantive steps in the development process are achieved and where the amount of the milestone payments approximates the value of achieving the milestone. We recognize revenue from up-front nonrefundable license fees on a straight-line basis over the period of our continued involvement in the research and development project.

Allowance for Doubtful Accounts. The preparation of our financial statements in accordance with U.S. GAAP requires us to make estimates and assumptions that affect the reported amount of assets at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Trade accounts receivable are comprised of amounts due from sales of our molecular diagnostic products. We analyze trade accounts receivable and consider historic experience, customer creditworthiness, facts and circumstances specific to outstanding balances, and payment term changes when evaluating the adequacy of the allowance for doubtful accounts. Changes in these factors could result in material adjustments to the expense recognized for bad debt.

Share-Based Payment Expense. Financial Accounting Standards Board Statement No. 123R, *Share-Based Payment* (SFAS 123R) and Staff Accounting Bulletin No. 107 set accounting requirements for share-based compensation to employees, including employee stock purchase plans, and require us to recognize in our consolidated statements of operations the grant-date fair value of our stock options and other equity-based compensation. The determination of grant-date fair value is estimated using an option-pricing model, which includes variables such as the expected volatility of our share price, the exercise behavior of our employees, interest rates, and dividend yields. These variables are projected based on our historical data, experience, and other factors. Changes in any of these variables could result in material adjustments to the expense recognized for share-based payments.

Table of Contents

Results of Operations for the Three Months Ended March 31, 2007 and 2006

Molecular diagnostic revenue is comprised primarily of sales of our four molecular diagnostic products. Molecular diagnostic revenue for the three months ended March 31, 2007 was $38.0 million compared to $26.9 million for the same three months in 2006, an increase of 41%. Increased sales, marketing, and education efforts have resulted in wider acceptance of our products by the medical community and increased testing volumes and revenue for the three months ended March 31, 2007. There can be no assurance that molecular diagnostic revenue will continue to increase at historical rates.

Research revenue is comprised of research payments received pursuant to collaborative agreements. Research revenue for the three months ended March 31, 2007 was $3.0 million compared to $2.9 million for the same three months in 2006. This 1% increase in research revenue is primarily attributable to a new research collaboration and was offset by the successful completion of a research collaboration in the prior year quarter. Research revenue from our research collaboration agreements is recognized using a proportional performance methodology. Consequently, as these programs progress and outputs increase or decrease, revenue may increase or decrease proportionately. In the future we expect to continue to de-emphasize external collaborations and focus on the operation of our molecular diagnostic and drug development segments.

Molecular diagnostic cost of revenue for the three months ended March 31, 2007 was $7.6 million compared to $7.5 million for the same three months in 2006. This increase of 1% in molecular diagnostic cost of revenue is primarily due to the 41% increase in molecular diagnostic revenues for the three months ended March 31, 2007 compared to the same three months in 2006. Our gross profit margin was 80% for the three months ended March 31, 2007 compared to 72% for the same three months in 2006. This increase in gross profit margins is primarily attributable to technology improvements and efficiency gains in the operation of our molecular diagnostic laboratory. There can be no assurance that molecular diagnostic gross profit margins will continue to increase and we expect that our gross profit margins will fluctuate from quarter to quarter based on the introduction of new products as well as new technologies and operating systems in our molecular diagnostic laboratory.

Research and development expenses for the three months ended March 31, 2007 were $23.4 million compared to $22.0 million for the same three months in 2006. This increase of 7% was primarily due to increased costs associated with our ongoing clinical trials, which added approximately $2.0 million to our research and development costs for the three months ended March 31, 2007 compared to the prior year quarter. Increased costs associated with our drug discovery and drug development programs added approximately $1.4 million to our research and development costs for the three months ended March 31, 2007 compared to the prior year quarter. Decreased costs from the successful completion of a research collaboration in the prior year quarter reduced our research and development costs approximately $2.0 million for the three months ended March 31, 2007 compared to the prior year quarter. We expect to increase our research and development expenses over the next several years as we expand clinical trials and begin commercialization of our product candidates currently in clinical development, including Flurizan and Azixa, advance our other product candidates into clinical trials, and expand our research and development activities. We expect that these expenses will continue to fluctuate from quarter to quarter based on changes in our research programs and the progression of our drug development programs.

Selling, general and administrative expenses consist primarily of salaries, commissions and related personnel costs for sales, marketing, customer service, billing and collection, executive, legal, finance and accounting, human resources, and allocated facilities expenses. Selling, general and administrative expenses for the three months ended March 31, 2007 were $19.1 million compared to $12.3 million for the same three months in 2006. This increase of 55% was partially attributable to increased sales and marketing commissions and headcount to support the 41% growth in our molecular diagnostic business, which resulted in an increase of $2.2 million compared to the prior year quarter. Marketing costs associated with the preparation of our upcoming direct-to-consumer advertising campaign resulted in an

Table of Contents

increase of $1.6 million compared to the prior year quarter. Increased non-cash expense under SFAS 123R associated with our stock option plan and Employee Stock Purchase Plan resulted in an increase of $0.7 million compared to the prior year quarter. General increases in costs to support growth in our molecular diagnostic business and therapeutic development efforts resulted in an increase of approximately $2.3 million to our selling, general, and administrative expense compared to the prior year quarter. We expect our selling, general and administrative expenses will continue to fluctuate depending on the number and scope of new product launches and our drug discovery and drug development efforts.

Results of Operations for the Nine Months Ended March 31, 2007 and 2006

Molecular diagnostic revenue for the nine months ended March 31, 2007 was $103.0 million compared to $71.8 million for the same nine months in 2006, an increase of 44%. Increased sales, marketing, and education efforts have resulted in wider acceptance of our products by the medical community and increased testing volumes and revenue for the nine months ended March 31, 2007. There can be no assurance that molecular diagnostic revenue will continue to increase at historical rates.

Research revenue for the nine months ended March 31, 2007 was $8.6 million compared to $10.5 million for the same nine months in 2006. This 18% decrease in research revenue is primarily attributable to the successful completion of two research collaborations in the prior year period and was partially offset by the initiation of a new collaboration in the current fiscal year.

Molecular diagnostic cost of revenue for the nine months ended March 31, 2007 was $23.2 million compared to $19.6 million for the same nine months in 2006. This increase of 19% in molecular diagnostic cost of revenue is primarily due to the 44% increase in molecular diagnostic revenues for the nine months ended March 31, 2007 compared to the same nine months in 2006. Our gross profit margin was 77% for the nine months ended March 31, 2007 compared to 73% for the same nine months in 2006.

Research and development expenses for the nine months ended March 31, 2007 were $74.5 million compared to $59.5 million for the same nine months in 2006. This increase of 25% was primarily due to increased costs associated with our ongoing clinical trials as well as increased costs associated with our drug discovery and drug development programs. These increases added approximately $20.0 million to our research and development costs for the nine months ended March 31, 2007 compared to the same nine months in 2006. Decreased costs from the successful completion of two research collaborations in the prior year reduced our research and development costs approximately $5.0 million for the nine months ended March 31, 2007 compared to the same nine months in 2006.

Selling, general and administrative expenses for the nine months ended March 31, 2007 were $49.4 million compared to $34.8 million for the same three months in 2006. This increase of 42% was partially attributable to increased sales and marketing commissions and headcount to support the 44% growth in our molecular diagnostic business, which resulted in an increase of $5.0 million compared to the prior year. Marketing costs associated with the preparation of our upcoming direct-to-consumer advertising campaign resulted in an increase of $1.7 million compared to the prior year. Increased non-cash expense under SFAS 123R associated with our stock option plan and Employee Stock Purchase Plan resulted in an increase of $2.1 million compared to the prior year. General increases in costs to support growth in our molecular diagnostic business and therapeutic development efforts resulted in an increase of approximately $5.8 million to our selling, general, and administrative expense compared to the prior year quarter.

Liquidity and Capital Resources

Cash, cash equivalents, and marketable investment securities increased $76.6 million, or 34%, from $227.7 million at June 30, 2006 to $304.3 million at March 31, 2007. This increase is primarily attributable to the public offering of $105.3 million (net proceeds) of our common stock in February

Table of Contents

2007, cash generated from our molecular diagnostic revenue and, to a lesser extent, proceeds from the exercise of stock options and sales of our common stock under our Employee Stock Purchase Plan. This increase was partially offset by expenditures for our ongoing clinical trials, internal research and drug development programs, acquisition of capital assets, and other expenditures incurred in the ordinary course of business.

Due primarily to increases in cash, cash equivalents, and marketable investment securities, interest income for the three and nine months ended March 31, 2007 was $3.1 million and $8.3 million, compared to $2.4 million and $4.9 million for the same three and nine months in 2006.

Net cash used in operating activities was $26.1 million during the nine months ended March 31, 2007 compared to $24.7 million used in operating activities during the same nine months in 2006. Trade accounts receivable increased $8.5 million between June 30, 2006 and March 31, 2007, primarily due to increases in molecular diagnostic sales during the same period. Accrued liabilities decreased by $3.3 million between June 30, 2006 and March 31, 2007, primarily due to payments made for amounts accrued for our clinical trials.

Our investing activities provided cash of $11.7 million during the nine months ended March 31, 2007 and used cash of $64.7 million during the same nine months in 2006. Investing activities were comprised primarily of purchases and maturities of marketable investment securities and capital expenditures for research equipment. Investing activities in both years were high due to the purchases and maturities of marketable investment securities following the receipt of $105.3 million and $139.7 million in net proceeds from the public offering of our common stock in February 2007 and November 2005, respectively.

Financing activities provided cash of $110.7 million during the nine months ended March 31, 2007 and provided cash of $146.4 million in the same nine months in 2006. During the nine months ended March 31, 2007 we received $5.5 million from the exercise of stock options and sales of our common stock under our Employee Stock Purchase Plan. Financing activities included the receipt of $105.3 million and $139.7 million in net proceeds from the public offering of our common stock in February 2007 and November 2005, respectively.

We have an effective shelf registration statement on Form S-3 (Registration No. 333-123914) on file with the Securities and Exchange Commission. We have approximately $43.4 million of various types of securities available for sale under this registration statement. Because of our significant long-term capital requirements, we may access the public or private equity markets whenever conditions are favorable, even if we do not have an immediate need for additional capital at such time.

We believe that with our existing capital resources, we will have adequate funds to maintain our current and planned operations for at least the next two years, although no assurance can be given that changes will not occur that would consume available capital resources before such time and we may need or want to raise additional financing within this period of time. Our future capital requirements, cash flows, and results of operations could be affected by and will depend on many factors that are currently unknown to us, including:

- the progress and results of our two current Phase 3 clinical trials of Flurizan for the treatment of Alzheimer s disease and any additional trials that may be required by the FDA or that we may initiate on our own;

- the progress and results of our two current Phase 2 clinical trials of Azixa for the treatment of cancer and any additional trials that may be required by the FDA or that we may initiate based on the Phase 2 results;

- the progress and results of our Phase 1 clinical trials for MPC-2130 and MPC-0920 and any future trials that may be required by the FDA or that we may initiate based on the Phase 1 results;

Table of Contents

the results of our preclinical studies and testing for our preclinical programs and any decisions to initiate clinical trials if supported by the preclinical results;

the costs, timing and outcome of regulatory review of Flurizan, Azixa, MPC-2130, MPC-0920, and any other preclinical drug candidates that may progress to clinical trials;

the costs of establishing sales and marketing functions and of establishing commercial manufacturing capacities if any of our drug candidates is approved;

the scope, progress, results and cost of preclinical development, clinical trials and regulatory review of any new drug candidates we may discover or acquire;

the progress, results and cost of developing additional molecular diagnostic products for our molecular diagnostic business;

the costs, timing and results of launching new molecular diagnostic products;

the costs, timing and outcome of any regulatory review of our existing or future molecular diagnostic products;

the costs of preparing, filing and prosecuting patent applications, maintaining and enforcing our issued patents and defending intellectual property-related claims;

our ability to enter into strategic collaborations, licensing or other arrangements favorable to us;

the costs to satisfy our obligations under potential future collaborations; and

the timing, receipt and amount of sales or royalties, if any, from Flurizan, Azixa, MPC-2130, MPC-0920, and any other drug candidates.

Effects of Inflation

We do not believe that inflation has had a material impact on our business, sales, or operating results during the periods presented.

Certain Factors That May Affect Future Results of Operations

The Securities and Exchange Commission encourages companies to disclose forward-looking information so that investors can better understand a company s future prospects and make informed investment decisions. This Quarterly Report contains such forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Words such as may, anticipate, estimate, expects, projects, intends, plans, believes and words and terms of similar substance used in with any discussion of future operating or financial performance, identify forward-looking statements. All forward-looking statements are management s present expectations of future events and are subject to a number of risks and uncertainties that could cause actual results to differ materially and adversely from those described in the forward-looking statements. These risks include, but are not limited to: our inability to further identify, develop and achieve commercial success for new products and technologies; our ability to discover drugs that are safer and more efficacious than our competitors; our ability to develop molecular diagnostic products that help assess which patients are subject to greater

risk of developing diseases and who would therefore benefit from new preventive therapies; the possibility of delays in the research and development necessary to select drug development candidates and delays in clinical trials; the risk that clinical trials may not result in marketable products; the risk that we may be unable to successfully finance and secure regulatory approval of and market our drug candidates; the risk that clinical trials will not be completed on the timelines we have estimated; uncertainties about our ability to obtain new corporate collaborations and acquire new technologies on satisfactory terms, if at all; the development of competing products and services; our ability to protect our proprietary technologies; patent-infringement claims; risks of new, changing and competitive technologies and regulations in the United States and internationally; and other factors discussed under the heading Risk Factors contained in Item 1A of our Annual Report on Form 10-K for the year ended June 30, 2006, which has been filed with the Securities and Exchange Commission, as well as any updates to those risk factors filed from time to time in our Quarterly Reports on Form 10-Q or Current Reports on Form 8-K.

Table of Contents

In light of these assumptions, risks and uncertainties, the results and events discussed in the forward-looking statements contained in this Quarterly Report or in any document incorporated by reference might not occur. Stockholders are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent forward-looking statements attributable to the Company or to any person acting on its behalf are expressly qualified in their entirety by the cautionary statements contained or referred to in this section.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We maintain an investment portfolio in accordance with our Investment Policy. The primary objectives of our Investment Policy are to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. Our Investment Policy specifies credit quality standards for our investments and limits the amount of credit exposure to any single issue, issuer or type of investment.

Our investments consist of securities of various types and maturities of three years or less, with a maximum average maturity of 12 months. These securities are classified as available-for-sale, which are recorded on the balance sheet at fair market value with unrealized gains or losses reported as part of accumulated other comprehensive income. Gains and losses on investment security transactions are reported on the specific-identification method. Dividend and interest income are recognized when earned. A decline in the market value of any marketable investment security below cost that is deemed other than temporary results in a charge to earnings and establishes a new cost basis for the security.

The securities held in our investment portfolio are subject to interest rate risk. Changes in interest rates affect the fair market value of the marketable investment securities. After a review of our marketable securities as of March 31, 2007, we have determined that in the event of a hypothetical ten percent increase in interest rates, the resulting decrease in fair market value of our marketable investment securities would be insignificant to the consolidated financial statements as a whole.

Item 4. Controls and Procedures

(a) *Evaluation of Disclosure Controls and Procedures*. Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us, including our consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

(b) *Changes in Internal Controls*. There were no changes in our internal control over financial reporting, identified in connection with the evaluation of such internal control that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II - Other Information

Item 1. Legal Proceedings.
Neither the Company nor any of its subsidiaries is a party to any material legal proceedings.

Item 1A. Risk Factors
There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.
None.

Item 3. Defaults Upon Senior Securities.
None.

Item 4. Submission of Matters to a Vote of Security Holders.
None.

Item 5. Other Information.
None.

Item 6. Exhibits.
(a) Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

32.1 Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

MYRIAD GENETICS, INC.

Date: May 1, 2007

By: /s/ Peter D. Meldrum
Peter D. Meldrum
President and Chief Executive Officer
(Principal executive officer)

Date: May 1, 2007

By: /s/ Jay M. Moyes
Jay M. Moyes
Chief Financial Officer
(Principal financial and chief accounting officer)