

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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**FORM 10-Q**

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

For the quarterly period ended October 3, 1999

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21794

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**GENZYME TRANSGENICS CORPORATION**

(Exact name of registrant as specified in its charter)

Massachusetts	04-3186494
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

175 Crossing Boulevard, Suite 410, Framingham, Massachusetts	01702
(Address of principal executive offices)	(Zip Code)

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(508) 620-9700

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Registrant's telephone number, including area code

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

<u>Class</u>	<u>Outstanding at November 5, 1999</u>
Common Stock, \$0.01 par value	20,830,430

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**GENZYME TRANSGENICS CORPORATION**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(Unaudited, dollars in thousands except per share amounts)

	<u>October 3, 1999</u>	<u>January 3, 1999</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 5,577	\$ 11,740
Accounts receivable, net of allowance of \$815 and \$487	11,031	12,334
Unbilled contract revenue	7,989	6,847
Other current assets	2,174	1,496
Total current assets	<u>26,771</u>	<u>32,417</u>
Net property, plant and equipment	33,229	30,486
Costs in excess of net assets acquired, net	17,546	18,404
Other assets	3,315	2,030
	<u>\$ 80,861</u>	<u>\$ 83,337</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,167	\$ 2,811
Accounts payable – Genzyme Corporation	420	1,487
Due to ATIII LLC	2,573	2,418
Revolving line of credit	15,750	11,096
Accrued expenses	10,540	8,403
Advance payments	7,160	8,317
Current portion of long-term debt	2,867	2,204
Total current liabilities	<u>41,477</u>	<u>36,736</u>
Long-term debt, net of current portion	13,410	9,561
Deferred lease obligation	770	741
Other liabilities	-	95
Total liabilities	<u>55,657</u>	<u>47,133</u>
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized; 4,000,000 have been designated as Series A Convertible, of which 11,000 and 20,000 shares are issued and outstanding at October 3, 1999 and January 3, 1999, respectively (Note 4) (liquidation preference \$11,000)	-	-
Common stock, \$.01 par value; 40,000,000 shares authorized; 20,830,090 and 18,384,024 shares issued and outstanding at October 3, 1999 and January 3, 1999, respectively	208	184
Dividend on preferred stock	(1,156)	(1,156)
Capital in excess of par value – preferred stock	10,326	18,777
Capital in excess of par value – common stock	76,382	65,716
Unearned compensation	(259)	(437)
Accumulated deficit	(60,263)	(46,864)
Accumulated other comprehensive loss	(34)	(16)
Total stockholders' equity	<u>25,204</u>	<u>36,204</u>
	<u>\$ 80,861</u>	<u>\$ 83,337</u>

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

**GENZYME TRANSGENICS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited, in thousands except per share amounts)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>October 3,</u>	<u>September</u>	<u>October 3,</u>	<u>September</u>
	<u>1999</u>	<u>27,</u> <u>1998</u>	<u>1999</u>	<u>27,</u> <u>1998</u>
Revenues				
Services	\$ 14,544	\$ 13,828	\$ 41,934	\$ 37,216
Sponsored research and development	<u>5,219</u>	<u>2,703</u>	<u>11,200</u>	<u>7,479</u>
	19,763	16,531	53,134	44,695
Costs and operating expenses:				
Services	11,888	11,538	35,472	31,751
Research and development				
Sponsored	3,017	2,983	7,805	7,115
Proprietary	1,169	1,597	3,347	4,999
Selling, general and administrative	4,912	3,869	14,616	11,955
Facility consolidation costs	1,245	-	1,245	-
Equity in loss of joint venture	<u>853</u>	<u>993</u>	<u>2,696</u>	<u>2,717</u>
	<u>23,084</u>	<u>20,980</u>	<u>65,181</u>	<u>58,537</u>
Loss from operations	(3,321)		(12,047)	
		(4,449)		(13,842)
Other income (expense):				
Interest income	19	121	39	231
Interest expense			(1,668)	
	(654)	(298)		(1,054)
Other income	<u>—</u>		<u>484</u>	<u>100</u>
	=	=		
Loss before income taxes	(3,956)		(13,192)	
		(4,6		(14,565)
Provision (benefit) for income taxes	<u>48</u>	<u>-</u>	<u>207</u>	<u>(10)</u>
Net loss	\$ (4,004)	\$ (4,6	\$ (13,399)	\$ (14,555)
Dividend to preferred shareholders				<u>(1,156)</u>
	=	=	=	
Net loss available to common shareholders	<u>\$ (4,004)</u>	<u>\$ (4,626)</u>	<u>\$ (13,399)</u>	<u>\$ (15,711)</u>
Net loss per common share (basic and diluted)	<u>\$ (0.</u>	<u>\$ (0.</u>	<u>\$ (0.</u>	<u>\$ (0.</u>
Weighted average number of shares outstanding (basic and diluted)	<u>20,150</u>	<u>18,262</u>	<u>19,356</u>	<u>17,857</u>
Comprehensive loss:				



Other long-term liabilities	<u>(66)</u>	<u>(65)</u>
Net cash provided by financing activities	<u>8,139</u>	<u>17,925</u>
Net increase (decrease) in cash and cash equivalents	(6,163)	3,836
Cash and cash equivalents at beginning of the period	<u>11,740</u>	<u>6,383</u>
Cash and cash equivalents at end of the period	\$ <u>5,577</u>	\$ <u>10,219</u>
Noncash Investing and Financing Activities:		
Property acquired under capital leases	\$ 1,781	\$ 1,167
Receipt of stock for Accounts Receivable and Advance Payment	-	583
Technology license acquired by issuance of stock	1,000	-

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

**GENZYME TRANSGENICS CORPORATION AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

1. Basis of Presentation:

These unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended January 3, 1999 and the financial statements and footnotes included therein. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to Securities and Exchange Commission rules and regulations.

The financial statements for the nine months ended October 3, 1999 and September 27, 1998 are unaudited but include, in the Company's opinion, all adjustments (consisting only of normally recurring accruals) necessary for a fair presentation of the results for the periods presented.

2. Accounting Policies:

The accounting policies underlying the quarterly financial statements are those set forth in Note 2 of the financial statements included in the Company's Annual Report on Form 10-K for the year ended January 3, 1999.

Per share information is based upon weighted average number of shares of Common Stock outstanding during the period. Common stock equivalents consisting of warrants, stock options and convertible preferred stock, totaled 5.5 million and 4.5 million shares at October 3, 1999 and September 27, 1998, respectively. Since the Company incurred a net loss for the period ending October 3, 1999 and September 27, 1998, these common stock equivalents were not used to compute diluted loss per share, as the effect was antidilutive.

Included in the net loss is an equity in loss of joint venture of \$2,696,000 which represents the Company's commitment to fund 30% of the losses and capital expenditures incurred in 1999 of the joint venture between the Company and Genzyme Corporation ("ATIII LLC"). Total net losses of the ATIII LLC in the first nine months of 1999 were \$8.6 million, and the ATIII LLC did not record any revenues.

3. Income Taxes:

Due to the profitability of some of its contract research laboratories in certain states, the Company has recorded a state provision for income taxes for the period ended October 3, 1999.

4. Preferred Stock Conversion:

During 1999, several institutional investors converted 9,000 shares of the Series A Convertible Preferred Stock (the "Series A Preferred Stock"), \$.01 par value per share, into 1,927,503 shares of the Company's common stock at conversion prices ranging from \$3.34 to \$5.98 per share. The conversion prices represented the average of the five lowest bid prices of the prior 20 trading days before conversion. After these conversions, 11,000 shares of the Series A Preferred Stock remained outstanding.

5. Segment Information:

Below is the Company's segment information for its two reportable segments: Contract research organization ("Primedica") and research and development ("Transgenics"). During 1999, the Company began to allocate certain corporate expenses to the Primedica segment in its evaluation of the segment's loss from operations. Certain reclassifications have been made to prior year's numbers to conform to 1999 classifications.

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>October 3, 1999</u>	<u>September 27, 1998</u>	<u>October 3, 1999</u>	<u>September 27, 1998</u>
Revenues:				
Primedica - external customers	\$ 14,544	\$ 13,828	\$ 41,934	\$ 37,216
Primedica - intersegment	332	666	1,108	1,556
Transgenics	5,219	2,703	11,200	7,479
	<u>20,095</u>	<u>17,197</u>	<u>54,242</u>	<u>46,251</u>
Elimination of intersegment revenues			(1,108)	
	<u>(332)</u>	<u>(666)</u>		<u>(1,556)</u>
	<u>\$ 19,763</u>	<u>\$ 16,531</u>	<u>\$ 53,134</u>	<u>\$ 44,695</u>
Loss from operations:				
Primedica	\$ (36)	\$ (76)	\$ (1,313)	\$ (1,742)
Transgenics	(17)	(2,719)	(3,307)	(7,397)
Unallocated amounts:				
Corporate expenses	(2,415)	(661)	(4,731)	(1,986)
Equity in loss of joint venture	(853)	(993)	(2,696)	(2,717)
	<u>\$ (3,321)</u>	<u>\$ (4,449)</u>	<u>\$ (12,047)</u>	<u>\$ (13,842)</u>

6. ACT License Agreement:

In June 1999, the Company entered into an Exclusive License and Development Agreement ("the Agreement") with Advanced Cell Technology, Inc. ("ACT").

The Company paid \$1,750,000 to ACT in consideration of the license granted to the Company from ACT. Of the amount paid, \$1million was in the form of 216,798 shares of the Company's common stock and \$750,000 was in cash. The number of shares issued was based on a price of \$4.61 per share, which was the fair market value at that time. Since the licensed technology is being used in research and development and to generate research and development revenues, the Company has capitalized the amount paid for the license fee as Other Assets which is being amortized over ten years based on its estimated economic life. Additionally, the Company paid ACT \$250,000 in cash as an advance payment which shall be fully creditable against ACT services for which parties have separately contracted, milestone payments, royalties, sublicense revenues or other payments payable or to become payable to ACT from the Company.

7. Facility Lease:

On March 26, 1999, the Company entered into a seven year facility lease for 12,468 square feet located in Framingham, Massachusetts. The monthly payment is \$26,945 for years one and two, \$27,534 for years three and four and \$28,573 for years five through seven.

8. Pharming Cross-License Agreement – Second Amendment:

On August 31, 1999, the Company entered into a Second Amendment (“Amendment”) with Pharming Group N.V. (“Pharming”). The Company paid a license fee of \$750,000 to Pharming which was recorded as research and development expense. Additionally, the Company has agreed to pay an annual maintenance fee, milestone payments and royalties on hSA-related income for any products that receive marketing approval.

9. Facility Consolidation:

In September 1999, the Company incurred costs of \$1,245,000 relating to the consolidation of certain facilities. The consolidation is expected to be completed by the end of fiscal 1999, therefore all costs are included in Accrued Expenses at October 3, 1999. Costs consisted of facility closure costs of \$740,000 and severance and employee related costs of \$505,000. The facility closure costs include write-offs of leasehold improvements of \$415,000 and rental and lease termination costs to be incurred after the consolidation of \$325,000. The rental and lease termination costs are expected to be paid through December of 2003. Severance costs related to the elimination of 20 positions of which 12 were laboratory positions, one was accounting/finance and seven were general and administrative positions. The total severance is to be paid through 2000.

10. Subsequent Event:

On November 12, 1999, the Company issued a redemption call on the outstanding \$11.0 million of Series A Preferred Stock. Under the redemption terms, the holders of the Series A Preferred Stock have five business days in which to convert the preferred shares into Common Stock or be redeemed at par plus 15%.

In conjunction with the redemption call, the Company will issue up to \$12.5 million of Series B Convertible Preferred Stock ("Series B Preferred Stock") to Genzyme. The Series B Preferred Stock carries an initial 11% dividend which increases to 12% effective July 1, 2000 and is convertible by the holder into Common Stock at a fixed rate of \$6.30 per common share. All accumulated or accrued and unpaid dividends will be paid upon conversion, liquidation or redemptions of the Series B Preferred Stock. The Company has the sole right to redeem the Series B Preferred Stock for cash at any time at its original value plus accrued dividends. Genzyme has the right to require redemption only under circumstances involving new permanent equity being invested in the Company. The Company will issue Series B Preferred Stock only to the extent needed to fund redemption of the Series A Preferred Stock.

In connection with signing the agreement to purchase the Series B Preferred Stock, the Company also issued to Genzyme a 10-year warrant to purchase 55,833 shares of the Company's Common Stock at an exercise price of \$6.30 per share. Additionally, upon the closing of the investment, an up to 55,833 additional warrant with similar terms will be issued based upon the amount of Series B Preferred Stock actually issued. Finally, if any shares of Series B Preferred Stock remain outstanding, on July 1, 2000, up to 55,833 warrants exercisable at the then-current market price for the Company's Common Stock will be issued based upon the amount of Series B Preferred then outstanding.

The Company will record a dividend to preferred shareholders in the fourth quarter of 1999 relating to this transaction.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### RESULTS OF OPERATIONS

*Three months ended October 3, 1999 and September 27, 1998*

Total revenues for the three-month period ending October 3, 1999 were \$19.8 million, compared with \$16.5 million in the comparable period of 1998, an increase of \$3.3 million or 20%. Service revenues increased to \$14.5 million in the third quarter of 1999 from \$13.8 million in the third quarter of 1998, an increase of \$700,000 or 5%. Research and development revenue increased to \$5.2 million in the third quarter of 1999 from \$2.7 million in the third quarter of 1998, an increase of \$2.5 million or 93%. The increase is primarily a result of a \$3.5 million milestone payment earned during the third quarter of 1999 in association with a program to produce human serum albumin ("the hSA program") in transgenic cattle offset by success fees earned on other programs during the third quarter of 1998.

Cost of services for the third quarter of 1999 were \$11.9 million compared to \$11.5 million in the comparable period of 1998, an increase of \$400,000 or 3.0%, due to the increase in revenues. Sponsored research and development expenses were \$3 million in both the third quarter of 1999 and the third quarter of 1998. Proprietary research and development expenses decreased to \$1.2 million in the third quarter of 1999 from \$1.6 million in the third quarter of 1998, a decrease of \$400,000 or 25%. The decrease is due to reduced expenditures on the cancer vaccine program.

Gross profit, defined as revenues less service costs and research and development costs, for the third quarter of 1999 amounted to a profit of \$3.7 million versus a profit of \$413,000 in the third quarter of 1998 due primarily to the increase in research and development revenues and milestones in the third quarter of 1999. Gross profit on services for the third quarter of 1999 was \$2.7 million, a gross margin of 18%, versus \$2.3 million, a gross margin of 17% in the third quarter of 1998.

Selling, general and administrative ("SG&A") expenses increased to \$4.9 million in the third quarter of 1999 from \$3.9 million in the third quarter of 1998, an increase of \$1 million or 26%. The increase is due to the increased marketing effort and to the addition of administrative personnel required to support the growth in transgenic research and development programs as well as additional patent related expenditures.

Interest income decreased to \$19,000 in the third quarter of 1999, from \$121,000 in the third quarter of 1998, due to lower funds available for investment. Interest expense increased to \$654,000 in the third quarter of 1999 from \$298,000 in the third quarter of 1998 due to increased borrowings in 1999.

The Company recognized \$853,000 of Joint Venture losses incurred on the joint venture ("ATIII LLC") between the Company and Genzyme Corporation ("Genzyme") during the third quarter of 1999 as compared to \$993,000 incurred during the third quarter of 1998.

During the third quarter of 1999, the Company recognized \$1.2 million of facility consolidation costs associated with the consolidation of Primedica's Massachusetts operations into a single facility. Costs consisted of facility closure costs of \$740,000 and severance and employee related costs of \$505,000. The facility closure costs include write-offs of leasehold improvements of \$415,000 and rental and lease termination costs to be incurred after the consolidation of \$325,000. The rental and lease termination costs are expected to be paid through December of 2003. Severance costs related to the elimination of 20 positions of which 12 were laboratory positions, one was accounting/finance and seven were general and administrative positions. The total severance is to be paid through 2000. This consolidation is expected to increase the Company's ability to perform higher margin clinical services due to the decreased capacity requirements of these services, while at the same time reducing operating expenses.

*Nine months ended October 3, 1999 and September 27, 1998*

Total revenues for the nine-month period ending October 3, 1999 were \$53.1 million, compared with \$44.7 million in the comparable period of 1998, an increase of \$8.4 million or 19%. Service revenues increased to \$41.9 million during the first nine months of 1999 from \$37.2 million in the comparable period of 1998, an increase of \$4.7 million or 13%. Research and development revenue increased to \$11.2 million during the first nine months of 1999 from \$7.5 million in the comparable period of 1998, an increase of \$3.7 million or 49%. The increase is primarily a result of a \$3.5 million milestone payment earned during the third quarter of 1999 in association with progress on the hSA program.

Cost of services during the first nine months of 1999 were \$35.5 million compared to \$31.8 million in the comparable period of 1998, an increase of \$3.7 million or 12%, due to the increase in revenues. Sponsored research and development expenses increased to \$7.8 million in the first nine months of 1999 from \$7.1 million in the comparable period of 1998, an increase of \$700,000 or 10%. The increase in expense was due to increased activity on sponsored research programs. Proprietary research and development expenses decreased to \$3.3 million in the first nine months of 1999 from \$5 million in the comparable period of 1998, a decrease of \$1.7 million or 34%. The decrease is due primarily to reduced expenditures on the cancer vaccine program and a shifting of resources to sponsored research and development.

Gross profit, defined as revenues less service costs and research and development costs, for the first nine months of 1999 increased to a profit of \$6.5 million versus \$830,000 in the comparable period of 1998 due to higher revenues and milestone payments and a decrease in proprietary costs. Gross profit on services for the first nine months of 1999 was \$6.5 million, a gross margin of 15%, versus \$5.5 million, a gross margin of 15%, in the comparable period of 1998.

Selling, general and administrative ("SG&A") expenses increased to \$14.6 million in the first nine months of 1999 from \$12.0 million in the comparable period of 1998, an increase of \$2.6 million or 22%. The increase is due to the increased marketing effort and to the addition of administrative personnel required to support the growth in transgenic research and development programs as well as additional patent related expenditures.

Interest income decreased to \$39,000 in the first nine months of 1999, from \$231,000 in the comparable period of 1998, due to lower funds available for investment. Interest expense increased to \$1.7 million in the first nine months of 1999 from \$1.1 million in the comparable period of 1998 due to increased borrowings in 1999. Other income increased to \$484,000 in the first nine months of 1999, from \$100,000 in the comparable period of 1998, due to the receipt in 1999 of an insurance settlement.

The Company recognized \$2.7 million of Joint Venture losses incurred on the joint venture (“ATIII LLC”) between the Company and Genzyme Corporation (“Genzyme”) during the first nine months of 1999 as well as during the comparable period of 1998.

During the third quarter of 1999, the Company recognized \$1.2 million of facility consolidation costs associated with the consolidation of Primedica’s Massachusetts operations into a single facility. Costs consisted of facility closure costs of \$740,000 and severance and employee related costs of \$505,000. The facility closure costs include write-offs of leasehold improvements of \$415,000 and rental and lease termination costs to be incurred after the consolidation of \$325,000. The rental and lease termination costs are expected to be paid through December of 2003. Severance costs related to the elimination of 20 positions of which 12 were laboratory positions, one was accounting/finance and seven were general and administrative positions. The total severance is to be paid through 2000. The consolidation is expected to increase the Company’s ability to perform higher margin clinical services due to the decreased capacity requirements of these services, while at the same time reducing operating expenses.

## **LIQUIDITY AND CAPITAL RESOURCES**

The Company had cash and cash equivalents of \$5.6 million at October 3, 1999. During the first nine months of 1999, the Company had a \$6.2 million net decrease in cash: \$6.7 million of cash used in operations (due primarily to the net loss of \$13.4 million and a decrease in non-cash working capital of \$749,000 offset by an increase in non-cash charges of \$7.4 million), \$4.7 million was invested in capital equipment, further expansion of the transgenic production facility and the expansion of the laboratory facilities, and \$1.9 million was used to pay down long-term debt. Sources of funds during the period included \$4.7 million in net borrowings under a commercial bank revolving line of credit, \$4.6 million of proceeds from issuance of long-term debt and \$820,000 of proceeds were received from the issuance of common stock under various employee stock plans.

The Company had a working capital deficit of \$14.7 million at October 3, 1999 compared to a deficit of \$4.3 million at January 3, 1999. As of October 3, 1999, the Company had approximately \$6.4 million available under a credit line with Genzyme (“the Genzyme Credit Line”), \$250,000 available under a line of credit with a commercial bank, \$3.2 million available under various capital lease lines and \$683,000 available under a term loan for the Charlton facility expansion. Under the Company’s 1999 operating plan, existing cash balances along with funds available under the bank and lease lines and the Genzyme Credit Line are expected to be sufficient to fund the Company into the third quarter of 2000. On November, 12, 1999, the Company issued

a redemption call on the outstanding \$11.0 million of Series A Preferred. Under the redemption terms, the holders of the Series A Preferred Stock have five business days in which to convert the preferred stock shares into Common Stock or be redeemed at par plus 15%.

In conjunction with the redemption call, the Company will issue up to \$12.5 million of Series B Convertible Preferred Stock ("Series B Preferred Stock") to Genzyme. The Series B Preferred Stock carries an initial 11% dividend which increases to 12% effective July 1, 2000 and is convertible by the holder into Common Stock at a fixed rate of \$6.30 per common share. All accumulated or accrued and unpaid dividends will be paid upon conversion, liquidation or redemptions of the Series B Preferred Stock. The Company has the sole right to redeem the Series B Preferred Stock for cash at any time at its original value plus accrued dividends. Genzyme has the right to require redemption only under circumstances involving new permanent equity being invested in the Company. The Company will issue Series B Preferred Stock only to the extent needed to fund redemption of the Series A Preferred Stock.

In connection with signing the agreement to purchase the Series B Preferred Stock, the Company also issued to Genzyme a 10-year warrant to purchase 55,833 shares of the Company's Common Stock at an exercise price of \$6.30 per share. Additionally, upon the closing of the investment, an additional warrant to purchase up to 55,833 shares with similar terms will be issued based upon the amount of Series B Preferred Stock actually issued. Finally, if any shares of Series B Preferred Stock remain outstanding on July 1, 2000, up to 55,833 warrants exercisable at the then-current market price for the Company's Common Stock will be issued based upon the amount of Series B Preferred then outstanding.

The Company is considering various alternative financing strategies, such as collaborative arrangements, public or private sales of its securities, including securities in certain subsidiaries, additional mortgage or lease financing, asset sales and other strategies.

Management's current expectations regarding the sufficiency of the Company's cash resources are forward-looking statements, and the Company's cash requirements may vary materially from such expectations. Such forward-looking statements are dependent on several factors, including the results of the Company's testing services business, the ability of the Company to enter into any transgenic research and development collaborations in the future and the terms of such collaborations, the results of research and development and preclinical and clinical testing, competitive and technological advances, regulatory requirements and the Company's ability to complete the financing for the Mason Laboratory expansion. The Company intends to seek additional financing through collaborative arrangements or from public or private sales of its securities, including equity securities. There can be no assurance that additional funding will be available on terms acceptable to the Company, if at all. If additional financing cannot be obtained on acceptable terms, to continue its operations the Company could be forced to delay, scale back or eliminate certain of its research and development programs or to enter into license agreements with third parties for the commercialization of technologies or products that the Company would otherwise undertake itself.

## **IMPACT OF THE YEAR 2000**

Certain companies may face problems if the computer processors and software upon which they directly or indirectly rely are unable to process date values correctly upon the turn of the millennium ("Year 2000"). Such a system failure and corruption of data of the Company or its customers or suppliers could disrupt the Company's operations, including, among other things a temporary inability to process transactions or engage in other business activities or to receive information or services from suppliers.

The Company has appointed a Year 2000 task force to address the issues and assess the potential impact of the Year 2000 problem. The task force is evaluating the Company's financial systems, computers, software and other equipment to ensure that the programs and systems will be Year 2000 compliant. The Company presently believes that its computer systems, software and other equipment will be Year 2000 compliant by the end of the fiscal year. The Company has spent approximately \$440,000 and estimates that it will spend approximately \$400,000 to \$460,000 in capital replacement of computers, equipment and software upgrades. The Company will incur another \$190,000 to \$275,000 for costs of implementation. The Company initiated communications with third party suppliers and is requesting that they represent that their products and services are to be Year 2000 compliant and that they have a program to test for compliance. Additionally, the Company has assessed those vendors that are not Year 2000 compliant and is in the process of finding alternative vendors that are compliant.

Because the Company currently anticipates that it will achieve Year 2000 compliance, it has not formulated a contingency plan. However, should the Company determine there is significant risk that it may be unable to adhere to its compliance timetable, it will assess reasonably likely scenarios resulting from noncompliance and establish a contingency plan to address such scenarios.

The Company's ability to achieve Year 2000 compliance is subject to various uncertainties including the Company's ability to successfully identify systems and programs not Year 2000 compliant, the nature and amount of programming required to correct or replace affected programs, the availability and magnitude of labor and consulting costs and the success of the Company's business partners, vendors and clients in addressing the Year 2000 issue. Therefore, while the financial impact of implementing Year 2000 compliance remediation has not been and is not anticipated to be material to the Company's business, financial position or results of operations, the Company can make no assurances with respect to the costs of remediation efforts not yet incurred. Additionally, the Company cannot be certain that it will achieve adequate Year 2000 compliance in a timely manner or that any impact of a failure to achieve such compliance will not have a material adverse effect on the Company's business, financial condition or results of operation.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in the Company's market risk since January 3, 1999. The Company's market risk disclosures are discussed in the Genzyme Transgenics Corporation Form 10-K under the heading Item 7A, Quantitative and Qualitative Disclosures About Market Risk.

## PART II

### ITEM 2: Changes in Securities

On July 23, July 27, August 27, September 2, September 7, and September 15, 1999, several institutional investors converted 1,000, 750, 500, 1,000, 500, and 2,000 shares of their Series A Convertible Preferred Stock, \$.01 par value per share, of the Company (the "Series A Preferred Stock"), into 223,462, 167,131, 93,458, 185,186, 90,908 and 334,378 shares of the Company's Common Stock, \$.01 par value per share (the "Common Stock"), at conversion prices of \$4.475, \$4.485, \$5.350, \$5.400, \$5.500 and \$5.981 per share, respectively. These conversions resulted in the issuance of an aggregate of 1,094,523 shares of the Company's Common Stock during the quarter ended October 3, 1999. The Company believes the issuance of its Common Stock upon conversion of the Preferred Stock qualified as a transaction by an issuer not involving a public offering within the meaning of Section 4(2) of the Securities Act of 1933, as amended, based on the number and nature of the holders.

On November 12, 1999, the Company issued a redemption call on the remaining, outstanding shares of its Series A Preferred Stock. Under the redemption terms, the holders can choose to convert their shares into Common Stock or be redeemed at a 15% redemption premium.

On the same date, the Company agreed to issue up to 12,500 shares of its Series B Convertible Preferred Stock, par value \$0.01 per share (the "Series B Preferred Stock"), and a warrant exercisable for 55,833 shares of its Common Stock to Genzyme for a maximum aggregate purchase price of \$12,500,000. Upon closing the investment, the Company will issue only enough shares of Series B Preferred Stock necessary to fund its redemption of the Series A Preferred Stock. It will also issue additional warrants to purchase up to another 55,833 shares of Common Stock, depending on the number of Series B Preferred Stock shares issued. The Company believes that the issuance of the Series B Preferred Stock and the warrants qualify as a transaction by an issuer not involving a public offering within the meaning of Section 4(2) of the Securities Act.

The Series B Preferred Stock initially yields an annual dividend of 11%, which increases to a 12% rate on July 1, 2000. Accumulated or accrued and unpaid dividends are payable upon conversion, liquidation or redemption of the Series B Preferred Stock. Each share of the Series B Preferred Stock is convertible into shares of the Company's Common Stock, determined by dividing the \$1,000 face amount of the share (the "Liquidation Value") by its \$6.30 conversion price. Each Initial Warrant is exercisable at any time until November 12, 2000 at a \$6.30 per share exercise price. The conversion price and Liquidation Value of the shares of Series B Preferred Stock and exercise price of the Initial Warrants are subject to customary anti-dilution adjustments.

The Company can completely or partially redeem the Series B Preferred Stock at any time for the Liquidation Value plus any accumulated dividends. If additional equity investment exceeding \$20,000,000 are made in the Company, the holders of the Series B

Preferred Stock can elect by majority vote to force the redemption of their shares in varying amounts depending on the size of the new investments. If any shares of Series B Preferred Stock remain outstanding on July 1, 2000, the Company must issue to Genzyme additional warrants to purchase up to 55,833 shares of Common Stock, depending on what fraction of the originally issued 12,500 shares of Series B Preferred Stock are outstanding, exercisable at the then-current market price of the Common Stock.

ITEM 6: Exhibits and Reports on Form 8-K

(a) Exhibits

See the Exhibit Index immediately following the signature page.

(b) Reports on Form 8-K

No reports were filed on Form 8-K during the quarter ended October 3, 1999.

**GENZYME TRANSGENICS CORPORATION AND SUBSIDIARY  
FORM 10-Q**

**October 3, 1999**

**SIGNATURES**

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

Date: November 17, 1999

GENZYME TRANSGENICS CORPORATION

By: /s/ John B. Green

John B. Green  
Duly Authorized Officer,  
Vice President and  
Chief Financial Officer

**EXHIBIT INDEX**

<u>Exhibit</u>	<u>Description</u>
27	Financial Data Schedule. (EDGAR only.)