GEN PROBE INC
Form 10-Q
August 04, 2010

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

(Mark One)

þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2010

OR

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
Commission File Number 000-49834

GEN-PROBE INCORPORATED
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**33-0044608**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
10210 Genetic Center Drive **San Diego, CA** (Address of Principal Executive Offices)	**92121** (Zip Code)

(858) 410-8000
(Registrant s Telephone Number, Including Area Code)

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

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 to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

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

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o	Smaller Reporting Company o

(Do not check if a smaller reporting company)

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

As of July 31, 2010, there were 48,679,490 shares of the registrant s common stock, par value $0.0001 per share, outstanding.

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GEN-PROBE INCORPORATED
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	June 30, 2010 (unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents, including restricted cash of $15 and $17 at June 30, 2010 and December 31, 2009, respectively	$ 174,922	$ 82,616
Marketable securities	288,718	402,990
Trade accounts receivable, net of allowance for doubtful accounts of $339 and $516 at June 30, 2010 and December 31, 2009, respectively	55,415	55,305
Accounts receivable other	5,776	4,707
Inventories	57,754	61,071
Deferred income tax	14,466	13,959
Prepaid income tax	1,433	7,317
Prepaid expenses	12,794	14,747
Other current assets	3,758	4,708
Total current assets	615,036	647,420
Marketable securities, net of current portion	11,130	15,472
Property, plant and equipment, net	157,782	157,437
Capitalized software, net	12,711	12,560
Goodwill	121,942	122,680
Purchased intangibles, net	102,813	108,015
License, manufacturing access fees and other assets, net	113,001	64,601
Total assets	$ 1,134,415	$ 1,128,185
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 18,850	$ 26,750
Accrued salaries and employee benefits	22,594	27,093
Other accrued expenses	19,561	18,460
Income tax payable	1,372	
Short-term borrowings	240,796	240,841
Deferred revenue	2,616	3,527
Total current liabilities	305,789	316,671
Non-current income tax payable	6,287	5,958
Deferred income tax	21,899	23,220
Deferred revenue, net of current portion	1,532	1,978
Other long-term liabilities	3,944	13,183
Commitments and contingencies		

Stockholders equity:		
Preferred stock, $0.0001 par value per share; 20,000,000 shares authorized, none issued and outstanding		
Common stock, $0.0001 par value per share; 200,000,000 shares authorized, 48,710,930 and 49,143,798 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively	5	5
Additional paid-in capital	223,452	242,615
Accumulated other comprehensive income (loss)	(733)	4,616
Retained earnings	572,240	519,939
Total stockholders equity	794,964	767,175
Total liabilities and stockholders equity	$ 1,134,415	$ 1,128,185

See accompanying notes to consolidated financial statements.

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GEN-PROBE INCORPORATED
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Revenues:				
Product sales	$ 132,734	$ 116,816	$ 263,303	$ 229,338
Collaborative research revenue	4,141	2,187	7,405	3,862
Royalty and license revenue	1,774	1,542	3,360	3,528
Total revenues	138,649	120,545	274,068	236,728
Operating expenses:				
Cost of product sales (excluding acquisition-related intangible amortization)	44,311	38,280	86,972	71,594
Acquisition-related intangible amortization	2,199	1,114	4,415	1,114
Research and development	27,104	26,069	56,785	51,067
Marketing and sales	15,824	14,015	30,605	25,070
General and administrative	15,018	17,823	29,697	31,670
Total operating expenses	104,456	97,301	208,474	180,515
Income from operations	34,193	23,244	65,594	56,213
Other income/(expense):				
Investment and interest income	3,269	10,122	7,167	15,004
Interest expense	(549)	(726)	(1,095)	(877)
Gain on contingent consideration	4,337		6,082	
Other expense, net	(190)	(895)	(349)	(1,037)
Total other income, net	6,867	8,501	11,805	13,090
Income before income tax	41,060	31,745	77,399	69,303
Income tax expense	12,950	11,930	25,096	23,741
Net income	$ 28,110	$ 19,815	$ 52,303	$ 45,562
Net income per share:				
Basic	$ 0.57	$ 0.39	$ 1.06	$ 0.88
Diluted	$ 0.57	$ 0.38	$ 1.05	$ 0.87
Weighted average shares outstanding:				
Basic	48,902	51,034	49,066	51,600
Diluted	49,366	51,739	49,549	52,291

See accompanying notes to consolidated financial statements.

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GEN-PROBE INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2010	**2009**
Operating activities		
Net income	$ 52,303	$ 45,562
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	22,628	19,463
Amortization of premiums on investments, net of accretion of discounts	4,523	2,720
Stock-based compensation	12,338	11,405
Stock-based compensation income tax benefits	2,096	310
Excess tax benefit from employee stock-based compensation	(919)	(702)
Deferred revenue	(1,241)	(255)
Deferred income tax	(1,930)	(1,134)
Gain on contingent consideration	(6,082)	
Loss on disposal of property and equipment	143	69
Changes in assets and liabilities:		
Trade and other accounts receivable	(1,494)	1,372
Inventories	2,998	3,890
Prepaid expenses	1,907	2,835
Other current assets	918	2,081
Other long-term assets	390	(2,486)
Accounts payable	(7,082)	(2,218)
Accrued salaries and employee benefits	(4,336)	(7,272)
Other accrued expenses	(1,086)	1,337
Income tax payable	6,434	(3,704)
Other long-term liabilities	(684)	335
Net cash provided by operating activities	81,824	73,608
Investing activities		
Proceeds from sales and maturities of marketable securities	279,853	293,504
Purchases of marketable securities	(166,290)	(189,091)
Purchases of property, plant and equipment	(14,567)	(14,666)
Purchases of capitalized software	(1,457)	(288)
Purchases of intangible assets, including licenses and manufacturing access fees	(1,365)	(811)
Net cash paid for business combinations		(123,816)
Cash paid for investment in Pacific Biosciences	(50,000)	
Cash paid for investment in DiagnoCure and related license fees	(500)	(5,250)
Other	(1,967)	(289)
Net cash provided by (used in) investing activities	43,707	(40,707)
Financing activities		
Repurchase and retirement of common stock	(52,299)	(105,577)

Proceeds from issuance of common stock and ESPP	20,062	3,777
Repurchase and retirement of restricted stock for payment of taxes	(43)	(38)
Excess tax benefit from stock-based compensation	919	702
Borrowings under credit facility		238,450
Net cash (used in) provided by financing activities	(31,361)	137,314
Effect of exchange rate changes on cash and cash equivalents	(1,864)	1,918
Net increase in cash and cash equivalents	92,306	172,133
Cash and cash equivalents at the beginning of period	82,616	60,122
Cash and cash equivalents at the end of period	$ 174,922	$ 232,255

See accompanying notes to consolidated financial statements.

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Notes to the Consolidated Financial Statements (unaudited)

Note 1 Summary of significant accounting policies

Basis of presentation

The accompanying interim consolidated financial statements of Gen-Probe Incorporated (Gen-Probe or the Company) at June 30, 2010, and for the three and six month periods ended June 30, 2010 and 2009, are unaudited and have been prepared in accordance with United States generally accepted accounting principles (U.S. GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In management s opinion, the unaudited consolidated financial statements include all adjustments, consisting only of normal recurring accruals, necessary to state fairly the financial information therein, in accordance with U.S. GAAP. Interim results are not necessarily indicative of the results that may be reported for any other interim period or for the year ending December 31, 2010.

These unaudited interim consolidated financial statements and related footnotes should be read in conjunction with the audited consolidated financial statements and related footnotes contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2009.

Certain prior year amounts have been reclassified to conform to the current year presentation.

Principles of consolidation

These unaudited interim consolidated financial statements include the accounts of Gen-Probe as well as its wholly owned subsidiaries. The Company does not have any interests in variable interest entities. All material intercompany transactions and balances have been eliminated in consolidation.

In April 2009, the Company completed its acquisition of Tepnel Life Sciences plc (Tepnel), a United Kingdom (UK) based international life sciences products and services company, now known as Gen-Probe Life Sciences Ltd. Tepnel s transplant diagnostics and genetic testing businesses have been included in the Company s clinical diagnostic operations beginning in April 2009. While Tepnel s research products and services business represents a new area of business for the Company, the activities of this business were immaterial to the Company s overall operations during the first six months of 2010 and 2009.

In October 2009, the Company acquired Prodesse, Inc. (Prodesse), a privately-held Wisconsin corporation, now known as Gen-Probe Prodesse, Inc. Prodesse develops molecular diagnostic products for a variety of infectious disease applications. Prodesse s results of operations have been included in the Company s clinical diagnostic operations beginning in October 2009.

The Company translates the financial statements of its non-U.S. operations using the end-of-period exchange rates for assets and liabilities and the average exchange rates for each reporting period for results of operations. Net gains and losses resulting from the translation of foreign financial statements and the effect of exchange rates on intercompany receivables and payables of a long-term investment nature are recorded as a separate component of stockholders equity under the caption Accumulated other comprehensive income (loss). These adjustments will affect net income upon the sale or liquidation of the underlying investment.

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make certain estimates and assumptions that affect the amounts reported in the consolidated financial statements. These estimates include assessing the collectability of accounts receivable, recognition of revenues, and the valuation of the following: stock-based compensation; marketable securities; equity investments in publicly and privately held companies; income tax; liabilities associated with employee benefit costs and contingent consideration; inventories; and goodwill and long-lived assets, including patent costs, capitalized software, acquired intangible assets and licenses and manufacturing access fees. Actual results could differ from those estimates.

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Marketable securities

The primary objectives of the Company s marketable security investment portfolio are liquidity and safety of principal. Investments are made with the goal of achieving the highest rate of return consistent with these two objectives. The Company s investment policy limits investments to certain types of debt and money market instruments issued by institutions primarily with investment grade credit ratings and places restrictions on maturities and concentration by type and issuer.

Marketable securities are carried at fair value, with unrealized gains and losses, net of tax, reported as a separate component of stockholders equity under the caption Accumulated other comprehensive income (loss). The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in Investment and interest income.

Realized gains and losses, and declines in value deemed to be other-than-temporary on marketable securities, are included in Investment and interest income. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in Investment and interest income.

The Company periodically reviews its marketable securities for other-than-temporary declines in fair value below the cost basis, or whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. When assessing marketable securities for other-than-temporary declines in value, the Company considers factors including: the significance of the decline in value compared to the cost basis; the underlying factors contributing to a decline in the prices of securities in a single asset class; how long the market value of the investment has been less than its cost basis; any market conditions that impact liquidity; the views of external investment managers; any news or financial information that has been released specific to the investee; and the outlook for the overall industry in which the investee operates.

The Company does not consider its investments in marketable securities with a current unrealized loss position to be other-than-temporarily impaired at June 30, 2010 because the Company does not intend to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their amortized cost. However, investments in an unrealized loss position deemed to be temporary at June 30, 2010 that have a contractual maturity of greater than 12 months have been classified as non-current marketable securities under the caption Marketable securities, net of current portion, reflecting the Company s current intent and ability to hold such investments to maturity. The Company has determined that its investments in municipal securities should be classified as available-for-sale.

Revenue recognition

The Company records shipments of its clinical diagnostic products as product sales when the product is shipped and title and risk of loss have passed and when collection of the resulting receivable is reasonably assured.

The Company manufactures blood screening products according to demand specifications of its collaboration partner, Novartis Vaccines and Diagnostics, Inc. (Novartis). Upon shipment to Novartis, the Company recognizes blood screening product sales at an agreed upon transfer price and records the related cost of products sold. Based on the terms of the Company s collaboration agreement with Novartis, the Company s ultimate share of the net revenue from sales to the end user is not known until reported to the Company by Novartis. The Company then adjusts blood screening product sales upon receipt of customer revenue reports and a net payment from Novartis of amounts reflecting the Company s ultimate share of net sales by Novartis for these products, less the transfer price revenues previously recognized.

Generally, the Company provides its instrumentation to its clinical diagnostics customers without requiring them to purchase the equipment or enter into an equipment lease. Instead, the Company recovers the cost of providing the instrumentation in the amount it charges for its diagnostic assays. The depreciation costs associated with an instrument are charged to cost of product sales on a straight-line basis over the estimated life of the instrument. The costs to maintain these instruments in the field are charged to cost of product sales as incurred.

The Company sells its instruments to Novartis for use in blood screening and records these instrument sales upon delivery since Novartis is responsible for the placement, maintenance and repair of the units with its customers. The Company also sells instruments to its clinical diagnostics customers and records sales of these instruments upon delivery and receipt of customer acceptance. Prior to delivery, each instrument is tested to meet Gen-Probe s and

United States Food and Drug Administration (FDA) specifications, and is shipped fully assembled. Customer acceptance of the Company s clinical diagnostic instrument systems requires installation and training by the

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Company s technical service personnel. Generally, installation is a standard process consisting principally of uncrating, calibrating and testing the instrumentation.

The Company records shipments of its blood screening products in the United States and other countries in which the products have not received regulatory approval as collaborative research revenue. This is done because price restrictions apply to these products prior to FDA marketing approval in the United States and similar approvals in foreign countries. Upon shipment of FDA-approved and labeled products following commercial approval, the Company classifies sales of these products as product sales in its consolidated financial statements.

The Company records revenue on its research products and services in the period during which the related costs are incurred, or services are provided. This revenue consists of outsourcing services for the pharmaceutical, biotechnology and healthcare industries, including nucleic acid purification and analysis services, as well as the sale of monoclonal antibodies.

The Company analyzes each element of its collaborative arrangements to determine the appropriate revenue recognition. The Company recognizes revenue on up-front payments over the period of significant involvement under the related agreements unless the fee is in exchange for products delivered or services rendered that represent the culmination of a separate earnings process and no further performance obligation exists under the contract. Revenue arrangements with multiple deliverables are divided into separate units of accounting if (i) the delivered item has stand-alone value, (ii) the vendor has objective and reliable evidence of the fair value of the undelivered item(s), and (iii) the customer has a general right of return relative to the delivered item(s) and delivery or performance of the undelivered item(s) is probable and substantially within the vendor s control. All of these criteria must be met in order for a delivered item to be accounted for as a separate unit.

The Company recognizes collaborative research revenue over the term of various collaboration agreements, as negotiated monthly contracted amounts are earned or reimbursable costs are incurred related to those agreements. Negotiated monthly contracted amounts are earned in relative proportion to the performance required under the applicable contracts. Non-refundable license fees are recognized over the related performance period or at the time that the Company has satisfied all performance obligations. Milestone payments are recognized as revenue upon the achievement of specified milestones when (i) the Company has earned the milestone payment, (ii) the milestone is substantive in nature and the achievement of the milestone is not reasonably assured at the inception of the agreement, (iii) the fees are non-refundable, and (iv) performance obligations after the milestone achievement will continue to be funded by the collaborator at a level comparable to the level before the milestone achievement. Any amounts received prior to satisfying the Company s revenue recognition criteria are recorded as deferred revenue on its consolidated balance sheets.

Royalty revenue is recognized related to the sale or use of the Company s products or technologies under license agreements with third parties. For those arrangements where royalties are reasonably estimable, the Company recognizes revenue based on estimates of royalties earned during the applicable period and adjusts for differences between the estimated and actual royalties in the following period. Historically, these adjustments have not been material. For those arrangements where royalties are not reasonably estimable, the Company recognizes revenue upon receipt of royalty statements from the applicable licensee.

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Stock-based compensation

The Company s unrecognized stock-based compensation expense as of June 30, 2010, before income taxes and adjusted for estimated forfeitures, related to outstanding unvested share-based payment awards is presented in the table as follows (in thousands, except number of years):

Awards	Weighted Average Remaining Expense Life (Years)	Unrecognized Expense as of June 30, 2010
Options	2.7	$ 31,622
Employee stock purchase plan	0.2	142
Performance share awards	2.7	1,135
Restricted stock	1.9	5,624
Deferred issuance restricted stock	2.2	1,611
Total		$ 40,134

The following table summarizes the stock-based compensation expense that the Company recorded in its consolidated statements of income for the three and six month periods ended June 30, 2010 and 2009 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Cost of product sales	$ 1,006	$ 805	$ 1,870	$ 1,603
Research and development	1,851	1,765	3,530	3,468
Marketing and sales	836	779	1,637	1,538
General and administrative	2,744	2,297	5,301	4,796
Total	$ 6,437	$ 5,646	$ 12,338	$ 11,405

The Company uses the following weighted average assumptions within the Black-Scholes model to estimate the fair value of options granted under the Company s equity incentive plans and the shares purchasable under the Company s Employee Stock Purchase Plan (ESPP) for the three and six month periods ended June 30, 2010 and 2009:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock Option Plans				
Risk-free interest rate	2.1%	1.7%	2.1%	1.6%
Volatility	31%	36%	32%	36%
Dividend yield				
Expected term (years)	4.4	4.2	4.4	4.2
Resulting average fair value	$ 13.52	$ 13.50	$ 12.74	$ 13.30
ESPP				

Risk-free interest rate	0.2%	1.3%	0.2%	1.3%
Volatility	26%	47%	26%	47%
Dividend yield				
Expected term (years)	0.5	0.5	0.5	0.5
Resulting average fair value	$ 9.65	$ 12.20	$ 9.65	$ 12.20

Net income per share

Basic earnings per share is computed using the two-class method. Under the two-class method, net income is allocated to common stock and participating securities. The Company s restricted stock meets the definition of participating securities. Basic net income per share is computed by dividing net income for the period by the weighted average number of common shares outstanding during the period. Diluted net income per share is computed by dividing net income for the period by the weighted average number of common and common equivalent shares outstanding during the period. The Company excludes stock options from the calculation of diluted net income per share when the combined exercise price, average unamortized fair values and assumed tax

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benefits upon exercise are greater than the average market price for the Company s common stock because their effect is anti-dilutive. Potentially dilutive securities totaling approximately 4,455,000 and 3,541,000 shares for the three month periods ended June 30, 2010 and 2009, respectively, and 4,290,000 and 3,568,000 shares for the six month periods ended June 30, 2010 and 2009, respectively, were excluded from the calculations of diluted earnings per share (EPS) below because of their anti-dilutive effect.

The following table sets forth the computation of basic and diluted EPS for the three and six month periods ended June 30, 2010 and 2009 (in thousands, except per share amounts):

	Three Months Ended June 30,					
	2010			2009		
	Income	Weighted Average Shares Outstanding	Per Share Amount	Income	Weighted Average Shares Outstanding	Per Share Amount
Net income	$ 28,110			$ 19,815		
Less: Earnings allocated to unvested stockholders	(128)			(80)		
Basic EPS						
Distributable income available to common stockholders	27,982	48,902	$ 0.57	19,735	51,034	$ 0.39
Effect of dilutive securities:						
Add back: Undistributed earnings allocated to unvested stockholders	128			80		
Dilutive stock options		464			705	
Less: Undistributed earnings reallocated to unvested stockholders	(126)			(79)		
Diluted EPS Common shares	$ 27,984	49,366	$ 0.57	$ 19,736	51,739	$ 0.38

	Six Months Ended June 30,					
	2010			2009		
	Income	Weighted Average Shares Outstanding	Per Share Amount	Income	Weighted Average Shares Outstanding	Per Share Amount
Net income	$ 52,303			$ 45,562		
	(227)			(183)		

Less: Earnings allocated to unvested stockholders							
Basic EPS							
Distributable income available to common stockholders	52,076	49,066	$ 1.06	45,379	51,600	$	0.88
Effect of dilutive securities:							
Add back: Undistributed earnings allocated to unvested stockholders	227			183			
Dilutive stock options		483			691		
Less: Undistributed earnings reallocated to unvested stockholders	(225)			(180)			
Diluted EPS Common shares	$ 52,078	49,549	$ 1.05	$ 45,382	52,291	$	0.87

Pending adoption of recent accounting pronouncements

Accounting Standards Update 2010-06

In January 2010, the Financial Accounting Standards Board (FASB) amended ASC Topic 820, Fair Value Measurements and Disclosures, to require reporting entities to make new disclosures about recurring and nonrecurring fair value measurements, including significant transfers into and out of Level 1 and Level 2 fair value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. Except for the detailed Level 3 roll forward disclosures, the guidance was effective January 1, 2010. The new disclosures about purchases, sales, issuances, and settlements in

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the roll forward activity for Level 3 fair value measurements are effective for the Company as of January 1, 2011. Early adoption is permitted. The Company is currently evaluating prospective adoption of the new Level 3 disclosures and determining the effects, if any, the adoption of this guidance will have on its consolidated financial statements.

Accounting Standards Update 2010-17

In March 2010, the FASB ratified the final consensus that offers an alternative method of revenue recognition for milestone payments. The guidance states that an entity can make an accounting policy election to recognize a payment that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. The guidance will be effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2010 with early adoption permitted, provided that the revised guidance is applied retrospectively to the beginning of the year of adoption. The guidance may be applied retrospectively or prospectively for milestones achieved after the adoption date. The Company is currently evaluating early prospective adoption and determining the effects, if any, the adoption of this guidance will have on its consolidated financial statements.

Accounting Standards Update 2009-13

In September 2009, the FASB revised the authoritative guidance for revenue arrangements with multiple deliverables. The guidance addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how the arrangement consideration should be allocated among the separate units of accounting. The guidance will be effective for the Company s fiscal year beginning January 1, 2011 with early adoption permitted. The guidance may be applied retrospectively or prospectively for new or materially modified arrangements. The Company is currently evaluating early prospective adoption and determining the effects, if any, the adoption of this guidance will have on its consolidated financial statements.

Note 2 Business combinations

The acquisitions described below were accounted for as business combinations and, accordingly, the Company has included the results of operations of the acquired entities in its consolidated statements of income from the date of acquisition. Neither separate financial statements nor pro forma results of operations have been presented because the acquisitions did not meet the quantitative materiality tests under Regulation S-X.

Acquisition of Tepnel Life Sciences plc

In April 2009, the Company acquired Tepnel, a UK-based international life sciences products and services company, now known as Gen-Probe Life Sciences Ltd., which has two principal businesses, molecular diagnostics and research products and services. As a result of the acquisition, Tepnel became a wholly-owned subsidiary of the Company.

Upon consummation of the acquisition, each issued ordinary share of Tepnel was cancelled and converted into the right to receive 27.1 pence in cash, or approximately $0.40 based on the then applicable Great Britain Pound (GBP) to United States Dollar (USD) exchange rate. In connection with the acquisition, the holders of issued and outstanding Tepnel capital stock, options and warrants received total net cash of approximately £92.8 million, or approximately $137.1 million based on the then applicable GBP to USD exchange rate. The acquisition was financed through amounts borrowed by the Company under a senior secured revolving credit facility established between the Company and Bank of America, N.A. (Bank of America).

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The final allocation of the purchase price for the acquisition of Tepnel is as follows (in thousands):

Total purchase price	$ 137,093
Exchange rate differences	(568)[1]
Allocated purchase price	$ 136,525
Net working capital	$ 14,811
Fixed assets	11,352
Goodwill	70,395
Deferred tax liabilities	(14,148)
Other intangible assets	57,497
Liabilities assumed	(3,382)
Allocated purchase price	$ 136,525

(1) Difference caused by exchange rate fluctuations between the date of acquisition and the date funds were wired.

The fair values of the acquired identifiable intangible assets with definite lives are as follows (in thousands):

Patents	$ 294
Software	441
Customer relationships	45,439
Trademarks / trade names	11,323
Total	$ 57,497

The amortization periods for the acquired intangible assets with definite lives are as follows: 10 years for patents, five years for software, 12 years for customer relationships, and 20 years for trademarks and trade names. The Company plans to amortize the acquired intangible assets set forth in the table above using the straight line method of amortization. The Company believes that the use of the straight line method is appropriate given the high customer retention rate of the acquired businesses and the historical and projected growth of revenues and related cash flows. The Company will monitor and assess the acquired intangible assets and will adjust, if necessary, the expected life, amortization method or carrying value of such assets to best match the underlying economic value.

The fair value assigned to trademarks and trade names has been determined primarily by using the income approach and a variation of the income approach known as the relief from royalty method, which estimates the future royalties which would have to be paid to the owner of the brand for its current use. Tax is deducted and a discount rate is used to state future cash flows to a present value. This is based on the brand in its current use and is based on savings from owning the brand, or relief from royalties that would be paid to the brand owner. The fair value assigned to customer relationships has been determined primarily by using the income approach and a variation of the income

approach known as the excess earnings method, which estimates the value of an asset based on discounted future earnings specifically attributed to that asset, that is, in excess of returns for other assets that contributed to those earnings. The fair value assigned to assembled workforce (a component of goodwill) and software has been determined primarily by using the cost approach and a variation of the cost approach known as the cost to recreate method, which represents the cost to recreate the workforce and software at the valuation date. The fair value assigned to patents has been determined primarily by using the income approach and a variation of the income approach known as the discounted cash flow method, which estimates the value based on the present value of the after-tax free cash flows attributable to owning the intangible asset. The discount rates used in these valuation methods range from 12 to 13 percent.

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The estimated amortization expense for acquired intangible assets over future periods is as follows (in thousands):

Years ending December 31,	
Remainder of 2010	$ 2,064
2011	4,129
2012	4,129
2013	4,129
2014	4,063
Thereafter	29,493
Total	$ 48,007

Acquisition of Prodesse, Inc.

In October 2009, the Company acquired Prodesse, a privately-held Wisconsin corporation, for approximately $60.0 million, subject to a designated pre-closing operating income adjustment. The Company may also be required to make additional cash payments to former Prodesse securityholders of up to an aggregate of $25.0 million based on the achievement of certain specified performance measures, of which $10.0 million was paid in July 2010. As a result of the acquisition, Prodesse (which is now known as Gen-Probe Prodesse, Inc.) became a wholly owned subsidiary of the Company. The Company financed the acquisition through existing cash on hand.

The purchase price allocation for the acquisition of Prodesse set forth below is preliminary and subject to change as more detailed analysis is completed and additional information with respect to the fair value of the assets and liabilities acquired becomes available. The Company expects to finalize the purchase price allocation by the fourth quarter of 2010. The preliminary allocation of the purchase price for the Company s acquisition of Prodesse is as follows (in thousands):

Total purchase price	$ 62,005
Net working capital	$ 10,240
Fixed assets	644
Goodwill	32,981
Deferred tax liabilities	(21,369)
Other intangible assets	58,570
Liabilities assumed	(1,067)
Contingent consideration	(17,994)
Allocated purchase price	$ 62,005

The fair values of the acquired identifiable intangible assets with definite lives are as follows (in thousands):

In-process research and development	$ 1,070
Developed technology	24,500
Customer relationships	31,800
Trademarks / trade names	1,200
Total	$ 58,570

The amortization periods for the acquired intangible assets with definite lives are as follows: 15 years for in-process research and development (to commence upon commercialization of associated product), 12 years for

developed technology, 12 years for customer relationships, and 20 years for trademarks and trade names. The Company is amortizing the acquired intangible assets set forth in the table above using the straight line method of amortization. The Company will monitor and assess the acquired intangible assets and will adjust, if necessary, the expected life, amortization method or carrying value of such assets to best match the underlying economic value.

The fair value assigned to trademarks and trade names and developed technology has been determined primarily by using the income approach and a variation of the income approach known as the relief from royalty method, which estimates the future royalties which would have to be paid to the owner of the brand for its current use. Tax is deducted and a discount rate is used to state future cash flows to a present value. This is based on the brand in its current use and is based on savings from owning the brand, or relief from royalties that would be paid to the brand

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owner. The fair value assigned to in-process research and development and customer relationships has been determined primarily by using the income approach and a variation of the income approach known as the excess earnings method, which estimates the value of an asset based on discounted future earnings specifically attributed to that asset, that is, in excess of returns for other assets that contributed to those earnings. The discount rates used in these valuation methods range from 25 to 30 percent.

In addition to acquiring Prodesse s existing products, the Company also acquired other products that can be classified as next generation products, which are in the process of being developed. Overall, a value of approximately $1.1 million was classified as in-process research and development for the products under development. The Company has incurred a total of approximately $1.2 million in research and development expenses since the acquisition of Prodesse, which includes these development activities related to next generation products. The Company anticipates revenues will be generated from these products starting in late 2010. The Company will commence amortizing the in-process research and development intangible assets upon FDA approval or clearance of these products, as applicable.

The estimated amortization expense for acquired intangible assets over future periods is as follows (in thousands):

Years Ending December 31,	
Remainder of 2010	$ 2,376
2011	4,752
2012	4,752
2013	4,752
2014	4,752
Thereafter	32,950
Total	$ 54,334

Changes in goodwill resulting from acquisitions

The $137.1 million purchase price for Tepnel exceeded the value of the acquired tangible and identifiable intangible assets, and therefore the Company allocated $70.4 million to goodwill. Included in this initial goodwill amount was $14.1 million related to deferred tax liabilities recorded as a result of non-deductible amortization of acquired intangible assets. Prior to finalizing the Company s purchase price allocation for its acquisition of Tepnel in the first quarter of 2010, the Company made a $0.4 million adjustment to the goodwill recognized as part of its acquisition of Tepnel based on additional information received during the period. This adjustment resulted in an increase in the estimated value of an acquired liability, which was paid in April 2010.

The $62.0 million purchase price for Prodesse exceeded the value of the acquired tangible and identifiable intangible assets, and therefore the Company allocated $33.0 million to goodwill. Included in this initial goodwill amount was $21.4 million related to deferred tax liabilities recorded as a result of non-deductible amortization of acquired intangible assets.

Changes in goodwill for the six months ended June 30, 2010 were as follows (in thousands):

Goodwill balance as of December 31, 2009	$ 122,680
Changes due to foreign currency translation	(738)
Goodwill balance as of June 30, 2010	$ 121,942

Note 3 Consolidation of UK Operations

Due to the acquisition of Tepnel in April 2009, the Company now has four locations in the UK: Manchester; Cardiff; Livingston; and Abingdon. In order to accommodate the anticipated growth in the business and to optimize expenses, the Company has decided to consolidate the location of its UK operations to Manchester and Livingston. This consolidation was communicated internally in May 2010. Consolidation activities related to the employees and

facilities were accounted for under ASC Topic 420, Exit or Disposal Costs (ASC 420). The Company estimates that expenses related to this consolidation will total approximately $2.4 million and be incurred over a two year period, as the consolidation will occur in phases with no immediate site closures. These expenses will include one-time termination costs including severance costs related to the elimination of certain redundant positions, as well as

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incentives and relocation costs for certain key employees. The Company will also incur charges related to the closure of the leased and owned facilities. During the quarter ended June 30, 2010, $0.1 million of expenses were incurred and accrued in accordance with ASC 420.

Note 4 Spin-off of industrial testing assets to Roka Bioscience, Inc.

In September 2009, the Company spun-off its industrial testing assets, including the Closed Unit Dose Assay (CUDA) system, to Roka Bioscience, Inc. (Roka), a newly formed private company focused on developing rapid, highly accurate molecular assays for biopharmaceutical production, water and food safety testing, and other applications. In consideration for the contribution of assets, the Company received shares of preferred stock representing 19.9% of Roka s capital stock on a fully diluted basis.

In addition to the CUDA system, the Company contributed to Roka other industrial assets and the right to use certain of its technologies and related know-how in certain industrial markets. These markets include biopharmaceutical production, water and food safety testing, veterinary testing, environmental testing and bioterrorism testing. Roka also has rights to develop certain infection control tests for use on the CUDA system.

The Company will receive royalties on any potential Roka product sales, and retains rights to use the CUDA system for clinical diagnostic applications. In addition, the Company is providing contract manufacturing and certain other services to Roka on a transitional basis.

The Company determined that Roka is not a variable interest entity and therefore is not included in the Company s consolidated financial statements.

Note 5 Fair value measurements

As discussed in Note 1, in January 2010 the Company adopted updated accounting guidance which requires additional disclosure about the amounts of and reasons for significant transfers in and out of Level 1 and Level 2 fair value measurements. This standard also clarifies existing disclosure requirements related to the level of disaggregation of fair value measurements for each class of assets and liabilities and disclosures about inputs and valuation techniques used to measure fair value for both recurring and nonrecurring Level 2 and Level 3 measurements. Because this accounting standard only requires enhanced disclosure, the adoption of this standard did not impact the Company s financial position or results of operations for the quarter ended June 30, 2010. In addition, effective for interim and annual periods beginning after December 15, 2010, this standard will require additional disclosure and require an entity to present disaggregated information about activity in Level 3 fair value measurements on a gross basis, rather than as one net amount.

Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. There is an established hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company s assumptions about the factors market participants would use in valuing the asset or liability. The guidance establishes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Assets and liabilities are classified based upon the lowest level of input that is significant to the fair value measurement. The Company reviews the fair value hierarchy on a quarterly basis. Changes in the observations or valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy.

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Set forth below is a description of the Company s valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy. Where appropriate, the description includes details of the valuation models, the key inputs to those models, as well as any significant assumptions.

Assets and liabilities measured at fair value on a recurring basis

The Company s marketable securities include tax advantaged municipal securities, Federal Deposit Insurance Corporation (FDIC) insured corporate bonds and money market funds. When available, the Company generally uses quoted market prices to determine fair value, and classifies such items as Level 1. If quoted market prices are not available, prices are determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals. The Company classifies such items as Level 2.

There were no changes to the Company s fair value measurement classifications for its assets and liabilities during the quarter ended June 30, 2010.

The following table presents the Company s fair value hierarchy for assets and liabilities measured at fair value on a recurring basis (as described above) as of June 30, 2010 and December 31, 2009 (in thousands):

	Fair Value Measurements at June 30, 2010			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Total Carrying Value in the Consolidated Balance Sheet**
Assets:				
Cash equivalents	$	$ 116,084	$	$ 116,084
Marketable securities				
Certificates of deposit		1,974		1,974
Treasury securities		7,975		7,975
Municipal securities		285,772		285,772
Corporate obligations		4,127		4,127
Total marketable securities		299,848		299,848
Deferred compensation plan assets		5,398		5,398
Total assets at fair value	$	$ 421,330	$	$ 421,330
Liabilities:				
Contingent consideration	$	$	$ 11,912	$ 11,912
Deferred compensation plan liabilities		5,110		5,110
Total liabilities at fair value	$	$ 5,110	$ 11,912	$ 17,022

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	Fair Value Measurements at December 31, 2009			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Carrying Value in the Consolidated Balance Sheet
Assets:				
Cash equivalents	$	$ 13,000	$	$ 13,000
Marketable securities				
Certificates of deposit		1,961		1,961
Municipal securities		324,252		324,252
Corporate obligations		92,249		92,249
Total marketable securities		418,462		418,462
Deferred compensation plan assets		5,671		5,671
Total assets at fair value	$	$ 437,133	$	$ 437,133
Liabilities:				
Contingent consideration	$	$	$ 17,994	$ 17,994
Deferred compensation plan liabilities		5,700		5,700
Total liabilities at fair value	$	$ 5,700	$ 17,994	$ 23,694

For those financial instruments with significant Level 3 inputs, the following table summarizes the activity for the six months ended June 30, 2010 (in thousands):

Level 3 contingent consideration as of December 31, 2009	$ 17,994
Gain included in other income (expense)	(6,082)
Level 3 contingent consideration as of June 30, 2010	$ 11,912

The range of potential contingent consideration that the Company could pay related to the acquisition of Prodesse was originally between $0 and $25.0 million. This range is tied to multiple performance measures including commercial and regulatory milestones. To the extent these milestones are earned, payments of up to $25.0 million in total will be made. The Company will reassess the fair value of this contingent consideration liability on a quarterly basis. This assessment is based on a calculation that considers the forecasted achievement of the underlying milestones as of the date of determination, as well as the timing of the related cash payments, and then discounts these amounts based on a discount rate the Company determines is appropriate for the underlying milestones.

Based on these calculations, the Company initially recorded $18.0 million as of the date of acquisition as the fair value of this potential contingent consideration liability. The fair value of this contingent consideration was reduced to $16.2 million as of March 31, 2010 and then further reduced to $11.9 million as of June 30, 2010. These reductions

were primarily associated with lower anticipated payouts for the related milestones.

On July 26, 2010, the Company received FDA clearance of its ProFAST + assay, thereby satisfying one of the acquisition-related milestones and triggering a $10.0 million payment to former Prodesse securityholders, the fair value of which was accrued as of June 30, 2010. The Company believes future milestone payments, if any, will occur between the fourth quarter of 2010 and the second quarter of 2012.

Assets and liabilities measured at fair value on a non-recurring basis

Certain assets and liabilities, including cost method investments, are measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances, for example, when there is evidence of impairment. The Company s assets which are evaluated on a non-recurring basis include investments in public and private companies, which are described below.

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Equity investment in public company

In April 2009, the Company made a $5.0 million preferred stock investment in DiagnoCure, Inc. (DiagnoCure), a publicly-held company traded on the Toronto Stock Exchange. The Company s equity investment was initially valued based on the transaction price under the cost method of accounting. The market value of the underlying common stock is the most observable value of the preferred stock, but because there is no active market for these preferred shares the Company has classified its equity investment in DiagnoCure as Level 2 in the fair value hierarchy. The Company s investment in DiagnoCure, which totaled $5.0 million as of June 30, 2010, is included in Licenses, manufacturing access fees and other assets, net on the Company s consolidated balance sheets.

Equity investments in private companies

The valuation of investments in non-public companies requires significant management judgment due to the absence of quoted market prices, inherent lack of liquidity and the long-term nature of such assets. The Company s equity investments in private companies are initially valued based upon the transaction price under the cost method of accounting. Equity investments in non-public companies are classified as Level 3 in the fair value hierarchy.

In June 2010, in connection with the execution of a collaboration agreement with Pacific Biosciences of California, Inc., a privately-held sequencing company (Pacific Biosciences), the Company made a $50.0 million preferred stock investment in Pacific Biosciences. The Company s investment in Pacific Biosciences, which totaled $50.0 million as of June 30, 2010, is included in Licenses, manufacturing access fees and other assets, net on the Company s consolidated balance sheets.

In September 2009, the Company spun-off its industrial testing assets to Roka, a newly formed private company. In consideration for the contribution of assets, the Company received shares of preferred stock representing 19.9% of Roka s capital stock on a fully diluted basis. The Company s investment in Roka totaled approximately $0.7 million as of June 30, 2010, and is also included in Licenses, manufacturing access fees and other assets, net on the Company s consolidated balance sheets.

In 2006, the Company invested in Qualigen, Inc. (Qualigen), a private company. The Company s investment in Qualigen, which totaled approximately $5.4 million as of June 30, 2010, is also included in Licenses, manufacturing access fees and other assets, net on the Company s consolidated balance sheets.

The Company records impairment charges when an investment has experienced a decline that is deemed to be other-than-temporary. The determination that a decline is other-than-temporary is, in part, subjective and influenced by many factors. Future adverse changes in market conditions or poor operating results of investees could result in losses or an inability to recover the carrying value of the investments, thereby possibly requiring impairment charges in the future. When assessing investments in private companies for an other-than-temporary decline in value, the Company considers many factors, including, but not limited to, the following: the share price from the investee s latest financing round; the performance of the investee in relation to its own operating targets and its business plan; the investee s revenue and cost trends; the investee s liquidity and cash position, including its cash burn rate; and market acceptance of the investee s products and services. From time to time, the Company may consider third party evaluations or valuation reports. The Company also considers new products and/or services that the investee may have forthcoming, any significant news specific to the investee, the investee s competitors and/or industry and the outlook of the overall industry in which the investee operates. In the event the Company s judgments change as to other-than temporary declines in value, the Company may record an impairment loss, which could have an adverse effect on its results of operations.

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Note 6 Balance sheet information

The following tables provide details of selected balance sheet items as of June 30, 2010 and December 31, 2009 (in thousands):

Inventories

	June 30, 2010	December 31, 2009
Raw materials and supplies	$ 12,667	$ 13,260
Work in process	23,831	23,656
Finished goods	21,256	24,155
Inventories, net	$ 57,754	$ 61,071

Property, plant and equipment, net

	June 30, 2010	December 31, 2009
Land	$ 19,268	$ 19,268
Building	80,108	80,130
Machinery and equipment	184,384	175,885
Building improvements	44,007	42,718
Furniture and fixtures	18,670	17,705
Construction in-progress	1,012	457
Property, plant and equipment, at cost	347,449	336,163
Less accumulated depreciation and amortization	(189,667)	(178,726)
Property, plant and equipment, net	$ 157,782	$ 157,437

Purchased intangibles, net

	June 30, 2010	December 31, 2009
Purchased intangibles, at cost	$ 144,630	$ 145,502
Less accumulated amortization	(41,817)	(37,487)
Purchased intangibles, net	$ 102,813	$ 108,015

License, manufacturing access fees and other assets, net

	June 30, 2010	December 31, 2009
Patents	$ 19,315	$ 19,042
License and manufacturing access fees	64,078	62,502
Investment in Pacific Biosciences	50,000	

Investment in Qualigen	5,404	5,404
Investment in DiagnoCure	5,000	5,000
Investment in Roka	725	725
Other assets	7,366	7,740
License, manufacturing access fees and other assets, at cost	151,888	100,413
Less accumulated amortization	(38,887)	(35,812)
License, manufacturing access fees and other assets, net	$ 113,001	$ 64,601

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Other accrued expenses

	June 30, 2010	December 31, 2009
Current component of contingent consideration	$ 10,855	$ 8,396
Royalties	2,972	2,907
Professional fees	1,645	1,175
Interest	264	726
Warranty	337	334
Contingent liability		433
Other	3,488	4,489
Other accrued expenses	$ 19,561	$ 18,460

Note 7 Marketable securities

The Company s marketable securities include tax advantaged municipal securities and FDIC insured corporate bonds with a minimum Moody s credit rating of A3 or a Standard & Poor s credit rating of A-. As of June 30, 2010, the Company did not hold auction rate securities and has never held any such securities. The Company s investment policy limits the effective maturity on individual securities to six years and an average portfolio maturity to three years. At June 30, 2010, the Company s portfolios had an average maturity of two years and an average credit quality of AA1 as defined by Moody s.

The following is a summary of the Company s marketable securities as of June 30, 2010 (in thousands):

Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
$ 298,065	$ 1,864	$ (81)	$ 299,848

The following table shows the estimated fair values and gross unrealized losses for the Company s investments in individual securities that have been in a continuous unrealized loss position deemed to be temporary for less than 12 months and for more than 12 months as of June 30, 2010 (in thousands):

	Less than 12 Months		More than 12 Months	
	Estimated	Unrealized		