SANGAMO BIOSCIENCES INC
Form 10-Q
August 09, 2005

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

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2005

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-30171

SANGAMO BIOSCIENCES, INC.

(exact name of small business issuer as specified in its charter)

Delaware	**68-0359556**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

501 Canal Blvd, Suite A100
Richmond, California 94804
(Address of principal executive offices)

(510) 970-6000
(Registrant s telephone number, including area code)

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

Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes þ No o

As of August 8, 2005, 25,415,849 shares of the issuer s common stock, par value $0.01 per share, were outstanding.

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SANGAMO BIOSCIENCES, INC.

Some statements contained in this report are forward-looking with respect to our operations, economic performance and financial condition. Statements that are forward-looking in nature should be read with caution because they involve risks and uncertainties, which are included, for example, in specific and general discussions about:

our strategy;

sufficiency of our cash resources;

product development and commercialization of our products;

clinical trials;

revenues from existing and new collaborations;

our research and development and other expenses;

our operational and legal risks; and

our plans, objectives, expectations and intentions and any other statements that are not historical facts.

Various terms and expressions similar to them are intended to identify these cautionary statements. These terms include: anticipates, believes, continues, could, estimates, expects, intends, may, plans, seeks, sh results may differ materially from those expressed or implied in those statements. Factors that could cause these differences include, but are not limited to, those discussed under Risks Related to Our Business and Management s Discussion and Analysis of Financial Condition and Results of Operations. Sangamo undertakes no obligation to publicly release any revisions to forward-looking statements to reflect events or circumstances arising after the date of this report. Readers are cautioned not to place undue reliance on the forward-looking statements, which speak only as of the date of this Quarterly Report.

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PART 1. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

SANGAMO BIOSCIENCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	June 30, 2005 (unaudited)	December 31, 2004 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 7,708	$ 8,626
Marketable securities	18,099	24,634
Interest receivable	227	260
Accounts receivable, net	227	569
Prepaid expenses	671	287
Total current assets	26,932	34,376
Property and equipment, net	349	318
Other assets	66	31
Total assets	$ 27,347	$ 34,725
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 462	$ 906
Accrued compensation and employee benefits	475	657
Deferred revenue	479	785
Total current liabilities	1,416	2,348
Stockholders equity:		
Common stock, $0.01 par value; 80,000,000 shares authorized, 25,414,943 and 25,271,059 shares issued and outstanding at June 30, 2005 and December 31, 2004, respectively	129,906	129,482
Accumulated deficit	(104,048)	(97,115)
Accumulated other comprehensive income	73	10
Total stockholders equity	25,931	32,377
Total liabilities and stockholders equity	$ 27,347	$ 34,725

(1) *Amounts derived from Audited Consolidated*

Statements dated December 31, 2004 filed as a part of Form 10-K.

See accompanying notes.

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SANGAMO BIOSCIENCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenues:				
Collaboration agreements	$ 353	$ 34	$ 533	$ 768
Federal government research grants	65	98	141	175
Total revenues	418	132	674	943
Operating expenses:				
Research and development (excludes $85 and $161 of stock-based compensation expense for the three months ended June 30, 2005 and 2004, respectively, and $185 and $343 of stock-based compensation expense for the six months ended June 30, 2005 and 2004, respectively)	2,726	2,268	5,321	5,079
General and administrative (excludes $1 and $0 of stock-based compensation expense for the six months ended June 30, 2005 and 2004, respectively)	1,063	1,100	2,203	2,097
Stock-based compensation expense	85	161	186	343
Total operating expenses	3,874	3,529	7,710	7,519
Loss from operations	(3,456)	(3,397)	(7,036)	(6,576)
Interest and other income, net	76	135	103	372
Net loss	$ (3,380)	$ (3,262)	$ (6,933)	$ (6,204)
Basic and diluted net loss per share	$ (0.13)	$ (0.13)	$ (0.27)	$ (0.25)
Shares used in computing basic and diluted net loss per share	25,391	25,128	25,364	25,052

See accompanying notes.

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SANGAMO BIOSCIENCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six months ended June 30,	
	2005	**2004**
Operating Activities:		
Net loss	$ (6,933)	$ (6,204)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	149	383
Amortization of premium / discount on investment, net	191	571
Realized loss on investment	41	7
Issuance of common stock in connection with license agreement		234
Stock-based compensation	186	343
Changes in operating assets and liabilities:		
Interest receivable	33	78
Accounts receivable	342	324
Prepaid expenses and other assets	(419)	(351)
Accounts payable and accrued liabilities	(444)	(293)
Accrued compensation and employee benefits	(182)	(168)
Deferred revenue	(306)	(68)
Net cash used in operating activities	(7,342)	(5,144)
Investing Activities:		
Purchases of investments	(8,852)	(9,081)
Maturities of investments	15,218	11,824
Purchases of property and equipment	(181)	(10)
Net cash provided by investing activities	6,185	2,733
Financing Activities:		
Proceeds from issuance of common stock	239	392
Net cash provided by financing activities	239	392
Net decrease in cash and cash equivalents	(918)	(2,019)
Cash and cash equivalents, beginning of period	8,626	9,803
Cash and cash equivalents, end of period	$ 7,708	$ 7,784

See accompanying notes.

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SANGAMO BIOSCIENCES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
June 30, 2005

NOTE 1-BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Sangamo Biosciences, Inc. (Sangamo or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The condensed consolidated financial statements include the accounts of Sangamo and its wholly-owned subsidiary, Gendaq Limited, after elimination of all material intercompany balances and transactions. Operating results for the six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005. These financial statements should be read in conjunction with the financial statements and footnotes thereto for the year ended December 31, 2004, included in Sangamo s Form 10-K as filed with the SEC.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

FOREIGN CURRENCY TRANSLATION

The Company records foreign currency transactions at the exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currency are translated into U.S. dollars at the exchange rates in effect at the balance sheet date. All currency translation adjustments arising from foreign currency transactions are recorded through profit and loss.

REVENUE RECOGNITION

In accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, revenue from research activities made under strategic partnering agreements is recognized as the services are provided when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable, and collectibility is reasonably assured. Amounts received under such agreements are deferred until the above criteria are met and the research services are performed. Sangamo s federal government research grants are typically multi-year agreements and provide for the reimbursement of qualified expenses for research and development as defined under the terms of the grant agreement. Revenue under grant agreements is recognized when the related research expenses are incurred. Grant reimbursements are typically received on a quarterly basis and are subject to the issuing agency s right of audit.

Sangamo recognizes revenue from its Universal GeneTools® agreements when ZFP TFs are delivered to the Universal GeneTools® collaborators, persuasive evidence of an agreement exists, there are no unfulfilled obligations, the price is fixed and determinable, and collectibility is reasonably assured. Generally, Sangamo receives partial payments from these collaborations prior to the delivery of ZFP TFs and the recognition of these revenues is deferred until the ZFP TFs are delivered, the risk of ownership has passed to the collaborator and all performance obligations have been satisfied. Upfront or signature payments received upon the signing of a Universal GeneTools® agreement are generally recognized ratably over the applicable period of the agreement or as ZFP TFs are delivered.

Milestone payments under research, partnering, or licensing agreements are recognized as revenue upon the achievement of mutually agreed upon milestones, provided that (i) the milestone event is substantive and its achievement is not reasonably assured at the inception of the agreement, and (ii) there are no further significant performance obligations associated with the milestone payment.

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In accordance with Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, revenue arrangements entered into after June 15, 2003, that include multiple deliverables, are divided into separate units of accounting if the deliverables meet certain criteria, including whether the fair value of the delivered items can be determined and whether there is evidence of fair value of the undelivered items. In addition, the consideration is allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criterion is considered separately for each of the separate units of accounting.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses consist of costs incurred for Company-sponsored as well as collaborative research and development activities. These costs include direct and research-related overhead expenses, which include salaries and other personnel-related expenses, facility costs, supplies and depreciation of facilities and laboratory equipment, as well as the cost of funding research at universities and other research institutions, and are expensed as incurred. Costs to acquire technologies that are utilized in research and development and that have no alternative future use are expensed as incurred.

STOCK-BASED COMPENSATION

Sangamo accounts for employee and director stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and has adopted the disclosure-only alternative of FAS No. 123, Accounting for Stock-Based Compensation. Stock options granted to non-employees, including Scientific Advisory Board Members, are accounted for in accordance with Emerging Issues Task Force Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, which requires the value of such options to be measured and compensation expenses to be recorded as they vest over a performance period. The fair value of such options is determined using the Black-Scholes model. The following table illustrates, pursuant to FAS No. 123, as amended by FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, the effect on net loss and related net loss per share had compensation cost for stock-based employee compensation plans been determined based upon the fair value method prescribed under FAS No. 123:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net loss:				
As reported	$(3,380)	$(3,262)	$(6,933)	$(6,204)
Add: stock-based employee compensation included in reported net loss				1
Less: stock-based employee compensation expense determined under the fair value based method	(371)	(865)	(579)	(1,049)
Pro forma net loss	$(3,751)	$(4,127)	$(7,512)	$(7,252)
Basic and diluted net loss per share:				
As reported	$ (0.13)	$ (0.13)	$ (0.27)	$ (0.25)
Pro forma	$ (0.15)	$ (0.16)	$ (0.30)	$ (0.29)

The above pro forma effects may not be representative of that to be expected in future periods, due to subsequent events including additional grants and related vesting. The fair values for all options granted in the three-month and six-month periods ended June 30, 2005 and 2004 were estimated at the date of grant using the Black-Scholes method with the following weighted-average assumptions:

	Three months ended June 30,		Six months ended June 30,	
	2005	**2004**	**2005**	**2004**
Risk-free interest rate	3.7%	3.9%	3.8%	3.7%
Expected life of option	5.0 years	5.0 years	4.5 years	5.0 years
Expected dividend yield of stock	0.0%	0.0%	0.0%	0.0%
Expected volatility	1.0	1.0	1.0	1.0

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RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123R, Share Based Payment (SFAS 123R). This statement is a revision to SFAS 123, supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. SFAS 123R requires a public entity to expense the cost of employee services received in exchange for an award of equity instruments. SFAS 123R also provides guidance on valuing and expensing these awards, as well as disclosure requirements of these equity arrangements. SFAS 123R is effective for the fiscal years beginning after June 15, 2005. The Company will be required to adopt SFAS 123R at the beginning of the first quarter of 2006. SFAS 123R permits public companies to choose between the following two adoption methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date; or

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB Opinion No. 25 s intrinsic value method and, as such, the Company generally recognizes no compensation cost for employee stock options. The impact of the adoption of SFAS 123R cannot be predicted at this time because it will depend on levels of share-based payments granted in the future. However, valuation of employee stock options under SFAS 123R is similar to SFAS 123, with minor exceptions. The impact on the results of operations and earnings per share had the Company adopted SFAS 123 is described in the stock-based compensation section above. Accordingly, the adoption of SFAS 123R s fair value method will have a significant impact on the Company s results of operations, although it will have no impact on the Company s overall financial position. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. The Company has not yet completed the analysis of the ultimate impact that this new pronouncement will have on the results of operations, nor the method of adoption for this new standard.

NOTE 2-BASIC AND DILUTED NET LOSS PER SHARE

Basic and diluted net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period. Weighted-average shares outstanding used to calculate the reported net loss per common share was equal to shares used to compute basic and diluted net loss per common share.

NOTE 3-COMPREHENSIVE LOSS

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Other comprehensive loss includes certain changes in stockholders equity that are excluded from net loss, which includes unrealized gains and losses on our available-for-sale securities and foreign currency translation adjustments. Comprehensive loss and its components are as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Net loss	$(3,380)	$(3,262)	$(6,933)	$(6,204)
Changes in unrealized gain (loss) on securities available-for-sale	5	(159)	63	(110)
Comprehensive loss	$(3,375)	$(3,421)	$(6,870)	$(6,314)

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NOTE 4-MAJOR CUSTOMERS, PARTNERSHIPS AND STRATEGIC ALLIANCES

Strategic Partnership with Edwards Lifesciences Corporation

In January 2000, we announced a therapeutic product development collaboration with Edwards Lifesciences Corporation. Under the agreement, we have licensed to Edwards, on a worldwide, exclusive basis, ZFP Therapeutics for use in the activation of VEGFs and VEGF receptors in ischemic cardiovascular and vascular diseases. Edwards purchased a $5.0 million note that converted, together with accrued interest, into 333,333 shares of common stock at the time of our initial public offering (IPO) at the IPO price. In March 2000, Edwards purchased a $7.5 million convertible note in exchange for a right of first refusal for three years to negotiate a license for additional ZFP Therapeutics in cardiovascular and peripheral vascular diseases. That right of first refusal was not exercised and terminated in March 2003. Together with accrued interest, this note converted into common stock at the time of our initial public offering at the IPO price. Through 2001, we received $2 million in research funding from Edwards and a $1.4 million milestone payment for delivery of a lead ZFP Therapeutic product candidate. In November 2002, Edwards signed an amendment to the original agreement and agreed to provide up to $3.5 million in research and development funding, including $2.95 million for research and development activities performed in 2002 and 2003. The filing of the IND for PAD in 2004, and the achievement of other research-related milestones in 2003, triggered a total of $1.0 million in milestone payments from Edwards Lifesciences in the first quarter of 2004. There were no revenues attributable to milestone achievement and collaborative research and development performed under the Edwards agreements for both the three-month and six-month periods ended June 30, 3005. Revenues attributable to milestone achievement and collaborative research and development performed under the Edwards agreements were approximately $8,000 for the three-month period ended June 30, 2004. Revenues attributable to milestone achievement and collaborative research and development performed under the Edwards agreements were approximately $608,000 for the six-month period ended June 30, 2004, representing approximately sixty-four percent of total revenues earned by Sangamo for that period.

Our License Agreement with Edwards Lifesciences provides Edwards with exclusive rights for the activation of VEGF and VEGF receptors for the treatment and prevention of ischemic cardiovascular and vascular disease in humans. We have retained all rights to use our technology for all therapeutic applications of VEGF activation outside of ischemic cardiovascular and vascular diseases, including use in wound healing and neurological disorders. Edwards has stated that their rights may include diabetic neuropathy. We believe diabetic neuropathy is a neurological disease and not an ischemic vascular disease and therefore is outside the scope of the Edwards License. The Company and Edwards are in discussions regarding this issue.

In the future, Sangamo may receive milestone payments and royalties under this agreement. We have received $2.5 million in milestone payments to date and we could receive $27.0 million in additional milestone payments under the agreement if all future milestones are met for the first product developed under the agreement. Any subsequent products developed under the agreement may generate up to $15.0 million in milestone payments each. We would also receive royalties on any sales of products generated under the agreement and these royalty obligations would continue until the expiration of the last-to-expire patent covering products developed under the agreement on a country-by-country basis. Based on currently issued patents, these royalty obligations would last through January 12, 2019. The development of any products is subject to numerous risks and no assurance can be given that any products will successfully be developed under this agreement. See Risks Related to our Business Our gene regulation technology is relatively new, and if we are unable to use this technology in all our intended applications, it would limit our revenue opportunities.

Under the Sangamo-Edwards agreement, we were responsible for advancing product candidates into preclinical animal testing. Edwards had responsibility for preclinical development, regulatory affairs, clinical development, and the sales and marketing of ZFP Therapeutic products developed under the agreement. Sangamo may receive milestone payments in connection with the development and commercialization of the first product under this agreement and may also receive royalties on product sales. As part of the November 2002 amendment to our original agreement, Edwards Lifesciences also entered into a joint collaboration with us to evaluate ZFP TFs for the regulation of a second therapeutic gene target, phospholamban (PLN), for the treatment of congestive heart failure. Under the amended agreement, Sangamo granted Edwards a right of first refusal to Sangamo s ZFP TFs for the regulation of PLN. This

right of first refusal terminated on June 30, 2004. On August 14, 2003 Edwards and Sangamo entered into a Third Amendment to the original license agreement. Under this amendment, Sangamo received payment for research and development milestones associated with the VEGF and PLN programs.

There is no assurance that the companies will achieve the development and commercialization milestones anticipated in these agreements. Edwards has the right to terminate the agreement at any time upon 90 days written notice. In the event of termination, we retain all payments previously received as well as the right to develop and commercialize all related products.

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Enabling Technology Agreements for Pharmaceutical Protein Production

In January 2005, we announced a research collaboration agreement with Pfizer Inc to develop enhanced cell lines for protein pharmaceutical production. Under the terms of the agreement, Pfizer is funding research at Sangamo and Sangamo will provide our proprietary ZFP technology for Pfizer to assess its feasibility for use in mammalian cell-based protein production. We will generate novel cell lines and vector systems for enhanced protein production as well as novel technology for rapid creation of new production cell lines. Revenues attributable to collaborative research and development performed under the Pfizer agreement were $298,000 for the three-month period ended June 30, 2005, representing 71% of total revenues earned by Sangamo during that period. Revenues attributable to collaborative research and development performed under the Pfizer agreement were $423,000 for the six-month period ended June 30, 2005, representing 63% of total revenues earned by Sangamo during that period. As of June 30, 2005 accounts receivable from Pfizer represented 66% of our total accounts receivable balance.

Enabling Technology Agreements for Regenerative Medicine

In September 2004, Sangamo announced that it had entered into an agreement with LifeScan, Inc., a Johnson & Johnson company. The agreement provides LifeScan with Sangamo s ZFP TFs for use in a program to develop therapeutic cell lines as a potential treatment for diabetes. In December 2004, this agreement was expanded to include additional targets important in diabetes. The agreements represented Sangamo s first collaboration in the field of regenerative medicine. During the three-month period ended June 30, 2005, revenues attributable to collaborative research and development performed under the LifeScan agreement were approximately $55,000, representing 13% of total revenues earned by Sangamo during that period. Revenues attributable to collaborative research and development performed under the LifeScan agreement were $110,000 for the six-month period ended June 30, 2005, representing 16% of total revenues earned by Sangamo during that period.

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

The discussion in Management s Discussion and Analysis of Financial Condition and Results of Operations contains trend analysis, estimates and other forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements include, without limitation, statements containing the words believes, anticipates, expects, continue, and other words of similar import or the negative of those terms or expressions. Such forward-looking statements are subject to known and unknown risks, uncertainties, estimates and other factors that may cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Actual results could differ materially from those set forth in such forward-looking statements as a result of, but not limited to, the Risks Related to Our Business described below. You should read the following discussion and analysis along with the Selected Financial Data and the financial statements and notes attached to those statements included elsewhere in this report.

Overview

We were incorporated in June 1995. From our inception through June 30, 2005, our activities related primarily to establishing and operating a biotechnology research and development organization and developing relationships with our corporate collaborators. Our scientific and business development endeavors currently focus on the engineering of novel zinc finger DNA binding proteins (ZFPs) for the regulation and modification of genes. We have incurred net losses since inception and expect to incur losses in the future as we continue our research and development activities. To date, we have funded our operations primarily through the issuance of equity securities, borrowings, payments from federal government research grants and from corporate collaborators and strategic partners. As of June 30, 2005, we had an accumulated deficit of $104 million.

Our revenues have consisted primarily of revenues from our corporate partners for ZFP TFs, contractual payments from strategic partners for research programs and research milestones, and Federal government research grant funding. We expect revenues will continue to fluctuate from period to period and there can be no assurance that new collaborations or partner fundings will continue beyond their initial terms.

During 2004, we began placing more emphasis on higher-value therapeutic product development and related strategic partnerships and less emphasis on our Universal GeneTools® collaborations. We believe this shift in emphasis has the potential to increase the return on investment to our stockholders by allocating capital resources to higher value, therapeutic product development activities. At the same time, it may reduce our revenues over the next several years and it increases our financial risk by increasing expenses associated with product development. During the first quarter of 2005, we filed an Investigational New Drug (IND) application with the U.S. Food and Drug Administration (FDA) and have now initiated our own Phase I clinical trial of a ZFP Therapeutic in patients with diabetic neuropathy. Development of novel therapeutic products is costly and is subject to a lengthy and uncertain regulatory process by the FDA. Our future products are gene-based therapeutics. Adverse events in both our own clinical program and other programs in gene therapy may have a negative impact on regulatory approval, the willingness of potential commercial partners to enter into agreements and the perception of the public.

Research and development expenses consist primarily of salaries and related personnel expenses, laboratory supplies, allocated facilities costs, subcontracted research expenses, and expenses for patent prosecution, trademark registration and technology licenses. Research and development costs incurred in connection with collaborator-funded activities are expensed as incurred. We believe that continued investment in research and development is critical to attaining our strategic objectives. We expect these expenses will increase significantly as we focus increasingly on

development of ZFP Therapeutics. The Company is also developing zinc finger nucleases (ZFNs) for therapeutic gene correction and therapeutic gene modification as a treatment and possible cure for certain monogenic and infectious diseases. Additionally, in order to develop ZFP TFs as commercially relevant therapeutics, we expect to expend additional resources for expertise in the manufacturing, regulatory affairs and clinical research aspects of biotherapeutic development.

General and administrative expenses consist primarily of salaries and related personnel expenses for executive, finance and administrative personnel, professional fees, allocated facilities costs and other general corporate expenses. As we pursue commercial development of our therapeutic leads we expect the business aspects of the Company to become more complex. We may be required in the future to add personnel and incur additional costs related to the maturity of our business.

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Enabling Technology Programs

We began marketing our Enabling Technologies to the pharmaceutical and biotechnology industry in 1998. Our Enabling Technology Agreements are based upon the delivery of an engineered ZFP TF that is capable of regulating the expression of a gene for which it is specifically designed and targeted. These agreements typically involve non-exclusive rights to use one or more ZFP TFs for internal research purposes or limited commercial applications.

As the emphasis of our pharmaceutical research and development has shifted away from target validation to the downstream bottlenecks of the drug discovery process, we have refocused our Enabling Technology products and services on two principal areas: supplying our partners with our ZFP technology to enhance the production of pharmaceutical proteins, and providing ZFP TFs or ZFP-engineered cells which over-express a gene of interest for use in development of products for regenerative medicine or in the generation of cell lines for high-throughput compound screening. In the latter case, typically, pharmaceutical company researchers will use a cDNA encoding the drug target of interest to create these cell-based drug screens. However, if a third party holds a patent covering that cDNA, the pharmaceutical company might be prevented from using it for this purpose. Use of the ZFP-engineered cell-based system allows our partners to screen against drug targets whose gene and/or cDNA sequence is covered by competitor intellectual property, without infringing that intellectual property.

Plant Agriculture

Sangamo scientists and collaborators have shown that ZFP TFs can be used to regulate the expression of endogenous genes in plants with similar efficacy as has been shown in various mammalian cells and organisms. The ability to identify and subsequently regulate gene expression with engineered ZFP TFs may lead to the creation of new plants that increase crop yields; lower production costs; are more resistant to herbicides, pesticides, and plant pathogens; and permit the development of branded agricultural products with unique nutritional and processing characteristics. In addition, ZFNs can be used to facilitate the efficient and reproducible production of transgenic plants. To commercialize ZFP TFs and ZFNs in agricultural biotechnology, we intend to seek strategic relationships with corporate partners having capabilities in the research, development, and commercialization of agricultural products.

Critical Accounting Estimates

The preparation of financial statements 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 reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Sangamo believes the following critical accounting policies have significant effect in the preparation of our consolidated financial statements.

Revenue Recognition

In accordance with Staff Accounting Bulletin No. 104, Revenue Recognition, revenue from research activities made under strategic partnering agreements is recognized as the services are provided when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable, and collectibility is reasonably assured. Amounts received under such agreements are deferred until the above criteria are met and the research services are performed. Sangamo s federal government research grants are typically multi-year agreements and provide for the reimbursement of qualified expenses for research and development as defined under the terms of the grant agreement. Revenue under grant agreements is recognized when the related research expenses are incurred. Grant reimbursements are typically received on a quarterly basis and are subject to the issuing agency s right of audit.

Sangamo recognizes revenue from its Universal GeneTools® agreements when ZFP TFs are delivered to the Universal GeneTools® collaborators, persuasive evidence of an agreement exists, there are no unfulfilled obligations, the price is fixed and determinable, and collectibility is reasonably assured. Generally, Sangamo receives partial payments from these collaborations prior to the delivery of ZFP TFs and the recognition of these revenues is deferred until the ZFP TFs are delivered, the risk of ownership has passed to the collaborator and all performance obligations have been satisfied. Upfront or signature payments received upon the signing of a Universal GeneTools® agreement are generally recognized ratably over the applicable period of the agreement or as ZFP TFs are delivered.

Milestone payments under research, partnering, or licensing agreements are recognized as revenue upon the achievement of mutually agreed upon milestones, provided that (i) the milestone event is substantive and its achievement is not reasonably assured at the inception of the agreement, and (ii) there are no further significant performance obligations associated with the milestone payment.

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In accordance with Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables, revenue arrangements entered into after June 15, 2003, that include multiple deliverables, are divided into separate units of accounting if the deliverables meet certain criteria, including whether the fair value of the delivered items can be determined and whether there is evidence of fair value of the undelivered items. In addition, the consideration is allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criterion is considered separately for each of the separate units of accounting.

Stock-Based Compensation

Sangamo accounts for employee and director stock options using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and has adopted the disclosure-only alternative of Financial Accounting Standards Board Statement No. 123, Accounting for Stock-Based Compensation (FAS 123). Stock options granted to non-employees, including Scientific Advisory Board Members, are accounted for in accordance with Emerging Issues Task Force Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, which requires the value of such options to be measured and compensation expense to be recorded as they vest over a performance period. The fair value of such options is determined using the Black-Scholes model. Pursuant to FAS 123, as amended by FAS 148, Accounting for Stock-Based Compensation Transition and Disclosure, the effect on net loss and related net loss per share has been calculated, had compensation cost for stock-based compensation plans been determined based upon the fair value method prescribed under FAS 123 (See Note 1 Organization and Summary of Significant Accounting Policies).

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RESULTS OF OPERATIONS

Three months ended June 30, 2005 and 2004

Revenues

	Three months ended June 30, (in thousands, except percentage values)				Six months ended June 30, (in thousands, except percentage values)			
	2005	2004	Change	%	2005	2004	Change	%
Revenues:								
Collaboration agreements	$ 353	$ 34	$ 319	938%	$ 533	$ 768	$ (235)	(31)%
Federal government research grants	65	98	(33)	(34)%	141	175	(34)	(19)%
Total revenues	$ 418	$ 132	$ 286	216%	$ 674	$ 943	$ (269)	(29)%

We are increasing the emphasis of our research and development activities on ZFP Therapeutics and are moving away from our historic emphasis on Enabling Technology agreements. Over the next several years, this change in resource allocation will reduce our revenues.

Total revenues increased to $418,000 for the three months ended June 30, 2005 from $132,000 in the corresponding period in 2004. The increase of $286,000 for the three months ended June 30, 2005 was principally due to revenue in connection with the Company s Enabling Technology Agreement with Pfizer, Inc of $298,000. The decrease for the six months ended June 30, 2005 of $269,000 was principally due to a decrease in revenue from Edwards Lifesciences of $608,000 related primarily to a $600,000 milestone payment in the quarter ended March 31, 2004. This was partially offset by revenue in connection with the Company s Enabling Technology Agreement with Pfizer, Inc. of $423,000. We anticipate continued revenues from collaboration agreements through the end of 2005, and we have applied for, and plan to continue to apply for, federal government research grants in the future to support the development of applications of our technology platform. Although we have negotiated collaboration agreements and received federal government research grants in the past, we cannot assure you that these efforts will be successful in the future.

Operating Expenses