Emergent BioSolutions Inc.
Form 10-Q
May 06, 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 March 31, 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). o 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 April 29, 2011, the registrant had 35,507,560 shares of common stock outstanding.

Emergent BioSolutions Inc.

Index to Form 10-Q

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, including those of Trubion Pharmaceuticals, Inc., which we acquired in October 2010;
- 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)

	March 31, 2011	December 31, 2010
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	$136,925	$169,019
Investments	6,338	2,029
Accounts receivable	11,976	39,326
Inventories	22,163	12,722
Deferred tax assets, net	6,743	2,638
Income tax receivable, net	23,966	8,728
Restricted cash	217	217
Prepaid expenses and other current assets	7,875	8,814
Total current assets	216,203	243,493
Property, plant and equipment, net	157,963	152,701
In-process research and development	51,400	51,400
Goodwill	5,029	5,029
Assets held for sale	12,741	12,741
Deferred tax assets, net	26,812	33,757
Other assets	1,129	1,198
Total assets	$471,277	$500,319
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$24,034	$25,409
Accrued expenses and other current liabilities	1,257	1,309
Accrued compensation	13,687	23,975
Contingent value rights, current portion	9,113	-
Long-term indebtedness, current portion	16,927	17,187
Deferred revenue, current portion	5,916	7,839
Total current liabilities	70,934	75,719
Contingent value rights, net of current portion	6,000	14,532
Long-term indebtedness, net of current portion	29,657	30,239
Deferred revenue, net of current portion	3,823	4,386
Other liabilities	1,940	1,882
Total liabilities	112,354	126,758
Commitments and contingencies	-	-

Stockholders’ equity:		
Preferred stock, $0.001 par value; 15,000,000 shares authorized, 0 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	-	-
Common stock, $0.001 par value; 100,000,000 shares authorized, 35,424,190 and 35,011,423 shares issued and outstanding at March 31, 2011 and December 31, 2010, respectively	35	35
Additional paid-in capital	204,367	197,689
Accumulated other comprehensive loss	(2,803)	(2,110)
Retained earnings	152,453	173,850
Total Emergent BioSolutions Inc. stockholders' equity	354,052	369,464
Noncontrolling interest in subsidiaries	4,871	4,097
Total stockholders’ equity	358,923	373,561
Total liabilities and stockholders’ equity	$471,277	$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 March 31,	
	2011	2010
	(Unaudited)	
Revenues:		
Product sales	$5,597	$38,853
Contracts and grants	12,936	7,947
Total revenues	18,533	46,800
Operating expenses:		
Cost of product sales	1,068	7,508
Research and development	34,759	19,922
Selling, general and administrative	18,212	16,192
Income (loss) from operations	(35,506)	3,178
Other income (expense):		
Interest income	35	388
Interest expense	-	(5)
Other income (expense), net	(1)	(8)
Total other income (expense)	34	375
Income (loss) before provision for (benefit from) income taxes	(35,472)	3,553
Provision for (benefit from) income taxes	(12,299)	1,635
Net income (loss)	(23,173)	1,918
Net loss attributable to noncontrolling interests	1,776	605
Net income (loss) attributable to Emergent BioSolutions Inc.	$(21,397)	$2,523
Earnings per share - basic	$(0.61)	$0.08
Earnings per share - diluted	$(0.61)	$0.08
Weighted-average number of shares - basic	35,179,317	30,879,970
Weighted-average number of shares - diluted	35,179,317	31,432,751

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

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

	Three Months Ended March 31,	
	2011	2010
	(Unaudited)	
Cash flows from operating activities:		
Net income (loss)	$(23,173)	$1,918
Adjustments to reconcile to net cash provided by (used in) operating activities:		
Stock-based compensation expense	2,441	1,522
Depreciation and amortization	2,235	1,296
Deferred income taxes	2,879	819
Non-cash development expenses from joint ventures	2,550	17
Loss (gain) on disposal of property and equipment	13	(34)
Provision for impairment of long-lived assets	-	548
Provision for fair value of contingent value rights	581	-
Excess tax benefits from stock-based compensation	(39)	(376)
Changes in operating assets and liabilities:		
Accounts receivable	27,350	21,467
Inventories	(9,441)	(3,560)
Income taxes	(15,238)	(2,459)
Prepaid expenses and other assets	1,008	576
Accounts payable	(453)	1,115
Accrued expenses and other liabilities	6	146
Accrued compensation	(10,288)	(5,580)
Deferred revenue	(2,486)	(14)
Net cash provided by (used in) operating activities	(22,055)	17,401
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,432)	(5,030)
Purchase of investments	(4,309)	-
Net cash used in investing activities	(12,741)	(5,030)
Cash flows from financing activities:		
Proceeds from borrowing on line of credit	-	15,000
Issuance of common stock subject to exercise of stock options	4,198	1,253
Principal payments on long-term indebtedness and line of credit	(842)	(15,755)
Excess tax benefits from stock-based compensation	39	376
Net cash provided by financing activities	3,395	874
Effect of exchange rate changes on cash and cash equivalents	(693)	215
Net increase (decrease) in cash and cash equivalents	(32,094)	13,460
Cash and cash equivalents at beginning of period	169,019	102,924
Cash and cash equivalents at end of period	$136,925	$116,384

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

5

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 March 31, 2011 and the results of operations and cash flows for the three month periods ended March 31, 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 March 31,	
(in thousands, except share and per share data)	2011	2010
Numerator:		
Net income (loss)	$(21,397)	$2,523
Denominator:		
Weighted-average number of shares—basic	35,179,317	30,879,970
Dilutive securities—equity awards	-	552,781
Weighted-average number of shares—diluted	35,179,317	31,432,751
Earnings per share-basic	$(0.61)	$0.08
Earnings per share-diluted	$(0.61)	$0.08

For the three month period ended March 31, 2011, no equity awards were included in the calculation of diluted earnings per share because the net loss attributable to Emergent BioSolutions Inc. would make these equity awards antidilutive. For the three month period ended March 31, 2010, outstanding stock options to purchase approximately 2.1 million shares of common stock are not considered in the diluted earnings per share calculation because the exercise price of these options is greater than the average per share closing price during the year.

Accounting for stock-based compensation

As of March 31, 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 March 31,	
	2011	2010
Expected dividend yield	0 %	0 %
Expected volatility	60 %	55 %
Risk-free interest rate	1.04 %	1.50 %
Expected average life of options	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 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) and other changes in equity that are excluded from net income (loss). 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 loss for the three months ended March 31, 2011 was $22.1 million. Comprehensive income for the three months ended March 31, 2010 was $2.7 million.

2. Inventories

Inventories consist of the following:

(in thousands)	March 31, 2011	December 31, 2010
Raw materials and supplies	$2,264	$2,311
Work-in-process	12,339	7,917
Finished goods	7,560	2,494
Total inventories	$22,163	$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 as of March 31, 2011:

(in thousands)	Level 1	Level 2	Level 3	Total
Assets:				

Investment in money market funds (1)	$78,381	$-	$-	$78,381
U.S. Treasury securities (2)	-	6,338	-	6,338
Total assets	$78,381	$6,338	$-	$84,719
Liabilities:				
Contingent value rights	$-	$-	$15,113	$15,113
Total liabilities	$-	$-	$15,113	$15,113

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

For the three months ended March 31, 2010, the Company had no assets or liabilities that were measured at fair value on a recurring basis.

The fair value of the Contingent Value Right (“CVR”) obligations are 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.

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 three months ended March 31, 2011.

(in thousands)	
Balance at January 1, 2011	$14,532
Expense (income) included in earnings	581
Purchases, sales, issuances and settlements	-
Transfers in/(out) of Level 3	-
Balance at March 31, 2011	$15,113

For the three months ended March 31, 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 months ended March 31, 2011, the Company recorded a charge to adjust the CVRs to fair value of $581,000. This charge is classified in the Company's statement of operations as research and development within the Company's biosciences segment.

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 March 31, 2011 and 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 March 31, 2011 was $46.6 million. The carrying value and fair value of long-term indebtedness was $50.0 million and $49.7 million, respectively, at March 31, 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 March 31, 2011:

(in thousands)	Amortized Costs	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Market Value
Money market funds	$78,381	$-	$-	$78,381
U.S. Treasury securities	6,338	-	-	6,338
Total	84,719	-	-	84,719
Less: cash equivalents	(78,381)	-	-	(78,381)
Amounts classified as investments	$6,338	$-	$-	$6,338

5. Stock options and restricted stock units

As of March 31, 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 March 31, 2011, an aggregate of 8,678,826 shares of common stock are authorized for issuance under the 2006 Plan, of which a total of 2,129,771 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	732,727	24.15	-	-	
Exercised	(340,027)	12.35	-	-	
Forfeited	(72,751)	17.69	-	-	
Outstanding at March 31, 2011	3,717,864	$ 16.36	67,541	$ 9.80	$29,969,023
Exercisable at March 31, 2011	1,838,779	$ 13.24	67,541	$ 9.80	$21,043,025

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

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Intrinsic Value
Outstanding at December 31, 2010	395,555	$ 16.09	$9,279,720
Granted	366,373	24.15	
Vested	(109,577)	15.91	
Forfeited	(16,304)	18.25	
Outstanding at March 31, 2011	636,047	$ 20.71	$15,366,896

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. The Opposition Division set a date of November 27, 2010 for all parties to file appeals, and the Company timely filed its appeal. 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 Opposition Division set due dates of January 29, 2011 and February 7, 2011 for Notices of Appeal to be filed for these Oppositions, and the Company timely filed its Notices of Appeal. The Company's Appeal Briefs were also timely filed. 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. A due date has not yet been set for the parties to file their appeals. 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 provides that all class members who wish to be excluded from the settlement of the Actions give notice by June 21, 2011. The State Court's hearing to determine whether the settlement is fair, reasonable and adequate to the class members and should be approved is scheduled to occur on July 29, 2011. There can be no assurance that the parties will ultimately enter into a stipulation of settlement, that the State Court will approve any proposed settlement, or that any eventual settlement will be under the same terms as those contemplated by the agreement in principle.

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 period ended March 31, 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 March 31, 2011				
External revenue	$15,500	$3,033	$-	$18,533
Net loss attributable to Emergent BioSolutions Inc.	(6,092)	(15,125)	(180)	(21,397)
Assets	179,732	107,927	183,618	471,277
Three Months Ended March 31, 2010				
External revenue	$46,800	$-	$-	$46,800
Net income (loss) attributable to Emergent BioSolutions Inc.	13,385	(9,606)	(1,256)	2,523
Assets	193,175	41,270	108,346	342,791

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 for the three months ended March 31, 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 three months ended March 31, 2011, the Company paid approximately $15,000 for services rendered under this agreement, of which $15,000 remained in accounts payable at March 31, 2011.

The Company entered into a transportation arrangement with an entity owned by the Company's Chief Executive Officer. This agreement was terminated in February 2011 with an effective termination date of December 31, 2010.

The Company has entered into a consulting agreement with a member of the Company's Board of Directors. For each of the three month periods ended March 31, 2011 and 2010, the Company paid approximately $45,000 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 March 31, 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 of up to $20.3 million 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 March 31, 2011 and 2010, respectively, assets of $413,000 and $79,000 and liabilities of $513,000 and $66,000 related to OETC are included within the Company's consolidated balance sheet. During the three months ended March 31, 2011 and 2010, respectively, the OETC incurred net losses of $3.6 million and $1.2 million of which $1.8 million and $630,000 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 March 31, 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 pandemic influenza strains 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 March 31, 2011, assets of $1.9 million and liabilities of $423,000 related to EPIC are included within the Company's consolidated balance sheet. During the three months ended March 31, 2011, EPIC incurred net losses of $24,000 of which $14,000 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 interest:

(in thousands)	Emergent BioSolutions Inc.	Noncontrolling Interest	Total
Stockholders' equity at December 31, 2010	$ 369,464	$ 4,097	$373,561
Non-cash development expenses from joint ventures	-	2,550	2,550
Net income (loss)	(21,397)	(1,776)	(23,173)
Other	5,985	-	5,985
Stockholders' equity at March 31, 2011	$ 354,052	$ 4,871	$358,923

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 expects to complete this restructuring in the first half of 2011, and estimates that the total cost of the restructuring will be approximately $6.3 million. These estimated costs are detailed below:

(in thousands)	Incurred in 2011	Inception to Date Cost Incurred	Total Expected to be Incurred
Termination benefits	$466	$2,884	$3,000
Contract termination costs	-	650	2,800
Other costs	-	260	500
Total	$466	$3,794	$6,300

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	466	-	466
Amount paid	(1,808)	-	(1,808)
Other adjustments	-	-	-
Balance at March 31, 2011	$ 1,076	$ 650	$ 1,726

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. No impairment charge was recorded for the three months ended March 31, 2011. The Company recorded an impairment charge of $548,000 for the three months ended March 31, 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. Subsequent events

In April 2011, the Company entered into a modification of its current procurement contract with the U.S. government to supply an additional 3.4 million doses of BioThrax at a value of up to $101 million.

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

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

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes and other financial information included elsewhere in this quarterly report on Form 10-Q. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report on Form 10-Q, including information with respect to our plans and strategy for our business, 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), NuThrax TM (Anthrax Vaccine Absorbed with CPG 7909 Adjuvant) and a double mutant recombinant protective antigen anthrax vaccine. Operations in this segment include biologics manufacturing, regulatory and quality affairs, marketing and sales in support of BioThrax and a product development infrastructure in support 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; and other infectious diseases such as tuberculosis, influenza and typhoid. 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 has 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. Department of Health and Human Services, or HHS, and 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 $5.6 million and $38.9 million for the three months ended March 31, 2011 and 2010, respectively. 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;
- Recombinant botulinum vaccine; and
- Typhella

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 and improvement of this facility. 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. As we proceed with this project, we expect the costs to be substantial and will likely seek external sources of funds to finance the project.

Critical Accounting Policies and Estimates

There have been no significant changes to our Critical Accounting Policies and Estimates during the three months ended March 31, 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 Strategic National Stockpile, or 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 agreement is from September 30, 2008 through September 30, 2011. Funds for the procurement of these doses of BioThrax have been fully committed. The total purchase price of the modified contract for 17.9 million doses is approximately $500 million. Through March 31, 2011, we have delivered approximately 11.8 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 invoice 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 — 5/2011
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 — 9/2011