

EDEN BIOSCIENCE CORP
Form 10-Q
August 01, 2008
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2008
- 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
(State or other jurisdiction of incorporation or organization)

91-1649604
(I.R.S. Employer Identification No.)

14522 NE North Woodinville Way, Suite 202B
Woodinville, Washington
(Address of principal executive offices)

98072
(Zip Code)

(425) 806-7300

(Registrant's telephone number, including area code)

11816 North Creek Parkway N, Bothell, WA 98011-8201

(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class | Outstanding as of August 1, 2008 |
|----------------------------------|----------------------------------|
| Common Stock, \$0.0025 Par Value | 2,716,486 |

Eden Bioscience Corporation

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PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

ASSETS

| | June 30, 2008 | December 31, 2007 |
|---|--------------------------|------------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 5,394,043 | \$ 5,668,239 |
| Accounts receivable | 516 | - |
| Inventory, current | 40,724 | 41,749 |
| Prepaid expenses and other current assets | 80,760 | 68,537 |
| Total current assets | 5,516,043 | 5,778,525 |
| Inventory, non-current | 32,334 | 60,035 |
| Property and equipment | 99 | 99 |
| Other assets | 52,093 | 59,027 |
| Total assets | \$ 5,600,569 | \$ 5,897,686 |

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LIABILITIES AND SHAREHOLDERS' EQUITY

| | | | |
|--|--|---------------|---------------|
| Current liabilities: | | | |
| Accounts payable | | \$ 35,446 | \$ 29,979 |
| Accrued liabilities | | 153,626 | 232,631 |
| Total current liabilities | | 189,072 | 262,610 |
| Commitments and contingencies | | | |
| Shareholders' equity: | | | |
| Preferred stock, \$0.01 par value, 10,000,000 shares authorized; no shares | | | |
| issued and outstanding at June 30, 2008 and December 31, 2007 | | | |
| | | - | - |
| Common stock, \$0.0025 par value, 11,111,111 shares authorized; | | | |
| 2,716,486 issued and outstanding shares at June 30, 2008 and | | | |
| | | 6,791 | 6,791 |
| December 31, 2007 | | | |
| Additional paid-in capital | | 132,885,661 | 132,882,325 |
| Accumulated deficit | | (127,480,955) | (127,254,040) |
| Total shareholders' equity | | 5,411,497 | 5,635,076 |
| Total liabilities and shareholders' equity | | \$ 5,600,569 | \$ 5,897,686 |

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | <u>Three Months Ended June 30,</u> | | <u>Six Months Ended June 30,</u> | |
|---|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2008</u> | <u>2007</u> | <u>2008</u> | <u>2007</u> |
| Product sales | \$ 66,118 | \$ 83,127 | \$ 147,008 | \$ 271,899 |
| Operating expenses: | | | | |
| Cost of goods sold | 14,958 | 15,093 | 43,980 | 138,335 |
| Research and development | - | - | - | 136,442 |
| Selling, general and administrative | 186,238 | 233,718 | 423,803 | 633,500 |
| Total operating expenses | 201,196 | 248,811 | 467,783 | 908,277 |
| Loss from operations | (135,078) | (165,684) | (320,775) | (636,378) |
| Other income: | | | | |
| Gain on sale of Harpin Protein Technology | - | - | - | 113,968 |
| Interest income | 38,439 | 84,103 | 93,860 | 148,064 |
| Total other income | 38,439 | 84,103 | 93,860 | 262,032 |

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| | | | | |
|--|-------------|-------------|--------------|--------------|
| Loss before income taxes | (96,639) | (81,581) | (226,915) | (374,346) |
| Income taxes | - | - | - | - |
| Net loss | \$ (96,639) | \$ (81,581) | \$ (226,915) | \$ (374,346) |
| Basic and diluted net loss per share | \$ (0.04) | \$ (0.03) | \$ (0.08) | \$ (0.14) |
| Weighted average shares outstanding used to compute net loss per share | 2,716,486 | 2,716,486 | 2,716,486 | 2,716,486 |

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| | Six Months Ended June 30, | |
|---|----------------------------------|--------------|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net loss | \$ (226,915) | \$ (374,346) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock compensation expense | 3,350 | 10,901 |
| Gain on sale of Harpin Protein Technology | - | (113,968) |
| Accretion expense | - | 5,672 |
| Deferred rent payable | - | (1,406) |
| Changes in assets and liabilities: | | |
| Accounts receivable | (516) | 149,544 |
| Inventory | 28,726 | 281,438 |
| Prepaid expenses and other assets | (5,289) | 327,571 |
| Accounts payable | 5,496 | (135,895) |
| Accrued liabilities | (81,767) | (318,917) |
| Net cash from operating activities | (276,915) | (169,406) |
| Cash flows from investing activities: | | |
| Proceeds from sale of Harpin Protein Technology | - | 1,903,074 |
| Proceeds from sale of equipment | - | 50,000 |
| Net cash from investing activities | - | 1,953,074 |
| Effect of foreign currency exchange rates on cash and cash equivalents | 2,719 | 35,809 |
| Net increase (decrease) in cash and cash equivalents | (274,196) | 1,819,477 |
| Cash and cash equivalents at beginning of period | 5,668,239 | 4,185,225 |
| Cash and cash equivalents at end of period | \$ 5,394,043 | \$ 6,004,702 |

The accompanying notes are an integral part of these statements.

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization and Business

Eden Bioscience Corporation (Eden Bioscience or the Company) was incorporated in the State of Washington on July 18, 1994. On February 28, 2007, the Company sold its proprietary harpin protein-based technology and substantially all of its assets used in the manufacturing and distribution of harpin-based products used in the worldwide agricultural and horticultural markets (Harpin Protein Technology) to Plant Health Care, Inc. (PHC). From December 1, 2006 through February 28, 2007, the Company operated under an Independent Distribution Agreement whereby PHC served as the exclusive distributor of the Company's products for all channels of trade, other than to retail distributors and consumers (the Home and Garden Market), in substantially all worldwide territories. The Company's business strategy after the sale is to sell harpin protein-based products to the Home and Garden Market (the Home and Garden Business) and use its available cash and any revenue generated from its Home and Garden Business to explore whether there may be opportunities to realize potential value from its remaining business assets, primarily its tax loss carryforwards.

The Company is subject to a number of risks including, among others: realizing potential value from tax loss carryforwards is highly speculative and subject to numerous material uncertainties; dependence on one manufacturer for the supply of harpin protein-based products; dependence on a limited number of products and the commercialization of those products, which may not be successful; reliance on independent distributors and retailers to sell the Company's products; ability to retain existing employees; and competition from other companies with greater financial, technical and marketing resources.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. 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 notes required by U.S. generally accepted accounting principles for complete financial statements. The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements. These financial statements and notes should be read in conjunction with the financial statements and notes as of and for the year ended December 31, 2007 included in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 28, 2008.

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 and six months ended June 30, 2008 are not necessarily indicative of the results expected for the full fiscal year or for any future period.

On February 22, 2008, the Company amended its Restated Articles of Incorporation, as amended, to reduce the Company's number of authorized shares of common stock from 33,333,333 to 11,111,111 and to effect a 1-for-3 reverse stock split of the Company's outstanding common stock. The reverse stock split was effective at 5:00 p.m., Pacific time, on February 22, 2008 and the Company's common stock began trading as adjusted for the reverse stock split on February 25, 2008. As a result of this reverse stock split, each three shares of common stock were exchanged for one share of common stock, with cash being issued for any fractional shares, and the total number of shares outstanding was reduced from 8.1 million shares to approximately 2.7 million shares. The Company has retroactively adjusted all the share information to reflect this reverse stock split in the accompanying condensed consolidated financial statements and notes.

Liquidity

The Company's operating expenditures have been significant since its inception. The Company currently anticipates that its operating expenses in 2008, although less than its operating expenses in 2007, will significantly exceed sales of its harpin protein-based home and garden products (Home and Garden Products) to the Home and Garden Market and that net losses and working capital requirements will consume a material amount of its cash resources in 2008. The Company's future capital requirements will depend on the success of its Home and Garden Business and its ability to successfully implement its strategy of realizing potential value from its remaining

EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

business assets, primarily its tax loss carryforwards. The Company does not plan to make a substantial investment toward the development of its Home and Garden Business. Management of the Company believes that the balance of its cash and cash equivalents at June 30, 2008 will be sufficient to meet its anticipated cash needs for net losses, working capital and capital expenditures for more than the next 12 months, although there can be no assurance in that regard.

Estimates Used in Financial Statement Preparation

The preparation of financial statements in conformity with generally accepted accounting principles in the United States 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 revenues and expenses during the reporting period. Examples include fair value of property and equipment; expense accruals; warranty claims, inventory valuation and classification; fair value of stock compensation arrangements and bad debts. Such estimates and assumptions are based on historical experience, where applicable, management's plans, and other assumptions. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the financial statements prospectively when they are determined to be necessary. Actual results could differ from these estimates.

Inventory

Inventory is valued at the lower of average cost or market. Costs include material, labor and overhead. The Company estimates inventory cost reductions based on expected sales value and the amount and age of product in the Company's inventory.

Property and Equipment

Property and equipment are recorded at estimated fair value using an orderly liquidation method. Property and equipment consist of assets used in our Home and Garden Business. Improvements and replacements are capitalized. Maintenance and repairs are expensed when incurred.

Other Assets

As of June 30, 2008 and December 31, 2007, other non-current assets consist primarily of prepaid insurance.

Revenues

The Company recognizes revenue from product sales when product is delivered to its customers and all significant obligations of the Company have been satisfied, unless acceptance provisions or other contingencies or arrangements exist. If acceptance provisions or contingencies exist, revenue is deferred and recognized later if such provisions or contingencies are satisfied. As part of the analysis of whether all significant obligations of the Company have been satisfied or situations where acceptance provisions or other contingencies or arrangements exist, the Company considers the following elements, among others: sales terms and arrangements, historical experience and current incentive programs. Customers do not have price protection or product-return rights. The Company provides an allowance for warranty claims based on historical experience and expectations. Shipping and handling costs related to product sales that are paid by the Company are included in cost of goods sold. Product sales by geographical region were:

| | <u>Three Months Ended June</u> | | <u>Six Months Ended June</u> | |
|---------------|---------------------------------------|--------------------|-------------------------------------|--------------------|
| | <u>30,</u> | | <u>30,</u> | |
| | <u>2008</u> | <u>2007</u> | <u>2008</u> | <u>2007</u> |
| United States | \$ 66,118 | \$ 74,403 | \$ 147,008 | \$ 252,067 |
| Spain | - | 8,724 | - | 19,832 |
| Product sales | \$ 66,118 | \$ 83,127 | \$ 147,008 | \$ 271,899 |

Income Taxes

The Company accounts for income taxes under the provisions of FASB Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS No. 109). SFAS No. 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

differences between the financial reporting and tax bases of assets and liabilities and operating loss and tax credit carryforwards using enacted tax rates in effect for the year in which the differences and carryforwards are expected to reverse.

Foreign Currency Translation

The Company conducts its operations in two primary functional currencies: the U.S. dollar and the euro. Balance sheet accounts of the Company's foreign operations are translated from foreign currencies into U.S. dollars at period-end exchange rates while income and expenses are translated at average exchange rates during the period. Cumulative translation gains or losses related to net assets located outside the U.S. are shown as a component of shareholders' equity. Gains and losses resulting from foreign currency transactions, which are denominated in a currency other than the entity's functional currency, are included in the consolidated statements of operations. As of February 28, 2007, the cumulative translation adjustment related to the Company's European subsidiary totaling \$103,470 was reclassified from accumulated other comprehensive income and reported as part of the gain on sale of Harpin Protein Technology as this subsidiary was substantially liquidated as a result of the sale to PHC. There were no significant gains or losses on foreign currency transactions in the three and six month periods ended June 30, 2008 and 2007.

Net Loss per Share

Basic net loss per share is the net loss divided by the average number of shares outstanding during the period. Diluted net loss per share is the net loss divided by the sum of the average number of shares outstanding during the period plus the additional shares that would have been issued had all dilutive stock options been exercised, less shares that would be repurchased with the proceeds from such exercise using the treasury stock method. The effect of including outstanding stock options is antidilutive for all periods presented. Therefore, stock options totaling 141,776 and 148,970 as of June 30, 2008 and 2007, respectively, have been excluded from the calculation of diluted net loss per share.

2. Sale of Harpin Protein Technology

On February 28, 2007, under the terms of an asset purchase agreement, the Company sold the Harpin Protein Technology to PHC for \$1,396,824 in cash, net of transaction costs incurred after January 1, 2007 totaling \$103,176, a promissory note in the principal amount of \$700,751 payable on December 31, 2007 and the assumption by PHC of certain of the liabilities relating to or arising out of the Company's Harpin Protein Technology. The promissory note had an interest rate of 5% per annum and was secured by equipment, certain intellectual property and other assets acquired by PHC and unconditionally guaranteed by PHC's indirect parent, Plant Health Care plc. On June 6, 2007, PHC sold substantially all of the equipment that secured the promissory note and, in accordance with the terms of the promissory note, paid the Company 75% of the proceeds from the sale which amounted to \$506,250. The remaining principal and interest was paid on December 31, 2007. The Company also sold \$281,044 of finished goods to PHC under the Independent Distribution Agreement. Harpin Protein Technology includes substantially all of the Company's assets used in the creation of plant health technology incorporating harpin proteins and the manufacture of biopesticide, plant health and nutrient products utilizing the Harpin Protein Technology. These assets include all intellectual property, contracts (including the Company's license agreement with the Cornell Research Foundation (CRF) and manufacturing and office facility lease), equipment and inventory related to the Company's worldwide agricultural and horticultural markets.

The sale of Harpin Protein Technology to PHC resulted in a gain calculated as follows:

| | |
|---|--------------|
| Cash portion of purchase price | \$ 2,200,751 |
| Less transaction costs incurred after January 1, 2007 | (103,176) |
| Assets sold to PHC: | |

Inventory

(1,895,978)

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | |
|--|------------|
| Equipment held for sale | (63,750) |
| Property and equipment held and used | (647,962) |
| Liabilities assumed by PHC: | |
| Accrued liabilities | 59,625 |
| Other long-term liabilities | 460,988 |
| Recognition of cumulative translation adjustment | 103,470 |
| Gain on sale of assets to PHC | \$ 113,968 |

The Company retained its cash, accounts receivable, tax attributes and assets relating to its Home and Garden Business, consisting primarily of inventory designated for the Home and Garden Market. In conjunction with the sale of its Harpin Protein Technology, the Company entered into a license and supply agreement with PHC, pursuant to which PHC granted the Company an exclusive worldwide right and license to sell harpin protein-based products for the protection of plants and seeds and the promotion of plant health in the Home and Garden Market and a royalty free, exclusive worldwide license to use the Messenger, MightyPlant and Harp-N-Tek trademarks in connection with the sale of its Home and Garden Products. Under the license and supply agreement, PHC will supply the Company harpin proteins and harpin-protein based products for its Home and Garden Business. The license and supply agreement will continue until the expiration of the last U.S. or foreign patent relating to the products held or acquired by PHC in connection with the asset purchase agreement and, thereafter, for automatic additional consecutive five year periods. The Company retained all liabilities associated with the Home and Garden Business and all liabilities associated with its Harpin Protein Technology that occurred or existed prior to February 28, 2007 that were not specifically assumed by PHC.

3. Stock Options

At June 30, 2008, the Company had reserved 32,777 shares of common stock for issuance under the 1995 Combined Incentive and Nonqualified Stock Option Plan, all of which had been granted, and 388,131 shares for issuance under the 2000 Stock Incentive Plan. Options totaling 108,999 under the 2000 Stock Incentive Plan had been granted at June 30, 2008, leaving 279,132 options available for future grant.

The following table summarizes stock option activity:

| | Number of Shares | Weighted Average Exercise Price Per Share |
|------------------------------|---------------------|---|
| Balance at December 31, 2007 | 146,776 | \$30.06 |
| Expired | (5,000) | 9.00 |
| Balance at June 30, 2008 | 141,776 | 30.81 |
| Exercisable at June 30, 2008 | 140,666 | \$30.99 |

4. Inventory

Inventory, at the lower of average cost or market, consists of the following:

June 30,

December 31,

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| | 2008 | 2007 |
|---------------------------------------|-----------|-----------|
| Raw materials | \$ 13,050 | \$ 18,941 |
| Finished goods | 60,008 | 82,843 |
| Total inventory | 73,058 | 101,784 |
| Less non-current portion of inventory | (32,334) | (60,035) |
| Current portion of inventory | \$ 40,724 | \$ 41,749 |

The non-current portion of inventory consists of raw materials and finished goods that the Company does not expect to utilize in the next 12 months following the balance sheet date.

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Accrued Liabilities

Accrued liabilities consist of the following:

| | June 30, 2008 | December 31, 2007 |
|---------------------------|------------------|----------------------|
| Compensation and benefits | \$ 63,202 | \$ 142,878 |
| Promotions | 40,182 | 37,416 |
| Warranty | 25,000 | 25,000 |
| Other | 25,242 | 27,337 |
| Total accrued liabilities | \$ 153,626 | \$ 232,631 |

6. Commitments and Contingencies

Employment Agreement

On July 25, 2007, the Company entered into an employment agreement with Bradley S. Powell, its President and Chief Financial Officer. The employment agreement extinguished Mr. Powell's change-in-control agreement, dated August 16, 2000, and severance agreement, dated January 28, 2002, in exchange for supplemental payments totaling \$356,145. The supplemental payments were paid in installments as follows: one-half on July 25, 2007; one-quarter on September 30, 2007; and one-quarter on January 15, 2008.

Legal Proceedings

The Company is subject to various claims and legal actions that arise in the ordinary course of business and believes that the ultimate liability, if any, with respect to these claims and legal actions will not have a material effect on its condensed consolidated financial statements.

7. Major Customers

Net product sales to the following distributors accounted for more than ten percent of net revenues for the periods indicated:

| | <u>Three Months Ended June</u> | | <u>Six Months Ended June</u> | | |
|------------|--------------------------------|-------------|------------------------------|-------------|--------|
| | <u>30,</u> | | <u>30,</u> | | |
| | <u>2008</u> | <u>2007</u> | <u>2008</u> | <u>2007</u> | |
| Customer A | \$ | -\$ | - | \$ - | 42,000 |

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| | | | | |
|------------|-------|-------|--------|--------|
| Customer B | 7,000 | 7,000 | 29,000 | 35,000 |
| Customer C | - | 9,000 | - | ** |

** Less than ten percent.

8. Income Taxes

The Company files a U.S. Federal and certain foreign and state tax returns and did not record an income tax benefit for any of the periods presented because it has experienced operating losses since inception. The Company's total U.S. Federal tax net operating loss carryforwards were approximately \$119.2 million at December 31, 2007 and expire between 2009 and 2027. The Company's total foreign tax net operating loss carryforwards were approximately \$5.2 million at December 31, 2007 of which \$2.3 million expires between 2008 and 2017 and \$2.9 million does not expire. The Company has total net operating loss carryforwards in 18 states that range between \$12.5 million to \$2,000 per state and expire between 2008 and 2027. The Company's total general business credit carryforwards were approximately \$1.4 million at December 31, 2007 and expire between 2013 and 2026.

If the Company were to undergo an ownership change as defined in Section 382 of the U.S. Internal Revenue Code (the "Code"), its net tax loss and general business credit carryforwards generated prior to the ownership change would be subject to annual limitations, which could reduce, eliminate, or defer the utilization of these losses. Based upon an analysis of past changes in the Company's ownership, the Company believes that it has experienced ownership changes (as defined under Section 382) on March 20, 1996 and October 2, 2000 and absent any other ownership changes in the future, there are no significant limitations on the Company's future ability to use tax loss

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EDEN BIOSCIENCE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

carryforwards generated prior to those dates. The Company does not believe that the sale to PHC resulted in another ownership change that would further limit its future ability to use tax loss carryforwards generated after October 2000 because it was a sale of assets. However, the IRS or some other taxing authority may disagree with the Company's position and contend that the Company has already experienced other such ownership changes or that the sale of assets resulted in an ownership change. In such case, the Company's ability to use its tax loss carryforwards to offset future taxable income would be severely limited. If the sale of assets to PHC results in an ownership change as defined in Section 382 of the Code, the Company's tax loss carryforwards available to offset future taxable income could be severely limited and the tax loss carryforwards may expire as a result of the limitation. If an ownership change does not occur as a result of the sale to PHC, there is still the potential for an ownership change to occur under Section 382 as a result of future changes in stock ownership. Net operating loss carryforwards may expire if the Company does not generate sufficient income to utilize the losses before their normal expiration. In addition to Section 382, certain other statutory provisions and common law doctrine could limit the Company's opportunities to realize potential value from, or otherwise adversely affect the Company's ability to preserve and utilize, the Company's tax loss carryforwards.

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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 our 2007 audited financial statements and notes thereto included in our most recent Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 28, 2008.

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, such as statements regarding our ability to preserve and employ our tax loss carryforwards and our

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belief that our cash balance at June 30, 2008 will be sufficient to meet anticipated cash needs for more than the next 12 months. We use words such as anticipate, believe, expect, future and intend, the negative of these terms 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 following factors.

Our business objective of realizing potential value from our tax loss carryforwards is highly speculative and subject to numerous material uncertainties.

Our inability to realize value from our tax loss carryforwards.

Our inability to use our tax loss carryforwards because we are unable to generate taxable income.

IRS challenge of the amount of our tax loss carryforwards.

Changes in legislation that could negatively affect our ability to use the tax benefits associated with our tax loss carryforwards.

Our inability to be successful in our Home and Garden Business, which has a limited operating history, has generated only limited revenue to date and in which we do not currently expect to substantially increase our investment.

Our inability to reduce operating losses and negative cash flow and achieve profitability or sustain operations.

The failure of PHC, on whom we are dependent for the manufacture and supply of harpin proteins and harpin protein-based products for our Home and Garden Business, to provide timely delivery of high-quality products, which could adversely affect our business and results of operations.

Our inability to be successful in building greater market awareness and increasing sales in our Home and Garden Business, which is relatively new and has limited market awareness.

Our inability to establish or maintain successful relationships with independent distributors and retailers, which could adversely affect our sales and our ability to generate revenue from our Home and Garden Business.

Our inability to compete successfully in the market for Home and Garden Products.

Our inability to compete with PHC's Harpin Protein Technology business until after February 28, 2009.

Our inability to achieve profitability or our inability to identify and acquire other businesses on favorable terms in order to increase our revenues and generate new income.

Our inability to obtain regulatory approvals, or to comply with ongoing and changing regulatory requirements, which could delay or prevent sales of our current or any future Home and Garden Products.

Our inability to adequately distinguish our products from genetically modified plants and products, which could negatively impact market acceptance and regulatory approval of our products.

The occurrence of product liability claims which could adversely affect our operations.

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Rapid changes in technology, which could render our current or any future products we may develop unmarketable or obsolete.

Our inability to retain our existing personnel, which could impair our ability to successfully manage our business or achieve our objectives.

We may be delisted from the Nasdaq Capital Market if we do not satisfy continued listing requirements.

Information about factors that potentially could affect our financial results and our business include, but are not limited to, those discussed under Item 1A "Risk Factors" in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2008. You should not place undue reliance on our forward-looking statements, which apply only as of the date of this report. The cautionary statements made in this report apply to all forward-looking statements wherever they appear in this report. Except as may be required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.

Overview

We have incurred significant operating losses since our inception in 1994. As of June 30, 2008, we had an accumulated deficit of \$127,480,956. We incurred net losses of \$226,915 in the first six months of 2008, \$1,001,103 in 2007, \$9,445,185 in 2006 and \$10,857,865 in 2005. On February 28, 2007, we sold our proprietary harpin protein-based technology and substantially all of our assets used in our worldwide agricultural

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and horticultural markets to Plant Health Care, Inc. (PHC). From December 1, 2006 through February 28, 2007, we operated under an Independent Distribution Agreement whereby PHC served as the exclusive distributor of our products for all channels of trade, other than to retail distributors and consumers (the Home and Garden Market), in substantially all worldwide territories. Our business strategy after the sale is to sell harpin protein-based products to the Home and Garden Market (the Home and Garden Business) and use our available cash and any revenue generated from the Home and Garden Business to explore whether there may be opportunities to realize potential value from our remaining business assets, primarily our tax loss carryforwards. This sale enabled us to significantly reduce our operating losses and liabilities, generated cash for our Home and Garden Business and preserved the potential future value of our remaining business assets, primarily our tax loss carryforwards. As part of the closing, we entered into a license and supply agreement with PHC, pursuant to which PHC granted us an exclusive worldwide right and license to sell harpin protein-based products (Home and Garden Products) for the protection of plants and seeds and the promotion of overall plant health in the Home and Garden Market and a royalty free, exclusive worldwide license to use the Messenger, MightyPlant and Harp-N-Tek trademarks in connection with the sale of our Home and Garden Products. Under the license and supply agreement, PHC agreed to supply us harpin proteins and harpin-protein based products for our Home and Garden Business.

As a result of the sale of our harpin protein-based technology, our Home and Garden Business is the only continuing portion of our operations and will be our primary source of revenue in 2008. Our Home and Garden Business has a limited operating history and has generated only limited revenue to date. For the three months ended June 30, 2008 and 2007, our Home and Garden Business generated revenue of \$66,118 and \$74,403, respectively. For the six months ended June 30, 2008 and 2007, our Home and Garden Business generated revenue of \$147,008 and \$209,058, respectively, while for the years ended December 31, 2007 and 2006, our Home and Garden Business generated revenue of \$260,371 and \$384,841, respectively. We have no current intention of making substantial additional investments in our Home and Garden Business. Our current business strategy is to use any revenue generated by our Home and Garden Business to support our continued operations while we explore whether there may be opportunities to realize potential value from our remaining business assets, primarily our tax loss carryforwards. The strategy is extremely speculative and subject to a large number of risks and uncertainties including those set forth under Item 1A Risk Factors in our most recent Annual Report on Form 10-K, which was filed on March 28, 2008, and elsewhere in this report. Strategies for realizing value from our tax loss carryforwards and remaining business assets may include pursuing acquisitions intended to increase revenues and generate net income. Although we do not currently have specific plans to do so, we may in the future commit resources to such acquisitions or other alternative opportunities. We expect to incur additional net losses as we proceed with our Home and Garden Business and as we explore whether there may be opportunities to realize potential value from our remaining business assets, primarily our tax loss carryforwards.

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On February 22, 2008, we amended our Restated Articles of Incorporation, as amended, to reduce the number of authorized shares of our common stock from 33,333,333 to 11,111,111 and to effect a 1-for-3 reverse stock split of our outstanding common stock. The reverse stock split was effective at 5:00 p.m., Pacific time, on February 22, 2008 and our common stock began trading as adjusted for the reverse stock split on February 25, 2008. As a result of this reverse stock split, each three shares of common stock were exchanged for one share of common stock, with cash being issued for any fractional shares, and the total number of shares outstanding was reduced from 8.1 million shares to approximately 2.7 million shares. We have retroactively adjusted all the share information in this Form 10-Q to reflect this reverse stock split.

Results of Operations

Three Months and Six Months Ended June 30, 2008 and 2007

Product Sales

Product sales through February 28, 2007, prior to the sale of our Harpin Protein Technology, resulted primarily from sales of Messenger STS, N-Hibit, ProAct, MightyPlant and other related products primarily to distributors in the agricultural markets in the United States and Spain. Product sales after the sale of our harpin protein-based technology, resulted primarily from sales of Messenger, Messenger Seed Treatment and MightyPlant with Messenger Gold primarily to distributors and consumers in the Home and Garden Market in the United States. Product sales are recognized 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 or arrangements have been satisfied, including whether collection is reasonably assured. As part of the analysis of whether all of our significant obligations have been satisfied or situations where acceptance provisions or other contingencies or arrangements exist, we consider the following elements, among others: sales terms and arrangements, historical experience and current incentive programs. Our distributor arrangements provide no price protection or product-return rights. Product sales by geographical region were:

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| | <u>Three Months Ended June</u> | | <u>Six Months Ended June 30,</u> | |
|---------------|--------------------------------|-------------|----------------------------------|-------------|
| | <u>2008</u> | <u>2007</u> | <u>2008</u> | <u>2007</u> |
| United States | \$ 66,118 | \$ 74,403 | \$ 147,008 | \$ 252,067 |
| Spain | - | 8,724 | - | 19,832 |
| Product sales | \$ 66,118 | \$ 83,127 | \$ 147,008 | \$ 271,899 |

Product sales for the second quarter of 2008 were \$66,118, a decrease of \$17,009 (20%) from \$83,127 in the same quarter of 2007. This decrease is a result of lower sales in our Home and Garden Business and no recognition of sales of Messenger STS in Spain, as described below. Product sales for the first six months of 2008 were \$147,008, a decrease of \$124,819 (46%) from \$271,899 in the first six months of 2007. This decrease is a result of the sale of our harpin protein technology to PHC on February 28, 2007, no recognition of sales of Messenger STS in Spain and lower sales in our Home and Garden Business.

Net product sales to consumers in the Home and Garden Market in the United States totaled \$66,118 and \$74,403 in the three months ended June 30, 2008 and 2007, respectively, and \$147,008 and \$209,058 in the six months ended June 30, 2008 and 2007, respectively. We believe this decrease in sales volume is due to lower spending on personnel, marketing and advertising following the sale of our harpin protein-based technology to PHC.

In February 2004, we received approval to sell Messenger in Spain. We initiated marketing activities in March 2004, but the approval was not received in time to meet initial sales activity. In order to ensure that an adequate supply of Messenger STS was quickly disbursed in the new distribution channel and to limit the amount of working capital required by our new distributors at this early stage of introduction, we granted flexible and/or extended payment terms to distributors in this new market. Because of this combination of factors, revenues from product deliveries to certain distributors were deferred and are recognized as payment is received. We recognized net revenue of \$8,724 in the second quarter of 2007 and \$19,832 in the first six months of 2007. Gross revenue of approximately \$54,000 is deferred at June 30, 2008 and will be recognized when payment is received.

Due to the growing seasons in the United States, we expect usage of our Home and Garden Products to be highly seasonal. Based on the recommended application timing, we expect the second quarter to be the most significant period of use. Our Home and Garden Product sales to distributors are also expected to be seasonal. However, actual

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timing of orders received from distributors will depend on many factors, including the amounts of our products in distributors' inventories.

Cost of Goods Sold

Cost of goods sold includes the cost of products sold and used for promotional purposes, shipping and handling and other costs necessary to store and deliver products to customers. Cost of goods sold was \$14,948 in the second quarter of 2008, compared to \$15,093 in the second quarter of 2007. This decrease in cost of goods sold was primarily due to lower sales volumes in our Home and Garden Business and was partially offset by higher storage costs in 2008. Cost of goods sold was \$43,980 in the first half of 2008, compared to \$138,335 in the first half of 2007. This decrease in cost of goods sold was primarily due to lower sales volumes in our Home and Garden Business and lower sales volumes, facility expenses, shipping and handling costs and products used for promotional purposes as a result of the sale of our harpin protein-based technology to PHC.

Research and Development Expenses

Research and development expenses consisted primarily of personnel, field trial, laboratory, regulatory, patent and facility expenses. Research and development expenses ceased as a result of the sale of our harpin protein-based technology to PHC and we do not expect to incur any such expenses in 2008.

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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 were \$186,238 in the second quarter of 2008, a decrease of \$47,480 from \$233,718 in the second quarter of 2007. Selling, general and administrative expenses were \$423,803 in the first half of 2008, a decrease of \$209,697 from \$633,500 in the first half of 2007. The decrease resulted primarily from reductions in personnel, advertising and marketing expenses in our Home and Garden Business and a reduction in facility and related costs resulting from the sale of our harpin protein-based technology to PHC.

Our business strategy moving forward is to use any revenues generated by our Home and Garden Business to support our operations while we explore whether there may be opportunities to realize potential value from our remaining business assets, primarily our tax loss carryforwards. We engaged legal professionals to validate the underlying assumptions related to our tax loss carryforwards and analyze and provide advice on the options that may be available to preserve and maximize the potential use of our deferred tax assets, as well as on potential limitations and risks of such utilization strategy. We also engaged Stephens Inc. to act as our exclusive financial advisor in connection with our efforts to effect one or more business combinations. We expect this to be an expensive and time consuming process, and we may not generate revenue from our Home and Garden Business or otherwise attract capital to support the process for its duration.

Gain on Sale of Harpin Protein Technology

On February 28, 2007, under the terms of an Asset Purchase Agreement, we sold our harpin protein-based technology to PHC for \$1,396,824 in cash, net of transaction costs incurred after January 1, 2007 totaling \$103,176, a promissory note in the principal amount of \$700,751 payable on December 31, 2007 and the assumption by PHC of certain of the liabilities relating to or arising out of our harpin protein-based technology totaling \$520,613. The promissory note had an interest rate of 5% per annum and was paid in full on December 31, 2007. Our harpin protein-based technology includes substantially all of our assets used in the creation of plant health technology incorporating harpin proteins and the manufacture of biopesticide, plant health and nutrient products utilizing the harpin protein-based technology. These assets included all intellectual property, contracts (including our license agreement with the CRF and our office and manufacturing facility lease), equipment and inventory related to our worldwide agricultural and horticultural markets. The sale of our harpin protein-based technology to PHC resulted in a gain of \$113,968.

Interest Income

Interest income consists primarily of earnings on our cash and cash equivalents and, during 2007, the PHC note receivable. Interest income decreased \$45,664 from \$84,103 in the second quarter of 2007 to \$38,439 in the same

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quarter of 2008. Interest income decreased \$54,204 from \$148,064 in the first half of 2007 to \$93,860 in the same period of this year. The decrease was primarily due to lower interest rates and a lower average cash balance available for investment in the three and six month periods ended June 30, 2008 compared to the same periods in 2007.

Income Taxes

We have generated a net loss from operations for each period since we began doing business. As of December 31, 2007, we had accumulated approximately \$119.2 million of net operating loss carryforwards for U.S. Federal income tax purposes, which expire between 2009 and 2027, and net operating loss carryforwards in 18 U.S. States that range between \$12.5 million to \$2,000 per state and expire between 2008 and 2027. Our total U.S. general business credit carryforwards were approximately \$1.4 million and expire between 2013 and 2026. We have also accumulated approximately \$1.4 million of net operating loss carryforwards in Mexico that expire between 2011 and 2017 and approximately \$3.7 million in France, of which \$800,000 expires in 2008 and \$2.9 million does not expire. We have provided a valuation allowance against our

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net deferred tax assets because of the significant uncertainty surrounding our ability to realize value on such assets.

Our business strategy is to use any revenue generated by our Home and Garden Business to support our continued operations while we explore whether there may be opportunities to realize potential value from our remaining business assets, primarily our tax loss carryforwards. The strategy is extremely speculative and subject to a large number of risks and uncertainties including those set forth under Item 1A Risk Factors in our most recent Annual Report on Form 10-K, which was filed on March 28, 2008, and elsewhere in our most recent Annual Report on Form 10-K and in this report. We have conducted limited analysis of our ability to utilize our tax loss carryforwards and have drawn no final conclusions about the viability of this strategy. In order to confirm whether there are opportunities to realize potential value from our tax loss carryforwards, we engaged legal and investment banking professionals during 2007 to validate the underlying assumptions related to our tax loss carryforwards and analyze and provide advice on the options that may be available to preserve and maximize the potential use of our tax loss carryforwards, as well as on potential limitations and risks of such utilization strategy. In September 2007, we engaged Stephens Inc. to act as our exclusive financial advisor in connection with our efforts to effect one or more business combinations. This will continue to be an expensive and time consuming process, and we may not generate sufficient revenue from our Home and Garden Business or otherwise attract sufficient capital to support the process for its duration.

If we were to undergo an ownership change as defined in Section 382 of the Internal Revenue Code of 1986, as amended (the Code), our net tax loss and general business credit carryforwards generated prior to the ownership change would be subject to annual limitations, which could reduce, eliminate, or defer the utilization of these losses. Based upon an analysis completed during the third quarter of 2007 of past changes in our ownership, we believe we have experienced ownership changes (as defined under Section 382 of the Code) on March 20, 1996 and October 2, 2000 and absent any other ownership changes in the future, there are no significant limitations on our future ability to use tax loss carryforwards generated prior to those dates. We do not believe that the sale to PHC resulted in another ownership change that would further limit our future ability to use tax loss carryforwards generated after October 2000 because it was a sale of assets. However, the IRS or some other taxing authority may disagree with our position and contend that we have already experienced other such ownership changes or that the sale of assets resulted in an ownership change. In such case, our ability to use our tax loss carryforwards to offset future taxable income would be severely limited. If the sale of assets to PHC results in an ownership change as defined in Section 382 of the Code, our tax loss carryforwards available to offset future taxable income could be severely limited and the tax loss carryforwards may expire as a result of the limitation. If an ownership change does not occur as a result of the sale to PHC, there is still the potential for an ownership change to occur under Section 382 of the Code as a result of future changes in stock ownership. Net operating loss carryforwards may expire if we do not generate sufficient income to utilize the losses before their normal expiration.

Generally, an ownership change occurs if one or more shareholders, each of whom owns 5% or more in value of a corporation's stock, increase their aggregate percentage ownership by more than 50% over the lowest percentage of stock owned by such shareholders at any time during the preceding three-year period. For example, if a single shareholder owning 10% of our stock acquired an additional 50.1% of our stock in a three-year period, a change of ownership would occur. Similarly, if ten persons, none of whom owned our stock, each acquired slightly over 5% of our stock within a three-year period (so that such persons own, in the aggregate, more than 50%) an ownership change would occur. Ownership of stock is determined by certain constructive ownership rules which can attribute

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ownership of stock owned by entities (such as estates, trusts, corporations, and partnerships) to the ultimate indirect owner.

For purposes of this rule, all holders who each own less than 5% of a corporation's stock are generally treated together as one (or, in certain cases, more than one) 5% shareholder. Transactions in the public markets among shareholders owning less than 5% of the equity securities generally are not included in the calculation. Special rules can result in the treatment of options (including warrants) or other similar interests as having been exercised if such treatment would result in an ownership change.

As we explore whether there may be opportunities to utilize our tax loss carryforwards, due to the importance of avoiding a future ownership change under the tax laws, we will be limited in our ability to issue additional stock in the future to provide capital for our business. We would only be able to issue such additional stock in a manner that would not cause an ownership change, for purposes of these rules, and thus our ability to access the equity markets could be restricted.

Finally, in addition to Section 382 of the Code, certain other statutory provisions and common law doctrine could limit our opportunities to realize potential value from, or otherwise adversely affect our ability to preserve and utilize, our tax loss carryforwards.

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The use of our tax loss carryforwards is subject to uncertainty because it is dependent upon the amount of taxable income we generate. We have no assurance that we will have sufficient taxable income in future years to use the tax loss carryforwards before they expire. We believe that our ability to achieve profitability may depend in substantial part on our ability to identify and acquire suitable acquisitions on favorable terms, so that we can increase our revenues and generate new income. We may seek additional capital from time to time, including through the sale of stock or other securities, which may result in dilution to existing shareholders. In addition, as noted above, the provisions of the Code and certain applicable IRS regulations will limit the number of shares of stock we can sell from time to time without causing a limitation on our ability to use our tax loss carryforwards to reduce our future tax obligations.

Liquidity and Capital Resources

Our operating expenditures have been significant since our inception. We currently anticipate that our operating expenses in 2008 will significantly exceed Home and Garden Product sales and that net losses and working capital requirements will consume a material amount of our cash resources in 2008. Our future capital requirements will depend on the success of our Home and Garden Business and our ability to successfully implement our strategy of realizing potential value from our remaining business assets, primarily our tax loss carryforwards. We have no current intention to make substantial investments to grow our Home and Garden Business. We believe that the balance of our cash and cash equivalents at June 30, 2008 will be sufficient to meet our anticipated cash needs for net losses, working capital and capital expenditures for more than the next 12 months, although there can be no assurance in this regard.

At June 30, 2008, our cash and cash equivalents totaled \$5,394,043, a decrease of \$274,196 from the balance of \$5,668,239 at December 31, 2007. In 2007, we received \$2,097,575 in net proceeds (after transaction costs incurred after January 1, 2007) from the sale of our harpin protein-based technology to PHC. We plan to finance our operations in 2008 using existing cash and cash equivalents. As discussed in detail above under Results of Operations Income Taxes, our business strategy of exploring whether there may be opportunities to utilize our remaining business assets, including our tax loss carryforwards, will, due to the importance of avoiding a future ownership change under the tax laws, limit us in our ability to issue additional stock to provide capital for our business.

Net cash used in operations increased by \$107,509 from \$169,406 in the first six months of 2007 to \$276,915 in the same period of 2008. Net cash used in operations in the first six months of 2008 resulted primarily from a net loss of \$226,915 and net fluctuations in various asset and liability balances totaling \$53,350. Net cash used in operations in the first six months of 2007 resulted primarily from a net loss of \$374,346 offset by net fluctuations in various asset and liability balances totaling \$303,741 offset by the gain on the sale of our harpin protein-based technology. We expect that net cash used in operations will continue to be significant. We currently have no long-term contractual obligations associated with capital and operating lease obligations.

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Net cash provided by investing activities was zero in the first six months of 2008 compared to \$1,953,074 in the same period of 2007. The amount in 2007 resulted from the proceeds from the sale of our harpin protein-based technology to PHC and the proceeds from a sale of equipment. No such sales occurred in 2008.

We conduct our operations in two primary functional currencies: the U.S. dollar and the euro. 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 invoice our international customers in euros. We are exposed to foreign exchange rate fluctuations as the financial results of foreign subsidiaries are translated into U.S. dollars in consolidation. As of February 28, 2007, the cumulative translation adjustment related to our European subsidiary totaling \$103,470 was reclassified from accumulated other comprehensive income and reported as part of the gain on the sale of our harpin protein-based technology as this subsidiary was substantially liquidated as a result of the sale to PHC. Foreign exchange rate fluctuations did not have a material impact on our financial statements in the three and six month periods ended June 30, 2008 and 2007.

Employment Agreement

On July 25, 2007, we entered into an employment agreement with Bradley S. Powell, our President and Chief Financial Officer. The employment agreement extinguished Mr. Powell's change-in-control agreement, dated August 16, 2000, and severance agreement, dated January 28, 2002, in exchange for supplemental payments totaling \$356,145. The supplemental payments were paid in installments as follows: one-half on July 25, 2007; one-quarter on September 30, 2007; and one-quarter on January 15, 2008. On March 19, 2008, the Compensation Committee

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of the Board of Directors approved a bonus plan for Mr. Powell pursuant to which he will be paid a cash bonus equal to one times his annual base salary upon completion of an acquisition, merger or consolidation to which we are a party. Previously, pursuant to the terms of Mr. Powell's existing employment agreement, any such bonus, including the amount thereof, was payable only if approved by the Compensation Committee at its sole discretion.

Critical Accounting Policies, Estimates and Judgments

Our critical accounting policies are more fully described in Note 1 to this report and in Note 1 to our audited consolidated financial statements included in our most recent Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 28, 2008. 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 condensed consolidated financial statements in the period in which they are determined to be necessary. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies and estimates include:

Revenue Recognition

Prior to the sale of our harpin protein-based technology assets on February 28, 2007, we sold the majority of our products to independent, third-party distributors in the agricultural and horticultural markets. We sell the majority of our Home and Garden Products to independent, third-party distributors and directly to consumers over the internet in the Home and Garden Markets. Our arrangements with those distributors provide no price protection or product-return rights. We recognize revenue from product sales when product is delivered to our distributors and all of our significant obligations have been satisfied, unless acceptance provisions or other contingencies or arrangements exist, including whether collection is reasonably assured. If acceptance provisions or contingencies exist, revenue is recognized after such provisions or contingencies have been satisfied. As part of the analysis of whether all of our significant obligations have been satisfied or situations where acceptance provisions or other contingencies or arrangements exist, we consider the following elements, among others: sales terms and arrangements, including customer payment terms, historical experience and current incentive programs.

We also record, at the time revenue is recognized, a liability for warranty claims based on a percentage of sales. The warranty accrual percentage and warranty liability are reviewed periodically and adjusted as necessary, based on historical experience and future expectations. Changes in our estimate of the warranty liability are recorded in cost of goods sold.

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Inventory Valuation

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, general economic conditions and the age of our inventory. Changes in the factors above or other factors could result in significant inventory cost reductions and write-offs.

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 interest rate debt and currently do not enter into any material transactions denominated in foreign currency. Because of the relatively short-term average maturity of our investment funds, such investments are sensitive to interest rate movements. Therefore, our future interest income may be adversely impacted by changes in interest rates. However, 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 or cash equivalents we hold is not material.

Item 4. Controls and Procedures

Our President and Chief Financial Officer has evaluated the effectiveness and design of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the fiscal quarter covered by this

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report. Based on that evaluation, our President and Chief Financial Officer concluded that, as of the end of the fiscal quarter covered by this report, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and is accumulated and communicated to our President and Chief Financial Officer to allow timely decisions regarding required disclosure.

There were no changes to our internal control over financial reporting that occurred during the quarter ended June 30, 2008, which were identified in connection with our management's evaluation required by Rules 13a-15(d) and 15d-15(d) under the Exchange Act, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II -- OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

The 2008 annual meeting of shareholders of Eden Bioscience Corporation was held on May 22, 2008. At the annual meeting, our shareholders were asked to elect two directors to our Board of Directors. The following directors were elected to serve for terms expiring at the 2011 annual meeting, or until the directors' earlier retirement, resignation or removal:

| | <u>Votes For</u> | <u>Votes Withheld</u> |
|---------------------------|------------------|-----------------------|
| <u>Class I Directors:</u> | | |
| Roger M. Ivesdal | 2,243,696 | 77,070 |
| Richard N. Pahre | 2,243,097 | 77,669 |

There were no broker non-votes in the election of directors as brokers who hold shares for the accounts of their clients have discretionary authority to vote such shares with respect to the election of directors.

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Item 6. Exhibits

Exhibit 31.1 is being filed as part of this quarterly report on Form 10-Q. Exhibit 32.1 is being furnished with this quarterly report on Form 10-Q.

Exhibit

| <u>Number</u> | <u>Description</u> |
|---------------|---|
| 31.1* | Rule 13a-14(a) Certification (President and Chief Financial Officer). |
| 32.1* | Section 1350 Certification (President and Chief Financial Officer). |

* Filed herewith.

SIGNATURE

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: August 1, 2008

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By: /s/ Bradley S. Powell
Bradley S. Powell
President, Chief Financial Officer and Secretary
(Signing on behalf of the registrant and as Principal
Executive, Financial and Accounting Officer)