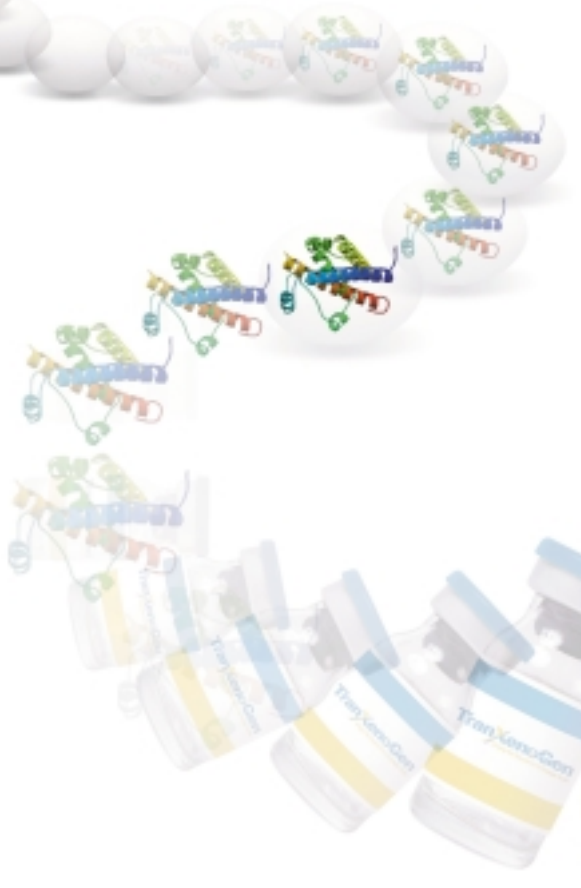
TranXenoGen

Bringing New Transgenic Technologies To Life

Annual Report 2001



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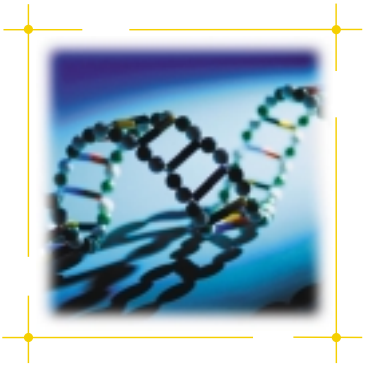

PRESIDENT AND CHIEF EXECUTIVE OFFICER'S STATEMENT

OVERVIEW

2001 was a year of development and transition for TranXenoGen, Inc. It was a year in which the Company:

- Made significant progress in developing the avian technology platform, including successful generation of germline chickens for insulin and chimeric chickens for two antibodies;
- Signed research and development deals with strategic partners Abbott Laboratories and Amgen, Inc., broadening the Company's monoclonal antibody research efforts; and
- Acquired, built out and moved into its new facility that houses laboratories, offices and product development operations in 30,000 square feet of an 80,000 square foot building. The remaining space will be built out as additional research, production and purification capacity is required.

Our accomplishments during the year created the foundation upon which we will build our proprietary avian transgenic technology.

MANAGEMENT CHANGES

During 2001, Steve Parkinson and Karl Ebert left TranXenoGen to pursue their individual interests, and I joined the Company as President and Chief Executive Officer in October. We strengthened our scientific team during 2001 through the addition of two research scientists who bring with them significant skills in the area of protein expression and molecular biology.

FINANCIAL REVIEW

TranXenoGen finished 2001 with a cash position of $10.3 million, which represents sufficient cash at the current cash burn rate to support our efforts through late 2003. For the year, TranXenoGen reported a net loss of $4.0 million, or $0.13 per share, compared to a loss of $2.5 million, or $0.12 per share, for 2000. On a cash basis (net loss less (i) non-cash charge related to the issuance of stock options granted to directors and employees prior to the Initial Public Offering in 2000, (ii) depreciation and (iii) amortization), the net cash loss was $3.1 million, or $0.10 per share, in 2001 as compared to $1.8 million, or $0.09 per share, in 2000.

Following the Company's IPO on the Alternative Investment Market of the London Stock Exchange in July 2000, the Company increased its spending levels in research and development and its selling, general and administrative expenses. Research and development spending increased by $643,000, or 54%, from 2000 to 2001 reflecting an increased level of activity to support the development of the Company's generic biologicals and its four collaborative monoclonal antibody projects. Selling, general and administrative expense increased by $537,000, or 56%, from 2000 to 2001 due to higher legal and consulting fees, an increase in advertising and marketing efforts to promote TranXenoGen's manufacturing technology, the costs of being a public company and additional facilities costs.

PRESIDENT AND CHIEF EXECUTIVE OFFICER'S STATEMENT

Research and development spending levels are expected to continue to increase in 2002 as we develop our avian transgenic platform and products. Selling, general and administrative expense is expected to increase only slightly as the 2002 focus is on proving the science and developing our proprietary and partners' product offerings.

The Company invested $7.6 million to acquire and build out its new facility, of which $3.5 million was funded through a credit facility of $3.9 million. Current liabilities include $647,000 remaining to be paid on the facility, of which $408,000 will be funded through additional borrowings under the credit facility. The Company anticipates capital expenditures of approximately $700,000 in 2002 as it completes the first expansion in the new facility and adds equipment to support its product development effort.

The Company had 17 employees as of December 31, 2001 and anticipates adding eight employees over the next year.

SCIENCE UPDATE

The Company currently has nine products in development: four generic biologicals: insulin, human serum albumin (''HSA''), calcitonin and human growth hormone (''HGH''); a research monoclonal antibody (''MAb''), sourced by the Company as a proof-of-principle MAb to test the avian transgenic system and four MAbs under development for partners.

The proof of principle for the avian transgenic platform utilizing insulin, originally forecasted in 2001, is now anticipated in mid-2002 as the combination of technical issues, a delay in bringing the new facility on line and the broadening of the Company's research efforts to include four antibody products resulted in an extension of the timeline. In 2001, the Company successfully demonstrated that the insulin gene was transmitted from chimeric chickens to the second generation, or germline transgenic, chickens. The Company continues to develop its antibody projects with the generation of chimeric chickens utilizing the direct egg transfection method. Chimeric chickens contain the transgene in only some cells and are bred to see if the transgene is transmitted to the next generation.

The Company's 2002 focus is to:

- Demonstrate proof of principle by mid-year;
- Achieve commercial expression levels for at least one potential product;
- Develop transgenic founder hens for three of the four partners' antibodies, insulin and HSA; and
- Develop chimeric chickens for one of our partners' antibodies.

The Company continued its research activities during 2001 with the principal focus on improved avian transgenic technologies such as cloning and avian stem cell research. The research team's priority was, and continues to be, to develop ways to further improve the efficiency of the transfection technologies used to make transgenic chickens, construct improved or novel expression cassettes and marker genes and broaden the application of existing technologies.

In addition, the Company continues to develop its purification technology for purifying a range of products from egg albumin (i.e. egg white). The purification process development is focused on establishing a scalable method for primary recovery and purification of the

Company's proprietary and strategic partners' products. The current purification program is aimed at developing an intellectual property position covering purification of pharmaceuticals from egg albumin and to accelerate the purification process development once proof of principle is achieved.

In February 2001, the Company licensed a novel anti-cancer product, human anti-neoplastic urinary protein (''ANUP'') from Antitumor Research Products, Inc. This product has been shown to be effective against human tumor cell lines *in-vitro*. During 2002, TranXenoGen will continue the development of ANUP, including obtaining highly purified protein from human donors and conducting animal model studies. The Company intends to develop the product and process, potentially with a strategic partner, before initiating the development of the protein in chicken eggs.

BUSINESS DEVELOPMENT/INDUSTRY PARTNERS

The Company's business development focus is designed to give TranXenoGen's avian transgenic technology visibility in the industry. As a result, the Company has four proof of principle projects in process. Once commercially viable expression levels are achieved, TranXenoGen will seek to secure additional partnerships with other MAb and therapeutic protein companies in order to add more products to its pipeline.

SUMMARY

As we move into 2002, our focus is on improving our avian transgenic platform and achieving key milestones in research, process and product development. The Company has three key focuses of its business:

- *Generic Biologicals* – Development of proven products for established and growing markets, including insulin and HSA;
- *Contract/Partnerships* – Delivering on its strategic alliances with Abbott Laboratories, KS Biomedix Holdings plc, Amgen Inc. and an unnamed US antibody development company; and
- *Proprietary novel products* – Development of first proprietary product in-licensed, ANUP.

We anticipate that if we are successful in achieving commercial expression levels of protein in the egg albumin, at least one of the four strategic alliances or generic biological products will lead to a product development and manufacturing agreement, which should result in TranXenoGen receiving revenue/funds in 2003. The three key areas provide, in our opinion, a well-balanced strategy that provides the groundwork for TranXenoGen's future commercial success. We believe that TranXenoGen is well positioned to capitalize on the increasing market requirements for large-volume biological products with a platform that we expect to offer an effectively priced product with increased flexibility and improved time to market.

George Uveges
President and Chief Executive Officer

DIRECTORS' REPORT

The Directors present their report and the audited financial statements for the year ended December 31, 2001.

PRINCIPAL ACTIVITIES

TranXenoGen is a development stage biotechnology company specializing in avian transgenics for the production of high volume therapeutic proteins. The objective is to provide a practical, effective production platform with sufficient capacity to satisfy the increasing demand for high volume therapeutics. TranXenoGen has three principal areas of business focus: the development and manufacture of well-characterized biological products; the low-cost, high volume production of novel therapeutic proteins, such as antibodies for corporate partners, and the development and manufacture of proprietary novel therapeutic protein products. TranXenoGen utilizes proprietary technology to generate transgenic chickens that express the selected protein or monoclonal antibody in the albumin fraction of their eggs.

BUSINESS REVIEW

Details of developments during the year and comments on expected future developments are given in the President and Chief Executive Officer's statement.

RESULTS AND DIVIDENDS

The audited financial statements for the year ended December 31, 2001 are set out on pages 13 to 27. The Directors did not recommend the payment of a dividend for the year.

RESEARCH AND DEVELOPMENT ACTIVITIES

The Directors consider that continued investment in research and development is essential to the future of TranXenoGen.

DIRECTORS

The directors as of December 31, 2001 were, and currently are, as follows:

Dr. Kim Sze Tan BSc, PhD *Non-Executive Chairman (47) (Term expires 2004)*

Dr. Tan is the founder and a director of KS Biomedix Holdings plc, GeneMedix plc and Asiaprise Sdn Bhd and a director of 3PG Investment Trust plc. Dr. Tan is also the inventor of the sheep monoclonal antibody technology. He is the author of more than 40 scientific publications and is a Fellow of the Royal Society of Medicine. Dr. Tan has been a Director since March 2000 and is a member of the Compensation and Audit Committees.

Cary Edmund Garner BSc *Non-Executive Director (54) (Term expires 2003)*

Mr. Garner has over 27 years' experience in rapid-growth, technology-driven businesses. Mr. Garner currently serves as Vice President and General Manager Global Business Unit for Parexel International, a contract research organization. Prior to joining Parexel International, Mr. Garner was employed as Senior Vice President of Oread, Inc., a contract pharmaceutical company that provides comprehensive product development and manufacturing services to the pharmaceutical and biotechnology industries. Mr. Garner was a principal at Cambridge Consulting Group (CCG). CCG specialized in establishing operating companies based on proprietary, innovative technologies. While at CCG, Mr. Garner participated in the formation of seven companies. Prior to joining CCG, he held sales and marketing positions with Abbott Laboratories and IBM Corporation. Mr. Garner served as a Director of Oread Biosafety, Inc., and served as a Director for Angenics, Inc., Brain Delivery Systems and RSP Amino Acid Analog. Mr. Garner was appointed to the Board of Directors in March 2000 and is a member of the Compensation and Audit Committees.

George Uveges *President and CEO (54) (Term expires 2004)*

Mr. Uveges joined the Company as President and Chief Executive Officer in October 2001. Mr. Uveges was previously the Chief Operating Officer of BioSource International (2000-2001), Senior Vice President and Chief Financial Officer of NEN Life Science (1997-2000), Chief Financial Officer and Vice President of Administration of Gelman Sciences (1996-1997), Chief Financial Officer, Treasurer and VP of Administration of GI Plastek (1991-1996) and Corporate Controller Treasurer and Chief Accounting Officer of Invacare Corporation (1985-1991). Mr. Uveges was appointed to the Board of Directors in October 2001.

Paul Anthony DiTullio BSc, MSc *Vice President, Product Development (37) (Term expires 2002 and is standing for re-election)*

Mr. DiTullio has over 13 years' experience in the transgenics industry as a research scientist for Integrated Genetics and Genzyme Transgenics Corporation, and has developed more than 40 different transgenic constructs for protein expression. Mr. DiTullio's expertise includes not only the cloning and engineering of specific genes for the expression of proteins in eggs and milk, but also the cloning and engineering of human genes for other proprietary expression systems. Mr. DiTullio also has extensive experience with large and small animal biology and husbandry. Mr. DiTullio was appointed to the Board of Directors in February 2000.

DIRECTORS' INTERESTS

The interests of the Directors in the shares of the Company and share options are disclosed in the report of the Compensation Committee on page 8.

SUBSTANTIAL SHAREHOLDINGS

To the Company's knowledge, the only persons who, directly or indirectly, were interested in three percent or more of the Company's common stock at April 16, 2002 were as follows:

Stockholder	*Number of shares held*	*Percentage of issued capital*
Pershing Keen Nominees Limited	7,045,092	22.00
Vidacos Nominees Limited	4,568,750	14.27
Chase Nominees Limited	2,462,066	7.69
Nigel Wray	1,880,000	5.87
Cosign Nominees Limited	1,800,000	5.62
Nortrust Nominees Limited	1,549,744	4.84
Pannell Kerr Forster Trustee Company Limited	1,800,000	5.62
Cheapside Nominees Limited	1,120,000	3.50
NCL (Nominees) Limited	1,085,200	3.39

SHARE CAPITAL

Details of the shares issued during the year and outstanding options are presented in Note 7 and Note 10 to the audited financial statements.

CREDITOR PAYMENT POLICY

It is the Company's policy to agree to payment terms with suppliers at the commencement of trading relationships and to abide by those terms. The Company does not have significant trade creditors.

FIXED ASSETS

Details of the fixed assets are presented in Note 4 to the audited financial statements.

DIRECTORS' REPORT

CHARITABLE AND POLITICAL CONTRIBUTIONS

During the year, the Company made charitable contributions of US$545. The Company made no political contributions.

EMPLOYEES

The Company places considerable value on the involvement of its employees and has continued to keep them informed on general business matters and other matters of concern. The Company has a policy of offering share options to all eligible employees, subject to availability of shares under the 1998 Equity Incentive Plan.

The Company does not discriminate on grounds of race, religion or gender.

ANNUAL MEETING OF STOCKHOLDERS

Explanatory information concerning the resolutions to be proposed at the Annual Meeting of Stockholders to be held on June 13, 2002 is set out on page 28.

CORPORATE GOVERNANCE

The Company supports the Combined Code, which is appended to the Listing Rules of the UK Listing Authority. The Combined Code sets out the principles of good governance and code of best practice prepared by the UK Committee on Corporate Governance, chaired by Sir Ronald Hampel, which was published in June 1998. Although the Company is a Delaware corporation, since our shares are quoted in London, the Board believes that it is appropriate generally to support the Combined Code. In view of the size of the Company, the Board intends to have regard to the guidance for smaller quoted companies on corporate governance published by the UK Quoted Companies Alliance in April 2001. Accordingly, there will follow in this document a Compensation Report and a report on Corporate Governance.

Registered Office:
1209 Orange Street
Wilmington, DE 19801
United States

April 22, 2002

By order of the Board,

Marc A. Rubenstein
Company Secretary

COMPENSATION REPORT

COMPOSITION OF THE COMPENSATION COMMITTEE

The Compensation Committee is comprised exclusively of Non-Executive Directors: Dr. Kim Tan, Chairman and Cary Garner. The Committee meets as required and at least once a year.

COMPLIANCE

The Company has, during the year under review, complied with the Combined Code in respect of the membership and operation of the Compensation Committee.

The Company's Compensation Committee decides the compensation policy that applies to all senior management and Executive Directors. Currently, the Company has two Executive Directors. In setting the policy, the Compensation Committee considers a number of factors, in addition to the performance of the individual, including:

(a) the basic salaries and benefits available to senior management and Executive Directors of comparable companies;

(b) the need to attract and retain senior management and Executive Directors of an appropriate caliber; and

(c) the need to ensure senior management and Executive Directors' commitment to the continued success of the Company by means of incentive plans.

COMPENSATION OF DIRECTORS

The Chairman and Mr. Garner have letters of appointment with the Company, which are reviewed on an annual basis. The compensation of the Non-Executive Directors is determined by the Board of Directors as a whole, based on review of current practices in other companies. The Compensation Committee considers and sets the annual salaries for senior management and Executive Directors.

ANNUAL BONUS

The Company does not have a formal bonus program. The Compensation Committee has the right to award discretionary bonuses based on Company or individual performance. No bonuses were paid in 2001 or 2000. The decision by the Compensation Committee not to pay any discretionary bonuses was based upon TranXenoGen being an early stage company and is not a reflection of performance.

DIRECTORS' COMPENSATION

Details of Directors' compensation and other benefits for the years ended December 31, 2001 and 2000 are as follows:

Name of director	*Basic salary/fees US$*	*Taxable benefits US$*	*Non-taxable benefits US$*	*Annual bonus US$*	*2001 Total US$*	*2000 Total US$*
Executive						
George Uveges[1]	30,477	–	1,214	–	31,691	–
Steve Parkinson[2]	136,533	–	7,349	–	143,882	134,549
Paul A DiTullio	89,966	–	3,218	–	93,184	70,795
Non-Executive						
Dr Kim S Tan	36,000	–	–	–	36,000	18,000
Cary E Garner	10,000	–	–	–	10,000	5,000

(1) Reflects compensation paid to Mr. Uveges from October 22, 2001 to December 31, 2001.
(2) Mr. Parkinson ceased to be an employee and director of the Company on September 5, 2001.

DIRECTORS' CONTRACTS

Mr. DiTullio has an Employment Agreement that provides for a base salary of $100,000, expires on July 3, 2002 and is automatically renewed for an additional year if not cancelled by the Company. In the event of early termination without cause, Mr. DiTullio will receive 50% of his base salary. Mr. Uveges has an Employment

COMPENSATION REPORT

Agreement that provides for an annual salary of $160,000, a severance period of twelve months for termination other than for cause and a change of control provision which includes an acceleration of vesting of previously unvested stock options and a twelve-month severance provision. Mr. Garner and Dr. Tan do not have service contracts but letters of appointment.

The Non-Executive Directors have no notice period.

DIRECTORS' SHARE OPTIONS

Aggregate compensation disclosed above does not include any amounts for the value of options to acquire shares in the Company granted to or held by the Directors. Details of Directors share options are as follows:

Name of director	*Held on January 1, 2001*	*Granted*	*Exercised*	*Held on December 31, 2001*	*Exercise price US$*	*Expiration Date*
Executive						
George Uveges	–	700,000	–	700,000	$2.54	October 22, 2011
Paul A DiTullio	500,000	–	–	500,000	$0.04	March 3, 2010
Non-Executive						
Dr Kim S Tan	2,000,000	–	–	2,000,000	$0.04	March 25, 2010
Cary E Garner	200,000	–	–	200,000	$0.04	March 3, 2010
	2,700,000	700,000	–	3,400,000		

The market price of the Company's shares as of December 31, 2001 was £1.62 (December 31, 2000 £4.50) and the range of market prices during 2001 was £1.55 to £5.42 (from July 18, 2000 to December 31, 2000 the market price range was between £2.00 and £4.52).

DIRECTORS' INTERESTS IN SHARES

The interests of the Directors in the shares of the Company at December 31, 2001 and 2000 were as follows:

Name of director	*Beneficial ownership as of December 31, 2001*	*December 31, 2000*
Executive		
George Uveges	40,000	–
Paul A DiTullio[(1)]	7,070,000	7,070,000
Non-Executive		
Dr Kim S Tan[(2)]	1,800,000	1,800,000
Cary E Garner	–	–

(1) Includes 3,850,000 shares held by CDT Riflemen's Partnership, of which Mr. DiTullio is a limited partner.

(2) These shares are held by Pannell Kerr Forster Trustee Company Limited.

DIRECTORS' INTERESTS IN SIGNIFICANT CONTRACTS

GeneMedix plc has granted the Company an exclusive worldwide license with the right to sublicense certain proprietary technologies relating to a novel pre-cursor gene used in recombinant insulin production. The Company is required to make one-time payments to GeneMedix based on the region where regulatory and market approvals are granted: $2 million for the United States, $2 million for Europe and $1 million for Asia. Additional one-time payments from $50,000 to $750,000 are due to GeneMedix from the Company upon development milestones being achieved by the Company. Such milestones or approvals have yet to be achieved. TranXenoGen's Chairman of the Board also serves as the Non-Executive Chairman of, and has an interest in approximately 156 million ordinary shares in GeneMedix plc.

CORPORATE GOVERNANCE

TranXenoGen is a US company incorporated in the State of Delaware under the Delaware General Corporation Law (''DGCL''). There are a number of differences under the DGCL and the corporate structure of the Company as compared to a public limited company incorporated in the UK under the Companies Act of 1985. While the Directors consider that it is appropriate to retain the majority of the usual features of a publicly traded Delaware corporation, since the Company's shares are quoted on the London AIM market they intend to take certain actions, whenever practicable, to meet UK standard practice.

CORPORATE GOVERNANCE

During the period under review, the Company has sought to comply fully with the Combined Code and has, in the Directors' opinion done so, except as noted below. The following statement, together with the Report of the Compensation Committee on pages 7 and 8, sets out the manner in which the Company has applied the principles contained in section 1 of the Combined Code.

BOARD OF DIRECTORS

The Board consists of two Executive Directors (Mr. Uveges and Mr. DiTullio) and two Non-Executive Directors (Dr. Tan and Mr. Garner), who bring considerable knowledge and experience to bear on issues of strategy, performance, resources and standards of conduct. Their biographical details are shown on pages 4 and 5.

The Board considers that both of the Non-Executive Directors are independent of management and free from any business or other relationship which could materially interfere with the exercise of independent judgment, except for Dr. Tan's association with GeneMedix plc as disclosed on page 8 of the Compensation Committee Report. The Board does not consider that this impairs the independence of Dr. Tan when balanced with the considerable expertise that he provides the Company.

The Board, which endeavors to meet at least nine times a year, has ultimate responsibility and accountability for the Company's operations and has a formal schedule of matters reserved for its sole approval. The Company has sought to ensure that Directors are properly briefed on issues arising at board meetings by establishing procedures for distributing meeting agendas, up-to-date reports on key areas of the business and information to support decisions in advance of the meetings. At each meeting, the Board reviews the progress of the Company towards its objectives, particular projects in development, major capital expenditure projects and financial performance against budget. Senior management endeavor to meet weekly to monitor and discuss all major issues affecting the Company, which do not require Board discussion or approval by Board Committees.

All Directors are aware of their right to seek independent advice at the Company's expense, where they feel it is appropriate, and have access to the advice and guidance of the Company Secretary, if required.

The Board is committed to ensuring that there continues to be a clear balance of authority and decision-making in its activities. The Board considers that having independent Non-Executives comprising 50% of the Board and a separation of the roles of CEO (Mr. Uveges) and Chairman (Dr. Tan) are the key to achieving this objective.

The Company's Audit and Compensation Committees are comprised solely of the Non-Executive Directors. The Combined Code requires that the Audit Committee should be comprised of at least three Non-Executive Directors, whereas the Board and Committee include only two, as recommended by the QCA. The Board considers that, as the two Non-Executives who comprise the Audit Committee are independent, the functioning of the Committee is not compromised by this departure from the Combined Code.

Since there are only four Directors, and as permitted by the Combined Code, the Board has not established a nomination committee. Mr. Uveges' appointment to fill the vacancy created by the resignation of Mr. Parkinson was discussed and approved by the full Board. Any future appointments may be proposed by any Director and will be discussed and voted on by the full Board.

CORPORATE GOVERNANCE

Under the DGCL, the certificate of incorporation of a Delaware corporation may provide for the classification of the board of directors into classes with staggered terms for re-election. The Company's Certificate of Incorporation provides for a classified board of three classes. Pursuant to the Company's Certificate of Incorporation, all Directors are subject to re-election every three years as required by the Combined Code.

BOARD COMPENSATION

The Compensation Committee reviews annually the remuneration packages of the Executive Directors, and the Executive Directors are responsible for the compensation packages of the Non-Executive Directors.

In framing policy, the Compensation Committee consults with the Board of Directors, and the Chief Executive Officer attends Compensation Committee meetings upon invitation.

The Compensation Report on pages 7 and 8 contains a detailed description of compensation and applicable policies.

RELATIONS WITH STOCKHOLDERS

The Directors seek to build on a mutual understanding of objectives between the Company and its stockholders by encouraging two-way communications with institutional investors, analysts and private investors. The Chairman and the Chief Executive Officer are the principal spokesmen for the Company with both institutional and private investors. Collective and individual presentations to institutional investors are held regularly.

The Company has established a website (www.TranXenoGen.com) to further aid global communications to investors by providing background information on the Company.

All stockholders are sent an Annual Report and are given notice to enable them to attend the Company's Annual Meeting of Stockholders. This year's Annual Meeting of Stockholders will be held at the at the offices of the Company, 800 Boston Turnpike, Shrewsbury, Massachusetts 01545, United States, on June 13, 2002 at 1:00 p.m. Eastern Daylight Time.

GOING CONCERN

After making inquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence through late 2003. For this reason, the Company continues to adopt the going concern basis in preparing the financial statements. The Directors consider that the financial statements present a balanced and understandable assessment of the Company's position and prospects.

INTERNAL CONTROL

The Directors are responsible for keeping proper accounting records, which disclose with reasonable accuracy at any time the financial position of the Company. They are also responsible for safeguarding the assets of the Company and consequently for taking steps for the prevention and detection of fraud and irregularities.

The Board has overall responsibility for the Company's system of internal control. Internal control systems are designed to meet the particular risks to which the Company is exposed. There are inherent limitations in any system of internal financial control and accordingly even the most effective system can provide only reasonable, not absolute, assurance with respect to the preparation of financial information and the safeguarding of assets.

The Board has applied Principle D.2 of the Combined Code by establishing a continuous process for identifying and managing the significant risks the Company faces. The Board regularly reviews the process, which is in accordance with Internal Control: Guidance for Directors on the Combined Code, published in September 1999. The Board is responsible for the Company's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

In compliance with Provision D.2.1 of the Combined Code, the Board continuously reviews the effectiveness of the Company's system of internal control. The Board's monitoring covers all controls, including financial, operational and compliance controls and risk management. In so monitoring, the Board reviews reports from management to consider whether significant risks are identified, evaluated, managed and controlled and whether any significant weaknesses are promptly remedied or indicate a need for more extensive monitoring. The Board has also performed a specific assessment for the purpose of this annual report. This assessment considers all significant aspects of internal control arising during the period covered by the report. The Audit Committee assists the Board in discharging its review responsibilities.

The Company has in place an organizational structure with clearly defined and understood lines of responsibility and delegation of authority from the Board.

The Board has the primary responsibility for identifying the major business risks facing the Company and developing the appropriate policies to manage those risks. The Board continues to assess the policies that manage those risks. The Directors, through the Audit Committee, have considered the principal business risks for the Company and, in that context, have reviewed the effectiveness of the Company's internal controls.

Financial results and key operational and financial performance indicators are reported monthly by management and the Board, and variances from plan and budgets are thoroughly investigated by the Board and reviewed with senior management.

The Company has a system of control procedures and compliance with these procedures is monitored through a system of internal review.

The Audit Committee is responsible for ensuring that the accounting policies and internal controls adopted by the Company are appropriate and prudent considering the size of the Company and that the Company's auditors perform an effective year-end audit and half-year review. The Audit Committee meets at least twice per year, and the external auditors, Chief Executive Officer and members of management may attend such meetings by invitation. Periodically, the Audit Committee reviews the cost effectiveness of the audit and the independence and objectivity of the auditors.

The Audit Committee has independent access to the auditors throughout all reporting periods.

TRANXENOGEN, INC.

(A Development Stage Company)

Financial Statements as of December 31, 2001, 2000 and 1999 together with Auditors' Report

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of
TranXenoGen, Inc.:

We have audited the accompanying balance sheets of TranXenoGen, Inc. (the Company) (a Delaware corporation in the development stage) as of December 31, 2001 and 2000 and the related statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of the Company for the period from inception to December 31, 1996. Such statements are included in the cumulative from inception to December 31, 2001, totals of the statements of operations and cash flows and reflect total revenues and net loss of 9% and 0%, respectively, of the related cumulative totals.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2001 and 2000 and the results of its operations and cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

Boston, Massachusetts — Arthur Andersen LLP

February 4, 2002

BALANCE SHEETS

December 31, 2001 and 2000

	2001 $	2000 $
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 9,992,726	$16,870,564
Restricted cash	351,536	–
Prepaid expenses	71,674	216,294
Other current assets	17,288	4,570
Total current assets	10,433,224	17,091,428
Property and equipment	8,115,107	271,207
Accumulated depreciation	(167,014)	(70,446)
Property and equipment, net	7,948,093	200,761
Other Assets:		
Intangible assets	66,470	131,486
Deposits	9,013	12,676
Other assets	–	84,480
Total other assets	75,483	228,642
Total assets	$18,456,800	$17,520,831
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 650,700	$ 223,997
Accrued expenses	538,167	159,923
Current portion of long-term debt	79,549	26,298
Other current liabilities	10,833	–
Total current liabilities	1,279,249	410,218
Long-Term Debt, less current portion	3,412,746	749
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, $0.001 par value per share – Authorized – 50,000,000 shares Issued and outstanding – 40,410,000 and 39,950,000 in 2001 and 2000, respectively	40,410	39,950
Series C Convertible Preferred Stock, $0.01 par value per share – Authorized – 150,000 shares Issued and outstanding – 0 in 2001 and 2000, respectively	–	–
Treasury stock, at cost – 8,390,000 shares of common stock in 2001 and 2000, respectively	(195,659)	(195,659)
Additional paid-in capital	23,339,318	23,593,378
Deferred compensation	(1,398,861)	(2,319,950)
Accumulated deficit	(8,020,403)	(4,007,855)
Total stockholders' equity	13,764,805	17,109,864
Total liabilities and stockholders' equity	$18,456,800	$17,520,831

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

STATEMENTS OF OPERATIONS

for the years ended December 31, 2001, 2000 and 1999 and
cumulative from inception (April 16, 1996) to December 31, 2001

	Years ended December 31,			Cumulative from inception (April 16, 1996) through December 31,
	2001 *$*	*2000* *$*	*1999* *$*	*2001* *$*
Income:				
Contract revenue	$ 16,667	$ 37,200	$ 14,660	$ 975,668
Expenses:				
Selling, general and administrative	1,496,932	960,332	548,635	3,325,078
Research and development	1,827,074	1,184,376	532,874	4,429,629
Stock-based compensation	649,089	486,050	–	1,135,139
Depreciation and amortization	254,937	208,538	138,239	648,203
Total expenses	4,228,032	2,839,296	1,219,748	9,538,049
Operating loss	(4,211,365)	(2,802,096)	(1,205,088)	(8,562,381)
Other Income (Expense):				
Interest income, net	432,448	413,419	37	853,536
Other income, net	35,393	509	–	36,139
Foreign currency loss	(269,024)	(71,165)	–	(340,189)
Loss before provision for income taxes	(4,012,548)	(2,459,333)	(1,205,051)	(8,012,895)
Provision for income taxes	–	–	1,464	7,508
Net loss	$(4,012,548)	$(2,459,333)	$(1,206,515)	$(8,020,403)
Net Loss per Share:				
Basic and diluted net loss per share	$(0.13)	$(0.12)	$(0.06)	
Basic and diluted weighted average common shares outstanding	31,681,975	20,106,422	19,339,560	

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

STATEMENTS OF CASH FLOWS

for the years ended December 31, 2001, 2000 and 1999 and
cumulative from inception (April 16, 1996) to December 31, 2001

	Years ended December 31,			Cumulative from inception (April 16, 1996) through December 31,
	2001	*2000*	*1999*	*2001*
	$	*$*	*$*	*$*
Cash Flows from Operating Activities:				
Net loss	$(4,012,548)	$(2,459,333)	$(1,206,515)	$(8,020,403)
Adjustments to reconcile net loss to net cash in operating activities–				
Depreciation and amortization expense	254,937	208,538	138,239	648,203
Compensation expense related to stock options issued	649,089	486,050	–	1,135,139
Loss on disposal of equipment	4,499	–	–	4,499
Changes in assets and liabilities–				
Accounts receivable	–	10,192	15,811	–
Prepaid expenses	144,620	(210,743)	(863)	(71,675)
Other assets and deposits	(9,056)	(85,204)	(9,569)	(110,000)
Accounts payable	426,703	125,392	(41,441)	585,528
Accrued expenses and other assets	389,077	64,639	(19,327)	548,221
Net cash used in operating activities	(2,152,679)	(1,860,469)	(1,123,665)	(5,280,488)
Cash Flows from Investing Activities:				
Purchase of intellectual property	(88,854)	(46,306)	–	(265,741)
Additions to property and equipment	(7,768,417)	(110,557)	(26,744)	(7,927,456)
Increase in restricted cash	(351,536)	–	–	(351,536)
Net cash used in investing activities	(8,208,807)	(156,863)	(26,744)	(8,544,733)
Cash Flows from Financing Activities:				
Issuance of common stock, net	–	17,195,609	–	17,198,109
Principal payments under capital lease obligations	(27,047)	(44,254)	(40,867)	(112,168)
Proceeds from issuance of convertable preferred stock,net	–	1,769,329	1,091,747	3,350,799
Exercise of stock options	18,400	2,000	–	20,400
Repurchase of common stock	–	(141)	–	(141)
Proceeds from notes payable	5,522,295	–	–	5,572,295
Repayment of notes payable	(2,030,000)	(130,345)	(50,000)	(2,211,347)
Net cash provided by financing activities	3,483,648	18,792,198	1,000,880	23,817,947
Net (decrease) increase in cash and cash equivalents	(6,877,838)	16,774,866	(149,529)	9,992,726
Cash and cash equivalents, beginning of period	16,870,564	95,698	245,227	–
Cash and cash equivalents, end of period	$9,992,726	$16,870,564	$95,698	$9,992,726
Supplemental disclosure of cash flow information:				
Cash paid for taxes	$–	$991	$2,653	$23,162
Cash paid for interest	$86,324	$4,512	$2,479	$93,315
Supplemental disclosure of noncash investing and financing transactions:				
Fair value of shares of common stock used in connection with the acquisition of Gestation	$–	$–	$–	$277,420
Notes issued in connection with the repurchase of common stock	$–	$–	$195,518	$195,518
Equipment acquired under capital lease obligations	$–	$–	$112,168	$112,168
Conversion of 1,410,000 shares of convertible preferred stock to 14,100,000 shares of common stock, net of issuance costs	$–	$3,248,799	$–	$3,248,799

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

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

for the years ended December 31, 2001, 2000 and 1999

	Class A Convertible Preferred Stock		*Class B Convertible Preferred Stock*		*Class C Convertible Preferred Stock*	
	Number of Shares	*$0.01 Par Value*	*Number of Shares*	*$0.01 Par Value*	*Number of Shares*	*$0.01 Par Value*
Balance at December 31, 1998	345,000	$ 250,000	100,000	$ 137,723	–	$–
Issuance of Class B convertible preferred stock	–	–	440,000	1,091,747	–	–
Purchase of Treasury Stock	–	–	–	–	–	–
Net loss	–	–	–	–	–	–
Balance at December 31, 1999	345,000	250,000	540,000	$1,229,470	–	–
Issuance of common stock, net of approximately $1,516,000 in issuance costs	–	–	–	–	–	–
Conversion of 345,000 shares of Class A convertible preferred stock to 3,450,000 common shares	(345,000)	(250,000)	–	–	–	–
Issuance of Class B convertible preferred stock	–	–	100,000	249,730	–	–
Conversion of 640,000 shares of Class B convertible preferred stock to 6,400,000 common shares	–	–	(640,000)	(1,479,200)	–	–
Issuance of Class C convertible preferred stock	–	–	–	–	175,000	524,030
Conversion of 175,000 shares of Class C convertible preferred stock to 1,750,000 common shares	–	–	–	–	(175,000)	(524,030
Issuance of Class D convertible preferred stock	–	–	–	–	–	–
Conversion of 250,000 shares of Class D convertible preferred shares to 2,500,000 common shares	–	–	–	–	–	–
Deferred compensation in connection with the issuance of stock options	–	–	–	–	–	–
Amortization of deferred compensation	–	–	–	–	–	–
Purchase of Treasury Stock	–	–	–	–	–	–
Exercise of stock options	–	–	–	–	–	–
Net loss	–	–	–	–	–	–
Balance at December 31, 2000	–	–	–	–	–	–
Amortization of deferred compensation	–	–	–	–	–	–
Forfeiture of stock options with deferred compensation	–	–	–	–	–	–
Exercise of stock options	–	–	–	–	–	–
Net loss	–	–	–	–	–	–
Balance at December 31, 2001	–	$–	–	$–	–	$–

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

Class D Convertible Preferred Stock		Treasury Stock		Common Stock		Additional Paid-In	Deferred		
Number of Shares	$0.01 Par Value	Number of Shares	Amount	Number of Shares	$0.001 Par Value	Capital Common	Compen-sation	Accumulated Deficit	Total
–	$–	–	$–	19,550,000	$ 19,550	$ 361,370	$–	$ (342,007)	$ 426,636
–	–	–	–	–	–	–	–	–	1,091,747
–	–	6,982,800	(195,518)	–	–	–	–	–	(195,518)
–	–	–	–	–	–	–	–	(1,206,515)	(1,206,515)
–	$–	6,982,800	$(195,518)	19,550,000	$19,550	$361,370	$–	$(1,548,522)	$116,350
–	–	–	–	6,250,000	6,250	17,189,359	–	–	17,195,609
–	–	–	–	3,450,000	3,450	246,550	–	–	–
–	–	–	–	–	–	–	–	–	249,730
–	–	–	–	6,400,000	6,400	1,472,800	–	–	–
–	–	–	–	–	–	–	–	–	524,030
–	–	–	–	1,750,000	1,750	522,280	–	–	–
250,000	995,569	–	–	–	–	–	–	–	995,569
(250,000)	(995,569)	–	–	2,500,000	2,500	993,069	–	–	–
–	–	–	–	–	–	2,806,000	(2,806,000)	–	–
–	–	–	–	–	–	–	486,050	–	486,050
–	–	1,407,200	(141)	–	–	–	–	–	(141)
–	–	–	–	50,000	50	1,950	–	–	2,000
–	–	–	–	–	–	–	–	(2,459,333)	(2,459,333)
–	$–	8,390,000	$(195,659)	39,950,000	$39,950	$23,593,378	$(2,319,950)	$(4,007,855)	$17,109,864
–	–	–	–	–	–	–	649,089	–	649,089
–	–	–	–	–	–	(272,000)	272,000	–	–
–	–	–	–	460,000	460	17,940	–	–	18,400
–	–	–	–	–	–	–	–	(4,099,625)	(4,099,625)
–	$–	8,390,000	$(195,659)	40,410,000	$40,410	$23,339,318	$(1,398,861)	$(8,107,480)	$13,677,728

NOTES TO FINANCIAL STATEMENTS

(1) Organization and Acquisition

TranXenoGen, Inc. (the Company) was incorporated on October 2, 1995, under the laws of Massachusetts, as Midas Biologicals, Inc. (Midas). The Company began operations on April 16, 1996 and is in the development stage devoting substantially all of its efforts toward product research and development.

On August 18, 1998, the Company acquired Gestation, Inc. (Gestation), a Delaware corporation, in a tax-free merger (the Merger). Under the terms of the agreement, Gestation was merged into Midas, with Midas becoming the surviving corporation. Midas simultaneously changed its name to TranXenoGen, Inc., a corporation organized under the laws of the State of Delaware. The holders of Gestation common stock were issued one share of stock in the Company for each share of stock previously held in Gestation (see Note 7).

In the Merger, an aggregate of 9,890,000 shares of the Company's common stock were issued to the Gestation stockholders with a fair value of $277,420, as determined by the Board of Directors, in exchange for all of the outstanding common stock of Gestation.

The Company purchased Gestation to gain access to certain research and patents. The Merger was accounted for as an acquisition using the purchase method of accounting. Prior to its acquisition by the Company, Gestation was also in the development stage and had insignificant operations and no tangible assets. As such, the entire purchase price, which consisted of approximately $277,420 in consideration for Gestation stock acquired and $28,194 in liabilities assumed, was allocated to intangible assets in the accompanying balance sheets. The intangible asset was amortized over three years, the estimated useful life of the asset, and is fully amortized as of December 31, 2001. Amortization expense related to this intangible asset was $64,118, $101,852 and $101,851 in 2001, 2000 and 1999, respectively.

(2) Operations

The Company's strategy is to establish itself as a leading drug development and manufacturing company, using its proprietary avian transgenic technology. The Company has three principal areas of business focus:

- the development and manufacture of well-characterized biological products;
- the low-cost, high-volume production of novel therapeutic proteins such as antibodies for corporate partners; and
- the development and manufacture of proprietary novel therapeutic protein products.

The Company is currently targeting its efforts primarily on achieving the production of protein drugs in the egg whites of transgenic chickens. The Company is developing transgenic processes to manufacture insulin, human serum albumin and antibodies for four strategic partners.

The Company is subject to risks common to emerging companies in the life sciences industry. Principal among those risks are the development of commercially usable products, development by its competitors of new technological innovations, dependence on key personnel, protection of proprietary technology, compliance with government regulations, including those of the U.S. Food and Drug Administration, and the ability to obtain adequate financing necessary to fund product development.

On July 4, 2000, the Company completed an initial public offering on the Alternative Investment Market (AIM) of the London Stock Exchange (see Note 7).

(3) Summary of Significant Accounting Policies

Use of Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents represent cash held in the bank and government security money market funds. Cash equivalents are carried at cost, which approximates their fair market value.

As of December 31, 2001, the Company maintained approximately £225,509 (or approximately US$327,273) in a bank in the United Kingdom. This cash is subject to foreign currency fluctuations between the United States Dollar and the British Pounds Sterling.

Foreign Currency Translation

The Company maintains a cash account in the United Kingdom denominated in British Pounds Sterling. Monetary assets denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date and are included in the results of operations.

Fair Value of Financial Instruments

The carrying amounts in the balance sheet for cash and cash equivalents approximate their fair value. The fair value of the Company's long-term debt is estimated to approximate the carrying amount reported in the balance sheet based on current interest rates for similar borrowings.

The Company has no involvement with derivative financial instruments, including those for speculative or trading purposes.

Property and Equipment

Property and equipment is stated at cost. Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. Property and equipment is depreciated on the straight-line basis over the estimated useful lives of the assets as follows: building – 20 years; machinery and equipment – 2 to 10 years.

Intangible Assets

Intangible assets represent intellectual property, including patents and licenses to use certain third-party patents. Intangible assets are being amortized on the straight-line basis over their estimated remaining useful lives of three years. Internal patent costs are expensed as incurred and included in research and development costs.

Revenue Recognition and Contract Accounting

The Company recognizes revenue in accordance with Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements,* which provides guidance in applying generally accepted accounting principles to certain revenue recognition issues. Revenue is recognized as services are performed over the life of the contracts. For cost-reimbursable contracts, revenue is recognized as costs are incurred and includes applicable fees earned through the date services are provided. Contract costs include direct and indirect costs.

Profits expected to be realized on contracts are based on the total contract sales value and the Company's estimates of costs at completion. These estimates are reviewed and revised periodically throughout the lives of the contracts. All adjustments to revenue and gross profit recorded from such reviews are recorded on a cumulative basis in the period in which the revisions are made. When management believes the cost of completing a contract will result in a loss, the full amount of the anticipated contract loss is immediately recognized.

Research and Development Costs

Research and development costs are expensed as incurred.

Segment Information

The Company complies with the provisions of Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company identifies its operating segments based on business activities and management responsibility. The Company currently operates as a single business segment, conducting research for the development of the Company's products.

Comprehensive Income (Loss)

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, *Reporting Comprehensive Income*. Under SFAS No. 130, companies are required to report comprehensive income as a measure of overall performance. Comprehensive income includes all changes in equity during a period, except those resulting from investments by owners and distributions to owners. For all periods presented, comprehensive loss is the same as reported net loss.

Recent Accounting Pronouncements

In June 2001, the FASB issued SFAS No. 141, *Business Combinations*. SFAS No. 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting. The Company does not expect the adoption of this statement to have a material impact on its operations.

In June 2001, the FASB issued SFAS No. 142, *Goodwill and Other Intangible Assets*. Under SFAS No. 142, companies will no longer amortize goodwill and certain other intangible assets with indefinite lives, but will instead assess for impairment using a fair-value-based test, on at least an annual basis. The Company does not expect the adoption of this statement to have a material impact on its operations.

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which is effective for fiscal years beginning after December 15, 2001. The provisions of this statement provide a single accounting model for impairment of long-lived assets. The Company is currently assessing the impact of this new standard.

Net Loss per Share

Net loss per share is computed based on the guidance of SFAS No. 128, *Earnings per Share*. SFAS No. 128 requires companies to report both basic loss per share, which is based on the weighted average number of common shares outstanding, and diluted loss per share, which is based on the weighted average number of common shares outstanding and the weighted average dilutive potential common shares outstanding. As a result of the losses incurred by the Company for fiscal 2001, 2000 and 1999, all potential common shares were antidilutive and were excluded from the diluted net loss per share calculations.

The following table summarizes securities outstanding as of each year-end that were not included in the calculation of diluted net loss per share, since their inclusion would be antidilutive.

	December 31,		
	2001	*2000*	*1999*
Convertible preferred stock	–	–	885,000
Preferred stock options (Note 7)	–	–	150,000
Common stock options outstanding	4,750,000	5,320,000	–

Impairment of Long-lived Assets

The Company applies SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*. SFAS No. 121 requires the Company to continually evaluate whether events or circumstances have occurred that indicate that the estimated remaining useful life of long-lived assets and certain identifiable intangibles may warrant revision or that the carrying value of these assets may be impaired. To compute whether assets have been impaired, the estimated gross cash flows for the estimated

remaining useful life of the assets are compared to the carrying value. To the extent that the gross cash flows are less than the carrying value, the assets are written down to the estimated fair value of the asset. The Company does not believe that its long-lived assets have been impaired.

Income Taxes

The Company provides for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities.

Reclassifications

Certain reclassifications have been made to prior-year balances in order to conform to the current-year presentation.

(4) Property and Equipment

Property and equipment is stated at cost at December 31, 2001 and 2000 and consists of the following:

	2001	*2000*
Land	$ 672,000	$ -
Building and improvements	6,816,004	-
Computers and other office equipment	154,253	55,872
Scientific equipment	472,850	215,335
	8,115,107	271,207
Less-Accumulated depreciation	(167,014)	(70,446)
Property and equipment, net	$7,948,093	$200,761

Depreciation expense was $101,066, $42,009 and $19,240 in 2001, 2000 and 1999, respectively.

(5) Patents and Licensing Agreements

Internally developed patents are expensed as incurred and included in research and development costs in the accompanying statements of operations.

On November 24, 1998, the Company entered into an exclusive, worldwide royalty-bearing license agreement with Brandeis University to license the rights to certain intellectual property patents involving cloning. The initial cost to license the patents, approximately $102,000, and the subsequent payments of approximately $77,500, have been recorded as intangible assets in the accompanying balance sheets. The patent license is stated at cost and will be amortized using the straight-line method over its remaining useful life, which has been estimated at three years. The Company is required to pay between 1% and 3.5% of the total net sales of any commercially available products that use the licensed technology. The Company is also required to pay 10% of any license fees and milestone payments from any affiliates, sublicensee or corporate or research partner. Minimum annual royalty payments and licensing fees due to the licensor under the agreement are $25,000.

On February 25, 2000, the Company entered into an exclusive worldwide royalty-bearing license agreement with GeneMedix plc, a U.K. public corporation, to license the rights to a proprietary technology for an insulin precursor gene and a process to purify, cleanse and convert said gene to human-identical insulin. In consideration of the rights granted to the Company, the Company will pay license fees and royalties based on net sales of licensed products, on a country-by-country basis. Based on the agreement, the Company will pay base royalties of 10% of net sales of licensed products, as defined. The Company will also pay a royalty of 25% on all sublicensed products, as defined. Percentage rates can be adjusted to account for third-party royalties and competing products, as defined. The Company has to pay one-time license fees to GeneMedix based upon successful approval by the appropriate regulatory authorities for sales of products in certain countries. The fee for sales in United States, Europe and Asia are $2.0 million, $2.0 million and $1.0 million,

respectively. The Company also has to pay one-time fees to GeneMedix upon the successful completion of certain production milestones ranging from $50,000 to $750,000. The agreement is in effect until the statutory expiration of the patents; however, the Company has the right to terminate the agreement for any reason after February 25, 2003. The Company's Chairman of the Board of Directors also serves as the Non-Executive Chairman of GeneMedix plc. No payments have been made to date under the GeneMedix agreement.

On February 6, 2001, the Company entered into an exclusive, worldwide royalty-bearing license agreement with Antitumor Research Products to license the rights to a novel anti-cancer product, human anti-neoplastic urinary protein. The initial cost to license the patent, approximately $50,000, and the subsequent payments of approximately $8,600, have been recorded as an intangible asset in the accompanying balance sheet. The patent license is stated at cost and will be amortized using the straight-line method over its remaining useful life, which has been estimated at three years. The Company is required to pay on a country-by-country basis a royalty of 2.5% of the total net sales of licensed products that use the technology. The Company is also required to pay 10% of all sublicensed revenues, as defined. Percentage rates can be adjusted to account for third-party royalties and competing products, as defined. The Company has to pay one-time license fees to Antitumor Research Products of $1 million based upon successful approval by the appropriate regulatory authorities for sales of products in each of the United States, Europe or Asia, and the successful launch of the licensed product in such territory. The Company also has to pay one-time fees to Antitumor Research Products upon the successful completion of certain production milestones ranging from $10,000 to $500,000 and 10,000 shares of the Company's stock. To date, none of these milestones have been achieved and, accordingly, no amounts are due pursuant to this agreement. The agreement is in effect until the earlier of the statutory expiration of the patent right on a country-by-country basis or February 6, 2011, whereupon the license rights and patent become fully paid and royalty-free.

Total amortization expense on patents and licensing agreements was $89,753, $64,677 and $17,148 in 2001, 2000 and 1999, respectively.

(6) Long-term debt

From January 26, 2001 through April 26, 2001, the Company borrowed $2,030,000 at the prime rate (as published in the Wall Street Journal), which ranged from 7.5% to 9% during the period, from the mortgage lender on its facility in anticipation of the mortgage loan. The proceeds were held by the lender as security on the loan and bore interest at 5.05%.

On June 6, 2001, the Company entered into a construction/mortgage loan to finance its new facility. The maximum amount of the mortgage loan is $3.9 million, of which $3,492,295 was borrowed as of December 31, 2001. The Company anticipates that the remaining $407,705 will be borrowed during the first quarter of 2002 as the final amounts due for construction are paid. The remaining amount due on the building ($663,153) is included in current liabilities as of December 31, 2001. The facility (land, building and fixtures) is security for the loan.

The mortgage loan bears interest at 1% above the prime rate (as published in the Wall Street Journal; 4.75% at December 31, 2001), requires equal monthly payments based on a 20-year amortization schedule and is due in full on January 31, 2007. Until June 6, 2003, the Company is required to keep on deposit with the lender an amount equal to one year of estimated debt service. The amount ($351,536) is reflected as restricted cash on the balance sheet.

The aggregate maturities of long-term debt for each of the years subsequent to December 31, 2001, based on the amount outstanding and assuming a 5.75% interest rate (the rate at December 31, 2001) are as follows: 2002, $79,549; 2003, $100,617; 2004, $106,558; 2005, $112,849; 2006, $119,511 and 2007, $2,973,211.

(7) Stockholders' Equity

Authorized Shares

As of December 31, 2001, the Company has authorized for issuance 51,150,000 shares of capital stock, as follows: 50,000,000 shares of common stock with a par value of $0.001 per share and 1,150,000 shares of preferred stock with a par value of $0.01 per share, of which 150,000 shares are designated as Class C Convertible Preferred Stock and 1,000,000 shares are undesignated.

Recapitalization

In August 1998, the Company's Board of Directors approved a 1,000-to-1 stock split of its capital shares. On June 23, 2000, a 10-to-1 stock split of the Company's outstanding common stock was effected. All shares and per share amounts of common stock for all periods presented have been retroactively adjusted to reflect the stock split.

Common Stock

In August 1998, the Company issued 9,890,000 shares of common stock (6,550,000 restricted shares and 3,340,000 unrestricted shares) in exchange for all the outstanding shares of common stock of Gestation (6,550,000 restricted shares and 3,340,000 unrestricted shares). The shares of Gestation were restricted pursuant to a Restriction Agreement, dated August 1998, between Gestation and its stockholders. The Restriction Agreement provided that all restrictions would lapse if the stockholders remained employed by the Company at the end of three years for the date of issuance. If the employees left the Company, the Company had the option to repurchase the restricted shares for $0.0001 per share. The restricted shares issued by the Company had the same terms as those of Gestation.

In August 1998, the Company effected a stock dividend in the form of issuance of 9,016,000 shares of common stock to existing stockholders for proceeds of $500.

In December 1999, the Company repurchased 6,982,800 shares (4,792,800 restricted shares and 2,190,000 unrestricted shares) of the 9,890,000 shares issued to the stockholders of Gestation for $0.028 per share or $195,518. In March 2000, the Company repurchased an additional 1,407,200 shares of the outstanding shares issued to the stockholders of Gestation for $0.0001 per share or $141. The repurchased shares are accounted for as Treasury shares in the accompanying balance sheets.

In July 2000, the Company completed an initial public offering of 6,250,000 shares of common stock at a per share price of $3.00. The Company received proceeds of approximately $17.2 million, net of issuance costs of approximately $1.5 million.

The Company issued 460,000 and 50,000 shares of common stock in 2001 and 2000, respectively, in connection with the exercise of employee stock options (see Note 10).

Preferred Stock

In December 1998, the Company authorized the issuance of 400,000 shares of Class B Convertible Preferred Stock. The shares were issued in 100,000 share increments, as follows: December 1998, March 1999, June 1999 and September 1999. The purchasers of the Class B Convertible Preferred Stock also received an option to purchase up to 150,000 shares of Class C Convertible Preferred Stock for a per share price of $3.00, the stock's estimated fair market value. The option to purchase Class C Convertible Preferred Stock was valued using the Black-Scholes option-pricing model generating a fair value of $0.68 per share, or $102,000 in aggregate. For financial reporting purposes, the proceeds received for the Class B Convertible Preferred Stock and the options were allocated based on their relative fair values.

In June 1999, the Company authorized the issuance of 80,000 additional shares of Class B Convertible Preferred Stock and issued 60,000 shares in June 1999 and 20,000 shares in September 1999 for a per share price of $2.50.

In December 1999, the Company authorized the issuance of an additional 160,000 shares of Class B Convertible Preferred Stock for $2.50 per share. The shares were issued as follows: 60,000 shares in December 1999 and 100,000 shares in January 2000.

In March 2000, the Company authorized the increase in the number of Class C Convertible Preferred shares to 175,000 and authorized the issuance of 250,000 shares of Class D Convertible Preferred Stock. The Class C Convertible Preferred shares were issued as follows: 25,000 shares in March 2000 and 150,000 shares in December 2000 for a per share price of $3.00. In March 2000, the Company issued 250,000 shares of Class D Convertible Preferred Stock for a per share price of $4.00.

In June 2000, the Company authorized amendments to its amended and restated certificate of incorporation to eliminate all classes of Convertible Preferred Stock from the authorized capital stock of the Company, except for the Class C Convertible Preferred Stock, for which the authorized amount of shares was changed to 150,000, and to authorize 1,000,000 shares of Preferred Stock to have such terms as may be designated by the Board of Directors from time to time. In addition, all outstanding shares of Class A, B, C and D Convertible Preferred Stock of the Company converted into common stock, at 10 for 1, upon the Company's initial public offering.

(8) Operating Lease

The Company leased office and laboratory space on the campus of the University of Massachusetts Medical School during 1999, 2000 and 2001. The lease terminated in December 31, 2001. Rent expense was $107,363, $80,765 and $69,824 in 2001, 2000 and 1999, respectively.

(9) Income Taxes

The Company is taxable as a Subchapter C corporation and, therefore, its income is subject to tax at the federal and state levels. The Company reports on a calendar year for tax purposes. Income taxes at the appropriate statutory rates have been provided for in the accompanying financial statements.

The Company's deferred tax assets and liabilities as of December 31, 2001 and 2000 are as follows:

	2001	*2000*
Temporary differences, net	$1,314,873	$ 220,631
Net operating loss carryforward	2,092,084	1,209,060
Deferred tax asset	3,406,957	1,429,691
Valuation allowance for deferred tax asset	(3,406,957)	(1,429,691)
Net deferred tax asset	$ –	$ –

The Company has provided a valuation allowance as it could not be determined that it was more likely than not that these deferred tax assets would be realized. At December 31, 2001, the Company has a net operating loss carry forward (NOL) for federal tax purposes of $5,195,143, which expires through 2021. The NOL may be limited if certain changes of ownership of the Company occur.

A reconciliation of the federal statutory rate to the Company's effective tax rate is as follows:

	2001 %	*2000* %	*1999* %
Income tax benefit at statutory rate	(34)	(34)	(34)
State tax benefit	(6)	(6)	(6)
Increase in valuation allowance	41	41	38
Non-deductible goodwill amortization	1	2	3
Other	(2)	(3)	(1)
	–%	–%	–%

(10) Stock Plans

2000 Employee Stock Purchase Plan

On June 16, 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the ESPP) under which 500,000 shares of common stock have been reserved for issuance. Eligible employees may purchase a limited number of shares of the Company's common stock at 85% of the market value at certain plan-defined dates. The ESPP terminates on June 16, 2010. No shares have been issued under the ESPP. At December 31, 2001, 500,000 shares were available for issuance under the ESPP.

1998 Equity Incentive Plan

In December 1998, the Company adopted the 1998 Equity Incentive Plan (the Plan). Under the Plan, 7,000,000 shares of common stock have been reserved for issuance. The Company may grant stock options, stock appreciation rights (SARs) and restricted stock to employees, directors and consultants of the Company as well as to employees and consultants of its subsidiaries who are capable of contributing significantly to the success of the Company. Issuances under the Plan generally expire ten years from issue date. The exercise price of all incentive stock options (ISOs) and nonstatutory stock options (NQs) granted under the Plan must be at least equal to 100% of the fair market value of the option shares on the date of grant, provided that a nonstatutory stock option granted to a new employee or consultant within 90 days of the date of employment may have a lower exercise price so long as it is not less than 100% of the fair market value on the date of employment. The Board of Directors determines all option grants, prices and vesting. All options generally vest over four years; however, the yearly proportions are at the discretion of the Board of Directors.

NOTES TO FINANCIAL STATEMENTS

A summary of the Company's stock option activity and related information for the years ended December 31, 2001 and 2000 is as follows:

	Options Available for Grant	*Options Outstanding*	*Weighted average Exercise Price*
Balance at December 31, 1999	7,000,000	–	$ –
Granted	(5,370,000)	5,370,000	$0.08
Exercised	–	(50,000)	$0.04
Cancelled	–	–	$ –
Balance at December 31, 2000	1,630,000	5,320,000	$0.08
Granted	(745,500)	745,500	$2.63
Exercised	–	(460,000)	$0.04
Cancelled	855,000	(855,000)	$0.08
Balance at December 31, 2001	1,739,500	4,750,500	$0.48

The following table summarizes additional information for options outstanding and exercisable at December 31, 2001:

	Options Outstanding			*Options Exercisable*	
Exercise Prices	*Number*	*Weighted-Average Remaining Contractual Life in Years*	*Weighted-Average Exercise Price*	*Number*	*Weighted-Average Exercise Price*
$0.04	3,980,000	8.2	$0.04	825,000	$0.04
2.07-2.76	720,500	9.8	$2.53	–	$0.00
4.82-5.51	20,000	9.7	$5.13	–	$0.00
6.20-6.89	30,000	9.0	$6.75	6,250	$6.72
Total	4,750,500	8.5	$0.48	831,250	$0.09

During the year ended December 31, 2000, the Company recorded noncash deferred compensation of $2,806,000. This amount represents the aggregate difference between the deemed fair value of the Company's stock and the exercise price of stock options granted prior to the Company's initial public offering. The deferred compensation will be recognized as an expense over the vesting period of the stock options. The Company recorded compensation expense of $649,089 and $486,050 in 2001 and 2000, respectively.

The Company follows the provisions of SFAS No. 123, *Accounting for Stock-Based Compensation*. The Company has elected to account for stock options issued to employees at their intrinsic value with disclosure of fair value accounting on net loss and loss per share on a pro forma basis. Had the Company elected to recognize the compensation cost based on the fair value of the options granted at grant date as prescribed by SFAS No. 123, net loss and net loss per share would have been increased to the pro forma amounts indicated in the table below:

	2001	*2000*
Net loss – As reported	$(4,012,548)	$(2,459,333)
Net loss – Pro forma	$(4,055,330)	$(2,588,434)
Basic and diluted net loss per share – As reported	$(0.13)	$(0.12)
Basic and diluted net loss per share – Pro forma	$(0.13)	$(0.13)

The weighted average fair value of options granted in 2001 and 2000 was $1.13 and $0.55, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	2001	*2000*
Expected dividend yield	0.0%	0.0%
Expected volatility	41.34%	53.76%
Risk-free interest rate	4.625%	6.5%
Expected life of the option	5 years	5 years

(11) Employee Benefit Plan

Employee 401(k) Plan

On May 1, 2000, the Company adopted the TranXenoGen, Inc. 401(k) Plan (the 401(k) Plan) to provide retirement benefits for its employees. The 401(k) Plan provides tax-deferred salary deductions for substantially all employees, as allowed under Section 401(k) of the Internal Revenue Code.

Employees may contribute from 1% to 15% of their annual compensation to the 401(k) Plan, limited to a maximum annual amount as set periodically by the Internal Revenue Service. The Company is required to match 50% of the employees' first 6% of contributions and may make additional profit-sharing contributions to the plan to the extent authorized by the Board of Directors. All matching contributions vest immediately. The Company's matching contributions to the 401(k) Plan were approximately $17,788 and $6,700 in 2001 and 2000, respectively. No profit-sharing contributions were made in 2001 or 2000.

NOTICE OF ANNUAL GENERAL MEETING

NOTICE IS HEREBY GIVEN THAT the 2002 Annual General Meeting of the Company (the ''Meeting'') will be held at the offices of the Company, 800 Turnpike, Shrewsbury, Massachusetts 01545, United States, on July 13, 2002 at 1:00 p.m. Eastern Daylight Time, for the following purposes:

		Resolution on Proxy Form
1.	To receive the report of the Directors and the audited accounts of the Company for the year ended December 31, 2001.	1
2.	To re-elect Mr. Paul A. DiTullio as a Director of the Company.	2

Registered Office:
1209 Orange Street
Wilmington, Delaware 19801
United States

April 22, 2002

BY ORDER OF THE BOARD

Marc Rubenstein
Company Secretary

Notes:

1. The votes on all resolutions will be by way of a poll.
2. A stockholder entitled to attend and vote at the Meeting may appoint a proxy to attend and, on a poll, to vote, instead of him. A proxy need not be a stockholder. Completion and return of the enclosed form of proxy will not preclude stockholders from attending and voting at the Meeting.
3. To be valid, the form of proxy, together with the power of attorney, if any, under which it is signed, or a notarially certified copy thereof, must be received at the office of the Company's Transfer Agent, Capita IRG plc, Bourne House, 34 Beckenham Road, Beckenham, Kent BR3 4TU, United Kingdom, not less than 48 hours before the time fixed for the Meeting or any adjourned Extraordinary General Meeting at which the proxy is to vote.
4. The Company specifies that only the stockholders registered in the register of members of the Company as of April 16, 2002 shall be entitled to attend or vote at the Meeting in respect of the number of shares registered in their respective names at that date. Changes to entries on the register after that time will be disregarded in determining the rights of any person to attend or vote at the Meeting.
5. The holders of a majority in interest of all stock issued and outstanding and entitled to vote upon matters to be considered at the Meeting, present in person or represented by proxy, will constitute a quorum for the transaction of business at the Meeting.
6. A majority of the Company's stock entitled to vote and represented at the Meeting will decide any matter at the Meeting; provided, however, that any election to the board of directors will be determined by a plurality of the vote cast at the Meeting.

DIRECTORS, SECRETARY AND ADVISORS

Directors:

Dr. Kim Sze Tan	*Non-Executive Chairman (47)*
Cary Edmund Garner	*Non-Executive Director (54)*
Paul Anthony DiTullio	*Vice President, Product Development (37)*
George Uveges	*President and Chief Executive Officer (54)*

Company secretary: Marc A. Rubenstein

Registered office:
1209 Orange Street
Wilmington, DE 19801
United States

Principal executive office:
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Shrewsbury, MA 01545
United States

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160 Aldersgate Street
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United States

Principal bankers:
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Bringing New Transgenic Technologies To Life

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