APPLERA CORP
Form 10-Q
November 06, 2006
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission file number: 001-04389

APPLERA CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**06-1534213**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
301 Merritt 7, Norwalk, Connecticut	**06851-1070**
(Address of Principal Executive Offices)	**(Zip Code)**

(203) 840-2000

(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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

Yes No

As of the close of business on October 31, 2006, there were 183,205,340 shares of Applera Corporation-Applied Biosystems Group Common Stock and 78,247,714 shares of Applera Corporation-Celera Genomics Group Common Stock outstanding.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.
APPLERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited)

(Dollar amounts in thousands except per share amounts)

	Three Months Ended September 30,	
	2006	**2005**
Products	**$391,082**	$338,529
Services	**58,140**	52,267
Other	**36,187**	31,432
Total Net Revenues	**485,409**	422,228
Products	**196,659**	168,207
Services	**24,598**	23,989
Other	**2,827**	3,634
Total Cost of Sales	**224,084**	195,830
Gross Margin	**261,325**	226,398
Selling, general and administrative	**142,385**	131,865
Research, development and engineering	**57,902**	69,697
Amortization of purchased intangible assets	**2,737**	1,039
Employee-related charges, asset impairments and other	**3,500**	871
Asset dispositions and legal settlements	**9,087**	23,509
Acquired research and development	**114,251**	
Operating Loss	**(68,537)**	(583)
Gain on investments, net	**209**	4,503
Interest expense	**(497)**	(87)
Interest income	**9,710**	9,757
Other income (expense), net	**1,417**	1,707
Income (Loss) before Income Taxes	**(57,698)**	15,297
Provision (benefit) for income taxes	**8,314**	(9,882)
Net Income (Loss)	**$(66,012)**	$25,179

Applied Biosystems Group (see Note 4)		
Net Income (Loss) per Share		
Basic and diluted	**$(0.32)**	$0.21
Dividends Declared per Share	**$0.0425**	$0.0425
Celera Genomics Group (see Note 4)		
Net Loss per Share		
Basic and diluted	**$(0.09)**	$(0.23)

See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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APPLERA CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited)

(Dollar amounts in thousands)

	At September 30, 2006	At June 30, 2006
Assets		
Current assets		
Cash and cash equivalents	**$283,012**	$434,191
Short-term investments	**567,536**	509,252
Accounts receivable, net	**340,455**	382,509
Inventories, net	**143,482**	137,651
Prepaid expenses and other current assets	**173,978**	163,362
Total current assets	**1,508,463**	1,626,965
Property, plant and equipment, net	**394,719**	396,436
Goodwill and intangible assets, net	**318,996**	322,097
Other long-term assets	**674,856**	667,477
Total Assets	**$2,897,034**	$3,012,975
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	**$164,100**	$201,691
Accrued salaries and wages	**51,185**	98,938
Current deferred tax liability	**17,587**	17,560
Accrued taxes on income	**38,037**	50,944
Other accrued expenses	**244,560**	239,157
Total current liabilities	**515,469**	608,290
Other long-term liabilities	**203,750**	200,351
Total Liabilities	**719,219**	808,641
Stockholders Equity		
Capital stock		
Applera Corporation Applied Biosystems Group	**2,134**	2,132
Applera Corporation Celera Genomics Group	**782**	773
Capital in excess of par value	**2,198,844**	2,192,559
Retained earnings	**646,356**	714,137
Accumulated other comprehensive income	**47,339**	40,947

Treasury stock, at cost	**(717,640)**	(746,214)
Total Stockholders Equity	**2,177,815**	2,204,334
Total Liabilities and Stockholders Equity	**$2,897,034**	$3,012,975

See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(Dollar amounts in thousands)

	Three months ended September 30,	
	2006	**2005**
Operating Activities of Continuing Operations		
Net income (loss)	**$(66,012)**	$25,179
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	**21,079**	20,978
Asset impairments		1,090
Employee-related charges and other	**3,500**	(219)
Share-based compensation programs	**4,503**	1,651
Sale of assets and legal settlements, net	**(209)**	19,906
Deferred income taxes	**(3,670)**	(920)
Acquired research and development	**114,251**	
Changes in operating assets and liabilities:		
Accounts receivable	**41,510**	52,415
Inventories	**(5,139)**	(13,070)
Prepaid expenses and other assets	**(16,281)**	3,795
Accounts payable and other liabilities	**(84,867)**	(104,286)
Net Cash Provided by Operating Activities of Continuing Operations	**8,665**	6,519
Net Cash Used by Operating Activities of Discontinued Operations		(50)
Investing Activities of Continuing Operations		
Additions to property, plant and equipment, net	**(14,911)**	(14,327)
Proceeds from maturities of available-for-sale investments	**40,870**	55,278
Proceeds from sales of available-for-sale investments	**115,800**	103,360
Purchases of available-for-sale investments	**(212,585)**	(144,254)
Acquisitions and investments	**(121,403)**	
Proceeds from the sale of assets, net	**322**	4,503
Net Cash Provided (Used) by Investing Activities of Continuing Operations	**(191,907)**	4,560
Financing Activities		
Dividends	**(7,647)**	
Purchases of common stock for treasury		(201,236)
Proceeds from stock issued for stock plans and other	**34,376**	36,289

Net Cash Provided (Used) by Financing Activities	**26,729**	(164,947)
Effect of Exchange Rate Changes on Cash	**5,334**	(2,272)
Net Change in Cash and Cash Equivalents	**(151,179)**	(156,190)
Cash and Cash Equivalents Beginning of Period	**434,191**	779,401
Cash and Cash Equivalents End of Period	**$283,012**	$623,211

See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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APPLERA CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Interim Condensed Consolidated Financial Statements

Basis of Presentation

We prepare our unaudited interim condensed consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America, or GAAP. In preparing these statements, we are required to use estimates and assumptions. While we believe we have considered all available information, actual results could affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The results for the interim periods are not necessarily indicative of trends or future financial results. When used in these notes, the terms Applera, Company, we, us, or our mean Applera Corporation and its subsid

Through December 31, 2005, we were comprised of three business segments: the Applied Biosystems group, the Celera Genomics group, and Celera Diagnostics, a 50/50 joint venture between the Applied Biosystems group and the Celera Genomics group. Effective January 1, 2006, the Celera Genomics group acquired the Applied Biosystems group s 50 percent interest in the Celera Diagnostics joint venture such that it now owns 100 percent of Celera Diagnostics. As a result of this restructuring and the manner by which our management now operates and assesses our businesses, Celera Diagnostics is no longer a separate segment within Applera and we have restated prior period consolidating financial information to reflect this change. See Note 15 to our consolidated financial statements included in our 2006 Annual Report to Stockholders for a detailed description of the Celera Diagnostic restructuring.

We consistently applied the accounting policies described in our 2006 Annual Report to Stockholders in preparing these unaudited interim financial statements. We made all adjustments that are necessary, in our opinion, for a fair statement of the results for the interim periods. These adjustments are of a normal recurring nature. We condensed or omitted from these interim financial statements several notes and other information included in our 2006 Annual Report to Stockholders. You should read these unaudited interim condensed consolidated financial statements in conjunction with our consolidated financial statements presented in our 2006 Annual Report to Stockholders. We have reclassified some prior year amounts in the condensed consolidated financial statements and notes for comparative purposes.

Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value under GAAP, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for our 2009 fiscal year beginning July 1, 2008, and interim periods within that fiscal year. We are currently evaluating the provisions of SFAS No. 157 and the resulting impact of adoption on our financial statements.

Also in September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and recognize changes in the funded status in the year in which the changes occur through comprehensive income. As the recognition and disclosure provisions of SFAS No. 158 are effective for our fiscal year ending June 30, 2007, we will be evaluating the provisions of SFAS No. 158 and the resulting impact of adoption on our financial statements nearer to the time of adoption. The amount we will record in our statement of financial position related to this Statement depends on numerous future events and circumstances, such as the assumptions used to value our pension plan assets and liabilities, and therefore, is not reasonably estimable at the time of filing this report.

Also in September 2006, the Securities and Exchange Commission staff issued Staff Accounting Bulletin (SAB) No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements. SAB 108 established an approach that requires quantification of financial statement errors based on the effects of an error on a company s balance sheet and income statement and related disclosures. Historically, we have used the rollover approach for quantifying identified financial statement misstatements. This approach quantifies misstatements based on the amount of the error originating in the current year. We are required to apply the provisions of SAB 108 in connection with the preparation of our annual financial statements for our fiscal year ended June 30, 2007.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

We are currently evaluating the provisions of SAB 108 and do not expect the resulting impact of adoption to have a material impact on our financial statements.

Note 2 Events Impacting Comparability

We are providing the following information on some actions taken by us or events that occurred in the periods indicated:

	Three months ended September 30,	
Income/(charge) **(Dollar amounts in millions)**	**2006**	2005
Asset impairments	**$**	$(1.1)
Other	**(3.5)**	
Reduction of expected costs		0.2
Total employee-related charges, asset impairments and other	**$(3.5)**	$(0.9)
Other events impacting comparability:		
Asset dispositions and legal settlements	**$(9.1)**	$(23.5)
Acquired research and development	**(114.3)**	
Investment gains		4.5
Tax items	**8.8**	13.5

Employee-Related Charges, Asset Impairments and Other

The following items have been recorded in the condensed consolidated statements of operations in employee-related charges, asset impairments and other, except as noted.

Applied Biosystems group

Fiscal 2006

In the first quarter of fiscal 2006, the Applied Biosystems group recorded a pre-tax benefit of $0.2 million for a reduction in anticipated employee-related costs associated with a severance and benefit charge recorded in fiscal 2005.

Also in the first quarter of fiscal 2006, the Applied Biosystems group recorded a $1.1 million pre-tax impairment charge to write-down the carrying amount of its San Jose, California facility to its estimated market value at that time less estimated selling costs. This charge was in addition to a charge recorded in fiscal 2005. In the fourth quarter of fiscal 2006, the Applied Biosystems group completed the sale and recognized a $0.9 million pre-tax favorable adjustment to the charges previously recorded based on the actual sales price per the agreement.

Other

During the first quarter of fiscal 2007, the Applied Biosystems group made cash payments of $0.4 million for severance and employee benefits and office closures related to charges recorded prior to fiscal 2006. The following table summarizes the remaining cash payments by event and the expected payment dates as of September 30, 2006.

(Dollar amounts in millions)	**Remaining cash payments**	**Expected payment dates**
Fiscal 2003 employee-related charge	**$0.4**	Fiscal 2007
Fiscal 2005 employee-related charge	**0.1**	Fiscal 2007
Fiscal 2005 excess lease space and other charges	**1.4**	Fiscal 2007 Fiscal 2011
	$1.9	

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

Celera Genomics group

Fiscal 2007

During the first quarter of fiscal 2007, the Celera Genomics group recorded a pre-tax charge of $3.5 million for its estimated share of a damage award in continuing litigation between Abbott Laboratories, our alliance partner, and Innogenetics N.V. In September 2006, a jury found that the sale of Hepatitis C Virus (HCV) genotyping analyte specific reagents (ASRs) products by Abbott willfully infringed a U.S. patent owned by Innogenetics. These products are manufactured by the Celera Genomics group and are sold through its alliance with Abbott. The U.S. District Court for the Western District of Wisconsin found Abbott liable for $7 million in damages. The Court set a schedule to address Innogenetics request for an injunction and enhanced damages, and this is ongoing. Abbott has informed the Celera Genomics group that it has brought post-trial motions and intends to appeal this judgment as both Abbott and the Celera Genomics group believe that Innogenetics patent is invalid and that the alliance s HCV genotyping ASRs do not infringe Innogenetics patent. Innogenetics did not name the Celera Genomics group as a party in this lawsuit. However, as these products are part of its alliance with Abbott, the Celera Genomics group shares equally in the costs of, and any financial implications relating to, this litigation.

Fiscal 2006

During fiscal 2006, the Celera Genomics group recorded pre-tax charges related to its decision to exit its small molecule drug discovery and development programs and the integration of Celera Diagnostics into the Celera Genomics group. These charges consisted of the following components:

(Dollar amounts in millions)	Employee-Related Charges	Asset Impairments	Excess Lease Space	Other Disposal Costs	Total
Third quarter	$ 10.7	$ 8.0	$0.8	$1.4	$20.9
Fourth quarter	2.1	1.8	0.4	1.2	5.5
Total charges	12.8	9.8	1.2	2.6	26.4
Cash payments	7.9		0.2	2.4	10.5
Non-cash activity		9.3		0.2	9.5
Balance at June 30, 2006	4.9	0.5	1.0		6.4
Cash payments	**4.1**		**0.5**		**4.6**
Balance at September 30, 2006	**$ 0.8**	**$ 0.5**	**$0.5**	**$**	**$1.8**

The employee-related charges were severance costs primarily for staff reductions in small molecule drug discovery and development. The asset impairment charges primarily related to a write-down of the carrying amount of an owned facility to its current estimated market value less estimated selling costs, as well as write-offs of leasehold improvements and equipment. All of the affected employees have been notified and substantially all were terminated by July 31, 2006. Cash expenditures were funded by available cash. The remaining cash expenditures related to these charges are expected to be disbursed by the end of fiscal 2007.

Other

During the first quarter of fiscal 2007, the Celera Genomics group made cash payments of approximately $0.4 million related to an excess facility lease space charge that was recorded prior to fiscal 2006. The remaining cash expenditures of approximately $2.5 million related to this charge are expected to be disbursed by fiscal 2011.

Other Events Impacting Comparability

Asset dispositions and legal settlements

The following items have been recorded in the condensed consolidated statements of operations in asset dispositions and legal settlements.

In the first quarter of fiscal 2007, the Applied Biosystems group recorded a $9.1 million pre-tax charge related to a settlement agreement entered into with another company which resolved outstanding legal disputes with that company.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

In the first quarter of fiscal 2006, we recorded a $23.5 million pre-tax charge related to a litigation matter and an award in an arbitration proceeding with Amersham Biosciences, now GE Healthcare. We recorded the pre-tax charge as follows: $22.8 million at the Applied Biosystems group and $0.7 million at the Celera Genomics group. The charge included an estimate of the liability that was incurred by us to resolve the litigation matter and the arbitration settlement. The arbitrator awarded Amersham past damages based on an increase in royalty rates for some of its DNA sequencing enzymes and kits that contain those enzymes, plus interest, fees, and other costs in an amount to be determined. As a result of this decision, the Applied Biosystems group recorded a pre-tax charge of $20.4 million in the first quarter of fiscal 2006, $19.5 million of which was recorded in asset dispositions and legal settlements.

Acquired research and development

In the first quarter of fiscal 2007, the Applied Biosystems group recorded a $114.3 million charge to write-off the value of acquired in-process research and development (IPR&D) in connection with the acquisition of Agencourt Personal Genomics (APG). As of the acquisition date, the technological feasibility of the acquired project had not been established, and it was determined that the acquired project had no future alternative use. The determination of the amount attributed to acquired IPR&D took into consideration an independent appraisal performed by an outside consultant. See Note 3 for more information on this acquisition.

Investments

In the first quarter of fiscal 2006, the Celera Genomics group recorded a pre-tax gain of $4.5 million in the condensed consolidated statements of operations in gain on investments, net from the sale of a non-strategic minority equity investment.

Tax items

In the first quarter of fiscal 2007, the Applied Biosystems group recorded a tax benefit of $8.8 million related to a reduction in the valuation allowance for some German net operating loss carryforwards. In the first quarter of fiscal 2006, the Applied Biosystems group recorded a tax benefit of $13.5 million related to the resolution of transfer pricing matters in Japan.

Note 3 Acquisition

In July 2006, we acquired APG for approximately $121 million in cash, including transaction costs. At the time of the purchase, APG was a privately-held developer of next-generation genetic analysis technology. APG s proprietary technology was based on stepwise ligation, a novel and very high throughput approach to DNA analysis.

In accordance with SFAS No. 141, Business Combinations, we accounted for this transaction as a purchase of assets as defined by Emerging Issues Task Force (EITF) Abstracts Issue 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business rather than a business combination. The key considerations impacting our accounting determination were that APG was primarily focused on research and development activities, had not commenced principal operations, and did not have products, customers or revenues. Because APG did not meet the definition of a business as defined by EITF 98-3, we allocated the purchase price, as follows:

(Dollar amounts in millions)	Fair Value
Property, plant and equipment	**$1.4**
Intangible asset workforce	**1.5**
Acquired IPR&D	**114.3**
Deferred tax asset	**4.7**
Deferred tax liability	**(0.5)**
Total purchase price	**$121.4**

We allocated this transaction to the Applied Biosystems group. The estimated fair value attributed to the workforce was determined based on the estimated cost to recruit, hire, and train a workforce comparable to that in existence at APG at

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS continued

the time of our purchase of its assets. At the time of the acquisition, approximately 20 employees of APG became employees of the Applied Biosystems group. The recorded fair value of the workforce intangible asset will be amortized over its expected period of benefit of 3 years.

At the time of the acquisition, APG was in the process of prosecuting certain patents, but none had been issued. Any licenses APG had were not exclusive and did not provide it a measurable technological advantage. As a result, neither the patents or licenses were deemed to be identifiable assets and no value was assigned.

As of the acquisition date, the technological feasibility of the acquired IPR&D project had not been established, and it was determined that the project had no future alternative use. The amount attributed to acquired IPR&D took into consideration an independent appraisal performed by an outside consultant and was developed using an income approach. The project was valued using a discounted cash flow model and a discount rate of 30%. This discount rate was based on an estimated weighted average cost of capital given APG s stage and development lifecycle. The projected cash flows from the project were based on an estimate of future revenues and expenses attributable to the project. The valuation assumptions were made solely for the purpose of calculating projected cash flows and valuing the intangible assets acquired at the date of acquisition. Additionally, the amount of purchase price which was in excess of the identifiable assets was allocated to IPR&D, as goodwill could not result from an acquisition of assets. Actual results may vary from the projected results.

The following table briefly describes the APG IPR&D project.

(Dollar amounts in millions)	**At Acquisition Date**		
Project	**Fair Value**	**Estimated Costs to Complete**	**Approximate Percentage Completed**
Instruments	**$66.6**	**$10.0**	**35%**
Reagents	**47.7**	**6.0**	**25%**
Total	**$114.3**	**$16.0**	

The instruments and reagents being developed are designed for very high throughput genetic analysis applications, which are expected to include DNA sequencing and expression profiling. The initial instrument and reagents are expected to begin generating revenue in fiscal 2008. Enhanced platforms are expected to begin generating revenues in fiscal 2010 and fiscal 2013.

The APG project will require additional research and development efforts by the Applied Biosystems group before any eventual product can be marketed, if ever.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Note 4 Earnings (Loss) per Share

The following table presents a reconciliation of basic and diluted earnings (loss) per share for the three months ended September 30:

	Applied Biosystems Group		**Celera Genomics Group**	
(Dollar amounts in millions, except per share amounts)	**2006**	2005	**2006**	2005
Net income (loss)	**$(58.7)**	$43.1	**$(7.1)**	$(16.7)
Allocated intercompany sale of assets	**(0.1)**			
Allocated interperiod taxes	**(0.1)**	(1.2)		
Total net income (loss) allocated	**(58.9)**	41.9	**(7.1)**	(16.7)
Less dividends declared on common stock	**7.7**	8.3		
Undistributed earnings (loss)	**$(66.6)**	$33.6	**$(7.1)**	$(16.7)
Allocation of basic earnings (loss) per share				
Basic distributed earnings per share[(1)]	**NA** *	$0.04	**$**	$
Basic undistributed earnings (loss) per share	**NA** *	0.17	**(0.09)**	(0.23)
Total basic earnings (loss) per share	**$(0.32)**	$0.21	**$(0.09)**	$(0.23)
Allocation of diluted earnings (loss) per share				
Diluted distributed earnings per share[(1)]	**NA** *	$0.04	**$**	$
Diluted undistributed earnings (loss) per share	**NA** *	0.17	**(0.09)**	(0.23)
Total diluted earnings (loss) per share	**$(0.32)**	$0.21	**$(0.09)**	$(0.23)
Weighted average number of common shares				
Basic	**182.1**	195.5	**77.8**	74.4
Common stock equivalents		2.4		
Diluted	**182.1**	197.9	**77.8**	74.4

(1) Amounts represent actual dividends per share distributed.

* Due to the net loss incurred for the first three months ended September 30, 2006, undistributed earnings per share have not been presented. Dividends of $0.04 per share for the first three months ended September 30, 2006 were distributed from prior period earnings.

Options to purchase shares of Applera Corporation-Celera Genomics Group Common Stock (Applera-Celera stock) were excluded from the computation of diluted loss per share because the effect was antidilutive. For the three months ended September 30, 2006, options to purchase shares of Applera Corporation-Applied Biosystems Group Common Stock (Applera-Applied Biosystems stock) were excluded from the computation of diluted loss per share because the effect was antidilutive. Additionally, for the three months ended September 30, 2005, options to purchase shares of Applera-Applied Biosystems stock at exercise prices greater than the average market prices were excluded from the computation of diluted earnings per share because the effect would have been antidilutive. The following table presents the number of shares excluded from the diluted earnings and loss per share computations at September 30:

(Shares in millions)	**2006**	2005
Applera-Applied Biosystems stock	**5.1**	15.0
Applera-Celera stock	**7.1**	11.2

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Note 5 Comprehensive Gain

The components of comprehensive gain (loss) are reflected net of tax, except for foreign currency translation adjustments, which are generally not adjusted for income taxes as they relate to indefinite investments in non U.S. subsidiaries. Comprehensive gain (loss) was as follows:

	Three months ended September 30,	
(Dollar amounts in millions)	**2006**	2005
Net income (loss)	**$(66.0)**	$25.2
Other comprehensive gain (loss):		
Net unrealized gains (losses) on investments	**2.1**	(0.5)
Net unrealized gains on investments reclassified into earnings	**(0.2)**	
Net unrealized gains on hedge contracts	**2.0**	1.6
Net unrealized losses on hedge contracts reclassified into earnings		2.1
Foreign currency translation adjustments	**2.5**	(3.3)
Total other comprehensive gain (loss)	**6.4**	(0.1)
Total comprehensive gain (loss)	**$(59.6)**	$25.1

Note 6 Inventories

Inventories included the following components:

(Dollar amounts in millions)	**September 30, 2006**	June 30, 2006
Raw materials and supplies	**$ 44.7**	$44.3
Work-in-process	**11.7**	12.8
Finished products	**87.1**	80.6
Total inventories, net	**$ 143.5**	$137.7

Note 7 Goodwill and Intangible Assets

The carrying amounts of our intangible assets were as follows:

	September 30, 2006		June 30, 2006	
(Dollar amounts in millions)	**Gross Carrying Amount**	**Accumulated Amortization**	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Acquired technology	**$83.5**	**$ 47.9**	$83.3	$ 44.5
Patents	**29.9**	**23.6**	29.9	22.9
Customer relationships	**27.1**	**2.3**	27.1	1.6
Other	**1.7**	**0.2**	0.3	0.3
Total amortized intangible assets	**$142.2**	**$ 74.0**	$140.6	$ 69.3
Unamortized intangible assets:				
Trade name	**4.9**		4.9	
Total	**$147.1**	**$ 74.0**	$145.5	$ 69.3

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Aggregate amortization expense was as follows:

	Three months ended September 30,	
(Dollar amounts in millions)	**2006**	2005
Applied Biosystems group	**$4.4**	$1.7
Celera Genomics group	**0.6**	1.3
Consolidated	**$5.0**	$3.0

We record amortization expense in cost of sales. However, amortization of acquisition-related intangible assets is recorded in the amortization of purchased intangible assets in the condensed consolidated statements of operations. At September 30, 2006, we estimated annual amortization expense of our intangible assets for each of the next five fiscal years as shown in the following table. Future acquisitions or impairment events could cause these amounts to change.

(Dollar amounts in millions)	**Applied Biosystems Group**	**Celera Genomics Group**	**Consolidated**
Remainder of fiscal 2007	**$ 12.9**	**$ 1.6**	**$ 14.5**
2008	**14.7**	**0.6**	**15.3**
2009	**13.0**	**0.2**	**13.2**
2010	**10.2**	**0.2**	**10.4**
2011	**6.6**	**0.1**	**6.7**

The carrying amount of goodwill at September 30, 2006 and June 30, 2006, was $245.9 million, of which $243.2 million was allocated to the Applied Biosystems group and $2.7 million was allocated to the Celera Genomics group.

Note 8 Supplemental Cash Flow Information

Significant non-cash financing activity for the three months ended September 30 was as follows:

(Dollar amounts in millions)	**2006**	2005

Dividends declared but not paid	**$7.7**	$8.3
Tax benefit related to employee stock options	**4.8**	0.6
Issuances of restricted stock	**8.8**	

Note 9 Guarantees

Leases

We provide lease-financing options to our customers through third party financing companies. For some leases, the financing companies have recourse to us for any unpaid principal balance on default by the customer. The leases typically have terms of two to three years and are secured by the underlying instrument. In the event of default by a customer, we would repossess the underlying instrument. We record revenues from these transactions on the completion of installation and acceptance of products and maintain a reserve for estimated losses on all lease transactions with recourse provisions based on historical default rates and current economic conditions. At September 30, 2006, the financing companies outstanding balance of lease receivables with recourse to us was $7.4 million. We believe that we could recover the entire balance from the resale of the underlying instruments in the event of default by all customers.

Pension Benefits

As part of the divestiture of our Analytical Instruments business in fiscal 1999, the purchaser of the Analytical Instruments business is paying for the pension benefits for employees of a former German subsidiary. However, we guaranteed payment of these pension benefits should the purchaser fail to do so, as these payment obligations were not transferable to the buyer under German law. The guaranteed payment obligation, which approximated $56 million at

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September 30, 2006, is not expected to have a material adverse effect on our condensed consolidated statement of financial position.

Indemnifications

In the normal course of business, we enter into some agreements under which we indemnify third parties for intellectual property infringement claims or claims arising from breaches of representations or warranties. In addition, from time to time, we provide indemnity protection to third parties for claims relating to past performance arising from undisclosed liabilities, product liabilities, environmental obligations, representations and warranties, and other claims. In these agreements, the scope and amount of remedy, or the period in which claims can be made, may be limited. It is not possible to determine the maximum potential amount of future payments, if any, due under these indemnities due to the conditional nature of the obligations and the unique facts and circumstances involved in each agreement. Historically, payments made related to these indemnifications have not been material to our consolidated financial position.

Product Warranties

We accrue warranty costs for product sales at the time of shipment based on historical experience as well as anticipated product performance. Our product warranties extend over a specified period of time ranging up to two years from the date of sale depending on the product subject to warranty. The product warranty accrual covers parts and labor for repairs and replacements covered by our product warranties. We periodically review the adequacy of our warranty reserve, and adjust, if necessary, the warranty percentage and accrual based on actual experience and estimated costs to be incurred.

The following table provides an analysis of the warranty reserve for the three months ended September 30:

(Dollar amounts in millions)	**2006**	2005
Balance beginning of period	**$10.6**	$14.0
Accruals for warranties	**3.4**	5.0
Usage of reserve	**(3.8)**	(5.5)
Other, including currency	**(0.1)**	
Balance at September 30	**$10.1**	$13.5

Note 10 Pension and Other Postretirement Benefits

The components of net pension and postretirement benefit expenses for the three months ended September 30 were as follows:

(Dollar amounts in millions)	Three months ended September 30, 2006	2005
Pension		
Service cost	**$0.3**	$0.7
Interest cost	**10.5**	8.9
Expected return on plan assets	**(11.5)**	(9.5)
Amortization of prior service cost	**0.2**	
Amortization of losses	**1.2**	1.9
Net periodic expense	**$0.7**	$2.0
Postretirement Benefit		
Service cost	**$**	$0.1
Interest cost	**0.9**	0.8
Amortization of gains	**(0.1)**	
Net periodic expense	**$0.8**	$0.9

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We contributed approximately $0.8 million to our foreign and non-qualified domestic plans during the three months ended September 30, 2006, and expect to contribute an additional $1.6 million during the remainder of fiscal 2007. Based on the level of our contributions to the qualified U.S. pension plan during fiscal 2006 and previous years, combined with the performance of the assets invested in the plan, we do not expect to have to fund our qualified U.S. pension plan in fiscal 2007 in order to meet minimum statutory funding requirements. We made benefit payments of approximately $0.7 million under the postretirement plan during the three months ended September 30, 2006, and we expect to make approximately $5.0 million of additional benefit payments during the remainder of fiscal 2007 under our postretirement plan.

Note 11 Contingencies

Supply Arrangement

Delphi Medical Systems Texas Corporation (Delphi Medical Systems) is a supplier of some instruments, parts, and components to the Applied Biosystems group under a manufacturing and supply contract. On October 8, 2005, Delphi Medical Systems and its parent Delphi Corporation, filed a petition in the United States Bankruptcy Court for the Southern District of New York seeking relief under the provisions of Chapter 11 of the federal Bankruptcy Code. As of September 30, 2006, the Applied Biosystems group had a pre-petition accounts receivable balance of approximately $7 million and a pre-petition accounts payable balance of approximately $4 million with Delphi Medical Systems. As of September 30, 2006, the Applied Biosystems group had in addition a post-petition accounts payable balance with Delphi Medical Systems of approximately $5 million. On October 23, 2006, the Bankruptcy Court entered an order granting a motion for recoupment filed by the Applied Biosystems group. Under the terms of the recoupment order, which became final on November 3, 2006, the Applied Biosystems group may offset and recoup all pre-petition amounts owed by Delphi Medical Systems to the Applied Biosystems group against amounts, pre-petition and post-petition, owed by the Applied Biosystems group to Delphi Medical Systems, so that all pre-petition amounts owed by Delphi Medical Systems to the Applied Biosystems group will be paid in full by application of the offset and recoupment. In addition, Delphi Medical Systems recently informed the Applied Biosystems group that it does not intend to continue performing under the manufacturing and supply agreement after approximately May 2007. The Applied Biosystems group intends to use its own existing manufacturing facilities to replace the supply of some critical items that it has been purchasing from Delphi Medical Systems, and it is evaluating the use of new suppliers for other critical items and is seeking to mitigate potential supply issues by increasing inventory of some critical items. However, it is uncertain whether the group will be able to transition the manufacture of these items to its own facilities, or hire new suppliers on acceptable terms, and whether it will be able to do so as quickly as needed. Also, the Applied Biosystems group does not expect to replace the supply of all items purchased from Delphi Medical Systems and accordingly some of its older, low demand products will be discontinued earlier than originally planned.

Legal Proceedings

We are involved in various lawsuits, arbitrations, investigations, and other legal actions from time to time with both private parties and governmental entities. These legal actions currently involve, for example, commercial, intellectual property, antitrust, environmental, securities, and employment matters. The following is a description of some claims we are currently defending, including some counterclaims brought against us in response to claims filed by us against others. We believe that we have meritorious defenses against the claims currently asserted against us, including those described below, and intend to defend them vigorously.

The company and some of its officers are defendants in a lawsuit brought on behalf of purchasers of Applera-Celera stock in our follow-on public offering of Applera-Celera stock completed on March 6, 2000. In the offering, we sold an aggregate of approximately 4.4 million shares of Applera-Celera stock at a public offering price of $225 per share. The lawsuit, which was commenced with the filing of several complaints in April and May 2000, is pending in the U.S. District Court for the District of Connecticut, and an amended consolidated complaint was filed on August 21, 2001. The consolidated complaint generally alleges that the prospectus used in connection with the offering was inaccurate or misleading because it failed to adequately disclose the alleged opposition of the Human Genome Project and two of its supporters, the governments of the U.S. and the U.K., to providing patent protection to our genomic-based products. Although the Celera Genomics group has never sought, or intended to seek, a patent on the basic human genome sequence data, the complaint also alleges that we did not adequately disclose the risk that the Celera Genomics group

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would not be able to patent this data. The consolidated complaint seeks monetary damages, rescission, costs and expenses, and other relief as the court deems proper. On March 31, 2005, the court certified the case as a class action.

We filed a patent infringement action against Bio-Rad Laboratories, Inc., MJ Research, Inc., and Stratagene Corporation in the U.S. District Court for the District of Connecticut on November 9, 2004. The complaint alleges that the defendants infringe U.S. Patent No. 6,814,934. The complaint specifically alleges that the defendants activities involving instruments for real-time PCR detection result in infringement. We are seeking monetary damages, costs, expenses, injunctive relief, and other relief as the court deems proper. Bio-Rad and MJ Research answered the complaint and counterclaimed for declaratory relief that the 934 patent was invalid and not infringed, but we settled all of these claims with Bio-Rad and MJ Research in February 2006. Stratagene also answered the complaint and counterclaimed for declaratory relief that the 934 patent is invalid and not infringed. Stratagene is seeking dismissal of our complaint, a judgment that the 934 patent is invalid and not infringed, costs and expenses, and other relief as the court deems proper.

Promega Corporation filed a patent infringement action against Lifecodes Corporation, Cellmark Diagnostics, Genomics International Corporation, and us in the U.S. District Court for the Western District of Wisconsin on April 24, 2001. The complaint alleged that the defendants infringed Promega s U.S. Patent Nos. 6,221,598 and 5,843,660, both entitled Multiplex Amplification of Short Tandem Repeat Loci, due to the defendants sale of forensic identification and paternity testing kits. Promega was seeking monetary damages, costs and expenses, injunctive relief, and other relief as the court deemed proper. The defendants answered the complaint on July 9, 2001, and we asserted counterclaims that alleged that Promega was infringing our U.S. Patent No. 6,200,748, entitled Tagged Extendable Primers and Extension Products, due to Promega s sale of forensic identification and paternity testing kits. Because of settlement negotiations, the case was dismissed on October 29, 2002. The dismissal was without prejudice, which means that Promega could have refiled its claim against us. However, on September 5, 2006, we announced that we had entered into a settlement agreement with Promega that resolved the claims and counterclaims between us and Promega described above.

On-Line Technologies, Inc. (since acquired by MKS Instruments, Inc.) filed claims for patent infringement, trade secret misappropriation, fraud, breach of contract and unfair trade practices against PerkinElmer, Inc., Sick UPA, GmbH, and us in the U.S. District Court for the District of Connecticut on or about November 3, 1999. The complaint alleges that products called the Spectrum One and the MCS100E manufactured by former divisions of the Applied Biosystems group, which divisions were sold to the co-defendants in this case, were based on allegedly proprietary information belonging to On-Line Technologies and that the MCS100E infringed U.S. Patent No. 5,440,143. On-Line Technologies seeks monetary damages, costs, expenses, injunctive relief, and other relief. On April 2, 2003, the U.S. District Court for the District of Connecticut granted our summary judgment motion and dismissed all claims brought by On-Line Technologies. On-Line Technologies filed an appeal with the U.S. Court of Appeals for the Federal Circuit seeking reinstatement of its claims, and on October 13, 2004, the Court of Appeals upheld dismissal of all claims except for the patent infringement claim, which will be decided by the District Court in subsequent proceedings.

Enzo Biochem, Inc., Enzo Life Sciences, Inc., and Yale University filed a patent infringement action against us in the U.S. District Court for the District of Connecticut on June 8, 2004. The complaint alleges that we are infringing six patents. Four of these patents are assigned to Yale University and licensed exclusively to Enzo Biochem, i.e., U.S.

Patent No. 4,476,928, entitled Modified Nucleotides and Polynucleotides and Complexes Formed Therefrom, U.S. Patent No. 5,449,767, entitled Modified Nucleotides and Polynucleotides and Methods of Preparing Same, U.S. Patent No. 5,328,824 entitled Methods of Using Labeled Nucleotides, and U.S. Patent No. 4,711,955, entitled Modified Nucleotides and Polynucleotides and Methods of Preparing and Using Same. The other two patents are assigned to Enzo Life Sciences, i.e., U.S. Patent No. 5,082,830 entitled End Labeled Nucleotide Probe and U.S. Patent No. 4,994,373 entitled Methods and Structures Employing Compoundly Labeled Polynucleotide Probes. The allegedly infringing products include the Applied Biosystems group s sequencing reagent kits, its TaqMan® genotyping and gene expression assays, and the gene expression microarrays used with its Expression Array System. Enzo Biochem, Enzo Life Sciences, and Yale University are seeking monetary damages, costs, expenses, injunctive relief, and other relief as the court deems proper.

Molecular Diagnostics Laboratories filed a class action complaint against us and Hoffmann-La Roche, Inc. in the U.S. District Court for the District of Columbia on September 23, 2004, and filed an amended complaint on July 5, 2006. The

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amended complaint alleges anticompetitive conduct in connection with the sale of Taq DNA polymerase. The anticompetitive conduct is alleged to arise from the prosecution and enforcement of U.S. Patent No. 4,889,818. This patent is assigned to Hoffmann-La Roche, with whom we have a commercial relationship covering, among other things, this patent and the sale of Taq DNA polymerase. The complaint seeks monetary damages, costs, expenses, injunctive relief, and other relief as the court deems proper. On July 5, 2006, the court certified the case as a class action.

We are involved in several legal actions with Thermo Electron Corporation and its subsidiary Thermo Finnigan LLC. These legal actions commenced when we, together with MDS, Inc. and our Applied Biosystems/MDS Sciex Instruments joint venture with MDS, filed a patent infringement action against Thermo Electron in the U.S. District Court for the District of Delaware on September 3, 2004. The complaint alleges infringement by Thermo Electron of U.S. Patent No. 4,963,736, and seeks monetary damages, costs, expenses, and other relief as the court deems proper. Thermo Electron has answered the complaint and counterclaimed for declaratory relief that the 736 patent is invalid, not infringed, and unenforceable, and is seeking dismissal of our complaint, a judgment that the 736 patent is invalid, not infringed, and unenforceable, costs and expenses, and other relief as the court deems proper. After the filing of the action against Thermo Electron, on December 8, 2004, Thermo Finnigan filed a patent infringement action against us in the U.S. District Court for the District of Delaware. The complaint alleges that we have infringed U.S. Patent No. 5,385,654 as a result of, for example, our Applied Biosystems group s commercialization of the ABI PRISM® 3700 Genetic Analyzer. Thermo Finnigan is seeking monetary damages, costs, expenses, and other relief as the court deems proper. We have answered the complaint and counterclaimed for declaratory relief that the 654 patent is invalid, not infringed, and unenforceable, and are seeking dismissal of Thermo Finnigan s complaint, a judgment that the 654 patent is invalid, not infringed, and unenforceable, costs and expenses, and other relief as the court deems proper. Thermo Finnigan subsequently filed a second patent infringement action against us, MDS, and the Applied Biosystems/MDS Sciex Instruments joint venture, in the U.S. District Court for the District of Delaware on February 23, 2005. The complaint alleges that we and the other defendants have infringed U.S. Patent No. 6,528,784 as a result of, for example, our commercialization of the API 5000 LC/MS/MS system. Thermo Finnigan is seeking monetary damages, costs, expenses, and other relief as the court deems proper. We have answered the complaint and counterclaimed for declaratory relief that the 784 patent is invalid and not infringed, and are seeking dismissal of Thermo Finnigan s complaint, a judgment that the 784 patent is invalid and not infringed, costs and expenses, and other relief as the court deems proper.

Other than for items deemed not material, we have not accrued for any potential losses in the legal proceedings described above because we believe that an adverse determination is not probable, and potential losses cannot be reasonably estimated, in any of these proceedings. However, the outcome of legal actions is inherently uncertain, and we cannot be sure that we will prevail in any of the proceedings described above or in our other legal actions. An adverse determination in some of our current legal actions, particularly the proceedings described above, could have a material adverse effect on us and our consolidated financial statements.

Note 12 Segment and Consolidating Information

Presented below is our segment and consolidating financial information, including the allocation of expenses between our segments in accordance with our allocation policies, as well as other related party transactions, such as sales of products between segments. Our board of directors approves the method of allocating earnings to each class of common stock for purposes of calculating earnings per share. This determination is generally based on net income or loss amounts of the corresponding group calculated in accordance with GAAP, consistently applied.

As a result of the restructuring effective January 1, 2006 and the manner by which our management now operates and assesses our businesses, Celera Diagnostics is no longer a separate segment within Applera and we have restated prior period condensed consolidating financial information to reflect this change. See Note 16 to our consolidated financial statements included in our 2006 Annual Report to Stockholders for a detailed description of the segments and the management and allocation policies applicable to the attribution of assets, liabilities, revenues and expenses to the segments (which information is incorporated in this quarterly report by reference).

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The following table summarizes revenues earned between segments:

	Three months ended September 30,	
(Dollar amounts in millions)	**2006**	2005
Applied Biosystems Group		
Sales to the Celera Genomics group (a)	**$1.1**	$1.5
Celera Genomics Group		
Royalties from the Applied Biosystems group (b)	**$**	$0.9

[(a)] The Applied Biosystems group recorded net revenues from leased instruments and sales of consumables and project materials to the Celera Genomics group.

[(b)] The Celera Genomics group recorded net revenues primarily for royalties generated from sales by the Applied Biosystems group of products integrating Celera Discovery System TM (CDS) and some other genomic and biological information under a marketing and distribution agreement. The Celera Genomics group forgave future royalties related to this agreement as discussed in Note 15 to our consolidated financial statements included in our 2006 Annual Report to Stockholders.

Additionally, the Applied Biosystems group received, without reimbursement, $8.6 million in the first three months of fiscal 2007 and $8.5 million in the first three months of fiscal 2006 of tax benefits generated by the Celera Genomics group in accordance with our tax allocation policy.

In the following consolidating financial information, the Eliminations column represents the elimination of intersegment activity.

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Condensed Consolidating Statement of Operations for the Three Months Ended September 30, 2006

(Dollar amounts in thousands)	Applied Biosystems Group	Celera Genomics Group	Eliminations	Consolidated
Products	$ 388,596	$ 2,486	$	$ 391,082
Services	58,140			58,140
Other	28,444	7,743		36,187
Net revenues from external customers	475,180	10,229		485,409
Intersegment revenues	1,093		(1,093)	
Total Net Revenues	476,273	10,229	(1,093)	485,409
Products	193,376	3,644	(361)	196,659
Services	24,669		(71)	24,598
Other	2,670	157		2,827
Cost of Sales	220,715	3,801	(432)	224,084
Gross Margin	255,558	6,428	(661)	261,325
Selling, general and administrative	123,545	5,647	13,193	142,385
Corporate allocated expenses	11,605	1,594	(13,199)	
Research, development and engineering	45,115	13,221	(434)	57,902
Amortization of purchased intangible assets	2,737			2,737
Employee-related charges, asset impairments and other		3,500		3,500
Asset dispositions and legal settlements	9,087			9,087
Acquired research and development	114,251			114,251
Operating Loss	(50,782)	(17,534)	(221)	(68,537)
Gain on investments, net	209			209
Interest income, net	2,630	6,583		9,213
Other income (expense), net	1,314	103		1,417
Loss before Income Taxes	(46,629)	(10,848)	(221)	(57,698)
Provision (benefit) for income taxes	12,093	(3,797)	18	8,314
Net Loss	$ (58,722)	$ (7,051)	$ (239)	$ (66,012)

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Condensed Consolidating Statement of Financial Position at September 30, 2006

(Dollar amounts in thousands)	Applied Biosystems Group	Celera Genomics Group	Eliminations	Consolidated
Assets				
Current assets				
Cash and cash equivalents	$ 262,682	$ 20,330	$	$ 283,012
Short-term investments	21,456	546,080		567,536
Accounts receivable, net	334,820	6,459	(824)	340,455
Inventories, net	135,343	8,372	(233)	143,482
Prepaid expenses and other current assets	143,742	32,176	(1,940)	173,978
Total current assets	898,043	613,417	(2,997)	1,508,463
Property, plant and equipment, net	386,208	8,814	(303)	394,719
Goodwill and intangible assets, net	313,609	5,387		318,996
Other long-term assets	540,221	134,714	(79)	674,856
Total Assets	$ 2,138,081	$ 762,332	$ (3,379)	$ 2,897,034
Liabilities and Stockholders Equity				
Current liabilities				
Accounts payable	$ 162,738	$ 3,446	$ (2,084)	$ 164,100
Accrued salaries and wages	47,185	4,000		51,185
Current deferred tax liability	17,587			17,587
Accrued taxes on income	24,301	13,736		38,037
Other accrued expenses	232,106	13,393	(939)	244,560
Total current liabilities	483,917	34,575	(3,023)	515,469
Other long-term liabilities	198,677	5,355	(282)	203,750
Total Liabilities	682,594	39,930	(3,305)	719,219
Total Stockholders Equity	1,455,487	722,402	(74)	2,177,815
Total Liabilities and Stockholders Equity	$ 2,138,081	$ 762,332	$ (3,379)	$ 2,897,034

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Condensed Consolidating Statement of Cash Flows for the Three Months Ended September 30, 2006

(Dollar amounts in thousands)	Applied Biosystems Group	Celera Genomics Group	Eliminations	Consolidated
Operating Activities of Continuing Operations				
Net loss	$ (58,722)	$ (7,051)	$ (239)	$ (66,012)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:				
Depreciation and amortization	19,376	1,781	(78)	21,079
Employee-related charges and other		3,500		3,500
Share-based compensation programs	3,728	775		4,503