Regulus Therapeutics Inc.
Form 10-Q
November 06, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2014

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: 001-35670

Regulus Therapeutics Inc.

(Exact name of registrant as specified in its charter)

Delaware	**26-4738379**
(State or Other Jurisdiction of	**(I.R.S. Employer**
Incorporation or Organization)	**Identification No.)**
3545 John Hopkins Ct., Suite 210	
San Diego, CA	**92121**
(Address of Principal Executive Offices)	**(Zip Code)**

858-202-6300

(Registrant s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of November 3, 2014, the registrant had 48,603,831 shares of Common Stock ($0.001 par value) outstanding.

Table of Contents

REGULUS THERAPEUTICS INC.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Regulus Therapeutics Inc.

CONDENSED BALANCE SHEETS

(in thousands, except share and per share data)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 9,958	$ 17,807
Short-term investments	84,107	96,198
Prepaid and other current assets	3,958	3,177
Total current assets	98,023	117,182
Property and equipment, net	3,840	3,768
Intangibles, net	1,114	1,128
Other assets	1,038	987
Total assets	$ 104,015	$ 123,065
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,642	$ 1,172
Accrued liabilities	3,633	3,013
Accrued compensation	1,444	1,297
Current portion of deferred revenue	4,174	4,888
Total current liabilities	11,893	10,370
Convertible note payable, at fair value	10,665	11,279
Deferred revenue, less current portion	6,235	6,500
Other long-term liabilities	1,142	1,459
Total liabilities	29,935	29,608
Stockholders equity:		
Common stock, $0.001 par value; 200,000,000 shares authorized, 43,439,562 and 41,787,326 shares issued and outstanding at September 30, 2014 (unaudited) and December 31, 2013, respectively	43	42
Additional paid-in capital	187,702	172,518
Accumulated other comprehensive loss	(66)	(16)

Accumulated deficit	(113,599)	(79,087)
Total stockholders equity	74,080	93,457
Total liabilities and stockholders equity	$ 104,015	$ 123,065

See accompanying notes to these condensed financial statements.

Table of Contents

Regulus Therapeutics Inc.

CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS

(In thousands, except share and per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	(Unaudited)			
Revenues:				
Revenue under strategic alliances and collaborations	$ 1,083	$ 6,118	$ 3,450	$ 14,115
Total revenues	1,083	6,118	3,450	14,115
Operating expenses:				
Research and development	10,173	7,106	30,572	21,710
General and administrative	2,569	1,917	8,255	5,545
Total operating expenses	12,742	9,023	38,827	27,255
Loss from operations	(11,659)	(2,905)	(35,377)	(13,140)
Other income (expense):				
Interest and other income	86	72	283	207
Interest expense	(10)	(7)	(31)	(25)
Gain (loss) from valuation of convertible note payable	1,785	671	614	(3,787)
Loss before income taxes	(9,798)	(2,169)	(34,511)	(16,745)
Income tax (benefit) expense		(5)	1	(4)
Net loss	$ (9,798)	$ (2,164)	$ (34,512)	$ (16,741)
Other comprehensive loss:				
Unrealized (loss) gain on short-term investments, net	(24)	37	(50)	8
Comprehensive loss	$ (9,822)	$ (2,127)	$ (34,562)	$ (16,733)
Net loss per share:				
Basic	$ (0.23)	$ (0.05)	$ (0.80)	$ (0.45)
Diluted	$ (0.26)	$ (0.07)	$ (0.80)	$ (0.45)
Weighted average shares used to compute net loss per share:				

Basic	43,406,251	40,154,812	43,155,601	37,367,368
Diluted	44,855,463	41,555,660	43,155,601	37,367,368

See accompanying notes to these condensed financial statements.

Table of Contents

Regulus Therapeutics Inc.

Condensed Statements of Cash Flows

(In thousands)

	Nine Months Ended September 30,	
	2014	2013
	(Unaudited)	
Operating activities		
Net loss	$ (34,512)	$ (16,741)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization expense	1,098	996
(Gain) loss from valuation of convertible note payable	(614)	3,787
Stock-based compensation	4,710	2,524
Amortization of premium on investments, net	1,235	1,012
Loss on disposal of long-term assets	18	
Change in operating assets and liabilities:		
Contracts and other receivables	50	(95)
Prepaid and other assets	(882)	(512)
Accounts payable	1,470	829
Accrued liabilities	610	851
Accrued compensation	147	(120)
Deferred revenue	(980)	(11,615)
Deferred rent and other liabilities	(203)	68
Net cash used in operating activities	(27,853)	(19,016)
Investing activities		
Purchases of short-term investments	(52,268)	(50,390)
Maturities and sales of short-term investments	63,074	16,520
Purchases of property and equipment	(1,120)	(608)
Acquisition of intangibles	(53)	(46)
Net cash provided by (used in) investing activities	9,633	(34,524)
Financing activities		
Proceeds from issuance of common stock, net	9,853	46,562
Proceeds from exercise of common stock options	624	
Principal payments on other long-term obligations	(106)	(84)
Net cash provided by financing activities	10,371	46,478
Net decrease in cash and cash equivalents	(7,849)	(7,062)
Cash and cash equivalents at beginning of period	17,807	40,552

Cash and cash equivalents at end of period	$ 9,958	$ 33,490
Supplemental disclosure of cash flow information		
Interest paid	$ 30	$
Income taxes paid	$ 1	$ 1
Supplemental disclosure of non-cash investing and financing activities		
Amounts accrued for property and equipment, net	$	$ 57
Allowance for tenant improvements	$	$ 947

See accompanying notes to these condensed financial statements.

Table of Contents

Regulus Therapeutics Inc.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In management s opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited condensed financial statements should be read in conjunction with the Company s audited financial statements and footnotes included in our Annual Report on Form 10-K for the year ended December 31, 2013, from which the balance sheet information herein was derived.

Use of Estimates

Our condensed financial statements are prepared in accordance with GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in our financial statements and accompanying notes. Although these estimates are based on our knowledge of current events and actions we may undertake in the future, actual results may ultimately differ from these estimates and assumptions.

Revenue Recognition

Our revenues generally consist of upfront payments for licenses or options to obtain licenses in the future, research and development funding and milestone payments under strategic alliance agreements, as well as funding received under government grants. We recognize revenues when all four of the following criteria are met: (1) persuasive evidence that an arrangement exists; (2) delivery of the products and/or services has occurred; (3) the selling price is fixed or determinable; and (4) collectability is reasonably assured.

Multiple element arrangements, such as our strategic alliance agreements with Sanofi, AstraZeneca AB (AstraZeneca), Glaxo Group Limited (GSK), an affiliate of GlaxoSmithKline plc, and our collaboration agreement with Biogen Idec MA Inc. (Biogen Idec), are analyzed to determine whether the deliverables within the agreement can be separated or whether they must be accounted for as a single unit of accounting. Deliverables under the agreement will be accounted for as separate units of accounting provided that (i) a delivered item has value to the customer on a stand-alone basis; and (ii) if the agreement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor. The allocation of consideration amongst the units of accounting under the agreement is derived using a best estimate of selling price if vendor specific objective evidence and third-party evidence of fair value is not available. If the delivered element does not have stand-alone value, the arrangement is then accounted for as a single unit of

accounting, and we recognize the consideration received under the arrangement as revenue on a straight-line basis over our estimated period of performance, which for us is often the expected term of the research and development plan.

Milestones

We apply the milestone method of accounting to recognize revenue from milestone payments when earned, as evidenced by written acknowledgement from the collaborator or other persuasive evidence that the milestone has been achieved and the payment is non-refundable, provided that the milestone event is substantive. A milestone event is defined as an event (i) that can only be achieved based in whole or in part on either our performance or on the occurrence of a specific outcome resulting from our performance; (ii) for which there is substantive uncertainty at the inception of the arrangement that the event will be achieved; and (iii) that would result in additional payments being due to us. Events for which the occurrence is either contingent solely upon the passage of time or the result of a counterparty s performance are not considered to be milestone events. A milestone event is substantive if all of the following conditions are met: (i) the consideration is commensurate with either our performance to achieve the milestone, or the enhancement of the value to the delivered item(s) as a result of a specific outcome resulting from our performance to achieve the milestone; (ii) the consideration relates solely to past performance; and (iii) the consideration is reasonable relative to all the deliverables and payment terms (including other potential milestone consideration) within the arrangement.

We assess whether a milestone is substantive at the inception of each arrangement. If a milestone is deemed non-substantive, we will account for that milestone payment in accordance with the multiple element arrangements guidance and recognize revenue consistent with the related units of accounting for the arrangement over the related performance period.

Table of Contents

Deferred Revenue

Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying balance sheets. Amounts not expected to be recognized within the next 12 months are classified as non-current deferred revenue.

Stock-Based Compensation

We account for stock-based compensation expense related to stock options granted to employees and members of our board of directors by estimating the fair value of each stock option on the date of grant using the Black-Scholes model. We recognize stock-based compensation expense using the accelerated multiple-option approach. Under the accelerated multiple-option approach (also known as the graded-vesting method), we recognize compensation expense over the requisite service period for each separately vesting tranche of the award as though the award was in substance multiple awards, resulting in accelerated expense recognition over the vesting period. For performance-based awards granted to employees (i) the fair value of the award is determined on the grant date, (ii) we assess the probability of the individual milestones under the award being achieved and (iii) the fair value of the shares subject to the milestone is expensed over the implicit service period commencing once management believes the performance criteria is probable of being met.

We account for stock options granted to non-employees, which primarily consist of members of our scientific advisory board, using the fair value approach. Stock options granted to non-employees are subject to periodic revaluation over their vesting terms.

Fair Value Option

Applicable accounting policies permit entities to choose, at specified election dates, to measure specified items at fair value if the decision about the election is: 1) applied instrument by instrument, 2) irrevocable, and 3) applied to an entire instrument.

In July 2012, we amended and restated the $5.0 million convertible promissory note originally issued in February 2010 to GSK (the 2010 GSK Note), which resulted in a debt extinguishment for accounting purposes. Concurrently with the debt extinguishment, we elected the fair value option for the 2010 GSK Note. The difference between the carrying value of the 2010 GSK Note and the fair value of the amended and restated 2010 GSK Note was recorded as a loss on extinguishment of debt to non-operating earnings. Thereafter, any change to the fair value of the amended note is recorded as gain (loss) from valuation of convertible note payable to non-operating earnings.

Clinical Trial and Pre-Clinical Study Accruals

We make estimates of our accrued expenses as of each balance sheet date in our financial statements based on the facts and circumstances known to us at that time. Our accrued expenses for pre-clinical studies and clinical trials are based on estimates of costs incurred and fees that may be associated with services provided by clinical trial investigational sites, clinical research organizations (CROs) and other clinical trial-related vendors. Payments under certain contracts with such parties depend on factors such as successful enrollment of patients, site initiation and the completion of clinical trial milestones. In accruing service fees, we estimate the time period over which services will be performed and the level of effort to be expended in each period. If possible, we obtain information regarding unbilled services directly from these service providers. However, we may be required to estimate these services based on other information available to us. If we underestimate or overestimate the activity or fees associated with a study or service at a given point in time, adjustments to research and development expenses may be necessary in future

periods. Historically, our estimated accrued liabilities have approximated actual expense incurred. Subsequent changes in estimates may result in a material change in our accruals.

Recent Accounting Pronouncements

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* (ASU 2013-11). This update provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013, with an option for early adoption. We adopted this guidance in 2014 and it did not have a material impact on our financial condition, results of operations or related financial statement disclosures.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-19). Adoption of ASU No. 2014-09 requires that an entity recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update is effective for annual reporting periods beginning after December 15, 2016 and interim periods therein and requires expanded disclosures. We are currently evaluating the impact of adoption on our financial position, results of operations and cash flows.

Table of Contents

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern*, which requires management to assess an entity s ability to continue as a going concern, and to provide related footnote disclosure in certain circumstances. This standard is effective for annual reporting periods ending after December 15, 2016 and interim periods thereafter. Early application is permitted. The adoption of this guidance will have no impact on our financial position, results of operations or cash flows.

2. Net Loss Per Share

Basic net loss per share is calculated by dividing the net loss by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share is calculated by dividing the net loss by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. Dilutive common stock equivalents are comprised of options outstanding under our stock option plan and convertible note payable.

As of September 30, 2014, we had a convertible note payable outstanding with a principal balance of $5.4 million that was convertible into shares of our common stock at a conversion price of $4.00 per share, at the option of the note holder.

Applicable accounting standards provide that a contract convertible into common stock that is reported as an asset or liability for accounting purposes may require an adjustment to the numerator of the diluted earnings per share calculation for any changes in income or loss that would result if the contract had been reported as an equity instrument during the period. Securities are assumed to be converted at the beginning of the period, and the resulting shares of common stock are included in the denominator of the diluted earnings per share calculation for the entire period presented, if the effect is dilutive. Adding back the gain from the change in valuation of the convertible note payable for the three months ended September 30, 2014 and 2013 to the numerator and adding the number of shares to be issued upon conversion of the convertible note payable into the denominator of the diluted earnings per share calculation resulted in an increase to the net loss per share for the period. The impact of the conversion to the numerator and denominator for the nine months ended September 30, 2014 and 2013 was anti-dilutive, and therefore was excluded.

The following table summarizes the adjustment to net loss for the diluted net loss per share calculation for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net loss	$ (9,798)	$ (2,164)	$ (34,512)	$ (16,741)
Less: gain from change in valuation of note payable	1,785	671		
Net loss used to compute diluted net loss per share	$ (11,583)	$ (2,835)	$ (34,512)	$ (16,741)

The following table summarizes the adjustment to weighted average shares outstanding for the diluted net loss per share calculation for the three and nine months ended September 30, 2014 and 2013:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Weighted average shares outstanding used for basic net loss per share	43,406,251	40,154,812	43,155,601	37,367,368
Add: weighted average shares of convertible note payable	1,449,212	1,400,848		
Weighted average shares outstanding used for diluted net loss per share	44,855,463	41,555,660	43,155,601	37,367,368

Table of Contents

Potentially dilutive securities not included in the calculation of diluted net loss per share because to do so would be anti-dilutive are as follows (in common equivalent shares):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Common stock options	1,949,096	3,041,033	2,313,182	2,474,614
Convertible note payable			1,449,212	1,400,848
Total	1,949,096	3,041,033	3,762,394	3,875,462

3. Investments

We invest our excess cash in commercial paper and debt instruments of financial institutions, corporations, U.S. government-sponsored agencies, and the U.S. Treasury. As of September 30, 2014, our short-term investments had a weighted average maturity of less than two years.

The following tables summarize our short-term investments (in thousands):

	Maturity (in years)	Amortized cost	Unrealized Gains	Unrealized Losses	Estimated fair value
As of September 30, 2014					
Corporate debt securities	2 or less	$ 68,270	$ 9	$ (42)	$ 68,237
Certificates of deposit	2 or less	13,870			13,870
Commercial paper	1 or less	2,000			2,000
Total		$ 84,140	$ 9	$ (42)	$ 84,107

	Maturity (in years)	Amortized cost	Unrealized Gains	Unrealized Losses	Estimated fair value
As of December 31, 2013					
Corporate debt securities	2 or less	$ 71,402	$ 39	$ (25)	$ 71,416
Certificates of deposit	2 or less	11,710			11,710
Commercial paper	1 or less	6,069	2		6,071
Debt securities of U.S. government-sponsored agencies	1 or less	7,000	1		7,001
Total		$ 96,181	$ 42	$ (25)	$ 96,198

4. Fair Value Measurements

We have certain financial assets and liabilities recorded at fair value which have been classified as Level 1, 2 or 3 within the fair value hierarchy as described in the accounting standards for fair value measurements.

Accounting standards define fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants as of the measurement date. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact, and (iv) willing to transact. The accounting standard provides an established hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from independent sources. Unobservable inputs are inputs that reflect our assumptions about the factors that market participants would use in valuing the asset or liability. The accounting standard prioritizes the inputs used in measuring the fair value into the following hierarchy:

Level 1 includes financial instruments for which quoted market prices for identical instruments are available in active markets.

Level 2 includes financial instruments for which there are inputs other than quoted prices included within Level 1 that are observable for the instrument such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets with insufficient volume or infrequent transactions (less active markets) or model-driven valuations in which significant inputs are observable or can be derived principally from, or corroborated by, observable market data.

Level 3 includes financial instruments for which fair value is derived from valuation techniques in which one or more significant inputs are unobservable, including management s own assumptions.

Table of Contents

The following table presents our fair value hierarchy for assets and liabilities measured at fair value on a recurring basis at September 30, 2014 and December 31, 2013 (in thousands):

	Fair value as of September 30, 2014			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 8,760	$ 8,760	$	$
Corporate debt securities	68,237		68,237	
Certificates of deposit	13,870		13,870	
Commercial paper	2,000		2,000	
	$ 92,867	$ 8,760	$ 84,107	$
Liabilities:				
Convertible note payable	$ 10,665	$	$	$ 10,665

	Fair value as of December 31, 2013			
	Total	Level 1	Level 2	Level 3
Assets:				
Cash equivalents	$ 17,170	$ 17,170	$	$
Corporate debt securities	71,416		71,416	
Certificates of deposit	11,710		11,710	
Debt securities of U.S. government-sponsored agencies	7,001		7,001	
Commercial paper	6,071		6,071	
	$ 113,368	$ 17,170	$ 96,198	$
Liabilities:				
Convertible note payable	$ 11,279	$	$	$ 11,279

Changes in the estimated fair value of convertible note payable from December 31, 2013 through September 30, 2014 are as follows (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Balance at December 31, 2013	$ 11,279
Change in estimated fair value of convertible note payable	(614)
Balance at September 30, 2014	$ 10,665

We obtain pricing information from quoted market prices or quotes from brokers/dealers. We generally determine the fair value of our investment securities using standard observable inputs, including reported trades, broker/dealer quotes, bids and/or offers. Refer to Note 3 for information regarding our investments.

We used an income approach in the form of a convertible bond valuation model to value the convertible note payable. The convertible bond model considered the debt and option characteristics of the note. The key inputs to the model as of September 30, 2014 and December 31, 2013 were volatility (80% and 66%, respectively), risk-free rate (0.17% and 0.325%, respectively), and credit spread (7.92% and 7.4%, respectively). The volatility inputs were based on historical and implied volatility of peer companies. Peer companies were materially consistent with those used to determine volatility for stock-based compensation. Beginning in 2014, our historical volatility was included with the peer companies for purposes of estimating volatility. As of September 30, 2014, the volatility input included 40% weighting of our historical volatility and 60% weighting of historical and implied volatility of peer companies. The risk-free rate inputs were based on the yield of U.S. Treasury Strips as of each date. The credit spread inputs were based on an analysis of our creditworthiness and market rates for comparable straight debt instruments. We recorded a gain from the change in valuation of convertible note payable of $1.8 million and $0.6 million for the three and nine months ended September 30, 2014, respectively on our condensed statements of operations and comprehensive loss. We recorded a gain of $0.7 million and a loss of $3.8 million, respectively, for the same periods in 2013. A 10% increase or decrease in volatility would result in approximately a 2% increase or decrease in our estimated fair value of convertible note payable.

Table of Contents

5. Convertible Note Payable

In October 2012, in conjunction with our initial public offering the amended and restated 2010 GSK Note provided for a rollover into a new promissory note (the Post-IPO GSK Note), and the Post-IPO GSK Note was established in the principal amount of $5.4 million, with a maturity date of October 9, 2015. At GSK s option, the Post-IPO GSK Note is convertible into shares of our common stock at any time prior to the maturity date with a conversion equal to the quotient of all outstanding principal and interest divided by our initial public offering price of $4.00 per share, subject to complying with certain threshold ownership percentage limitations. At September 30, 2014 and December 31, 2013, the fair value of the Post-IPO GSK Note was $10.7 million and $11.3 million, respectively, and is classified as Convertible note payable, at fair value on our condensed balance sheets.

6. Stockholders Equity

Shares Reserved for Future Issuance

The following shares of common stock are reserved for future issuance:

	September 30, 2014
Common stock options outstanding	6,271,214
Common stock available for future grant	1,398,649
Employee Stock Purchase Plan	840,071
Convertible note payable (Post-IPO GSK Note)	1,449,212
Total common shares reserved for future issuance	9,959,146

The following table summarizes our stock option activity under all stock option plans for the nine months ended September 30, 2014 (in thousands):

	Number of options	Weighted average exercise price
Options outstanding at December 31, 2013	5,598	$ 3.69
Granted	1,191	$ 7.71
Exercised	(310)	$ 2.01
Canceled/forfeited/expired	(208)	$ 5.46
Options outstanding at September 30, 2014	6,271	$ 4.47

Table of Contents

Stock-Based Compensation

The following table summarizes the weighted average assumptions used to estimate the fair value of stock options and performance stock awards granted to employees under our 2012 Equity Incentive Plan and the shares purchasable under our 2012 Employee Stock Purchase Plan during the periods presented:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Stock options				
Risk-free interest rate	2.0%	1.7%	1.9%	1.4%
Volatility	70.1%	72.7%	73.0%	67.8%
Dividend yield	0%	0%	0%	0%
Expected term (years)	6.1	6.1	6.1	6.1
Performance stock options				
Risk-free interest rate			2.1%	
Volatility			69.6%	
Dividend yield			0%	
Expected term (years)			6.3	
Employee stock purchase plan shares				
Risk-free interest rate	0.07%	0.10%	0.07%	0.11%
Volatility	71.3%	57.8%	69.4%	57.7%
Dividend yield	0%	0%	0%	0%
Expected term (years)	0.5	0.5	0.5	0.5

The following table summarizes the allocation of our stock-based compensation expense for all stock awards during the periods presented (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Research and development	$ 890	$ 594	$ 2,548	$ 1,664
General and administrative	737	384	2,162	860
Total	$ 1,627	$ 978	$ 4,710	$ 2,524

7. Strategic Alliances and Collaborations

The following table summarizes our total revenues from our strategic alliances and collaborations during the periods presented (in thousands):

	Three months ended September 30,	Nine months ended

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Sanofi	$ 18	$ 5,422	$ 961	$ 10,828
AstraZeneca	465	465	1,394	1,394
GSK	144	144	433	1,634
Biogen Idec	449	87	622	259
Other	7		40	
Total	$ 1,083	$ 6,118	$ 3,450	$ 14,115

Table of Contents

Sanofi

In July 2012, we amended and restated our collaboration and license agreement with Sanofi to expand the potential therapeutic applications of the *micro*RNA alliance targets to be developed under such agreement. We determined that the elements within the strategic alliance agreement with Sanofi should be treated as a single unit of accounting because the delivered elements did not have stand-alone value to Sanofi. The following elements were delivered as part of the strategic alliance with Sanofi: (1) a license for up to four *micro*RNA targets; and (2) a research license under our technology alliance.

In June 2013, the original research term expired, upon which we and Sanofi entered into an option agreement pursuant to which Sanofi was granted an exclusive right to negotiate the co-development and commercialization of certain of our unencumbered *micro*RNA programs and we were granted the exclusive right to negotiate with Sanofi for co-development and commercialization of certain miR-21 anti-miRs in oncology and Alport Syndrome. In July 2013, we received an upfront payment of $2.5 million, of which $1.25 million is creditable against future amounts payable by Sanofi to us under any future co-development and commercialization agreement we enter pursuant to the option agreement. Revenue associated with the creditable portion of this payment remained deferred as of September 30, 2014, and will remain deferred until its application to a creditable transaction. The non-creditable portion of this payment, $1.25 million, was recognized as revenue over the option period from the effective date of the option agreement in June 2013 through the expiration of the option period in January 2014.

In conjunction with the option agreement, we agreed to continue specified research on the miR-21 programs during the option period. We re-evaluated our remaining estimated period of performance from the original research term through the term of the option agreement and amortized the remaining deferred revenue of $10.1 million associated with the initial $25.0 million upfront payment from June 2013 through the expiration of the option period in January 2014.

In February 2014, we and Sanofi entered into a second amended and restated collaboration and license agreement (the 2014 Sanofi Amendment) to renew our strategic alliance to discover, develop and commercialize *micro*RNA therapeutics to focus on specific orphan disease and oncology targets. Under the terms of our renewed alliance, Sanofi will have opt-in rights to our preclinical fibrosis program targeting miR-21 for the treatment of Alport Syndrome, our preclinical program targeting miR-21 for oncology indications, and our preclinical program targeting miR-221/222 for hepatocellular carcinoma (HCC). We are responsible for developing each of these programs to proof-of-concept, at which time Sanofi has an exclusive option on each program. If Sanofi chooses to exercise its option on any of these programs, Sanofi will reimburse us for a significant portion of our preclinical and clinical development costs and will also pay us an option exercise fee for any such program, provided that $1.25 million of the $2.5 million upfront option fee paid to us by Sanofi in connection with the June 2013 option agreement will be creditable against such option exercise fee. In addition, we will be eligible to receive clinical and regulatory milestone payments and potentially commercial milestone payments for these programs. We also continue to be eligible to receive royalties on *micro*RNA therapeutic products commercialized by Sanofi and will have the right to co-promote these products.

In connection with the 2014 Sanofi Amendment, we entered into a Common Stock Purchase Agreement (the Purchase Agreement), pursuant to which we sold 1,303,780 shares of our common stock to Aventisub LLC (formerly Avantis Holdings, Inc.) (Aventis), an entity affiliated with Sanofi, in a private placement at a price per share of $7.67 for an aggregate purchase price of $10.0 million. Under the terms of the Purchase Agreement, Aventis may not sell, transfer, make any short sale of, or grant any option for the sale of any common stock for a 12-month period following its effective date. The Purchase Agreement and the 2014 Sanofi Amendment were negotiated concurrently and were therefore evaluated as a single agreement. Based upon restricted stock studies of similar duration and a Black-Scholes valuation to measure the discount for lack of marketability, approximately $0.4 million of the proceeds from the

Purchase Agreement was attributed to the 2014 Sanofi Amendment, and represents consideration for the value of the program targeting miR-221/222 for HCC. As this element does not have stand-alone value, we are recognizing the $0.4 million into revenue ratably over the estimated period of performance of the miR-221/222 program. As of September 30, 2014, deferred revenue associated with the Purchase Agreement and the 2014 Sanofi Amendment was $0.4 million, which we are expecting to recognize over the remaining estimated period of performance of approximately five years.

We have evaluated the remaining contingent event-based payments under our 2014 Sanofi Amendment and determined that event-based payments for which payment is contingent upon the results of Sanofi s performance will be recognized as revenue over our remaining estimated period of performance, if any, and when collectability is reasonably assured. We are eligible to receive milestone payments of up to $101.8 million for proof-of-concept option exercise fees (net of $1.25 million creditable, as noted above), $15.0 million for clinical milestones and up to $300.0 million for regulatory and commercial milestones. In addition, we are entitled to receive royalties based on a percentage of net sales of any products from the miR-21 and miR-221/222 programs which, in the case of sales in the United States, will be in the middle of the 10 to 20% range, and, in the case of sales outside of the United States, will range from the low end to the middle of the 10 to 20% range, depending upon the volume of sales. If we exercise our option to co-promote a product, we will continue to be eligible to receive royalties on net sales of each product in the United States at the same rate, unless we elect to share a portion of Sanofi s profits from sales of such product in the United States in lieu of royalties.

Table of Contents

AstraZeneca

In August 2012, we entered into a collaboration and license agreement with AstraZeneca. Under the terms of the agreement, we have agreed to collaborate with AstraZeneca to identify, research and develop compounds targeting three *micro*RNA alliance targets primarily in the fields of cardiovascular diseases, metabolic diseases and oncology. Pursuant to the agreement, we granted AstraZeneca an exclusive, worldwide license to thereafter develop, manufacture and commercialize lead compounds designated by AstraZeneca in the course of the collaboration activities against the alliance targets for all human therapeutic uses. Under the terms of the agreement we are required to use commercially reasonable efforts to perform all research, development and manufacturing activities described in the research plan, at our cost, until the acceptance of an investigational new drug application (IND) or the end of the research term, which extends until the fourth anniversary of the date of the agreement, and may be extended only by mutual written agreement of us and AstraZeneca. Following the earlier to occur of the acceptance of an IND in a major market or the end of the research term, AstraZeneca will assume all costs, responsibilities and obligations for further development, manufacture and commercialization of alliance product candidates.

Under the terms of the agreement, we received an upfront payment of $3.0 million in October 2012. We determined the elements within the strategic alliance agreement should be treated as a single unit of accounting because the delivered element, the license, does not have stand-alone value. As a result, we are recognizing revenue related to the upfront payment on a straight-line basis over our estimated period of performance, which is four years based on the expected term of the research and development plan. If all three targets are successfully developed and commercialized through pre-agreed sales targets, we could receive milestone payments up to $498.0 million, including preclinical milestones of up to $5.0 million upon lead compound identification, up to $123.0 million for clinical milestones and up to $370.0 million for commercialization milestones. In addition, we are entitled to receive royalties based on a percentage of net sales which will range from the mid-single digits to the low end of the 10 to 20% range, depending upon the product and the volume of sales, which royalties may be reduced in certain, limited circumstances.

We have evaluated the contingent event-based payments under our strategic alliance agreement with AstraZeneca and determined that the preclinical payments meet the definition of substantive milestones. Accordingly, revenue for these achievements will be recognized in its entirety in the period when the milestone is achieved and collectability is reasonably assured. Other contingent event-based payments under the strategic alliance agreement for which payment is contingent upon the results of AstraZeneca s performance will not be accounted for using the milestone method. Such payments will be recognized as revenue over the remaining estimated period of performance, if any, and when collectability is reasonably assured.

Concurrently with the collaboration and license agreement, we entered into a Common Stock Purchase Agreement (CSPA) with AstraZeneca, pursuant to which we agreed to sell to AstraZeneca an aggregate of $25.0 million of our common stock in a private placement concurrently with our initial public offering, at a price per share equal to the initial public offering price. In October 2012, in accordance with the CSPA, we sold AstraZeneca 6,250,000 shares of our common stock at a price per share of $4.00. Further, the CSPA stipulated that AstraZeneca could not sell, transfer, make any short sale of, or grant any option for the sale of any common stock for a 365-day period following the effective date of our initial public offering. Accounting standards for multiple element arrangements contains a presumption that separate contracts negotiated and/or entered into at or near the same time with the same entity were negotiated as a package and should be evaluated as a single agreement. We valued the discount applied to the shares of common stock due to the one-year restriction. Based upon restricted stock studies of similar duration and a Black-Scholes valuation to measure a discount for lack of marketability, $4.3 million was attributed to the collaboration and license agreement. We continue to recognize the $4.3 million into revenue ratably over the estimated period of performance of the collaboration. As of September 30, 2014, deferred revenue associated with the

collaboration and license agreement and CSPA was $3.4 million, which we are expecting to recognize over the remaining contractual term and corresponding estimated period of performance of approximately two years.

GSK

In April 2008, we entered into a strategic alliance with GSK to discover, develop and commercialize novel *micro*RNA-targeted therapeutics to treat inflammatory diseases (the immuno-inflammatory alliance). In February 2010, we and GSK expanded the strategic alliance to include hepatitis C virus infection (HCV) to discover, develop and commercialize *micro*RNA therapeutics targeting miR-122 for the treatment of HCV (the HCV alliance). In June 2012, we amended our immuno-inflammatory alliance to extend the target selection period for the fourth collaboration target. We determined that the elements within the immuno-inflammatory alliance should be treated as a single unit of accounting because the delivered elements, the opt-in licenses for *micro*RNA product candidates, did not have stand-alone value to GSK. As a result of the extension of the target selection period, we extended the amortization period for the remaining deferred revenue to approximately eight years, which represented our new estimated period of performance. As of September 30, 2014, deferred revenue associated with the immuno-inflammatory alliance was $3.1 million, which we are expecting to recognize over the remaining estimated period of performance of approximately five years. Refer to Note 9 Subsequent Events.

Table of Contents

In June 2013, the HCV alliance was amended to state that RG-101, and other formulations thereof, will be developed by us independently of our alliance for the treatment of HCV. This amendment removed any further milestone or royalty obligations owed by GSK to us as it relates to RG-101. Concurrently with the amendment in June 2013, we recorded the remaining $1.1 million in deferred revenue associated with the upfront payment from the HCV alliance, as our estimated period of performance was complete.

Immuno-Inflammatory Alliance

Under the terms of the immuno-inflammatory alliance, if all the product candidates are successfully developed and commercialized through pre-agreed sales targets we could receive milestone payments up to $432.5 million, including up to $15.5 million for preclinical milestones, up to $87.0 million for clinical milestones, up to $150.0 million for regulatory milestones and up to $180.0 million for commercialization milestones. We are also entitled to receive tiered royalties as a percentage of annual sales which can increase up to the low end of the 10 to 20% range.

We have evaluated the remaining contingent event-based payments under our immuno-inflammatory alliance and determined that the preclinical and clinical payments meet the definition of a substantive milestone. Accordingly, revenue for these achievements will be recognized in its entirety in the period when the milestone is achieved and collectability is reasonably assured. Other contingent event-based payments under the strategic alliance agreement for which payment is contingent upon the results of GSK s performance will not be accounted for using the milestone method. Such payments will be recognized as revenue over the remaining estimated period of performance, if any, and when collectability is reasonably assured. We can earn the following preclinical milestones: $0.5 million upon the selection of a fourth *micro*RNA target and $5.0 million upon the selection of a development candidate for each of the selected three targets. We can also earn the following clinical milestones for each of the selected three targets: $4.0 million for the initiation of a Phase 1 clinical trial; $5.0 million for the initiation of a Phase 2 clinical trial; and $20.0 million if GSK chooses to opt-in to the program following the completion of a proof-of-concept trial. Refer to Note 9 Subsequent Events.

HCV Alliance

Notwithstanding the foregoing, GSK has retained its interest in the miR-122 program in HCV, and miR-122 remains a collaboration target under the alliance. If the HCV program is successful, we could receive contractual milestone payments up to $144.5 million, including up to $5.5 million for preclinical milestones, up to $29.0 million for clinical milestones, up to $50.0 million for regulatory milestones and up to $60.0 million for commercialization milestones. We are also entitled to receive tiered royalties which can increase up to the low end of the 10 to 20% range on sales from any product that GSK successfully commercializes under this alliance.

We have evaluated the remaining contingent event-based payments under the HCV alliance and determined that the preclinical and clinical payments meet the definition of a substantive milestone. Accordingly, revenue for these achievements will be recognized in its entirety in the period when the milestone is achieved and collectability is reasonably assured. Other contingent event-based payments under the strategic alliance agreement for which payment is contingent upon the results of GSK s performance will not be accounted for using the milestone method. Such payments will be recognized as revenue over the remaining estimated period of performance, if any, and when collectability is reasonably assured. We can earn a preclinical milestone of $5.5 million upon the selection of a development candidate. We can also earn the following clinical milestones: $4.0 million for initiation of a Phase 1 clinical trial; $5.0 million for the initiation of a Phase 2 clinical trial; and $20.0 million if GSK chooses to opt-in to the program following the completion of a proof-of-concept trial. We have no obligation to perform any research or development activities under the HCV alliance unless mutually agreed upon by the parties. Refer to Note 9 Subsequent Events.

Biogen Idec

In August 2012, we entered into a collaboration and license agreement with Biogen Idec pursuant to which we and Biogen Idec agreed to collaborate on *micro*RNA biomarkers for multiple sclerosis (MS). Pursuant to the terms of the agreement, in August 2012 we received an upfront payment of $0.8 million. We were also eligible to receive research milestone payments up to an aggregate of $1.3 million. We considered the elements within the collaboration and license agreement as a single unit of accounting because the delivered element, the license, did not have stand-alone value. As a result, we recognized revenue relating to the upfront payment of $0.8 million on a straight-line basis over our estimated period of performance, which was approximately two years based on the original expected term of the research and development plan.

In June 2013, we amended the collaboration and license agreement to provide for revised terms with respect to the initial phase of the research plan and related milestone payment provisions. The Biogen Idec amendment did not modify the maximum dollar amount we were originally eligible to receive in connection with the Biogen Idec agreement, or our estimated period of performance. In October 2013 and November 2013, we received research milestone payments totaling $0.3 million under the August 2012 collaboration and license agreement.

Table of Contents

In August 2014, we entered into a new collaboration and license agreement with Biogen Idec to collaborate on *micro*RNA biomarkers for MS and simultaneously executed an agreement terminating the August 2012 collaboration and license agreement. As a result of the termination agreement, we recognized $0.1 million in deferred revenue associated with the upfront payment, as our estimated period of performance was complete. Pursuant to the terms of the August 2014 collaboration and license agreement, we received an upfront payment of $2.0 million in August 2014. We are also eligible to receive research-based milestone payments up to an aggregate of $0.7 million. We determined that the elements within the August 2014 collaboration and license agreement should be treated as a single unit of accounting because the delivered element, the license, does not have stand-alone value to Biogen Idec. As a result, we are recognizing revenue relating to the upfront payment of $2.0 million on a straight-line basis over the estimated period of performance, which is approximately one year based on the expected term of the research and development plan.

(Purchase) sale of short-term investments, net
(18,253,100) (2,247,500) 1,412,000
Restricted cash
(1,520,900)
Sale of discontinued operations
16,871,300
Capital expenditures
(2,013,200) (762,300) (1,125,000)
Sale of G.C. Industries
664,000
Net investing activities of discontinued operations
(76,800) (530,200) (759,200)
Other assets
46,200 34,400 (211,800)

Net cash used in continuing investing activities
(4,946,500) (2,841,600) (684,000)

Cash flows from financing activities:

Exercise of stock options
81,400 183,800 179,600
Bank borrowings, net
1,541,000
Payments under long-term debt and capital leases
(224,600) (1,286,800) (133,800)

Net cash (used in) provided by financing activities	(143,200)	438,000	45,800
Net increase (decrease) in cash and cash equivalents	735,600	(693,000)	760,800
Cash and cash equivalents at beginning of year	270,100	963,100	202,300
Cash and cash equivalents at end of year	$1,005,700	270,100	963,100

Table of Contents

INVIVO CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(1) Significant Accounting Policies

(a) Business

Invivo Corporation and subsidiaries (the Company) are engaged in two businesses, medical devices and industrial instrumentation. The medical device business designs, manufactures, and markets monitoring systems that measure and display vital signs of patients in medical settings. The industrial instrumentation business designs, manufactures, and markets sensor-based instruments for industrial process control applications.

(b) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

(c) Cash Equivalents

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.

(d) Restricted Cash

At June 30, 2002 cash of $1,520,900 was restricted from withdrawal and was related to the sale of Sierra Precision and Lumidor Safety Corporation.

(e) Short-Term Investments

The Company classifies all of its short-term investments as available-for-sale securities. Such short-term investments consist primarily of municipal and corporate bonds, mutual bond funds and money market funds, with unrealized gains and losses on the securities reflected as other comprehensive income in stockholders equity. Realized gains and losses on short-term investments are included in earnings and are derived using the specific identification method for determining the cost of securities. It is the Company s intent to maintain a liquid portfolio to take advantage of investment opportunities; therefore, all securities are considered to be available-for-sale and are classified as current assets.

The Company derives the fair value of its short-term investments based on quoted market prices.

(f) Inventories

Inventories are stated at the lower of cost or market on a first-in, first-out basis.

(g) Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets as follows:

Buildings	30 years
Equipment	3 to 5 years
Furniture and fixtures	3 to 5 years
Leasehold improvements	Shorter of life of lease or 5 years
Automotive	5 years

Table of Contents

(h) Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The measurement of deferred tax assets is reduced, if necessary, by a valuation allowance for any tax benefits which are not expected to be realized.

(i) Intangible Assets

The Company adopted SFAS No. 142, *Goodwill and Other Intangible Assets effective* July 1, 2001. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS No. 142. Accordingly, the Company did not record any amortization during fiscal 2002 related to goodwill. SFAS No. 142 requires a two-step process for testing impairment. First, the fair value of each reporting unit is compared to its carrying value to determine whether an indication of impairment exists. If impairment is indicated, then the fair value of the reporting unit s goodwill is determined by allocating the unit s fair value to its assets and liabilities (including any unrecognized intangible assets) as if the reporting unit had been acquired in a business combination. The amount of impairment for goodwill and other intangible assets is measured as the excess of its carrying value over its fair value. The Company completed its transitional impairment testing of goodwill in July 2001, and its first annual impairment testing as of June 30, 2002 for its reporting units and concluded that no impairment of goodwill exists.

The following table reconciles the prior year s reported net income to its respective pro forma balance adjusted to exclude the amortization of goodwill, which is no longer recorded under SFAS No. 142.

	For the Year Ended June 30, 2001		
		Earnings per Share	
	Amount	Basic	Diluted
Net income	$3,054,100	.69	.68
Add back goodwill amortization	254,400	.06	.06
Adjusted net income	$3,308,500	.75	.74

	For the Year Ended June 30, 2000		
		Earnings per Share	
	Amount	Basic	Diluted
Net income	$4,966,900	1.15	1.10
Add back goodwill amortization	260,700	.06	.06
Adjusted net income	$5,227,600	1.21	1.16

Intangible assets include the cost in excess of amounts otherwise assigned to net assets of businesses acquired (goodwill). Accumulated amortization as of June 30, 2001 and 2000 was approximately $1,240,000 and $1,319,800, respectively. Amortization expense was approximately $254,400 and $260,700 for 2001 and 2000, respectively. There was no amortization expense recorded during the year ended June 30, 2002.

(j) Revenue Recognition

The Company recognizes revenue and all related costs upon shipment of products to its customers. The Company does not as a matter of contract provide its customers the right of return. However, under certain circumstances the Company has allowed the return of product. Based on experience and other information available to the Company, the Company believes the amount of future returns can be reasonably estimated. An allowance for sales returns is reflected as a current liability with sales revenue in the income statement reduced to reflect estimated sales returns.

Table of Contents

(k) Net Income per Share

Basic net income per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common and dilutive potential common shares outstanding during the period. Dilutive potential common shares consist of employee stock options.

(l) Warranties

Product warranties providing for the repair or replacement of defective products are included in the sale price of the Company s products. The typical warranty period is one year. Warranty obligations are accrued as a current liability for the estimated amount of warranty expense expected in future accounting periods based on experience and other information available to the Company.

(m) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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.

(n) Impairment of Long-Lived Assets

Long-lived assets and certain identifiable intangibles held and used by the Company are reviewed for impairment whenever events or changes indicate that the carrying amount of an asset may not be recoverable. The Company has identified no long-lived assets or identifiable intangibles which are considered impaired.

(o) Fair Value of Financial Instruments

Carrying amounts of certain of the Company s financial instruments including accounts receivable, accounts payable and accrued expenses approximate their fair values because of their short maturities.

(p) Research and Experimental Costs

Research and experimental costs related to the design, development and testing of new monitors, applications and technologies are charged to expense as incurred.

(q) Accounting for Stock Options

The Company accounts for its stock option plan in accordance with the provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. As such, compensation expense would be recorded only if the current market price of the underlying stock exceeded the exercise price on the date of the grant. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-Based Compensation*, which allows entities to continue to apply the provisions of APB Opinion No. 25 and provide pro forma net income and pro forma net income per share disclosures for employee stock option grants made in 1996 and future years as if the fair-value-based method defined in SFAS No. 123 had been applied.

(r) Reclassifications

Certain reclassifications have been made in the prior years financial statements to conform to classifications used in the current year. These reclassifications had no effect on reported earnings.

(s) New Accounting Pronouncements

In August 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). SFAS 144 supersedes SFAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of , and provides new rules on asset impairment and a single accounting model for long-lived assets to be disposed of. Although retaining many of the fundamental recognition and measurement provisions of SFAS 121, the new rules significantly change the criteria that would have to be met to classify an asset as held-for-sale. The new rules also supersede the provisions of Accounting Principles Board Opinion No. 30, Reporting

Table of Contents

the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, with regard to reporting the effects of a disposal of a segment of a business and require expected future operating losses from discontinued operations to be displayed in discontinued operations in the period(s) in which the losses are incurred. SFAS 144 is effective in fiscal 2003, and is not expected to have a material impact on Invivo s consolidated financial statements.

In April 2002, the FASB issued SFAS No. 145, Recision of SFAS Nos. 4, 44 and 64, Amendment of SFAS 13, and Technical Corrections as of April 2000 (SFAS 145). SFAS 145 revises the criteria for classifying the extinguishments of debt as extraordinary and the accounting treatment of certain lease modifications. SFAS 145 is effective in fiscal 2003, and is not expected to have a material impact on the Company s consolidated financial statements.

On July 30, 2002, the FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities (SFAS 146). SFAS 146 establishes accounting guidelines for the recognition and measurement of a liability for the cost associated with an exit or disposal activity initially at its fair value in the period in which the liability is incurred, rather than at the date of a commitment to an exit or disposal plan. This standard is effective January 1, 2003 for all exit or disposal activities initiated after that date.

(2) Discontinued Operations

(a) Sierra Precision

On May 10, 2002, the Company completed its sale of substantially all of the assets and the transfer of certain liabilities of Sierra Precision, a wholly-owned subsidiary of the Company, to 3D Instruments, LLC (3D Instruments). Sierra Precision is a manufacturer of gauges that monitor and control oxygen flow for safety, industrial and governmental markets. The final sales price was approximately $4.9 million, of which $170,000 is being held in escrow for a period of 120 days as collateral with respect to the satisfaction of certain conditions. In addition, the Company entered into an agreement to not compete with the business of Sierra Precision for a period of three years. The Sierra Precision subsidiary has been accounted for as a discontinued operation. Accordingly, Sierra Precision s current and non-current assets have been segregated from continuing operations in the fiscal 2001 consolidated balance sheet, and its operating results have been segregated and reported as discontinued operations in the accompanying consolidated statements of income and cash flows, and related notes. Excluded from the transaction were substantially all the liabilities of Sierra Precision. In conjunction with the planned discontinuance of operations, the Company recorded in the third quarter ended March 31, 2002 a provision for disposition of $287,300 (net of income tax benefit of $223,100) for the loss, including transaction costs estimated to be incurred in the Sierra Precision disposition. At June 30, 2002, the Company revised its estimated loss on disposal of the business to $608,700 (net of income tax benefit of $401,300). Revenue from the discontinued operations of Sierra Precision for the fiscal years 2000, 2001 and 2002 was $8,031,000, $7,248,800 and $5,624,400, respectively. Income from the discontinued operations of Sierra Precision for fiscal 2000, 2001 and 2002 was $1,033,300, $572,000 and $24,700, respectively.

The assets of the discontinued operations of Sierra Precision have been recorded at their estimated net realizable value as current assets of discontinued operations or non-current assets of discontinued operations in the accompanying consolidated balance sheet at June 30, 2001 and consist of the following:

	June 30, 2001
Current assets:	
Cash	$ 1,000
Accounts receivable	1,622,900
Inventory	2,692,400
Other	26,000
	4,342,300
Property and equipment, net	1,287,200
Other	18,000
Total Assets	$ 5,647,500

(b) Lumidor Safety Corporation

On May 30, 2002, the Company sold substantially all of the assets and transferred certain liabilities of Lumidor Safety Corporation (Lumidor), a wholly-owned subsidiary of the Company, to Zellweger Analytics, Inc. Lumidor is a manufacturer of portable and fixed gas detection instrumentation for worker safety. The final sales price was approximately $12 million, of which $1.35 million is being held in escrow for a period of one year to secure indemnification obligations of Lumidor. In addition, the Company entered into an agreement not to compete with the business of Lumidor for a period of five years. The Lumidor subsidiary has been accounted for as a discontinued operation. Accordingly, Lumidor s current and non-current assets and liabilities have been segregated from continuing

Table of Contents

operations in the fiscal 2001 consolidated balance sheet, and its operating results have been segregated and reported as discontinued operations in the accompanying consolidated statements of income and cash flows, and related notes. For fiscal 2002, the Company recorded a gain on the disposal of the business at $4,112,000 (net of income tax of $2,291,100). Revenue from the discontinued operations of Lumidor for the fiscal years 2000, 2001 and 2002 was $8,085,500, $8,976,700 and $6,551,000, respectively. Income from the discontinued operations of Lumidor for fiscal 2000, 2001 and 2002 was $1,328,500, $1,085,700 and $141,300, respectively.

The assets and liabilities of the discontinued operation have been recorded at their estimated net realizable value as current assets and liabilities of discontinued operations or non-current assets of discontinued operations in the accompanying consolidated balance sheet at June 30, 2001 and consist of the following:

	June 30, 2001
Current assets:	
Cash	8,900
Accounts receivable	2,385,300
Inventory	1,986,900
	4,381,100
Non-current assets:	
Property and equipment, net	410,000
Intangible assets	378,600
Other	15,000
Total assets	5,184,700
Current liabilities	
Accounts payable	292,100
Accrued expenses	142,800
Other	143,900
Total liabilities	578,800

(3) Short-Term Investments

Short-term investments consist of the following:

	Cost	Unrealized holding gains (losses)	Fair value
As of June 30, 2002:			
Municipal and corporate bonds	$18,076,000	12,600	18,088,600
Mutual bond funds	8,000,200	(13,500)	7,986,700
Money market funds	2,790,000		2,790,000
	28,866,200	(900)	28,865,300
As of June 30, 2001:			
Money market funds	$ 9,091,300		9,091,300

Table of Contents

(4) Inventories

A summary of inventories as of June 30 follows:

	2002	2001
Raw materials	$3,173,700	3,133,700
Work in process	2,080,500	2,351,600
Finished goods	1,176,200	1,084,500
	$6,430,400	6,569,800

(5) Property and Equipment

A summary of property and equipment as of June 30 follows:

	2002	2001
Land and building	$ 2,852,700	2,648,500
Equipment	5,501,400	5,068,500
Furniture and fixtures	1,235,900	1,190,500
Vehicles	39,900	39,900
Leased improvements	415,300	37,000
	10,045,200	8,984,400
Less accumulated depreciation and amortization	(4,569,200)	(4,283,600)
	$ 5,476,000	4,700,800

(6) Borrowings

A summary of debt and bank borrowings as of June 30 follows:

	2002	2001
Term loan payable in monthly installments of approximately $9,400, including interest at LIBOR plus 2% (3.84 % as of June 30, 2002); secured by land and building	$1,577,200	1,679,600
Less current portion	(113,300)	(113,300)
	$1,463,900	1,566,300

The aggregate maturities of long-term debt as of June 30, 2001 are as follows:

Year ending June 30:	
2003	$ 113,300
2004	113,300
2005	113,300
2006	113,300
2007	113,300
Thereafter	1,010,700

$1,577,200

Table of Contents

During fiscal year 2002, the Company renewed its bank line of credit from December 1, 2001 to December 1, 2002. The revolving line of credit requires the Company to maintain a minimum tangible net worth, a maximum ratio of total liabilities to tangible net worth, a minimum working capital balance, and quarterly and annual profitability, and prohibits the Company from paying dividends. As of June 30, 2002, $1,000,000 was available under the line of credit.

(7) Accrued Expenses

A summary of accrued expenses as of June 30 follows:

	2002	2001
Accrued compensation and benefits	$4,467,200	1,677,700
Other	1,578,700	1,578,800
	$6,045,900	3,256,500

(8) Lease Commitments

The Company leases certain facilities and equipment under operating leases. The facilities leases require the Company to pay certain executory costs such as taxes, insurance, and maintenance. Rent expense related to operating leases was approximately $639,818, $498,000 and $566,200 for the years ended June 30, 2002, 2001 and 2000, respectively.

A summary of future minimum lease payments required under noncancelable leases with terms in excess of one year, net of sublease rental income, as of June 30, 2002 follows:

	Operating leases
Fiscal year ending June 30:	
2003	673,000
2004	688,200
2005	698,400
2006	543,500
2007	262,900
Thereafter	982,600
	$3,848,600

(9) Other Income and Expense

A summary of other, net as of June 30 follows:

	2002	2001	2000
Gain on sale of securities			834,000
Settlement of lawsuit		450,000	
Other	(27,500)	(23,700)	2,400
	(27,500)	426,300	836,400

Table of Contents

(10) Income Taxes

Total income taxes for the years ended June 30, 2002, 2001, and 2000 were allocated as follows:

	2002	2001	2000
Income from continuing operations	1,133,100	694,600	1,314,300
Discontinued operations	2,252,200	923,600	941,300
	3,385,300	1,618,200	2,255,600

A summary of the components of income tax expense (benefit) attributable to income from continuing operations for the years ended June 30 is as follows:

	Current	Deferred	Total
2002:			
Federal	$ 570,100	296,100	866,200
Foreign	3,400		3,400
State	231,600	31,900	263,500
	$ 805,100	328,000	1,133,100
2001:			
Federal	$ 258,100	371,500	629,600
State	50,200	14,800	65,000
	$ 308,300	386,300	694,600
2000:			
Federal	$1,331,900	(225,000)	1,106,900
State	138,100	69,300	207,400
	$1,470,000	(155,700)	1,314,300

The effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities as of June 30 are as follows:

	2002	2001
Deferred tax assets:		
Reserves and other accruals	$1,131,400	1,013,300
State taxes	31,400	
Gross deferred tax assets	1,162,800	1,013,300
Valuation allowance		
Total deferred tax assets, less valuation allowance	1,162,800	1,013,300
Deferred tax liabilities:		
Tax depreciation in excess of book depreciation	(550,400)	(276,300)
Deferred revenue relating to Lumidor escrow	(325,000)	

State taxes		(3,400)
Total deferred tax liabilities	(875,400)	(279,700)
Net deferred tax asset	$ 287,400	733,600

Table of Contents

Management believes that it is more likely than not that the results of future operations will generate sufficient taxable income to realize the net deferred tax asset, or that the amounts will be recovered from previously paid taxes. Therefore no valuation allowance against deferred tax assets is needed.

Income Tax expense attributable to income from continuing operations was $1,133,100, $694,600, and $1,314,300, for the years ended June 30, 2002, 2001, and 2000, respectively, and differed from the amounts computed by applying the U.S. federal income tax rate of 34% to pretax income from continuing operations as a result of the following:

	2002	2001	2000
Federal income tax at statutory rate	$1,136,000	710,900	1,460,900
State income taxes	173,900	42,900	136,900
Utilization of research, experimental, and other credits	(78,700)	(136,300)	(78,000)
Benefit of foreign sales corporation	(141,900)	(92,800)	(174,300)
Nondeductible goodwill		328,200	88,100
Meals and entertainment	22,200	29,500	70,500
Decrease in valuation allowance on capital loss carryforward		(173,300)	
Federal tax exempt interest income	(8,900)		
Other	(28,200)	(14,500)	(50,800)
Adjustment of prior year s taxes	58,700		(139,000)
	$1,133,100	694,600	1,314,300

(11) Stock Option Plan

The Company has established stock option plans to provide for the granting of stock options to employees (including officers and directors) at prices not less than the fair market value of the Company s common stock at the date of grant. Options vest ratably over four years and expire in ten years. The Company has reserved 37,800 and 1,020,000 shares of its common stock for issuance under the 1986 and 1994 plans, respectively. During 2002, the Company granted 203,800 options to purchase shares of common stock.

Pro forma information regarding net income and net income per share is required by SFAS No. 123, and has been determined as if the Company had accounted for the plans under the fair-value method. The fair value of options issued under the plans was determined at the date of grant using a Black-Scholes option pricing model with the following assumptions: no dividend yield; volatility factor of the expected market price of the Company s stock of 74% per SFAS 123 worksheets; a forfeiture rate of 5%; a weighted-average expected life of options of five years; and a risk-free interest rate of 4.44%, 5.31% and 6.20% for 2002, 2001 and 2000, respectively. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options vesting period. The Company s pro forma net income and net income per common share would approximate the following:

		2002	2001	2000
Net income	As reported	$5,624,500	3,054,100	4,966,900
	Pro forma	4,686,400	2,098,200	4,140,300
Basic net income per share	As reported	1.27	.69	1.15
	Pro forma	1.06	.48	0.96
Diluted net income per share	As reported	1.23	.68	1.10
	Pro forma	1.02	.47	0.92

Table of Contents

A summary of stock option activity for the years ended June 30, 2002, 2001 and 2000 follows:

	Shares Available for Grant	Options	Weighted-average exercise price	Weighted-average grant date fair value	Options exercisable at year end	Weighted-average exercise price of options exercisable at year end
June 30, 1999	325	763,825	8.89		426,575	6.96
Reserved	200,000					
Granted	(186,850)	186,850	10.03	6.32		
Exercised		(82,425)	2.18			
Canceled	19,575	(19,575)	11.25			
June 30, 2000	33,050	848,675	6.94		466,575	8.83
Reserved						
Granted	(55,600)	55,600	8.81	5.37		
Exercised		(60,250)	3.05			
Canceled	32,350	(32,350)	11.25			
June 30, 2001	9,800	811,675	10.11		574,150	9.99
Reserved	220,000					
Granted	(203,800)	203,800	11.74			
Exercised		(11,750)	6.92			
Canceled	6,300	(6,300)	10.81			
June 30, 2002	32,300	997,425	10.48	7.47	632,975	10.15

Range of exercise prices	Number outstanding as of June 30, 2002	Weighted-average remaining contractual life	Weighted average exercise price	Number exercisable as of June 30, 2002	Weighted-average exercise price
$ 2.00-5.130	37,800	.54	$ 4.60	37,800	$ 4.60
7.00-9.875	239,625	6.15	8.97	157,250	8.50
10.00-16.130	720,000	7.03	11.29	437,925	11.22
	997,425	6.57	10.48	632,975	10.15

(12) Salary Deferral Plan

The Company s executive officers, together with all other eligible employees, may participate in the Company s 401(k) Salary Deferral Plan (the Plan). Employees become eligible upon completion of six months of service. Each eligible employee receives a retirement benefit based upon accumulated contributions to the Plan by the employee and the Company plus any earnings on such contributions. The Company contributes an amount equal to 35% of the first 4% of compensation which the employee contributes. The Plan currently provides that participants vest 25% each year over a four-year period. Company contributions to the Plan for the years ended December 31, 2001 and 2000 were $132,500 and $120,400, respectively.

(13) Legal Proceedings

The Company s medical device subsidiary, Invivo Research, was one of two third-party defendants named in a lawsuit in June of 1994 by Southern Nevada Surgical Center and Surgex Southern Nevada, Inc. in Nevada State District Court. The underlying action in this matter stemmed from an incident involving a surgical patient undergoing a procedure at the Southern Nevada Surgical Center. The patient suffered a serious permanent brain injury. A lawsuit was filed on behalf of the patient against the surgical center and the anesthesiologist who monitored the patient. The defendants in that action made a substantial settlement to the patient. Southern Nevada Surgical Center (SNSC) and Surgex were seeking indemnity and contribution of

Table of Contents

approximately $14 million from the manufacturer of the anesthetic gas machine and Invivo Research, which manufactured the vital signs monitor used in this procedure. SNSC and Surgex alleged that both the anesthetic gas machine and the vital signs monitor were defective. The Company believes that the vital signs monitor operated properly and was properly designed for its intended function.

On August 18, 1999, the Nevada District Court granted the Company s Motion to Dismiss for Failure to Prosecute. The Order granted dismissal of the SNSC and Surgex contribution claims, without prejudice, based upon Nevada law that provides that an action must be brought to trial within five years of the date of the filing of the original action. The dismissal is being appealed.

In April of 1997, the plaintiff s insurer, CNA, filed an action with identical causes in the same Nevada State Court. This second action was removed by the Company to U.S. District Court. The action by CNA was dismissed by the District Court on January 19, 2000 as the District Court found CNA did not have standing as the real party of interest. CNA appealed the decision to the Ninth Circuit Court of Appeals. A three-member panel of the Ninth Circuit reversed the dismissal and remanded the case back to Federal District Court on July 30, 2001. The Company appealed this decision and requested a decision from the full panel of the Ninth Circuit. The Ninth Circuit, without issuing an opinion, unanimously voted to deny the Petition for Rehearing in this matter. The action has been remanded to the U.S. District Court for further proceedings.

Any judgment against the Company that exceeds the amount that its insurer is required to pay could have a material adverse effect on its business and results of operations.

(14) Major Customers and Credit Risk

In fiscal 2002, one customer accounted for greater than 10% of the Company s revenues or trade accounts receivable. In fiscal 2001 and 2000, no individual customer accounted for greater than 10% of the Company s revenues or trade accounts receivable.

The Company has a customer base that is diverse geographically and by industry. Customer credit evaluations are performed on an ongoing basis, and collateral is generally not required for trade accounts receivable. Management does not believe the Company has any significant concentration of credit risk as of June 30, 2002.

(15) Net Income per Common Share

The following table presents the calculation for basic and diluted net income per common share:

	For the fiscal year ended June 30,		
	2002	2001	2000
Basic:			
Weighed-average common shares outstanding	4,427,185	4,402,760	4,328,897
Net income	$5,624,500	3,054,100	4,966,900
Basic net income per common share	$ 1.27	0.69	1.15
Diluted:			
Weighed-average common shares outstanding (basic)	4,427,185	4,402,760	4,328,897
Dilutive stock options	153,468	73,254	168,593
Weighted-average common shares outstanding (diluted)	4,580,653	4,476,014	4,497,490
Net income	$5,624,500	3,054,100	4,966,900
	$ 1.23	0.68	1.10

Diluted net income per common share			

For the years ended June 30, 2002, 2001 and 2000, options to purchase 30,500, 642,350 and 349,300 shares of common stock, respectively, were outstanding but were not included in the computation of net income per common share - assuming dilution, because the options' exercise prices were greater that the average market price of the common shares.

Table of Contents

(16) Segment Information

The Company has adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 131, Disclosure About Segments of an Enterprise and Related Information. SFAS 131 establishes standards for the reporting by public business enterprises of information about operating segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the way that management organizes the operating segments within the Company for making operating decisions and assessing financial performance. As a result of the sales of Sierra Precision and Lumidor in our industrial instrumentation segment, the Company currently operates in one segment.

The Company markets its products in the United States and in foreign countries through its sales personnel and distributors. Export sales account for a portion of the Company s net revenue and are approximately summarized by geographic area as follows (in thousands):

	Year ended June 30,		
	2002	2001	2000
United States	$31,200	27,900	26,700
Export:			
Europe	5,600	5,700	5,400
Pacific Rim	3,300	3,100	3,900
Other International	2,000	1,400	600
Total net sales	$42,100	38,100	36,600

(17) Supplemental Cash Flow Information

Noncash investing and financing activities and supplemental cash flow information are summarized as follows:

	Year ended June 30,		
	2002	2000	2000
Cash paid:			
Income taxes	1,172,400	2,186,000	2,109,000
Interest	79,800	114,700	137,000

Table of Contents

SELECTED QUARTERLY FINANCIAL DATA (NOT COVERED BY REPORT OF INDEPENDENT ACCOUNTANTS):

In thousands, except per share amounts	1ST QTR	2ND QTR	3RD QTR	4TH QTR
FISCAL YEAR 2002				
Sales	$9,573	10,246	10,907	11,362
Gross Profit	5,028	5,600	5,692	5,776
Net Income	703	766	230	3,926
Net Income per common share (basic)	0.16	0.17	0.05	0.89
Net Income per common share (diluted)	0.16	0.17	0.05	0.85
FISCAL YEAR 2001				
Sales	$8,751	9,172	9,728	10,402
Gross Profit	4,743	4,908	5,078	5,425
Net Income	845	881	485	844
Net Income per common share (basic)	0.19	0.20	0.11	0.19
Net Income per common share (diluted)	0.19	0.20	0.11	0.19

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10.

The information required is incorporated by reference from the Company s definitive proxy statement for the Company s 2002 Annual Meeting of Stockholders.

ITEM 11.

The information required is incorporated by reference from the Company s definitive proxy statement for the Company s 2002 Annual Meeting of Stockholders.

ITEM 12.

The information required is incorporated by reference from the Company s definitive proxy statement for the Company s 2002 Annual Meeting of Stockholders.

ITEM 13.

The information required is incorporated by reference from the Company s definitive proxy statement for the Company s 2002 Annual Meeting of Stockholders.

Table of Contents

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

EXHIBIT INDEX

NUMBER	DESCRIPTION OF DOCUMENT
3.01	Restated Certificate of Incorporation of the Registrant(1)
3.02	Restated By-Laws of the Registrant(2)
4.01	Form of Common Stock Certificate(2)
10.01	Sensor Control Corporation 1986 Incentive Stock Option Plan and 1986 Non-statutory Stock Option Plan, as amended(3)
10.02	Indemnity Agreement(2)
10.03	SafetyTek 1994 Stock Option Plan(4)
10.04	Credit Agreement between Wells Fargo Bank and Invivo Corp. dated October 6, 1998(5)
10.05	First Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated November 1, 1998(5)
10.06	Stock Option Agreement with Walden Management Corporation Pension Fund for the Benefit of George S. Sarlo(1)
10.07	Second Amendment to Credit Agreement between Invivo Corp. and

Wells Fargo Bank dated December 1, 1999(6)10.08 Third Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated May 15, 2000(7)10.09 First Amendment to Lease between Miramar Flexspace Ltd. and Invivo Corporation dated June 12, 2000(7)10.10 Lease between Sierra Precision and Capellino/Galleano dated June 7, 2000(7)10.11 First Amendment to Lease between Sierra Precision and Capellino/Galleano dated July 12, 2000(7)10.12 Fourth Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated December 1, 2000(8)10.13 First Amendment to Lease between Principal Life insurance Company and Invivo Corporation dated February 26, 2001(9)10.14 Lease between Arcadia Management Services and Invivo Corporation dated November 29, 2000(9)10.15 Note and Mortgage Modification Agreement and Notice of Future Advance between Suntrust Bank and Invivo Research Inc. dated May 30, 2001(10)10.16 Fifth Amendment to Credit Agreement between

Invivo Corp. and Wells Fargo Bank dated March 2, 2001**10.17 Sixth Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated December 1, 2001(11)10.18 Seventh Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated April 16, 2002(12)10.19 Asset Purchase Agreement dated April 20, 2002 by and among 3D Instruments, LLC and Sierra Precision and Invivo Corporation(11)

Table of Contents

NUMBER	DESCRIPTION OF DOCUMENT
10.20	Asset Purchase Agreement dated as of May 30, 2002, by and between Lumidor Safety Corporation and Zellweger Analytics, Inc. and Invivo Corporation(13)
10.21	Eighth Amendment to Credit Agreement between Invivo Corp. and Wells Fargo Bank dated May 29, 2002**
10.22	Amended and Restated Employment Agreement for James B. Hawkins**
10.23	Amended and Restated Employment Agreement for John F. Glenn**
10.24	Amended and Restated Employment Agreement for Stuart Baumgarten**
21.01	Subsidiaries of Registrant**
23.01	Consent of KPMG LLP**
99.01	Certification of Chief Executive Officer and Chief Financial Officer pursuant to pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

** Filed herewith

(1) Incorporated by reference to corresponding Exhibit included with Registrant s Registration Statement on Form S-2 filed on March 9, 1999. (File No. 333-72071)(2) Incorporated by reference to corresponding Exhibit included with Registrant s Form 10-K filed September 28, 1990. (File No. 0-15963)(3) Incorporated by reference to corresponding Exhibit included with Registrant s Form 8-K filed January 28, 1991. (File No. 0-15963)(4) Incorporated by reference to corresponding Exhibit included with Registrant s Form S-8 filed January 27, 1995. (File No. 33-88798)(5) Incorporated by reference to corresponding Exhibit included with Registrant s Form 10-Q filed November 12, 1998. (File No. 0-15963)(6) Incorporated by reference to corresponding Exhibit included with Registrant s Form 10-Q filed February 14, 2000. (File No. 0-15963)(7) Incorporated by reference to corresponding Exhibit included with Registrant s Form 10-K filed September 26, 2000. (File No. 0-15963)(8) Incorporated by reference to corresponding Exhibit included

with Registrant s
Form 10-Q filed
February 14,
2001. (File
No. 0-15963)(9) Incorporated
by reference to
corresponding
Exhibit included
with Registrant s
Form 10-Q filed
April 15, 2001.
(File
No. 0-15963)(10) Incorporated
by reference to
corresponding
Exhibit included
with Registrant s
Form 10-K filed
September 28,
2001 (File
No. 0-15963)(11) Incorporated
by reference to
corresponding
Exhibit included
with Registrant s
Form 10-Q filed
February 14,
2002. (File
No. 0-15963(12) Incorporated
by reference to
corresponding
Exhibit included
with Registrant s
Form 10-Q filed
May 15, 2002.
(File
No. 0-15963(13) Incorporated
by reference to
corresponding
Exhibit included
with Registrant s
Form 8-K filed
June 14, 2002.
(File
No. 0-15963

Table of Contents

(B) FINANCIAL STATEMENT SCHEDULES

Invivo Corporation and Subsidiaries

Schedule II

Valuation and Qualifying Accounts
Years ended June 30, 2002, 2001 and 2000

	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions(1)	Balance at end of Year
Allowance for doubtful accounts(1)				
Fiscal 2002	441,000	112,700	223,200	330,500
Fiscal 2001	471,400	205,900	236,300	441,000
Fiscal 2000	208,100	491,300	228,000	471,400
Warranty Reserve				
Fiscal 2002	330,400	489,500	399,500	420,400
Fiscal 2001	310,400	448,100	428,100	330,400
Fiscal 2000	218,000	330,800	238,400	310,400

(1) Deductions as a result of write-offs

(C) REPORTS ON FORM 8-K

(1) Current Report on Form 8-K dated April 23, 2002 reporting the Company had entered into a definitive agreement with 3D Instruments, LLC to sell the assets of Sierra Precision. A copy of the press release was filed as Exhibit 99.1 to the report.

(2) Current Report on Form 8-K dated May 30, 2002 reporting the Company had sold the assets and transferred certain liabilities of Lumidor Safety Corporation to Zellweger Analytics, Inc. A copy of the press release was filed as Exhibit 99.1 to the report.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

Invivo Corporation

/s/ John F. Glenn

John F. Glenn
Vice President-Finance\
Chief Financial Officer

September 27, 2002

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Ernest C. Goggio Ernest C. Goggio	Chairman of the Board	September 27, 2002
/s/ James B. Hawkins James B. Hawkins	President, Chief Executive Officer, Director (principal executive officer)	September 27, 2002
/s/ John F. Glenn John F. Glenn	Chief Financial Officer (principal financial and accounting officer)	September 27, 2002
/s/ Laureen DeBuono Laureen DeBuono	Director	September 27, 2002
/s/ George S. Sarlo George S. Sarlo	Director	September 27, 2002

Table of Contents

CHIEF EXECUTIVE OFFICER CERTIFICATION

I, James B. Hawkins, President and Chief Executive Officer of Invivo Corporation certify that:

1. I have reviewed this Annual Report on Form 10-K of Invivo Corporation (the Registrant);

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

3. Based on my knowledge, the financial statements, and other financial Information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Annual Report.

Table of Contents

CHIEF FINANCIAL OFFICER CERTIFICATION

I, John F. Glenn, Vice President of Finance and Chief Financial Officer of Invivo Corporation certify that:

1. I have reviewed this Annual Report on Form 10-K of Invivo Corporation (the Registrant);

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

3. Based on my knowledge, the financial statements, and other financial Information included in this Annual Report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this Annual Report.

/S/ John F. Glenn

John F. Glenn
Dated: 9/27/02