EDEN BIOSCIENCE CORP
Form 10-Q
November 07, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2002

or

[ ] **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from ____________ to ____________ .

Commission File Number 0-31499

EDEN Bioscience Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1649604**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3830 Monte Villa Parkway
Bothell, Washington 98021-6942
(Address of principal executive offices, including zip code)

(425) 806-7300
(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 past 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 [X] No [ ]

State the number of shares outstanding of each of the registrant s classes of common equity, as of the latest practicable date:

Class	Outstanding as of November 4, 2002
Common Stock, $.0025 Par Value	24,307,495

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

EDEN BIOSCIENCE CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

ASSETS

	September 30, 2002	December 31, 2001
Current assets:		
Cash and cash equivalents	$ 34,878,637	$ 48,327,022
Accounts receivable	164,653	89,128
Inventory	2,249,362	2,117,953
Other current assets	544,253	897,825
Total current assets	37,836,905	51,431,928
Property and equipment, net	20,336,059	22,385,662
Other assets	1,659,806	1,721,413
Total assets	$ 59,832,770	$ 75,539,003

LIABILITIES AND SHAREHOLDERS EQUITY

	September 30, 2002	December 31, 2001
Current liabilities:		
Accounts payable	$ 275,149	$ 906,557
Accrued liabilities	3,817,587	4,019,396
Current portion of capital lease obligations	137,605	216,452
Total current liabilities	4,230,341	5,142,405
Capital lease obligations, net of current portion	36,098	129,916
Other long-term liabilities	343,343	272,874
Total liabilities	4,609,782	5,545,195
Commitments and contingencies		
Shareholders equity:		
Preferred stock, $.01 par value, 10,000,000 shares authorized; no shares issued and outstanding at September 30, 2002 and December 31, 2001		
Common stock, $.0025 par value, 100,000,000 shares authorized; issued and outstanding shares - 24,289,988 shares at September 30, 2002; 24,099,944 shares at December 31, 2001	60,725	60,250
Additional paid-in capital	132,442,265	132,326,759
Deferred stock option compensation expense	(2,540)	(10,145)
Cumulative translation adjustment	(61,074)	(33,577)
Accumulated deficit	(77,216,388)	(62,349,479)
Total shareholders equity	55,222,988	69,993,808

Total liabilities and shareholders equity	$ 59,832,770	$ 75,539,003

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	**2001**	**2002**	**2001**
Product sales, net of sales allowances	$ 59,884	$ 439,125	$ 1,687,420	$ 3,496,002
Operating expenses:				
Cost of goods sold	373,591	782,351	2,106,892	3,959,416
Research and development	2,525,478	3,645,357	8,139,694	9,329,530
Selling, general and administrative	1,939,977	2,495,848	6,819,987	8,955,061
Total operating expenses	4,839,046	6,923,556	17,066,573	22,244,007
Loss from operations	(4,779,162)	(6,484,431)	(15,379,153)	(18,748,005)
Other income (expense):				
Interest income	170,347	585,341	582,994	2,556,004
Interest expense	(7,940)	(19,331)	(31,390)	(66,716)
Loss on disposal of assets	(35,753)		(39,360)	
Total other income	126,654	566,010	512,244	2,489,288
Loss before income taxes	(4,652,508)	(5,918,421)	(14,866,909)	(16,258,717)
Provision for income taxes				
Net loss	$ (4,652,508)	$ (5,918,421)	$ (14,866,909)	$ (16,258,717)
Basic and diluted net loss per share	$ (0.19)	$ (0.25)	$ (0.61)	$ (0.68)
Weighted average shares outstanding used to compute net loss per share	24,254,210	23,978,189	24,219,932	23,946,978

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2002	**2001**
Cash flows from operating activities:		
Net loss	$(14,866,909)	$(16,258,717)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation	1,981,489	1,138,319
Amortization of stock option compensation expense	7,605	13,860
Loss (gain) on disposal of fixed assets	39,360	(765)
Deferred rent payable	102,969	206,051
Changes in assets and liabilities:		
Accounts receivable	(73,444)	178,926
Inventory	75,551	(811,316)
Other assets	414,591	(2,207,865)
Accounts payable	(650,370)	(979,661)
Accrued liabilities	(217,555)	1,526,882
Other long-term liabilities	(32,500)	32,500
Net cash used in operating activities	(13,219,213)	(17,161,786)
Cash flows from investing activities:		
Purchases of property and equipment	(204,615)	(12,768,201)
Proceeds from disposal of equipment	24,473	2,733
Net cash used in investing activities	(180,142)	(12,765,468)
Cash flows from financing activities:		
Reduction in capital lease obligations	(172,665)	(189,844)
Proceeds from issuance of common stock	115,981	290,342
Net cash provided by (used in) financing activities	(56,684)	100,498
Effect of foreign currency exchange rates on cash and cash equivalents	7,654	(19,226)
Net decrease in cash and cash equivalents	(13,448,385)	(29,845,982)
Cash and cash equivalents at beginning of period	48,327,022	86,556,865
Cash and cash equivalents at end of period	$ 34,878,637	$ 56,710,883
Supplemental disclosures:		
Cash paid for interest	$ 31,390	$ 66,716
Accrued liabilities for construction in process		2,287,540
Depreciation charges capitalized into inventory	208,225	265,703

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization and Business

EDEN Bioscience Corporation (the Company) was incorporated in the State of Washington on July 18, 1994. The Company is a plant technology company focused on developing, manufacturing and marketing innovative, natural protein-based products for agriculture and began sales of its initial product, Messenger®, in August 2000.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2001 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements and notes should be read in conjunction with the financial statements and notes for the year ended December 31, 2001 included in the Company s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 29, 2002.

In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial information set forth therein. Results of operations for the three months and nine months ended September 30, 2002 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Examples include depreciable lives of property and equipment, expense accruals and provisions for sales allowances, warranty claims, inventory valuation and bad debts. Such estimates and assumptions are based on historical experience, where applicable, and other assumptions that the Company believes are reasonable under the circumstances. We periodically review estimates and assumptions and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Actual results could differ from these estimates.

Property and Equipment

Equipment and leasehold improvements are stated at historical cost. Improvements and replacements are capitalized. Maintenance and repairs are expensed when incurred. The provision for depreciation is determined using straight-line and accelerated methods, which allocate costs over estimated useful lives of one to 20 years. On January 1, 2001, the Company adopted the units-of-production method of depreciation for manufacturing equipment placed into service after that date. Equipment leased under capital leases is depreciated over the shorter of the equipment s estimated useful life or lease term, which ranges between three to five years.

Revenue

The Company recognizes revenue from product sales, net of sales allowances, when product is delivered to distributors and all significant obligations of the Company have been satisfied, unless acceptance provisions or other contingencies exist. If acceptance provisions or contingencies exist, revenue is recognized after such provisions or contingencies have been satisfied. Distributors do not have price protection or product return rights. The Company provides an allowance for warranty claims based on reasonable expectations. Shipping and handling costs related to product sales that are paid by the Company are included in cost of goods sold.

EDEN BIOSCIENCE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Sales allowances represent allowances granted to independent distributors for sales and marketing support, product warehousing and delivery and information exchange and are based on a percentage of sales. Sales allowances are estimated and accrued when the related product sales revenue is recognized and are paid to distributors when the distributors sell the product and report the sales data to the Company, usually on a quarterly basis. Gross product sales and sales allowances are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Gross product sales	$65,239	$ 644,299	$2,166,160	$ 5,360,737
Sales allowances	(5,355)	(205,174)	(478,740)	(1,864,735)
Product sales, net of sales allowances	$59,884	$ 439,125	$1,687,420	$ 3,496,002

Net Loss Per Share

Basic net loss per share is calculated as the net loss divided by the weighted average number of common shares outstanding during the period. Diluted net loss per share is calculated as the net loss divided by the sum of the weighted average number of common shares outstanding during the period plus the additional common shares that would have been issued had all dilutive warrants and options been exercised, less shares that would be repurchased with the proceeds from such exercises (treasury stock method). The effect of including outstanding options and warrants is antidilutive for all periods presented. Therefore, options and warrants have been excluded from the calculation of diluted net loss per share and consist of the following:

	As of September 30,	
	2002	2001
Options to purchase common stock	2,124,452	2,675,737
Warrants to purchase common stock	260,805	290,805

Comprehensive Loss

The following table summarizes the Company s comprehensive loss for the three months and nine months ended September 30, 2002 and 2001:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
Net loss	$(4,652,508)	$(5,918,421)	$(14,866,909)	$(16,258,717)
Cumulative translation adjustment	(16,941)	(5,538)	(27,497)	(23,687)
Total comprehensive loss	$(4,669,449)	$(5,923,959)	$(14,894,406)	$(16,282,404)

Reclassifications

Certain reclassifications have been made in prior years financial statements to conform to classifications used in the current year.

2. Inventory

Inventory, at average cost, consists of the following:

	September 30, 2002	December 31, 2001
Raw materials	$ 857,755	$ 934,824
Work in process	291,118	82,069
Finished goods	1,100,489	1,101,060
Total inventory	$ 2,249,362	$ 2,117,953

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EDEN BIOSCIENCE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Property and Equipment

Property and equipment, at cost, consist of the following:

	September 30, 2002	December 31, 2001
Equipment	$13,101,971	$12,986,850
Equipment under capital leases	512,742	714,626
Leasehold improvements	12,572,529	12,486,376
	26,187,242	26,187,852
Less accumulated depreciation	(5,851,183)	(3,802,190)
Net property and equipment	$20,336,059	$22,385,662

The Company recorded depreciation of $676,862 and $520,761 for the three months ended September 30, 2002 and 2001, respectively, and $2,189,714 and $1,404,022 for the nine months ended September 30, 2002 and 2001, respectively.

4. Accrued Liabilities

Accrued liabilities consist of the following:

	September 30, 2002	December 31, 2001
Sales allowances and marketing expenses	$1,226,583	$ 389,775
Compensation and benefits	1,004,322	1,397,639
Research and development field trial expenses	490,968	1,113,546
Deferred revenue	308,952	52,283
Warranty	268,861	324,249
Patent costs	167,388	204,885
Insurance premiums		342,320
Other	350,513	194,699
Total accrued liabilities	$3,817,587	$4,019,396

5. Stock Options and Warrants

The following table summarizes stock option activity since December 31, 2001:

	Number of Options
Balance at December 31, 2001	2,740,603

Options granted	676,000
Options cancelled	(1,049,485)
Options exercised	(242,666)
Balance at September 30, 2002	2,124,452

The Company has elected to apply the disclosure-only provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation. Accordingly, the Company accounts for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations.

On June 17, 2002, the Company offered to exchange certain outstanding options to purchase shares of its common stock granted to its current U.S. employees and officers (other than its Chief Financial Officer and then-Interim President) under the EDEN Bioscience Corporation 1995 Combined Incentive and Nonqualified Stock Option Plan (the 1995 Plan) and the EDEN Bioscience Corporation 2000 Stock Incentive Plan (the 2000 Plan and, together with the 1995 Plan, the Stock Option Plans) for new options it will grant under the 2000 Plan. The offer expired on July 17, 2002, at which time the Company cancelled options to purchase 788,900 shares of its common stock that were tendered for exchange or cancellation without replacement. Under the terms and subject to the conditions of the offer, the Company expects to grant new options to purchase approximately 578,200 shares of its common stock on or about January 20, 2003, the date that is at least six months and one day after the date that the Company cancelled the tendered options, subject to new option agreements to be executed by the Company and its employees who participated in the offer. Each new option will have an exercise price equal to the fair market value

EDEN BIOSCIENCE CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of the Company s common stock on the new grant date and will vest over four years at a rate of 25% on each anniversary of the vesting start date of the tendered option that it replaces.

As of September 30, 2002, the Company had warrants outstanding to purchase 260,805 shares of its common stock. No warrants to purchase shares of the Company s common stock were issued during the nine-month period ended September 30, 2002.

6. Major Customers

Net sales revenue for the nine months ended September 30, 2002 resulted from sales to 24 distributors, three of which accounted for an aggregate of 33% of net sales revenue. One of these distributors, AG Rx, Inc., accounted for $195,000 (12%) of net sales revenue. Helena Chemical Company accounted for $191,200 (11%) of net sales revenue and Triangle Chemical Company, Inc. accounted for $164,700 (10%) of net sales revenue.

Net sales revenue for the nine months ended September 30, 2001 resulted from sales to seven distributors, two of which accounted for an aggregate of 83% of net sales revenue. Sales to United Agri Products, a subsidiary of ConAgra Foods, Inc., accounted for $2.5 million (71%) of net sales revenue and sales to Western Farm Service accounted for $420,300 (12%) of net sales revenue.

7. Restructuring Charges and Other Costs

The Company recorded restructuring costs of $273,342 for severance and other costs associated with workforce reductions in the quarter ended June 30, 2002. These costs are recorded in the consolidated statements of operations as a component of research and development expense or selling, general and administrative expense, depending upon the classification of the affected employees. Of the 20 employees included in the workforce reduction, 14 worked in research and development and the remainder worked in a variety of other areas. Although the Company s restructuring plan was executed by June 30, 2002, payment of certain restructuring costs will continue through the end of 2002. Restructuring costs are summarized as follows:

	Total Charges	Non-Cash Charges	Cash Payments	Liability at September 30, 2002
2002	$273,342	$	$221,012	$ 52,330

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

This discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes thereto included in this report and with the 2001 audited financial statements and notes thereto included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 29, 2002.

The following discussion of our financial condition and results of operations contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. We use words such as anticipate, believe, expect, future and intend and similar expressions to identify forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the factors described below and under the caption Factors That May Affect Our Business, Future Operating Results and Financial Condition set forth at the end of this Item 2. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q. The cautionary statements made in this report should be read as being applicable to all forward-looking statements wherever they appear in this report.

Overview

We are a plant technology company focused on developing, manufacturing and marketing innovative, natural protein-based products for agriculture. We have a fundamentally new, patented and proprietary technology that we believe will improve crop production and plant protection worldwide. We believe our technology and initial product,

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Messenger, offer innovative solutions versus traditional plant protection and crop enhancement alternatives and, importantly, avoid the substantial and growing public resistance to chemical pesticides and gene-based biotechnology. Commercial sales of Messenger began in August 2000.

We have incurred significant operating losses since inception. As of September 30, 2002, we had an accumulated deficit of $77.2 million. We incurred net losses of $4.7 million and $5.9 million for the quarters ended September 30, 2002 and 2001, respectively. The net loss for the nine months ended September 30, 2002 was $14.9 million, compared to a loss of $16.3 million for the nine months ended September 30, 2001. We expect to incur additional net losses as we proceed with the commercialization of Messenger and the development of new products and technologies.

Results of Operations

Three Months and Nine Months Ended September 30, 2002 and 2001

Revenue

We recognize revenue from product sales when (a) the product is delivered to independent distributors, (b) we have satisfied all of our significant obligations and (c) any acceptance provisions or other contingencies have been satisfied. We do not offer price protection or product return rights to our distributors. We generated our first product sales revenue in August 2000. All product sales revenue to date has resulted from sales of Messenger, our only product, to distributors primarily in the United States. Product sales revenue is reported net of applicable sales allowances, as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(in thousands)		(in thousands)	
Gross product sales	$ 65	$ 644	$2,166	$ 5,361
Sales allowances	(5)	(205)	(479)	(1,865)
Product sales, net of sales allowances	$ 60	$ 439	$1,687	$ 3,496

Gross product sales revenue for the third quarter of 2002 was $65,200, a decrease of $579,100 (90%) from $644,300 in the comparable quarter of 2001. Gross product sales revenue for the first nine months of the year totaled $2.2 million, a decrease of $3.2 million (59%) from $5.4 million for the same period in 2001. Sales in the first nine months of 2002 were made to 24 distributors, three of which accounted for an aggregate of 33% of net sales revenue. One of these distributors, AG Rx, Inc., accounted for $195,000 (12%) of net sales revenue. Helena Chemical Company accounted for $191,200 (11%) of net sales revenue and Triangle Chemical Company, Inc. accounted for $164,700 (10%) of net sales revenue.

Foreign sales to customers in Europe and Central America totaled $42,000 in the three months ended September 30, 2002, or 64% of gross sales for the quarter, and $64,400 in the nine months ended September 30, 2002, or 3% of gross sales for that period. No foreign sales were recorded in the nine months ended September 30, 2001.

Some of our major distributors in the United States, particularly in our Southern region, currently hold significant inventories of Messenger. In 2000, we shipped approximately 453,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 66,000 ounces were sold by our distributors to growers in 2000 and approximately 387,000 ounces remained in distributors inventories at December 31, 2000. In 2001, we shipped approximately 1,225,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 596,000 ounces were sold by our distributors to growers in 2001 and approximately 1,016,000 ounces remained in distributors inventories at December 31, 2001. In the first nine months of 2002, we shipped approximately 477,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 611,000 ounces were sold by our distributors to growers in the first nine months of 2002 and that approximately 882,000 ounces remained in distributors inventories at September 30, 2002. We do not expect distributors that have significant inventories of Messenger to place additional orders for Messenger until their current inventories are reduced and, therefore, we expect sales to distributors in the next quarter to be minor. We are working with our distributors and growers to reduce distributors inventories of Messenger.

Sales Allowances

Sales allowances represent allowances granted to independent distributors for sales and marketing support, product warehousing and delivery and information exchange and are based on a percentage of sales. Sales allowances are accrued when the related product sales revenue is recognized and are paid to distributors when the distributors sell the product and report the sales data to us, usually on a quarterly basis. Sales allowances were $5,400 (8% of gross product sales) for the third quarter of 2002 and $205,000 (32% of gross product sales) in the comparable quarter of 2001. Sales allowances for the first nine months of the year totaled $478,700 (22% of gross product sales) in 2002 and $1.9 million (35% of gross product sales) in 2001. Sales allowances as a percentage of gross product sales have declined as we have increased the number of distributors and diversified the outlets through which our product is sold. Sales allowances also declined in the three months and nine months ended September 30, 2002 due to increased foreign sales, for which no sales allowance is typically owed. We expect 2002 sales allowances to average approximately 20-25% of gross product sales. Actual sales allowances paid may be higher or lower than the estimate accrued, depending upon the level of service provided by the distributor.

Cost of Goods Sold

Cost of goods sold consists primarily of the cost of Messenger sold to distributors, idle capacity charges and the cost of Messenger used for promotional purposes. Cost of goods sold was $373,600 in the third quarter of 2002 compared to $782,400 in the third quarter of 2001. This reduction resulted primarily from steps taken earlier in the year to reduce staffing and other manufacturing overhead costs during periods of non-production and from a reduction in net sales. Idle capacity charges for the quarter ended September 30, 2002 were down by $226,000 from the same quarter last year. We expect to incur idle capacity charges in the future and will continue to take steps to minimize such costs.

For the first nine months of 2002, cost of goods sold was $2.1 million, compared to $4.0 million for the same period in 2001. This decrease was due primarily to an approximate $1.4 million write-down of inventory recorded in the second quarter of 2001, consisting primarily of bulk Messenger product, that resulted from the following circumstances: inventory levels that exceeded our revenue forecasts; an expectation that we would change our product formulation within the revenue forecast period; and disposal of bulk Messenger that did not meet our highest standards as a result of a change, since rectified, in the manufacturing process at our new facility. Also, the reduction in gross sales for the nine months ended September 30, 2002 contributed to a decrease of $706,000 in cost of goods sold for the period. These reductions were offset by increases in other components of cost of goods sold, principally an increase of $421,900 in Messenger distributed for promotional purposes.

Research and Development Expenses

Research and development expenses consist primarily of personnel, field trial, laboratory, patent and facility expenses. Research and development expenses decreased $1.1 million (31%) from $3.6 million in the third quarter of 2001 to $2.5 million in the same quarter of 2002. For the first nine months of 2002, research and development costs were $8.1 million, a decrease of $1.2 million (13%) from $9.3 million in the same period last year. These decreases were primarily due to lower spending on personnel costs, field trials, patents and trademarks, research supplies and travel, offset by increases in depreciation and facility costs. Compared to the second quarter of this year, company-wide research and development costs in the third quarter were lower by 7%. We expect research and development costs to continue to decrease as we re-focus our research and development efforts in the United States and scale back such efforts in Europe.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist of payroll and related expenses for sales and marketing, executive and administrative personnel; advertising, marketing and professional fees; and other corporate expenses. Selling, general and administrative expenses decreased $555,900 (22%) from $2.5 million in the third quarter of 2001 to $1.9 million in the same quarter of 2002. For the first nine months of 2002, selling, general and administrative expenses were $6.8 million, a decrease of $2.2 million (24%) from $9.0 million in the same period last year. The majority of the decreases occurred in the United States and resulted primarily from reductions in advertising and marketing, travel and personnel costs, offset by increases in insurance, consultant, depreciation and facility costs. Compared to the second quarter of this year, company-wide selling, general and administrative costs in the third quarter were lower by 12%. We expect these costs to decrease for the remainder of the year as the growing season ends.

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In an effort to reduce facility and related costs going forward, we have begun to market excess laboratory and office space at our headquarters in Bothell, Washington. If we are successful in finding a qualified subtenant and negotiating a sublease agreement, the market lease rate is not likely to cover all of the unamortized costs of leasehold improvements and equipment related to the subleased space. While it is not possible at this time to estimate the amount of a shortfall, the write-off of these fixed assets would likely have a material adverse impact on our results of operations for the quarter and year in which the charge is recorded. At September 30, 2002, the estimated net book value of leasehold improvements and equipment in the space being marketed for sublease was approximately $4.6 million.

Interest Income

Interest income consists of earnings on our cash and cash equivalents. Interest income decreased $415,000 (71%) from $585,300 in the third quarter of 2001 to $170,300 in the same quarter of 2002. For the first nine months of 2002, interest income was $583,000, down $2.0 million (77%) from $2.6 million in the same period last year. These decreases were due primarily to significantly lower average cash balances available for investment in the current year and significant interest rate reductions that have occurred in the last year.

Interest Expense

Interest expense consists of interest we pay on capital leases used to finance certain equipment purchases. Interest expense decreased $11,400 (59%) from $19,300 in the third quarter of 2001 to $7,900 in the same quarter of 2002. For the first nine months of 2002, interest expense was $31,400, down $35,300 (53%) from $66,700 in the same period last year. These decreases were due to reduced leasing activity and lower average principal balances as we pay down our existing capital lease obligations.

Income Taxes

We have generated a net loss from operations in each period since we began doing business. As of December 31, 2001, we had accumulated approximately $62 million of net operating loss carryforwards for federal income tax purposes. These carryforwards expire between 2009 and 2021. The annual use of these net operating loss carryforwards may be limited in the event of a cumulative change in ownership of more than 50%.

Liquidity and Capital Resources

At September 30, 2002, our cash and cash equivalents totaled $34.9 million, a decrease of $13.4 million from the balance at December 31, 2001. Prior to October 2000, we financed our operations primarily through the private sale of our equity securities, resulting in net proceeds of approximately $36.5 million through September 30, 2000. In October 2000, we received approximately $91.5 million in net proceeds from the initial public offering of 6,670,000 shares of our common stock. To a lesser extent, we have financed our equipment purchases through lease financings.

Net cash used in operations decreased $4.0 million (23%) from $17.2 million in the first nine months of 2001 to $13.2 million in the same period of 2002. Net cash used in operations in the first nine months of 2002 resulted primarily from a net loss of $12.9 million, after adding back depreciation expense of $2.0 million, and fluctuations in various asset and liability balances totaling $483,700. We expect that cash expenditures on operations will continue to be significant.

Net cash used in investing activities decreased $12.6 million (98%) from $12.8 million in the first nine months of 2001 to $180,100 in the same period of 2002. Investing activities in the first nine months of 2001 consisted primarily of property and equipment purchases in connection with expansion of our manufacturing and research and development facilities, which was completed by December 31, 2001.

Net cash used in financing activities increased $157,200 (156%) from $100,500 cash provided in the first nine months of 2001 to $56,700 used in the same period of 2002. The primary use of funds in both periods was to pay down principal on our outstanding capital leases, offset by proceeds from the issuance of common stock of $116,000 in 2002 and $290,000 in 2001.

We conduct our operations in three primary functional currencies: the U.S. dollar, the European Union euro and the Mexican peso. Historically, neither fluctuations in foreign exchange rates nor changes in foreign economic conditions have had a significant impact on our financial condition or results of operations. We currently do not hedge our foreign currency exposures and are therefore subject to the risk of exchange rate fluctuations. We may invoice our international customers in U.S. dollars, euros and Mexican pesos, as the case may be. We are exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. Foreign exchange rate fluctuations did not have a material impact on our financial results in the three-month or nine-month periods ended September 30, 2002 and 2001.

The following are our contractual obligations as of September 30, 2002 associated with our capital and operating lease obligations:

	Payments Due by Period				
	Total	Less Than 1 Year	1-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
Capital lease obligations, including interest	$ 192	$ 152	$ 38	$ 2	$
Operating leases	14,016	1,858	3,745	3,349	5,064
Total contractual cash obligations	$ 14,208	$ 2,010	$ 3,783	$ 3,351	$ 5,064

Our operating expenditures have been significant since inception. We currently anticipate that our operating expenses will significantly exceed net product sales and that net losses and working capital requirements will consume a material amount of our cash resources. We believe that the balance of our cash and cash equivalents at September 30, 2002 will be sufficient to meet our anticipated cash needs for net losses, working capital and capital expenditures for at least the next 18 months.

In the future, we may require additional funds to support our working capital requirements or for other purposes and may seek to raise such additional funds through public or private equity financing or through other sources, such as credit facilities. We may be unable to obtain adequate or favorable financing at that time or at all. The sale of additional equity securities could result in dilution to our shareholders.

Significant Accounting Policies, Estimates and Judgments

Our significant accounting policies are more fully described in Note 1 to our consolidated financial statements included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 29, 2002. Certain of our accounting policies require the application of significant judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, terms of existing contracts, commonly accepted industry practices, information provided by our customers and other assumptions that we believe are reasonable under the circumstances. Our estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Actual results may differ from these estimates under different assumptions or conditions. Our significant accounting policies and estimates include:

Revenue Recognition

We sell our product through independent, third-party distributors. Our contracts with those distributors provide no price protection or product-return rights. We recognize revenue from product sales, net of sales allowances, when product is delivered to our distributors and all of our significant obligations have been satisfied, unless acceptance provisions or other contingencies exist. If acceptance provisions or contingencies exist, revenue is recognized after such provisions or contingencies have been satisfied. Sales allowances represent estimated allowances granted to independent distributors for sales and marketing support, product warehousing and delivery and information exchange and are based on a percentage of sales. Sales allowances are accrued when the related product sales revenues are recognized and are paid to distributors when the distributors sell the product and report the sales data to us, usually on a quarterly basis. Actual sales allowances paid may be higher or lower than the estimate accrued, depending upon the level of service provided by the distributor. We also record an allowance for warranty claims based on a percentage of sales, at the time revenues are recognized. The warranty percentage, which has ranged between one to five percent, is reviewed periodically and adjusted as necessary, based on our experience and future estimations.

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Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable balances are reported net of related deferred revenue and liabilities for sales allowances payable. In determining the adequacy of the allowance for doubtful accounts, we consider a number of factors, including the aging of the accounts receivable portfolio, customer payment trends, the financial condition of our customers, historical bad debts and current economic trends. Based upon our analysis of outstanding net accounts receivable at September 30, 2002, no allowance for doubtful accounts was recorded.

Inventory

Our inventory is valued at the lower of cost or market on an average-cost basis. We regularly review inventory balances to determine whether a write-down is necessary. We consider various factors in making this determination, including recent sales history and predicted trends, industry market conditions and general economic conditions. No inventory write-downs were recorded during the three months ended September 30, 2002.

Valuation of Property and Equipment

We periodically review the carrying values of our property and equipment to determine whether such assets have been impaired. An impairment loss must be recorded pursuant to SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, when the undiscounted net cash flows to be realized from the use of such assets are less than their carrying value. The determination of undiscounted net cash flows requires us to make many estimates, projections and assumptions, including the lives of the assets, future sales and expense levels, additional capital investments or expenditures necessary to maintain the assets, industry market trends and general and industry economic conditions. Based upon our most recent analysis of net cash flows to be realized from our investments in property and equipment, no impairment loss was recorded.

We are currently marketing excess laboratory and office space at our headquarters in Bothell, Washington. If we are successful in finding a qualified subtenant and negotiating a sublease agreement, the market lease rate is not likely to cover all of the unamortized costs of leasehold improvements and equipment related to the subleased space. While it is not possible at this time to estimate the amount of a shortfall, the write-off of these fixed assets would likely have a material adverse impact on our results of operations for the quarter and year in which the charge is recorded. At September 30, 2002, the estimated net book value of leasehold improvements and equipment in the space being marketed for sublease was approximately $4.6 million. Changes in the factors listed above or other factors could result in significantly different cash flow estimates and an impairment charge.

Recent Accounting Pronouncements

SFAS No. 143 In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations, which provides the accounting requirements for retirement obligations associated with tangible long-lived assets. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. This statement will be effective for our 2003 fiscal year, and early adoption is permitted. The adoption of SFAS No. 143 is not expected to have a material impact on our consolidated results of operations, financial position or cash flows.

SFAS No. 146 In June 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. This statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). This statement requires that a liability for a cost associated with an exit or disposal activity be recognized at fair value when the liability is incurred. This statement will be effective for our 2003 fiscal year, and early adoption is permitted. We are currently assessing the impact of this statement on our results of operations, financial position and cash flows.

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Factors That May Affect Our Business, Future Operating Results and Financial Condition

You should carefully consider the risks described below, together with all of the other information included in this quarterly report on Form 10-Q. The risks and uncertainties described below are not the only ones facing our company. If any of the following risks actually occurs, our business, financial condition or operating results could be harmed.

We currently depend on a single product and our development and commercialization of that product may not be successful.

For the immediately foreseeable future we will be dependent on the successful development and commercialization of one product, Messenger, which is based on a new technology. While Messenger has been subject to numerous field tests on a wide variety of crops with favorable results, we have only recently begun sales of Messenger, and Messenger could prove to be commercially unsuccessful. Messenger may not prove effective or economically viable for all crops or markets. In addition, because Messenger has not been put to widespread commercial use over significant periods of time, no assurance can be given that adverse consequences might not result from the use of Messenger, such as soil or other environmental degradation, the development of negative effects on animals or plants or reduced benefits in terms of crop yield or protection.

The markets for Messenger and other harpin-based products we may develop are unproven. Messenger may not gain commercial acceptance or success. If we are unable to successfully achieve broad market acceptance of Messenger, we may not be able to generate enough product revenues in the future to achieve profitability. A variety of factors will determine the success of our market development and commercialization efforts and the rate and extent of market acceptance of Messenger, including our ability to implement and maintain an appropriate pricing policy for Messenger, general economic conditions in agricultural markets, including commodity prices, climatic conditions and the extent that growers, regulatory authorities and the public accept new agricultural practices and products developed through biotechnology.

Inability to develop adequate sales and marketing capabilities could prevent us from successfully commercializing Messenger and other products we may develop.

We currently have limited sales and marketing experience and capabilities. Our internal sales and marketing staff consists primarily of sales and marketing specialists and field development specialists who are trained to educate growers and independent distributors on the uses and benefits of Messenger. We will need to further develop our sales, marketing and field development capabilities in order to enhance our commercialization efforts, which will involve substantial costs. These specialists require a high level of technical expertise and knowledge regarding Messenger s capabilities and other plant protection and yield enhancement products and techniques. We cannot assure you that our specialists and other members of our sales and marketing team will successfully compete against the sales and marketing operations of our current and future competitors that may have more established relationships with distributors, retailers and growers. Failure to recruit, train and retain important sales and marketing personnel, such as our sales and marketing specialists and field development specialists, or the inability of new sales and marketing personnel to effectively market and sell Messenger and other products we may develop, could impair our ability to gain market acceptance of our products and cause our sales to suffer.

We have a history of losses since inception, we expect to continue to incur losses and we may not achieve or sustain profitability.

We have incurred operating losses in each quarter since inception and we expect to continue to incur further operating losses for the foreseeable future. From our inception in July 1994 to September 30, 2002, we have accumulated a deficit of $77.2 million. For the years ended December 31, 2001 and 2000, we had net losses of $23.7 million and $15.7 million, respectively. For the nine months ended September 30, 2002, we had a net loss of $14.9 million. To date, our revenues have been limited. We expect our future revenues to come primarily from the sale of Messenger, and these sales are highly uncertain. For example, there were no sales of Messenger in the fourth quarter of 2001, sales in the third quarter of this year were down by 90% from the same quarter last year and we expect sales in the fourth quarter of 2002 to be minor.

Moreover, some of our major distributors in the United States, particularly in our Southern region, currently hold significant inventories of Messenger. In 2000, we shipped approximately 453,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 66,000 ounces were sold by our distributors to growers in 2000 and approximately 387,000 ounces remained in distributors inventories at December 31, 2000. In 2001, we shipped approximately 1,225,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 596,000 ounces were sold by our distributors to growers in 2001 and approximately 1,016,000 ounces remained in distributors inventories at December 31, 2001. In the first nine months of 2002, we shipped approximately 477,000 ounces of Messenger to our U.S. distributors. We estimate that approximately 611,000 ounces were sold by our distributors to growers in the first nine months of 2002 and that approximately 882,000 ounces remained in distributors inventories at September 30, 2002. We do not expect distributors that hold significant inventories of Messenger to place additional orders for Messenger until their current inventories are reduced, which will adversely affect our sales and results of operations. We expect to continue to devote substantial resources to maintaining and operating our manufacturing facility and to funding our research and development and sales and marketing activities in the United States and foreign countries. As a result, we will need to generate significant revenues to achieve and maintain profitability. We may never generate profits, and if we do become profitable, we may be unable to sustain or increase profitability on a quarterly or annual basis.

We may have to reduce operations if we are unable to meet our funding requirements.

We will require substantial additional funding to continue our research and development activities, maintain and operate our manufacturing facilities and commercialize worldwide Messenger and any other products we may develop. If we are unable to generate sufficient cash flow from operations, or obtain funds through additional financing, we may have to delay, curtail or eliminate some or all of our research and development, field testing, marketing or manufacturing programs. For example, we reduced our workforce by 23% in May 2002, significantly curtailing our European operations. We believe that our existing capital resources will be sufficient to support our operations for at least the next 18 months. Our future capital requirements will depend on the success of our operations.

If our capital requirements vary from our current plans, we may require additional financing sooner than we anticipate. Financing may be unavailable to us when needed or on acceptable terms.

If our ongoing or future field trials are unsuccessful, we may be unable to achieve market acceptance or obtain regulatory approval of our current product or any other products we may develop.

The successful completion of multiple field trials in domestic and foreign locations on a wide variety of crops is critical to the success of our product development and marketing efforts. If our ongoing or future field trials are unsuccessful or produce inconsistent results or adverse side effects, or if we are unable to collect reliable data, regulatory approval of our current product or any other products we may develop could be delayed or withheld or we may be unable to achieve market acceptance of these products. Although we have conducted successful field trials on a broad range of crops, we cannot be certain that additional field trials conducted on a greater number of acres, or on crops for which we have not yet conducted field trials, will be successful. Moreover, the results of our ongoing and future field trials are subject to a number of conditions beyond our control, including weather-related events such as droughts and floods, severe heat and frost, hail, tornadoes and hurricanes. Generally, we pay third parties, such as growers, consultants and universities, to conduct our field trials for us. Incompatible crop treatment practices or misapplication of the product by third parties could interfere with the success of our field trials.

We are at an early stage of development and are subject to the risks of a new enterprise and the commercialization of a new technology.

We began our operations in 1994 and began the marketing and sale of our first product, Messenger, in the third quarter of 2000. Our early stage of development, the newness of our technology and the uncertain nature of the market in which we compete make it difficult to assess our prospects or predict our future operating results. We are subject to risks and uncertainties frequently encountered in the establishment of a new business enterprise, particularly in the rapidly changing market for plant protection and yield enhancement products. These risks include our inability to transition from a company with a research focus to a company capable of supporting commercial activities, including manufacturing, quality control and assurance, regulatory approval and compliance, marketing, sales, distribution and customer service. Our inability to adequately address these risks could cause us to be unprofitable or to cease operations.

Actual storage conditions of Messenger may cause it to degrade more rapidly than we anticipate, which could adversely affect market acceptance of Messenger or our results of operations.

Messenger is currently being stored in large quantities under various conditions by us and by our distributors in the United States. We have conducted laboratory studies that indicate Messenger is stable for at least two years under our recommended storage conditions. No assurance can be given, however, that actual storage conditions will not cause Messenger s quality to degrade over a shorter time period. If this were to occur, we may have to record inventory write-downs or, if required or we decide to do so, replace product held by distributors or growers, which could adversely impact the market acceptance of Messenger or our results of operations.

We may be unable to establish or maintain successful relationships with independent distributors and retailers, which could adversely affect our sales.

We intend to rely on independent distributors and retailers of agri-chemicals to distribute and assist with the marketing and sale of Messenger and any other products we may develop. We have engaged several independent distributors and retailers for the distribution and sale of Messenger. Our future revenue growth will depend in large part on our success in establishing and maintaining these sales and distribution channels. We are in the early stages of developing our distribution network and we may be unable to establish or maintain these relationships in a timely or cost-effective manner. Moreover, we cannot assure you that the distributors and retailers on which we rely will focus adequate resources on selling these products or will be successful in selling them. Many of our potential distributors and retailers are in the business of distributing and sometimes manufacturing other, possibly competing, plant protection and yield enhancement products and may perceive Messenger as a threat to various product lines currently being manufactured or distributed by them. In addition, the distributors may earn higher margins by selling competing products or combinations of competing products. If we are unable to establish or maintain successful relationships with independent distributors and retailers, we will need to further develop our own distribution capabilities, which would be expensive and time-consuming and the success of which would be uncertain.

Three of our distributors accounted for an aggregate of 33% of our net sales revenue for the nine months ended September 30, 2002. One of these distributors, AG Rx, Inc., accounted for $195,000 (12%) of our net sales revenue. Helena Chemical Company accounted for $191,200 (11%) of our net sales revenue and Triangle Chemical Company, Inc. accounted for $164,700 (10%) of our net sales revenue. If any of these distributors, or any other distributor which purchases a significant amount of our products, were to discontinue purchasing our products at any time, our sales would be adversely affected. In addition, the failure of any of these distributors, or of any other distributor to which we extend a significant amount of credit, to pay its account, now or in the future, may harm our operating results.

Inability to obtain regulatory approvals, or to comply with ongoing and changing regulatory requirements, could delay or prevent sales of Messenger or any other products we may develop.

The field testing, manufacture, sale and use of plant protection and yield enhancement products, including Messenger and any other products we may develop, are extensively regulated by the EPA and state, local and foreign governmental authorities. These regulations substantially increase the cost and time associated with bringing Messenger and any other products we may develop to market. If we do not receive the necessary governmental approvals to test, manufacture and market these products, or if the regulatory authorities revoke our approvals or grant them subject to restrictions on their use, we may be unable to sell these products and our business may fail.

In April 2000, we received conditional approval from the EPA to market and sell our first product, Messenger, in the United States. In April 2002, the EPA determined that all conditions for registration had been satisfied and converted the conditional registration of Messenger to unconditional. We are also required to obtain regulatory approval from certain state and foreign regulatory authorities before we market Messenger in those jurisdictions. Certain of these jurisdictions may apply different criteria than the EPA in connection with their approval processes. Although we are authorized to sell Messenger in 48 states on virtually all crops for crop production and disease management and in California on strawberries, grapes and fruiting vegetables, such as tomatoes and peppers, for disease management, we have not received approval for Messenger in Colorado or for use on other crops in California. We have also received authorization to sell Messenger in 26 foreign countries, including China, Germany, Mexico and six Central American countries. Our registration in China is temporary and limited to the sale of Messenger for use on several crops, including tomatoes, peppers, rice, cotton, tobacco and rape seed.

If we significantly modify Messenger s design as a result of our ongoing research and development projects, additional EPA and other regulatory approvals may be required. Moreover, we cannot assure you that we will be able to obtain approval for marketing additional harpin-based products or product extensions that we may develop. For example, while the EPA has in place a registration procedure for products such as Messenger that is streamlined in comparison to the registration procedure for chemical pesticides, there can be no assurance that all of our products or product extensions will be eligible for the streamlined procedure or that the EPA will not impose additional requirements that could make the procedure more time-consuming and costly for any future products we may develop.

Even if we obtain all necessary regulatory approvals to market and sell Messenger and any other products we may develop, Messenger and these other products will be subject to continuing review and extensive regulatory requirements. The EPA, as well as state and foreign governmental authorities, could withdraw a previously approved product from the market upon discovery of new information, including an inability to comply with regulatory requirements, the occurrence of unanticipated problems with the product or for other reasons. In addition, federal, state and foreign regulations relating to crop protection products developed through biotechnology are subject to public concerns and political circumstances and, as a result, regulations have changed and may change substantially in the future. These changes may result in limitations on the manufacturing, marketing or use of Messenger or any other products we may develop and commercialize.

Inability to satisfy the conditions of our California registration for strawberries could limit or prevent sales of Messenger in that state.

Our registration to sell Messenger in California for use on strawberries for disease management is conditioned on the requirement that we submit data from several additional studies within various required timeframes ending on March 31, 2003. There are no conditions on our registration to sell Messenger in California for use on fruiting vegetables and grapes for disease management. As required by the California registration for use on strawberries, in April 2001 we submitted to the California Department of Pesticide Regulation the data required by the EPA as a condition of federal registration. We submitted the results of six additional strawberry field trials in December 2001, other information in March 2002 and the results of another six strawberry field trials in July 2002. We will submit the results of additional studies to the CDPR at various times in 2002 and 2003, in accordance with the conditions of our registration. If we are unable to conduct the studies required by the CDPR in a timely manner, or if the results of the studies are unacceptable to the CDPR, they may not allow the continued use of Messenger on strawberries in California or they may impose limitations on this use of Messenger, which could have a negative impact on our sales. Because EPA and state approvals are required for commercial sales of Messenger, the loss of any of these approvals for any reason would prevent further sales of Messenger in the affected state or nationwide.

The high level of competition in our market may result in price reductions, reduced margins or the inability of our products to achieve market acceptance.

The market for plant protection and yield enhancement products is intensely competitive, rapidly changing and undergoing consolidation. We may be unable to compete successfully against our current or future competitors, which may result in price reductions, reduced margins or the inability to achieve market acceptance of Messenger or any other products we may develop.

Many companies are engaged in developing plant protection and yield enhancement products. Our competitors include major international agri-chemical companies, specialized biotechnology companies and research and academic institutions. Many of these organizations have significantly more capital, research and development, regulatory, manufacturing, distribution, sales, marketing, human and other resources than we do. As a result, they may be able to devote greater resources to the development, manufacture, promotion or sale of their products, receive greater resources and support from independent distributors, initiate or withstand substantial price competition or take advantage of acquisition or other opportunities more readily. Furthermore, these large agri-chemical companies have a more diversified product offering than we do, which may give them an advantage in meeting customer needs by enabling them to offer integrated solutions to plant protection and yield enhancement.

International expansion will subject us to risks associated with international operations, which could adversely affect both our domestic and international operations.

Our success depends in part on our ability to expand internationally as we obtain regulatory approvals to market and sell Messenger and any other products we may develop in other countries. We have been conducting field trials in several international locations, and we have personnel in Europe and Mexico to develop operations in those regions. International expansion of our operations could impose substantial burdens on our resources, divert management s attention from domestic operations or otherwise adversely affect our business. Furthermore, international operations are subject to several inherent risks, especially different regulatory requirements and reduced protection of intellectual property rights, that could adversely affect our ability to compete in international markets and could have a negative effect on our operating results.

Inability to protect our patents and proprietary rights in the United States and foreign countries could limit our ability to compete effectively since our competitors may take advantage of our patents or proprietary rights.

Our success depends on our ability to obtain and maintain patent and other proprietary-right protection for our technology and products in the United States and other countries. If we are unable to obtain or maintain these protections, we may not be able to prevent third parties from using our proprietary rights. We also rely on trade secrets, proprietary know-how and continuing technological innovation to remain competitive. We have taken measures to protect our trade secrets and know-how, including the use of confidentiality agreements with our employees, consultants and advisors. It is possible that these agreements may be breached and that any remedies for breach will not make us whole. We generally control and limit access to, and the distribution of, our product documentation and other proprietary information. Despite our efforts to protect these proprietary rights, unauthorized parties may copy aspects of our products or obtain and use information that we regard as proprietary. We also cannot guarantee that other parties will not independently develop our know-how or otherwise obtain access to our technology.

The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant problems and incurred significant costs in protecting their proprietary rights in these foreign countries.

Patent law is still evolving with respect to the scope and enforceability of claims in the fields in which we operate. We are like many biotechnology companies in that our patent protection is highly uncertain and involves complex legal and technical questions for which legal principles are not firmly established. Our patents and those patents for which we have license rights may be challenged, narrowed, invalidated or circumvented. In addition, our issued patents may not contain claims sufficiently broad to protect us against third parties with similar technologies or products, or provide us with any competitive advantage. We are not certain that our pending patent applications will be issued. Moreover, our competitors could challenge or circumvent our patents or pending patent applications.

The U.S. Patent and Trademark Office and the courts have not established a consistent policy regarding the breadth of claims allowed in biotechnology patents. The allowance of broader claims may increase the incidence and cost of patent interference proceedings and the risk of infringement litigation. On the other hand, the allowance of narrower claims may limit the value of our proprietary rights.

Other companies may claim that we infringe their intellectual property or proprietary rights, which could cause us to incur significant expenses or be prevented from selling Messenger or any other products we may develop.

Our success depends on our ability to operate without infringing the patents and proprietary rights of third parties. Product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. Future patents issued to third parties may contain claims that conflict with our patents. Although we believe that Messenger does not infringe the proprietary rights of any third parties, third parties could assert infringement claims against us in the future. Any litigation or interference proceedings, regardless of their merit or outcome, would probably be costly and require significant time and attention of our key management and technical personnel. Litigation or interference proceedings could also force us to:

- stop or delay selling, manufacturing or using products that incorporate the challenged intellectual property;
- pay damages; or
- enter into licensing or royalty agreements that may be unavailable on acceptable terms.

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If we do not adequately distinguish Messenger from products that genetically modify plants and certain other products, public concerns over those products could negatively impact market acceptance of Messenger.

Claims that genetically engineered products are unsafe for consumption or pose a danger to the environment have led to public concerns and negative public attitudes, particularly in Europe. We intend to distinguish Messenger and harpin-related technologies from products that genetically modify plants. While our technology does involve genetic modification in the process of manufacturing Messenger, Messenger and harpin-related technologies are topically applied and do not genetically modify the plant s DNA. If the public or potential customers perceive Messenger as a product that genetically modifies the plant, Messenger may not gain market acceptance. Similarly, countries that have imposed more restrictive regulations on products that genetically modify plants, including Japan and certain members of the European Union, may perceive Messenger as a product that genetically modifies plants. If so, regulators in those countries may impose more restrictive regulations on Messenger, which could delay, limit or impair our ability to market and sell Messenger in those countries.

We may be exposed to product liability claims, which could adversely affect our operations.

We may be held liable or incur costs to settle product liability claims if any products we may develop, or any products that use or incorporate any of our technologies, cause injury or are found unsuitable during product testing, manufacturing, marketing, sale or use. These risks exist even with respect to any products that have received, or may in the future receive, regulatory approval, registration or clearance for commercial use. We cannot guarantee that we will be able to avoid product liability exposure.

We currently maintain product liability insurance at levels we believe are sufficient and consistent with industry standards for companies at our stage of development. We cannot guarantee that our product liability insurance is adequate, and, at any time, it is possible that such insurance coverage may not be available on commercially reasonable terms or at all. A product liability claim could result in liability to us greater than our assets and insurance coverage. Moreover, even if we have adequate insurance coverage, product liability claims or recalls could result in negative publicity or force us to devote significant time and attention to matters other than those that arise in the normal course of business.

Rapid changes in technology could render our current product or any other products we may develop unmarketable or obsolete.

We are engaged in an industry characterized by extensive research efforts and rapid technological development. Our competitors, many of which have substantially greater technological and financial resources than we do, may develop plant protection and yield enhancement technologies and products that are more effective than ours or that render our technology and products obsolete or uncompetitive. To be successful, we will need to continually enhance Messenger and any other products we may develop and to design, develop and market new products that keep pace with new technological and industry developments.

Our product development efforts, which are based on an innovative technology that is commercially unproven, may not be successful.

Our harpin and harpin-related technology is new, in an early stage of development and commercially unproven. It may take years and significant capital investment to develop viable enhancements of Messenger or any new products we may develop based on our harpin and harpin-related technology. Risks inherent in the development of products based on innovative technologies include the possibility that:

- new products or product enhancements will be uneconomical to market or will be difficult to produce on a large scale;
- proprietary rights of third parties will prevent us from marketing products; and
- third parties will market superior or equivalent products or will market their products first.

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Inability to comply with regulations applicable to our facilities and procedures could delay, limit or prevent our research and development or manufacturing activities.

Our research and development and manufacturing facilities and procedures are subject to continual review and periodic inspection. To comply with the regulations applicable to these facilities and procedures, we must spend funds, time and effort in the areas of production, safety and quality control and assurance to help ensure full technical compliance. If the EPA or another regulator determines that we are not in compliance, regulatory approval of Messenger or any other products we may develop could be revoked, delayed or withheld or we may be required to limit or cease our research and development or manufacturing activities or pay a monetary fine. If we were required to limit or cease our research and development activities, our ability to develop new products would be impaired. In addition, if we were required to limit or cease our manufacturing activities, our ability to produce Messenger in commercial quantities would be impaired or prohibited, which could have an adverse effect on our sales.

Inability to produce a high quality product could impair our business.

To be successful, we will have to manufacture Messenger in large quantities at acceptable costs while also preserving high product quality. If we cannot maintain high product quality on a large scale, we may be unable to achieve market acceptance of our product and our sales would likely suffer. Moreover, we do not have back-up manufacturing systems and, as a result, any failure of any component required in the manufacturing process could delay or impair our ability to manufacture Messenger in the quantities that we may require.

We intend to continue to make changes to our manufacturing processes and facilities in order to improve the efficiency and quality of our manufacturing activities. We cannot guarantee that we will be successful in this regard or that the changes we make will improve our manufacturing activities. We may encounter difficulties in the production of our current product or any future products we may develop, including problems involving manufacturing processes or yields, packaging, distribution, storage, quality control and assurance, shortages of qualified personnel or compliance with regulatory requirements. Even if we are successful in developing our manufacturing capability and processes, there can be no assurance that we will satisfy the requirements of our distributors or customers.

If third-party manufacturers fail to adequately perform, we could be unable to meet demand and our revenues could be impaired.

We currently depend on independent manufacturers to perform certain portions of our production process. We intend to engage additional third-party manufacturers as necessary to perform these processes. Any failure or delay in the ability of our current or any future manufacturers to provide us with material they produce could adversely affect our ability to produce Messenger in the quantities necessary to satisfy the requirements of our distributors or customers, or could increase our costs associated with obtaining such materials. In addition, the time and resources that our current or future third-party manufacturers devote to our business are not within our control. We cannot ensure that our current or future third-party manufacturers will perform their obligations to meet our quality standards, that we will derive cost savings or other benefits from our relationships with them or that we will be able to maintain a satisfactory relationship with them on terms acceptable to us. Moreover, these manufacturers may support products that compete directly or indirectly with ours, or offer similar or greater support to our competitors. If any of these events were to occur, our business and operations could be adversely affected.

Inability to address strain on our resources caused by growth could result in ineffective management of our business.

As we add manufacturing, marketing, sales, field development and other personnel, both domestically and internationally, during the commercialization of Messenger, and expand our manufacturing and research and development capabilities, we expect that our operating expenses and capital requirements will increase. Our ability to manage growth effectively requires us to continue to expend funds to improve our operational, financial and management controls, reporting systems and procedures. In addition, we must effectively expand, train and manage our employee base. We will be unable to effectively manage our business if we are unable to timely and successfully alleviate the strain on our resources caused by growth in our business, which could adversely affect our operating results.

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Inability to retain our key employees or other skilled managerial or technical personnel could impair our ability to maintain or expand our business.

We are highly dependent on the efforts and abilities of our current key managerial and technical personnel, particularly Dr. Rhett R. Atkins, our President and Chief Executive Officer; Bradley Powell, our Chief Financial Officer; and Dr. Zhongmin Wei, our Chief Scientific Officer and Vice President of Research. Our success will depend in part on retaining the services of Drs. Atkins and Wei and Mr. Powell and our other existing key management and technical personnel and on attracting and retaining new, highly qualified personnel.

Inability to retain our existing key management or technical personnel or to attract additional qualified personnel could, among other things, delay our sales, marketing and research and development efforts. Moreover, in our field, competition for qualified management and technical personnel is intense and many of the companies with which we compete for experienced personnel have greater financial and other resources than we do. As a result, we may be unable to recruit, train and retain sufficient qualified personnel.

Our operating results are likely to fluctuate, resulting in an unpredictable level of sales and earnings and possibly in a decrease in our stock price.

Our operating results for a particular quarter or year are likely to fluctuate, which could result in uncertainty surrounding our level of sales and earnings and possibly result in a decrease in our stock price. For example, there were no sales of Messenger in the fourth quarter of 2001. Numerous other factors will contribute to the unpredictability of our operating results. In particular, our sales are expected to be highly seasonal. Sales of plant protection and yield enhancement products are dependent on planting and growing seasons, climatic conditions, economic and other variables, which we expect to result in substantial fluctuations in our quarterly sales and earnings. For example, weather-related events such as droughts and floods, severe heat and frost, hail, tornadoes and hurricanes could decrease demand for our product and any future products we may develop, and have an adverse impact on our operating results from quarter to quarter. In addition, most of our expenses, such as employee compensation and lease payments for facilities and equipment, are relatively fixed. Our expense levels are based, in part, on our expectations regarding future sales. As a result, any shortfall in sales relative to our expectations could cause significant changes in our operating results from quarter to quarter. Other factors may also contribute to the unpredictability of our operating results, including the amount of Messenger carried in inventory by independent distributors and retailers, the size and timing of significant customer transactions, the delay or deferral of customer use of our product and the fiscal or quarterly budget cycles of our customers. For example, customers may purchase large quantities of our product in a particular quarter to store and use over long periods of time, or time their purchases to coincide with the availability of capital, which may cause significant fluctuations in our operating results for a particular quarter or year.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We do not currently hold any derivative instruments, and we do not engage in hedging activities. Also, we do not have any outstanding variable rate debt and currently do not enter into any material transactions denominated in foreign currency. Therefore, our direct exposure to interest rate and foreign exchange rate fluctuation is currently not material to our results of operations. We believe that the market risk arising from the financial instruments we hold is not material.

Item 4. Controls and Procedures

Within the 90 days prior to the date of this report, we carried out an evaluation, under the supervision and with the participation of management, including our President and Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14 under the Securities Exchange Act of 1934). Based upon that evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective. There have been no significant changes in our internal controls or in other factors which could significantly affect internal controls subsequent to the date we carried out our evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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PART II OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

On September 26, 2000, the SEC declared effective our Registration Statement on Form S-1, as amended (Registration No. 333-41028), as filed with the SEC in connection with our initial public offering. Proceeds to EDEN, after accounting for $7.0 million in underwriting discounts and commissions and approximately $1.6 million in other expenses of the offering, were approximately $91.5 million.

To date, of the net offering proceeds, we have used approximately $18.3 million to expand and enhance our manufacturing, research and development and administration facilities, and approximately $39.2 million for working capital and general corporate purposes. The remaining portion of the net offering proceeds has been invested in cash equivalent investments. Our use of the proceeds from the offering does not represent a material change in the use of proceeds described in the prospectus included as part of the Registration Statement.

Item 6. Exhibits

The following exhibits are being filed as part of this quarterly report on Form 10-Q.

(a) *Exhibits.*

Exhibit Number	Description
99.1	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99.2	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

EDEN BIOSCIENCE CORPORATION

Date: November 7, 2002

By: /s/ Rhett R. Atkins

Rhett R. Atkins
Chief Executive Officer and President

By: /s/ Bradley S. Powell

Bradley S. Powell
Chief Financial Officer and Secretary

(principal financial and accounting officer)

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CHIEF EXECUTIVE OFFICER CERTIFICATION

I, Rhett R. Atkins, President and Chief Executive Officer of EDEN Bioscience Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of EDEN Bioscience Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have;

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 7, 2002

/s/ Rhett R. Atkins

Rhett R. Atkins
President and Chief Executive Officer

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CHIEF FINANCIAL OFFICER CERTIFICATION

I, Bradley S. Powell, Chief Financial Officer of EDEN Bioscience Corporation, certify that:

1. I have reviewed this quarterly report on Form 10-Q of EDEN Bioscience Corporation;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant s other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have;

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant s other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant s auditors and the audit committee of registrant s board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 7, 2002

/s/ Bradley S. Powell

Bradley S. Powell
Chief Financial Officer