CIPHERGEN BIOSYSTEMS INC
Form 10-Q/A
December 21, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

AMENDMENT NO. 1

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005

OR

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

Commission file number: 000-31617

CIPHERGEN BIOSYSTEMS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0595156**
(State or other jurisdiction of incorporation of organization)	(I.R.S. Employer Identification Number)

6611 DUMBARTON CIRCLE, FREMONT, CALIFORNIA	**94555**
(Address of principal executive offices)	(ZIP Code)

Registrant s telephone number, including area code: **510-505-2100**

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 ý No o

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

Yes ý No o

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

Yes o No ý

Number of shares of common stock, $0.001 par value, outstanding as of November 30, 2005: 35,998,881

CIPHERGEN BIOSYSTEMS, INC.

INDEX FOR FORM 10-Q/A

FOR THE QUARTER ENDED JUNE 30, 2005

INTRODUCTORY NOTE

The Audit Committee of our Board of Directors recently completed an investigation focused on our revenue recognition in connection with certain sales transactions. Upon completion of this investigation, we concluded that it was necessary to restate certain financial data for the three and six month periods ended June 30, 2005 in order to recognize revenue for these sales transactions on a basis consistent with our revenue recognition policies.

We are today filing an amended Form 10-Q to restate our financial results with respect to the quarterly period ended June 30, 2005. We are also filing our Quarterly Report on Form 10-Q for the quarter ended September 30, 2005, which was delayed during the investigation of the issues surrounding this financial restatement.

Generally, no attempt has been made in this Form 10-Q/A to modify or update other disclosures presented in the original report on Form 10-Q except as required to reflect the effects of the restatement. This Form 10-Q/A generally does not reflect events occurring after the filing of the original Form 10-Q or modify or update those disclosures affected by subsequent events. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the Securities and Exchange Commission subsequent to the filing of the original Form 10-Q, including any amendments to those filings. The following items have been amended as a result of the restatement:

Part I, Item 1, Financial Information, has been revised to reflect the restatement;

Part I, Item 2, Management s Discussion and Analysis of Financial Condition and Results of Operations, has been revised to reflect the restatement; and

Part I, Item 4, Controls and Procedures.

Our Chief Executive Officer and Chief Financial Officer have also reissued their certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act.

We are restating our financial results for the three and six month periods ended June 30, 2005 to conform to our revenue recognition policies. As a result of the restatement, total revenues have decreased by $552,000 for the quarter ended June 30, 2005 and for the six months ended June 30, 2005; net loss has increased by $354,000 for the quarter ended June 30, 2005 and for the six months ended June 30, 2005; and basic and diluted net loss per share has increased $0.01 for the quarter ended June 30, 2005 and for the six months ended June 30, 2005.

None of the adjustments resulting from the restatement has any impact on cash balances for any period. However, our unaudited condensed consolidated statement of cash flows and balance sheet have been restated to reflect the restated net loss and revisions to certain balance sheet accounts. There were no other changes to the cash flows statement.

Additional detail regarding the restatement is discussed below in note 1 of our Unaudited Condensed Consolidated Financial Statements. This amendment incorporates certain revisions to historical financial data and related commentary, but is not intended to update other information presented in this Quarterly Report as originally filed, except where specifically noted.

ITEM 1. FINANCIAL STATEMENTS

CIPHERGEN BIOSYSTEMS, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2005 (Restated)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,256	$ 35,392
Short-term investments	2,206	2,175
Accounts receivable, net of allowance for doubtful accounts of $275 and $247, respectively	6,134	10,811
Notes receivable from related parties	12	126
Prepaid expenses and other current assets	1,502	1,847
Inventories	6,696	6,919
Total current assets	37,806	57,270
Property, plant and equipment, net	8,216	9,315
Goodwill	2,529	2,529
Other intangible assets, net	2,760	3,040
Other long-term assets	2,056	2,223
Total assets	$ 53,367	$ 74,377
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 3,593	$ 3,369
Accrued liabilities	6,197	7,499
Deferred revenue	4,801	5,529
Current portion of capital lease obligations	26	16
Current portion of long-term debt	740	925
Total current liabilities	15,357	17,338
Deferred revenue	676	855
Capital lease obligations, net of current portion	50	28
Long-term debt, net of current portion		377
Convertible senior notes, net of discount	28,317	28,051
Other long-term liabilities	756	1,013
Total liabilities	45,156	47,662
Stockholders equity:		
Common stock	30	29
Additional paid-in capital	187,334	187,133
Notes receivable from stockholders	(36)	(349)
Accumulated other comprehensive income (loss)	(29)	263
Accumulated deficit	(179,088)	(160,361)

Total stockholders equity		8,211		26,715
Total liabilities and stockholders equity	$	53,367	$	74,377

See notes to unaudited condensed consolidated financial statements.

CIPHERGEN BIOSYSTEMS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005 (Restated)	2004	2005 (Restated)	2004
Revenue:				
Products	$ 4,886	$ 6,160	$ 9,367	$ 17,050
Services	2,055	2,176	4,222	4,538
Total revenue	6,941	8,336	13,589	21,588
Cost of revenue:				
Products	2,570	3,211	4,682	6,279
Services	1,013	1,089	2,036	1,991
Total cost of revenue	3,583	4,300	6,718	8,270
Gross profit	3,358	4,036	6,871	13,318
Operating expenses:				
Research and development	3,626	5,535	7,133	11,292
Sales and marketing	4,792	7,361	10,065	13,297
General and administrative	3,742	3,554	7,246	7,229
Total operating expenses	12,160	16,450	24,444	31,818
Loss from operations	(8,802)	(12,414)	(17,573)	(18,500)
Interest and other income (expense), net	(537)	(442)	(948)	(969)
Loss from continuing operations before income taxes	(9,339)	(12,856)	(18,521)	(19,469)
Income tax provision (benefit) from continuing operations	(11)	140	139	192
Net loss from continuing operations	(9,328)	(12,996)	(18,660)	(19,661)
Discontinued operations:				
Loss from discontinued operations, net of tax		(146)		(962)
Loss from sale of discontinued operations, net of tax	(67)		(67)	
Net loss from discontinued operations	(67)	(146)	(67)	(962)
Net loss	$ (9,395)	$ (13,142)	$ (18,727)	$ (20,623)
Net loss per share, basic and diluted:				
Net loss per share from continuing operations	$ (0.32)	$ (0.45)	$ (0.63)	$ (0.68)
Net loss per share from discontinued operations	(0.00)	(0.00)	(0.00)	(0.03)
Net loss per share	$ (0.32)	$ (0.45)	$ (0.63)	$ (0.71)

Shares used in computing basic and diluted net loss per share	29,575	29,205	29,524	29,121

See notes to unaudited condensed consolidated financial statements.

CIPHERGEN BIOSYSTEMS, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30,	
	2005 (Restated)	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (18,727)	$ (20,623)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,895	3,546
Stock-based compensation expense		360
Amortization of debt discount associated with beneficial conversion feature of convertible senior notes	265	267
Accrued investment income	(31)	(32)
Interest accrued on notes receivable from related parties	(6)	(41)
Gain from sale of BioSepra business	67	
Changes in operating assets and liabilities:		
Accounts receivable, net	4,557	5,920
Prepaid expenses and other current assets	449	(577)
Inventories	278	(1,564)
Other long-term assets	140	169
Accounts payable and accrued liabilities	9	(924)
Deferred revenue	(885)	(357)
Other long-term liabilities	(107)	368
Net cash used in operating activities	(11,096)	(13,488)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment, net	(1,322)	(2,903)
Proceeds from capital lease financing to reimburse previous cash outlays to purchase facility improvements		601
Maturities of marketable securities		7,280
Cash paid for license related to litigation settlement	(325)	(498)
Cash paid for post-closing adjustment related to sale of BioSepra business	(1,111)	
Increase to goodwill from BioSepra acquisition due to income tax settlement		(203)
Purchase of Ciphergen Biosystems KK common stock		(1,000)
Net cash provided by (used in) investing activities	(2,758)	3,277
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock, net	201	828
Repayments of notes receivable from stockholders	314	230
Principal payments on capital lease obligations	(12)	(176)
Repayments of long-term debt	(561)	(325)
Net cash provided by (used in) financing activities	(58)	557
Effect of exchange rate changes	(224)	(433)
Net decrease in cash and cash equivalents	(14,136)	(10,087)
Cash and cash equivalents, beginning of period	35,392	32,853
Cash and cash equivalents, end of period	$ 21,256	$ 22,766

SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Reductions in deferred stock-based compensation	$	$ (40)
Transfer of fixed assets to inventory	126	326
Acquisition of property and equipment under capital leases	48	21

See notes to unaudited condensed consolidated financial statements.

CIPHERGEN BIOSYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 30, 2005

1. ORGANIZATION AND BASIS OF PRESENTATION

The Company

Ciphergen Biosystems, Inc. (the Company or Ciphergen) develops, manufactures and sells ProteinChip® Systems for life science researchers. The core technology, which is patented, is Surface Enhanced Laser Desorption/Ionization (SELDI). The systems consist of ProteinChip Readers, ProteinChip Software and related accessories, which are used in conjunction with consumable ProteinChip Arrays. These products are sold primarily to biologists at pharmaceutical and biotechnology companies, and academic and government research laboratories. The Company also provides research services primarily through its Biomarker Discovery Center® laboratories, and offers consulting services, customer support services and training classes to its customers and collaborators.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. The unaudited interim financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement have been included. Certain financial statement items have been reclassified to conform to the current year s format. The results of operations for the interim periods shown herein are not necessarily indicative of operating results for the entire year or any other future interim period.

The accompanying unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions have been eliminated in consolidation. BioSepra S.A. was a wholly-owned subsidiary and was consolidated through November 30, 2004, at which time the Company sold BioSepra S.A., along with other assets related to its process chromatography business. All comparative periods shown in the statements of operations have been restated to reflect the BioSepra business as a discontinued operation.

This unaudited financial data should be read in conjunction with the audited consolidated financial statements and footnotes contained in the Company s 2004 Form 10-K.

Restatement

On November 7, 2005, the Company announced that the Audit Committee (the Committee) of the Board of Directors was, with the assistance of independent investigators, conducting an investigation primarily regarding the recognition of revenue in connection with certain sales transactions. On November 16, 2005, the Company announced its intent to restate its financial results for the three and six month periods ended June 30, 2005, after determining that certain transactions during the second quarter of 2005 involved undisclosed provisions in violation of the Company's revenue recognition policies. Specifically;

(a) Two transactions involving customer orders for ProteinChip Systems, one for $44,000 and another for $248,000, were contingent upon the occurrence of a future event outside the control of the Company. For these two transactions, the earnings process was completed in the third and fourth quarters of 2005, respectively.

(b) One customer order for a ProteinChip System in the amount of $204,000 should not have been recorded as revenue due to collection not being reasonably assured. Revenue on this transaction will not be recognized. The Company has reached an agreement to take back the ProteinChip System from the customer.

(c) Two separate customer orders involved undisclosed credits for other goods and services totalling $15,000. Recognition of the revenue attributable to these items will be deferred until the delivery of the goods and services to the customer.

(d) One sale involving $38,000 of ProteinChip Arrays included an undisclosed right of exchange. Recognition of the revenue will be deferred until the right of exchange no longer exists.

(e) Lastly, it was discovered that one accessory with a price of $3,150 was shipped to a customer separately from the rest of the order shortly after the end of the quarter and thus the portion of the revenue attributable to this accessory should have been recorded in the third quarter rather than the second quarter.

Consequently, for the three and six month periods ended June 30, 2005, total revenue decreased $552,000, net loss increased by $354,000, and basic and diluted net loss per share increased $0.01, each as compared to the amounts previously reported by the Company on its Form 10-Q filed on August 9, 2005. The principal effects of these adjustments on the accompanying condensed consolidated financial statements are as follows (in thousands except per share amounts):

Unaudited Condensed Consolidated Balance Sheet:

	June 30, 2005	
	As Previously Reported	As Restated
Accounts receivable, net	$ 6,746	$ 6,134
Prepaid expenses and other current assets	1,462	1,502
Inventories	6,542	6,696
Total current assets	38,224	37,806
Total assets	53,785	53,367
Deferred revenue	4,865	4,801
Total current liabilities	15,421	15,357
Total liabilities	45,220	45,156
Accumulated deficit	(178,734)	(179,088)
Total stockholders equity	8,565	8,211
Total liabilities and stockholders equity	53,785	53,367

Unaudited Condensed Consolidated Statements of Operations:

	Three Months Ended June 30, 2005		Six Months Ended June 30, 2005	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Revenue-products	$ 5,438	$ 4,886	$ 9,919	$ 9,367
Total revenue	7,493	6,941	14,141	13,589
Cost of revenue-products	2,770	2,570	4,882	4,682
Total cost of revenue	3,783	3,583	6,918	6,718
Gross profit	3,710	3,358	7,223	6,871
Net loss	(9,041)	(9,395)	(18,373)	(18,727)
Net loss per share, basic and diluted	(0.31)	(0.32)	(0.62)	(0.63)

The restatement had no effect on the Company s net cash used in operating activities.

Liquidity

From its inception through June 30, 2005, the Company has financed its operations principally with $197.4 million (as restated) from the sales of products and services to customers and net proceeds from equity financings totaling approximately $145.8 million. Ciphergen received $28.1 million of net proceeds from the sale of 4.5% convertible senior notes on August 22, 2003. These notes are due September 1, 2008. The Company also received $27.0 million from the sale of its BioSepra business in November 2004. The Company has incurred significant net losses and negative cash flows from operations since inception. At June 30, 2005, the Company had an accumulated deficit of $179.1 million (as restated).

Management believes that currently available resources, including funds received in July 2005 from Quest Diagnostics (see note 12, Subsequent Events Strategic Alliance Agreement), will provide sufficient funds to enable the Company to meet its obligations for at least the next 18 months. Ciphergen currently expects to fund liquidity needs as well as expenditures for capital requirements from a combination of available cash, proceeds from the alliance with Quest Diagnostics including forgiveness of loan obligations to Quest Diagnostics, sales of equity and/or debt, and the receipt of approximately $1.0 million plus accrued interest from the sale of the BioSepra business to Pall Corporation which is being held in an interest-bearing escrow account. If anticipated operating results are not achieved, however, management believes that planned expenditures may need to be reduced in order to extend the time period over which the currently available resources will be adequate to fund the Company s operations. At such time

as the Company requires additional funding, the Company will seek to raise such additional funding from various possible sources, including the public equity market, private financings, sales of assets, collaborative arrangements and debt. If additional capital is raised through the issuance of equity or securities convertible into equity, stockholders may experience dilution, and such securities may have rights, preferences or privileges senior to those of the holders of its common stock or convertible senior notes. If the Company obtains additional funds through arrangements with collaborators or strategic partners, it may be required to relinquish its rights to certain technologies or products that it might otherwise seek to retain. There can be no assurance that the Company will be able to obtain such financing, or obtain it on acceptable terms. If Ciphergen is unable to obtain financing on acceptable terms, it may be unable to execute its business plan and it could be required to delay or reduce the scope of its operations, and it may not be able to pay off the convertible senior notes if and when they come due.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs, an amendment of ARB 43, Chapter 4 . SFAS 151 requires certain inventory costs to be recognized as current period expenses. This standard also provides guidance for the allocation of fixed production overhead costs. This standard is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company will adopt this standard in fiscal 2006. The Company has not yet determined the impact, if any, this standard will have on its financial statements and related disclosures, but does not expect it to have a material impact.

In December 2004, the FASB issued SFAS No. 123 (Revised), Share-Based Payment. This standard revises SFAS 123, APB 25 and related accounting interpretations, and eliminates the use of the intrinsic value method. As noted previously, the Company currently uses the intrinsic value method of APB 25 to value stock options and, accordingly, no compensation expense has been recognized for stock options. This new standard requires the expensing of all stock-based compensation, including stock options, using the fair value method. The FASB s transition provisions require implementation of SFAS 123(R) for quarters beginning after June 15, 2005. However, in April 2005, the Securities and Exchange Commission announced a deferral of the required implementation date to fiscal years beginning after June 15, 2005 or, in Ciphergen s case, its 2006 fiscal year. SFAS 123(R) will apply to all awards granted after the implementation date and to previously-granted awards unvested as of the implementation date. The impact of SFAS 123(R) on the Company s financial statements and related disclosures is still being evaluated by management but is expected to be material. The Company s actual share-based compensation expense in 2006 will be dependent on a number of factors, including the amount of awards granted and the fair value of those awards at the time of grant.

In December 2004, the FASB issued SFAS No. 153, Exchanges of Nonmonetary Assets An Amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions . SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, Accounting for Nonmonetary Transactions, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for fiscal periods beginning after June 15, 2005 and is required to be adopted by Ciphergen in the third quarter of 2005. The Company does not expect this standard to have a material impact on its financial statements and related disclosures.

In December 2004, the FASB issued FASB Staff Position No. 109-2 (FSP 109-2), Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 (AJCA) . FSP 109-2 allows the Company up until October 31, 2005 to evaluate the effect of the AJCA on its plans for reinvestment or repatriation of foreign earnings for purposes of applying SFAS 109 Accounting for Income Taxes. On May 10, 2005, the Treasury Department and the IRS issued Notice 2005-38, the second in a series of notices, which is intended to provide additional guidance for U.S. companies evaluating the effect of the AJCA on plans for reinvestment or repatriation of foreign earnings. Management currently believes all foreign earnings will be reinvested and is not considering repatriation of any significant amounts under this provision.

In March 2005, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment . SAB 107 provides guidance on the initial implementation of SFAS 123(R). In particular, the statement includes guidance related to share-based payment awards for non-employees, valuation methods and selecting underlying assumptions such as expected volatility and expected term. It also gives guidance on the classification of compensation expense associated with such awards and accounting for the income tax effects of those awards upon the adoption of SFAS 123(R). The Company is currently assessing the guidance provided in SAB 107 in connection with the implementation of SFAS 123(R).

In March 2005, the FASB issued Interpretation No. 47 (FIN 47) to clarify the guidance included in SFAS No. 143, Accounting for Asset Retirement Obligations . FIN 47 requires companies to recognize a liability for the fair value of a legal obligation to perform asset retirement activities that are conditional on a future event if the amount can be reasonably estimated. If

amounts cannot be reasonably estimated, certain disclosures will be required about the unrecognized asset retirement obligations. The interpretation is required to be adopted in the first quarter of 2006. The Company has not yet determined the impact, if any, this standard will have on its financial statements and related disclosures, but does not expect it to have a material impact.

In May 2005, the FASB issued SFAS No. 154, Accounting Changes and Error Corrections . SFAS 154 is a replacement of Accounting Principles Board Opinion (APB) No. 20 and SFAS 3. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company will be adopting this pronouncement beginning in its fiscal year 2006.

3. INVENTORIES

Inventories consisted of the following (in thousands):

	June 30, 2005 (Restated)	December 31, 2004
Raw materials	$ 2,186	$ 2,822
Work in process	1,510	1,400
Finished goods	3,000	2,697
	$ 6,696	$ 6,919

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill and other intangible assets consisted of the following (in thousands):

	June 30, 2005			December 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Total	Gross Carrying Amount	Accumulated Amortization	Total
Non-amortizing:						
Goodwill	$ 2,529	$	$ 2,529	$ 2,529	$	$ 2,529
Amortizing:						
Acquired license related to litigation settlement	5,481	2,721	2,760	5,156	2,116	3,040
	$ 8,010	$ 2,721	$ 5,289	$ 7,685	$ 2,116	$ 5,569

During the first six months of 2005, the acquired license related to the Company s litigation settlement in 2003 increased $325,000 as a result of cash payments made by the Company for license fees.

Amortization expense for these intangible assets was (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Acquired completed technology	$	$ 192	$	$ 384
Patents		15		29
Acquired license related to litigation settlement	302	302	605	605
	$ 302	$ 509	$ 605	$ 1,018

Annual amortization expense for these intangible assets is expected to be approximately $1,209,000 in both 2005 and 2006, $342,000 in 2007 and zero thereafter.

5. WARRANTIES AND MAINTENANCE CONTRACTS

Ciphergen has a direct field service organization that provides service for its products. The Company generally includes a

standard 12 month warranty on its ProteinChip Systems, ProteinChip Tandem MS Interfaces and accessories in the form of a maintenance contract upon initial sale, after which maintenance and support may be provided under a separately priced contract or on an individual call basis. Ciphergen makes no distinction between a standard warranty and a maintenance (extended warranty) contract. The Company substitutes a maintenance contract in place of a standard 12-month warranty on its instruments and accessories upon initial sale. Ciphergen also sells separately priced maintenance (extended warranty) contracts, which are generally for 12 or 24 months, upon expiration of the initial warranty. Coverage under both the standard and extended warranty maintenance contracts is identical. Because the Company does not offer traditional warranties but enhances them such that they are identical to its separately priced maintenance contracts, management believes it is appropriate to account for them in the same way. Revenue for both the standard and extended warranty maintenance contracts is deferred and recognized on a straight line basis over the period of the applicable maintenance contract. Related costs are recognized as incurred.

Changes in product warranty obligations, including separately priced maintenance obligations, were as follows (in thousands):

		Three Months Ended June 30,		Six Months Ended June 30,	
		2005 (Restated)	2004	2005 (Restated)	2004
Balance at the beginning of period		$ 3,439	$ 3,593	$ 3,778	$ 3,442
Add:	Costs incurred for maintenance contracts	680	719	1,386	1,208
	Revenue deferred for separately priced maintenance contracts	1,252	1,184	2,231	2,524
Less:	Settlements made under maintenance contracts	(680)	(719)	(1,386)	(1,208)
	Revenue recognized for separately priced maintenance contracts	(1,271)	(1,244)	(2,589)	(2,433)
Balance at end of period		$ 3,420	$ 3,533	$ 3,420	$ 3,533

6. FOREIGN CURRENCY TRANSACTIONS

During the three and six month periods ended June 30, 2005, there were no transactions related to forward contracts. Net realized foreign currency gains and losses related to foreign currency forward contracts and a related intercompany loan were not material for the three and six month periods ended June 30, 2004.

7. STOCK-BASED COMPENSATION

The Company accounts for its stock-based employee compensation arrangements using the intrinsic value method of accounting. Unearned compensation expense is based on the difference, if any, on the date of the grant between the fair value of the Company s stock and the exercise price. Unearned compensation is amortized and expensed using an accelerated method. The Company accounts for stock issued to non-employees using the fair value method of accounting.

Had compensation expense for options granted to employees, officers and directors been determined based on fair value at the grant date, the Company s net loss per share would have increased to the pro forma amounts indicated below (in thousands, except per share amounts):

		Three Months Ended June 30,		Six Months Ended June 30,	
		2005 (Restated)	2004	2005 (Restated)	2004
Net loss as reported		$ (9,395)	$ (13,142)	$ (18,727)	$ (20,623)
Add:	Employee stock-based compensation expense in reported net loss, net of tax		157		373
Less:	Employee stock-based compensation expense determined under the fair value method, net of tax	(819)	(1,328)	(1,882)	(2,355)
Pro forma net loss		$ (10,214)	$ (14,313)	$ (20,609)	$ (22,605)
Basic and diluted net loss per share:					
As reported		$ (0.32)	$ (0.45)	$ (0.63)	$ (0.71)
Pro forma		$ (0.35)	$ (0.49)	$ (0.70)	$ (0.78)

8. INCOME TAXES

Based on the available objective evidence, management believes it is more likely than not that the net deferred tax assets related to the Company s operations will not be fully realizable. Accordingly, the Company has provided a full valuation allowance against the net deferred tax assets related to its operations at June 30, 2005. The Company incurs income tax liabilities primarily in Japan, as well as in most of the other countries outside the U.S. in which it operates.

9. COMPREHENSIVE LOSS

Comprehensive loss consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005 (Restated)	2004	2005 (Restated)	2004
Net loss	$ (9,395)	$ (13,142)	$ (18,727)	$ (20,623)
Other comprehensive income (loss):				
Net change in unrealized gains/losses on investments		(7)		
Currency translation losses	(48)	(69)	(292)	(669)
Other comprehensive loss	(48)	(76)	(292)	(669)
Total comprehensive loss	$ (9,443)	$ (13,218)	$ (19,019)	$ (21,292)

10. NET LOSS PER SHARE

Basic net loss per share is calculated using the weighted average number of common shares outstanding during the period. Because the Company is in a net loss position, diluted earnings per share is calculated using the weighted average number of common shares outstanding and excludes the effects of 9.1 million and 8.7 million potential common shares as of June 30, 2005 and 2004, respectively, that are antidilutive. Potential common shares include shares that could be issued if all convertible senior notes were converted into common stock, common stock subject to repurchase, common stock issuable under the Company s 2000 Employee Stock Purchase Plan, and incremental shares of common stock issuable upon the exercise of outstanding stock options. The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005 (Restated)	2004	2005 (Restated)	2004
Numerator:				
Net loss	$ (9,395)	$ (13,142)	$ (18,727)	$ (20,623)
Denominator:				
Weighted average common shares outstanding	29,575	29,241	29,525	29,166
Weighted average unvested common shares subject to repurchase		(36)	(1)	(45)
Denominator for basic and diluted calculations	29,575	29,205	29,524	29,121
Basic and diluted net loss per share	$ (0.32)	$ (0.45)	$ (0.63)	$ (0.71)

11. SEGMENT INFORMATION AND GEOGRAPHIC DATA

Ciphergen s revenue is derived from the sales of related products and services on a worldwide basis. Although discrete components that earn revenues and incur expenses exist, significant expenses such as sales and marketing and corporate administration are not incurred by nor allocated to these operating units but rather are employed by the entire enterprise. Additionally, the chief operating decision maker evaluates resource allocation not on a product or geographic basis, but rather on an enterprise-wide basis. Therefore, management has determined that Ciphergen operates in only one reportable segment, which is the protein research tools and collaborative services business.

The Company sells most of its products and services directly to customers in North America, Western Europe and Japan, and through distributors in other parts of Europe and Asia. Revenue for geographic regions reported below is based upon the customers

locations and excludes revenue from discontinued operations. Following is a summary of the geographic information related to revenue from continuing operations for the three and six month periods ended June 30, 2005 and 2004 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005 (Restated)	2004	2005 (Restated)	2004
Revenue				
U.S.	$ 1,923	$ 3,854	$ 5,253	$ 9,155
Canada	290	68	623	375
Europe	2,491	1,945	4,008	5,334
Asia-Pacific	2,237	2,469	3,705	6,724
Total	$ 6,941	$ 8,336	$ 13,589	$ 21,588

During the three and six month periods ended June 30, 2005, sales to customers in Japan represented 30% and 26%, respectively, of revenue from continuing operations. During both the three and six month periods ended June 30, 2004, sales to customers in Japan represented 28% of revenue from continuing operations. No other country outside the U.S. accounted for 10% or more of total revenue from continuing operations during these periods.

Long-lived assets, primarily machinery and equipment, are reported based on the location of the assets. Long-lived asset information by geographic area as of June 30, 2005 and December 31, 2004 is presented in the following table (in thousands):

	June 30, 2005	December 31, 2004
Long - lived assets		
United States	$ 6,638	$ 7,308
Canada	53	111
Europe	768	958
Asia-Pacific	757	938
Total	$ 8,216	$ 9,315

12. SUBSEQUENT EVENTS

Strategic Alliance Agreement

On July 22, 2005, the Company entered into a strategic alliance agreement with Quest Diagnostics Incorporated covering a three year period during which the parties will strive to develop and commercialize up to three diagnostic tests based on Ciphergen s proprietary SELDI ProteinChip technology. Pursuant to the agreement, Quest Diagnostics will have the non-exclusive right to commercialize these tests on a worldwide basis, with exclusive commercialization rights in territories where Quest Diagnostics has a significant presence for up to five years post-launch. Pursuant to the agreement, there is a supply agreement between the two parties and a royalty arrangement. In addition, for an aggregate purchase price of $15 million, Quest Diagnostics has purchased 6.225 million shares of Ciphergen common stock, or approximately 17.4% of shares outstanding after the transaction, and a five-year warrant to purchase an additional 2.2 million shares for $3.50 per share. Quest Diagnostics has also agreed to loan Ciphergen up to $10 million to fund certain development activities. This loan will be forgiven should Ciphergen achieve certain milestones, including the commercialization and FDA clearance of certain diagnostic tests.

Component Part Retrofit Initiated by a Supplier

In July 2005, the Company was notified by a supplier about a potential safety hazard in certain pumps used in some older model ProteinChip Systems. This does not affect the Company s current Series 4000 line. The supplier is recommending a capacitor retrofit, but at this time it is not clear how much, if any, of the cost of such retrofits will be borne by the supplier. The Company s management is currently evaluating the situation with the supplier and with legal counsel, but does not have a sufficient basis upon which to estimate its potential cost, if any, for retrofitting the affected instruments. When the Company is able to determine its potential cost for the retrofits, it will record an appropriate reserve.

Reduction in Force

In July 2005, the Company took actions, consisting principally of headcount reductions, to reduce our operating expenses. These cost control measures involved most areas of the company and in particular our sales and marketing organization, but left our resources devoted to developing diagnostic products largely unaffected. As a result, Ciphergen s headcount is expected to decrease by approximately 20% by the end of the third quarter of 2005. Substantially all related severance payments will be made before the end of the third quarter of 2005.

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

We have made statements under the captions Management s Discussion and Analysis of Financial Condition and Results of Operations , Factors That May Affect Our Results and in other sections of this Form 10-Q that are forward-looking statements for purposes of the safe harbor provisions under the Private Securities Litigation Reform Act of 1995. We claim the protection of such safe harbor, and disclaim any intent or obligation to update any forward-looking statement. You can identify these statements by forward-looking words such as may , will , expect , intend , anticipate , believe , estimate , plan , could , should and continue or similar words. These forward-looking statements may also phrases. We have based these forward-looking statements on our current expectations and projections about future events. Examples of forward-looking statements include statements about expected timing of the recognition of revenue, projections of our future revenue, gross margin, expenses, results of operations and financial condition; anticipated deployment, capabilities and uses of our products and our product development activities and product innovations; the importance of proteomics as a major focus of biology research; the ability of our products to enable proteomics research; competition and consolidation in the markets in which we compete; existing and future collaborations and partnerships; our ability to operate and expand our Biomarker Discovery Center® laboratories and secure the commercial rights to biomarkers discovered at our Biomarker Discovery Center laboratories; the utility of biomarker discoveries and the effectiveness of our Biomarker Discovery Center laboratories; our plans to develop and commercialize diagnostic tests through our strategic alliance with Quest Diagnostics; our ability to comply with applicable government regulations; our ability to expand and protect our intellectual property portfolio; increasing the future sales volumes of consumables; increasing general and administrative costs; decreasing sales and marketing and research and development costs; anticipated future losses; potential expenses associated with a product retrofit; expected levels of capital expenditures; forgiveness of loan obligations to Quest Diagnostics; the rating of our convertible notes and the value of the related put options; the period of time for which our existing financial resources and interest income will be sufficient to enable us to maintain current and planned operations; foreign currency exchange rate fluctuations and our plans for mitigating foreign currency exchange risks; and the market risk of our investments. These statements are subject to risks and uncertainties that could cause actual results to differ materially, including the risks set forth under the caption Factors That May Affect Our Results in this Form 10-Q and the similar factors and risks outlined in our other filings with the Securities and Exchange Commission (SEC).

OVERVIEW

We develop, manufacture and sell our ProteinChip® Systems, which use patented Surface Enhanced Laser Desorption/Ionization (SELDI) technology. These systems consist of a ProteinChip Reader, ProteinChip Software and related accessories which are used in conjunction with our consumable ProteinChip Arrays. We also offer consulting services, customer support services and training classes to further our customers success in using SELDI technology. We market and sell our products primarily to research biologists in pharmaceutical and biotechnology companies, and academic and government research laboratories. In 1997, we acquired IllumeSys Pacific, Inc., which holds specific rights to the SELDI technology for the life science research market. Our first designed and manufactured system, the ProteinChip System, Series PBS I, was available for shipment in the third quarter of 1997. In 1997, we also established a subsidiary in the U.K. and began direct selling in Europe. During 1999, we initiated an expanded marketing program and in May began shipping the ProteinChip System, Series PBS II, which is now referred to as the ProteinChip Biology System. In 1999, we also established a joint venture with Sumitomo Corporation to distribute our products in Japan. During 2000, we began offering research services and established Biomarker Discovery Center laboratories in Fremont, California; Copenhagen, Denmark; and Malvern, Pennsylvania.

In 2001, we introduced the ProteinChip Biomarker System, which utilizes sophisticated third-party software to automate pattern recognition-based statistical analysis methods and correlate protein expression patterns from clinical samples with disease phenotypes. We also began selling the Biomek® 2000 Workstation, later superceded by the Biomek 3000 workstation, a robotic accessory which is manufactured by Beckman Coulter and which has been optimized for use with our ProteinChip Biomarker System to increase sample throughput and reproducibility. In addition, we expanded our product offering with a SELDI ProteinChip interface to high-end tandem mass spectrometers,

which we developed and which is manufactured for us by a third party manufacturing company. On July 31, 2001, Ciphergen acquired the BioSepra® process chromatography business from Invitrogen Corporation; this business was subsequently sold to Pall Corporation on November 30, 2004.

On August 31, 2002, we increased our ownership interest in Ciphergen Biosystems KK, the Japanese joint venture we formed with Sumitomo Corporation in 1999, from 30% to 70%. Shortly thereafter, we opened a Biomarker Discovery Center laboratory at the Yokohama facility of Ciphergen Biosystems KK. In October 2002, we launched the ProteinChip AutoBiomarker System, an automated version of our ProteinChip Biomarker System, which incorporates an autoloader and a Biomek robot to increase sample throughput and automate the reading of ProteinChip Arrays. On March 23, 2004, we purchased the remaining 30% ownership interest in Ciphergen Biosystems KK. In July 2004, we launched the ProteinChip System, Series 4000, our next generation ProteinChip System.

We have used our resources primarily to develop and expand our proprietary ProteinChip Systems and related consumables and to establish a marketing and sales organization for commercialization of our products. We also used our funds to establish a joint venture to distribute our products in Japan and to increase our ownership in the joint venture to 100%. In addition, we acquired the

BioSepra process chromatography business in 2001, which we sold for a gain in 2004. We have also used our resources to establish Biomarker Discovery Center laboratories to provide research services to our clients, to foster further adoption of our products and technology, and to discover biomarkers that we seek to patent for diagnostic and other purposes. In early 2004, we increased our efforts to discover protein biomarkers and panels of biomarkers that can be developed into protein molecular diagnostic tests that improve patient care; to date, these efforts have not generated any revenue from diagnostic tests. Since our inception we have incurred significant losses and as of June 30, 2005, we had an accumulated deficit of $179.1 million.

Our sales are currently driven by the need for new and better tools to perform protein discovery, characterization, purification, identification and assay development. In addition, many of our customers later enhance their ProteinChip Systems to add automation accessories and advanced software. Most of the ProteinChip Systems sold to our customers also generate a recurring revenue stream from the sale of consumables and maintenance contracts.

Our expenses have consisted primarily of materials, contracted manufacturing services, labor and overhead costs to manufacture our ProteinChip Systems and ProteinChip Arrays and to provide customer services; marketing and sales activities; research and development programs; litigation; and general and administrative costs associated with our operations. We expect our research and development expenses to decrease in 2005 relative to 2004 due to the transition of the ProteinChip System, Series 4000 into manufacturing and scaling back selected other projects, which has led to reduced research and development headcount as well as reduced use of outside contractors and services. We anticipate that these decreases will be partly offset by increased efforts at our Biomarker Discovery Center laboratories to discover, validate and patent biomarkers that may have diagnostic and/or therapeutic utility. We expect our selling expenses to decrease in 2005 relative to 2004 as a result of a smaller sales force and reduced marketing programs. We expect our general and administrative expenses to increase slightly in 2005 relative to 2004 due to normal salary increases and additional legal fees related to the strategic alliance with Quest Diagnostics, partly offset by a decline in stock-based compensation expense associated with our initial public offering. As a result, we expect to incur losses for at least the next year. Our current level of revenue is insufficient for us to become profitable. To become profitable, we will need to increase unit sales of our ProteinChip Systems and Arrays into the research and development market as well as begin achieving revenue from diagnostic tests.

We anticipate that our quarterly results of operations will fluctuate for the foreseeable future due to several factors, including market acceptance of current and new products, the length of the sales cycle and timing of significant orders, the timing and results of our research and development efforts, the introduction of new products by our competitors and possible patent or license issues. Our limited operating history makes accurate prediction of future results of operations difficult.

RESTATEMENT

On November 7, 2005, we announced that the Audit Committee (the Committee) of the Board of Directors was, with the assistance of independent investigators, conducting an investigation primarily regarding the recognition of revenue in connection with certain sales transactions. On November 16, 2005, we announced our intent to restate our financial results for the three and six month periods ended June 30, 2005, after determining that certain transactions during the second quarter of 2005 involved undisclosed provisions in violation of our revenue recognition policies. Specifically;

(a) Two transactions involving customer orders for ProteinChip Systems, one for $44,000 and another for $248,000, were contingent upon the occurrence of a future event outside of our control. For these two transactions, the earnings process was completed in the third and fourth quarters of 2005, respectively.

(b) One customer order for a ProteinChip System in the amount of $204,000 should not have been recorded as revenue due to collection not being reasonably assured. Revenue on this transaction will not be recognized. We have reached an agreement to take back the ProteinChip System from the customer.

(c) Two separate customer orders involved undisclosed credits for other goods and services totalling $15,000. Recognition of the revenue attributable to these items will be deferred until the delivery of the goods and services to the customer.

(d) One sale involving $38,000 of ProteinChip Arrays included an undisclosed right of exchange. Recognition of the revenue will be deferred until the right of exchange no longer exists.

(e) Lastly, it was discovered that one accessory with a price of $3,150 was shipped to a customer separately from the rest of the order shortly after the end of the quarter and thus the portion of the revenue attributable to this accessory should have been recorded in the third quarter rather than the second quarter.

Consequently, for the three and six month periods ended June 30, 2005, total revenue decreased $552,000, net loss increased by $354,000, and basic and diluted net loss per share increased $0.01, each as compared to the amounts previously reported by us

on our Form 10-Q filed on August 9, 2005. The principal effects of these adjustments on the accompanying condensed consolidated financial statements are as follows (in thousands except per share amounts):

Unaudited Condensed Consolidated Balance Sheet:

	June 30, 2005	
	As Previously Reported	As Restated
Accounts receivable, net	$ 6,746	$ 6,134
Prepaid expenses and other current assets	1,462	1,502
Inventories	6,542	6,696
Total current assets	38,224	37,806
Total assets	53,785	53,367
Deferred revenue	4,865	4,801
Total current liabilities	15,421	15,357
Total liabilities	45,220	45,156
Accumulated deficit	(178,734)	(179,088)
Total stockholders equity	8,565	8,211
Total liabilities and stockholders equity	53,785	53,367

Unaudited Condensed Consolidated Statements of Operations:

	Three Months Ended June 30, 2005		Six Months Ended June 30, 2005	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Revenue-products	$ 5,438	$ 4,886	$ 9,919	$ 9,367
Total revenue	7,493	6,941	14,141	13,589
Cost of revenue-products	2,770	2,570	4,882	4,682
Total cost of revenue	3,783	3,583	6,918	6,718
Gross profit	3,710	3,358	7,223	6,871
Net loss	(9,041)	(9,395)	(18,373)	(18,727)
Net loss per share, basic and diluted	(0.31)	(0.32)	(0.62)	(0.63)

The restatement had no effect on our net cash used in operating activities.

This Management's Discussion and Analysis of Financial Condition and Results of Operations gives effect to the restatement of our consolidated financial statements for the three and six month periods ended June 30, 2005, as explained in note 1 of the Unaudited Condensed Consolidated Financial Statements.

RECENT DEVELOPMENTS

On November 30, 2004, we completed the sale of our process chromatography business, consisting of our wholly-owned French subsidiary, BioSepra S.A., along with certain other related assets (together, the BioSepra business), to Pall Corporation for net proceeds of approximately $27.0 million, and an additional $1.0 million was deposited in an escrow account. We recorded a gain of $18.5 million on the sale, net of tax and approximately $321,000 of transaction costs, in net income from discontinued operations. The BioSepra business operating results have been removed from our results of continuing operations for all periods presented.

In January 2005 and in July 2005, we took actions, consisting principally of headcount reductions, to reduce our operating expenses. These cost control measures primarily involved our sales and marketing organization, leaving our resources devoted to developing diagnostic products largely unaffected. At July 31, 2005, we had approximately 187 employees, consisting of 27 in manufacturing, 42 in research and development, 84 in sales and marketing, and 34 in administration.

In April 2005, we repaid Pall Corporation approximately $1.1 million in post-closing adjustments related to the sale of our BioSepra business, based on the final financial statements as of the closing date, as specified in the purchase agreement. All but $67,000 of this amount was accrued at December 31, 2004.

On July 22, 2005, we entered into a strategic alliance agreement with Quest Diagnostics Incorporated covering a three year period during which the parties will strive to develop and commercialize up to three diagnostic tests based on Ciphergen s proprietary SELDI ProteinChip technology. Pursuant to the agreement, Quest Diagnostics will have the non-exclusive right to commercialize these tests on a worldwide basis, with exclusive commercialization rights in territories where Quest Diagnostics has a significant presence for up to five years post-launch. Pursuant to the agreement, there is a supply agreement between the two parties and a royalty arrangement. In addition, for an aggregate purchase price of $15 million, Quest Diagnostics has purchased 6.225 million shares of Ciphergen common stock, or approximately 17.4% of shares outstanding after the transaction, and a five-year warrant to

purchase an additional 2.2 million shares for $3.50 per share. Quest Diagnostics has also agreed to loan Ciphergen up to $10 million to fund certain development activities. This loan will be forgiven based on Ciphergen s achievement of certain milestones, including the commercialization and FDA clearance of certain diagnostic tests.

In July 2005, we were notified by a supplier about a potential safety hazard in certain pumps used in some older model ProteinChip Systems. This does not affect our current Series 4000 line. The supplier is recommending a capacitor retrofit, but at this time it is not clear how much, if any, of the cost of such retrofits will be borne by the supplier. Our management is currently evaluating the situation with the supplier and with legal counsel, but does not have a sufficient basis upon which to estimate our potential cost, if any, for retrofitting the affected instruments. When we are able to determine our potential cost for the retrofits, we will record an appropriate reserve.

RESULTS OF OPERATIONS

COMPARISON OF THE THREE AND SIX MONTH PERIODS ENDED JUNE 30, 2005 AND JUNE 30, 2004

PRODUCTS REVENUE. Products revenue decreased to $4.9 million in the second quarter of 2005 from $6.2 million in the same period of 2004, a decrease of $1.3 million or 21%. The decrease was primarily the result of a 28% decrease in revenue from sales of our ProteinChip Systems, accessories and software. This was largely due to a 25% decrease in unit sales of ProteinChip Systems, which we believe reflects a more competitive selling environment, reductions in our sales force, and more limited funding available to our academic prospects. In addition, average revenue per system sold declined approximately 4% comparing the second quarter of 2005 to the same period in 2004, due to lower list prices for the Series 4000 as well as increased discounting as a result of pricing pressure caused by generally lower funding available to academia, incentives we ve offered to expedite orders, lower prices offered when customers trade in their older ProteinChip Systems for a new Series 4000, and the competitive environment.

Products revenue decreased to $9.4 million in the first six months of 2005 from $17.1 million in the same period of 2004, a decrease of $7.7 million or 45%. The decrease was primarily the result of a 60% decrease in revenue from sales of our ProteinChip Systems, accessories and software. This was largely due to a 47% decrease in unit sales of ProteinChip Systems, which we believe reflects a more competitive selling environment, reductions in our sales force, and more limited funding available to our academic prospects. In addition, we experienced a decrease of approximately 24% in average revenue per system sold which was due to lower list prices for the Series 4000 as well as increased discounting as a result of pricing pressure caused by generally lower funding available to academia, incentives we ve offered to expedite orders, lower prices offered when customers trade in their older ProteinChip Systems for a new Series 4000, and the competitive environment.

SERVICES REVENUE. Services revenue decreased to $2.1 million in the second quarter of 2005 from $2.2 million in the same period of 2004, a decrease of $121,000 or 6%. This decrease was primarily due to a $212,000 decline in consulting and training revenues, reflecting fewer new product placements. This was partly offset by increases of $64,000 and $27,000 in revenue from Biomarker Discovery Center projects and maintenance contracts, respectively.

Services revenue decreased to $4.2 million in the first six months of 2005 from $4.5 million in the same period of 2004, a decrease of $316,000 or 7%. The decrease resulted primarily from a $460,000 decline in Biomarker Discovery Center project revenue due to completing two large contracts early in 2004; during the comparable period in 2005 we redirected our selling efforts towards ProteinChip System sales and away from service projects, due in part to our desire to focus more of our Biomarker Discovery Center resources on research for our own account. This was partly offset by an increase of $156,000 in revenue from maintenance contracts driven by growth in our installed base and increased efforts being made to obtain contract renewals.

We expect revenue in the third quarter of 2005 to be approximately $6.0 to $8.0 million.

COST OF PRODUCTS REVENUE. Cost of products revenue decreased to $2.6 million in the second quarter of 2005 from $3.2 million in the same period of 2004, a decrease of $641,000 or 20%. The decrease resulted primarily from a decrease in unit sales of our ProteinChip Systems, accessories and software. The gross margin for products revenue decreased slightly to 47% in the second quarter of 2005, compared to 48% in the same period of 2004. This decrease was partly due to the decrease in the average selling price of our new systems. In the twelve months since launching the ProteinChip System, Series 4000 in July 2004, this new product accounted for 82% of our unit sales, with older model ProteinChip Systems and Tandem MS Interfaces accounting for 18%. We have also been discounting our remaining stock of older models of our ProteinChip System. In addition, approximately $388,000 of amortization of unabsorbed manufacturing overhead due to a decline in array production volumes adversely impacted the gross margin in the second quarter of 2005, compared to approximately $85,000 of amortization of unabsorbed manufacturing overhead in the comparable period in 2004. The gross margin for products revenue in the second quarter of 2004 also included a provision of $804,000 made to our reserves for inventory obsolescence largely in anticipation of the introduction of the new Series 4000 platform, thereby lowering the gross margin in the comparative period. Provisions made to our inventory reserves in the second quarter of 2005 amounted to $156,000.

Cost of products revenue decreased to $4.7 million in the first six months of 2005 from $6.3 million in the same period of 2004, a decrease of $1.6 million or 25%. The decrease resulted primarily from a decrease in unit sales of our ProteinChip Systems, accessories and software. The gross margin for products revenue decreased to 50% in the first six months of 2005, compared to 63% in the same period of 2004. This decline was due to the decrease in the average selling price for our new systems, as well as discounting the remaining stock of our older model ProteinChip Systems, and approximately $721,000 of amortization of unabsorbed manufacturing overhead due to a decline in array production volumes in the first six months of 2005, compared to approximately $222,000 of amortization of unabsorbed manufacturing overhead in the comparable period in 2004. The gross margin for products revenue in the first six months of 2004 also included a provision of $685,000 made to our reserves for inventory obsolescence largely in anticipation of the introduction of the new Series 4000 platform, thereby lowering the gross margin in the comparative period. Provisions made to our inventory reserves in the first six months of 2005 amounted to $509,000.

COST OF SERVICES REVENUE. Cost of services revenue decreased to $1.0 million in the second quarter of 2005 from $1.1 million in the same period of 2004, a decrease of $76,000 or 7%. The largest component of this decrease came from Biomarker Discovery Center contracts, whose costs typically vary based on the complexity and difficulty of the work being undertaken. The gross margin for services revenue increased to 51% in the second quarter of 2005, compared to 50% in the same period of 2004. This increase was mainly due to improved gross margins for Biomarker Discovery Center contracts in the second quarter of 2005, but partly offset by lower margins realized from our training classes.

Cost of services revenue remained flat at $2.0 million in the first six months of 2005 compared to the same period of 2004. The gross margin for services revenue decreased to 52% in the first six months of 2005, compared to 56% in the same period of 2004. The gross margin on Biomarker Discovery Center contracts improved, but this was offset by lower margins realized from our training classes and lower margins in field service which resulted primarily from higher net usage of parts for repairing instruments in the first six months of 2005.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses decreased to $3.6 million in the second quarter of 2005 from $5.5 million in the same period of 2004, a decrease of $1.9 million or 34%. The decrease was largely due to completing the development of the ProteinChip System, Series 4000 in July 2004 and scaling back or canceling other research and development projects related to new instrumentation platforms. This resulted in decreases of $608,000 for materials and supplies used in the development of new products, $420,000 in consultant fees, and $129,000 in collaboration costs. In addition, payroll and related expenses decreased approximately $703,000 as a result of a 35% reduction in research and development headcount, comparing June 30, 2005 to June 30, 2004.

Research and development expenses decreased to $7.1 million in the first six months of 2005 from $11.3 million in the same period of 2004, a decrease of $4.2 million or 37%. This decrease was primarily the result of completing the development of the ProteinChip System, Series 4000 in July 2004 and scaling back or canceling other research and development projects related to new instrumentation platforms. This resulted in decreases of $1.9 million for materials and supplies used in the development of new products, $696,000 in consultant fees, and $210,000 in collaboration costs. In addition, payroll and related expenses decreased approximately $1.2 million as a result of a 35% reduction in research and development headcount, comparing June 30, 2005 to June 30, 2004.

We expect research and development expenses to decline in 2005 relative to 2004 due to having fewer research and development employees in 2005 as well as slowing or canceling selected early-stage research and development programs related to new instrumentation platforms as part of our efforts to control expenses, partially offset by an increase in our research and development activities associated with discovering biomarkers that could potentially be developed into diagnostic products.

SALES AND MARKETING EXPENSES. Sales and marketing expenses decreased to $4.8 million in the second quarter of 2005 from $7.4 million in the same period of 2004, a decrease of $2.6 million or 35%. The decrease was largely due to a 33% decrease in headcount comparing June 30, 2005 to June 30, 2004, resulting in a decrease in payroll and related costs of approximately $1.3 million. Also as a result of the decrease in staffing, travel expenses in sales and marketing declined approximately $692,000 and internal consumption of ProteinChip Arrays

and other consumables for customer demonstrations and support decreased approximately $153,000. Costs for trade shows, advertising and other marketing activities declined $420,000. However, depreciation expense increased approximately $164,000, largely related to the addition of demonstration instruments following the introduction of the ProteinChip System, Series 4000.

Sales and marketing expenses decreased to $10.1 million in the first six months of 2005 from $13.3 million in the same period of 2004, a decrease of $3.2 million or 24%. This decrease was primarily the result of a 33% decrease in headcount comparing June 30, 2005 to June 30, 2004, resulting in a decrease in payroll and related costs of approximately $1.5 million. Also as a result of the decrease in staffing, travel expenses in sales and marketing declined approximately $869,000 and internal consumption of ProteinChip Arrays and other consumables for customer demonstrations and support decreased approximately $221,000. Costs for

trade shows, advertising and other marketing activities declined $456,000. However, depreciation expense increased approximately $326,000, largely related to the addition of demonstration instruments following the introduction of the ProteinChip System, Series 4000.

We expect sales and marketing expenses to decrease in 2005 relative to 2004 as a result of a smaller sales force and reduced associated selling expenses.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased to $3.7 million in the second quarter of 2005 from $3.6 million of the same period of 2004, an increase of $188,000 or 5%. The increase was largely driven by increases of approximately $175,000 in consulting and outside service fees, mostly related to business development activities; $126,000 in legal fees, consisting of $279,000 related to the strategic alliance with Quest Diagnostics, partly offset by reductions in other legal fees primarily due to being more selective in patent activities; and $119,000 in payroll and related costs related to the hiring of senior-level employees related to our efforts to develop diagnostic products and for business development related to pharmaceutical customers. These increases were partly offset by decreases of approximately $105,000 in the provision for bad debts, consistent with the decline in our accounts receivable, and $102,000 in stock-based compensation associated with our initial public offering.

General and administrative expenses remained flat at $7.2 million in the first six months of 2005 compared to the same period of 2004. This was composed of increases of approximately $381,000 in payroll and related costs related to the hiring of senior-level employees related to our efforts to develop diagnostic products and for business development related to pharmaceutical customers, partly offset by a net decline of 2 people (5%) in administrative headcount comparing June 30, 2005 to June 30, 2004; $264,000 in accrued accounting and audit fees; and $42,000 in consulting and outside service fees, consisting principally of $320,000 related to business development, largely offset by reductions in outside assistance with investor relations and recruiting. However, these increases were almost entirely offset by decreases of approximately $228,000 in stock-based compensation associated with our initial public offering; $218,000 in the provision for bad debts, consistent with the decline in our accounts receivable; $100,000 in travel; and $82,000 in legal fees, consisting of an increase of $291,000 in fees related to the strategic alliance with Quest Diagnostics, but more than offset by decreases in other legal fees primarily as a result of being more selective in patent activities.

We expect general and administrative expenses to increase slightly in 2005 relative to 2004 due to normal salary increases and additional legal fees related to the strategic alliance with Quest Diagnostics, partly offset by a decline in stock-based compensation associated with our initial public offering.

INTEREST AND OTHER INCOME (EXPENSE), NET. Interest income in the second quarter of 2005 was $170,000 compared to $128,000 in the same period of 2004. Despite lower average investment balances in the second quarter of 2005 compared to the same period in 2004, interest income increased due to higher average interest rates in the second quarter of 2005 compared to the same period in 2004. Interest expense in the second quarter of 2005 was $491,000 compared to $501,000 in the same period of 2004. Interest expense in both periods consisted largely of interest accrued for our convertible senior notes, equipment-financing loan and capital leases. Approximately $133,000 of the interest expense in the second quarters of 2005 and 2004 were non-cash, attributable to amortization of the beneficial conversion feature associated with the notes. Other income (expense) in the second quarter of 2005 was a net expense of $216,000 compared to a net expense of $69,000 in the same period of 2004. The net expense in the second quarter of 2005 resulted primarily from $93,000 for the amortization of the offering costs related to the convertible senior notes, realized foreign exchange losses of approximately $67,000 and losses on disposals of fixed assets of approximately $39,000. The net expense in the second quarter of 2004 resulted primarily from the amortization of the offering costs related to the convertible senior notes.

Interest income in the first six months of 2005 was $352,000 compared to $295,000 in the same period of 2004. Despite lower average investment balances in the first six months of 2005 compared to the same period in 2004, interest income increased due to higher average interest rates in the first six months of 2005 compared to the same period in 2004. Interest expense of $1.0 million in the first six months of

2005 was approximately flat compared to the same period of 2004. Interest expense in both periods consisted largely of interest accrued for our convertible senior notes, equipment-financing loan and capital leases. Approximately $265,000 and $267,000 of the interest expense in the first six months of 2005 and 2004, respectively, were non-cash, attributable to amortization of the beneficial conversion feature associated with the notes. Other income (expense) in the first six months of 2005 was a net expense of $317,000 compared to a net expense of $260,000 in the same period of 2004. The net expense in the first six months of 2005 resulted primarily from $186,000 for the amortization of the offering costs related to the convertible senior notes, realized foreign exchange losses of approximately $122,000 and losses on disposals of fixed assets of approximately $97,000, partly offset by a recovery of approximately $119,000 related to a tax dispute concerning our foreign operations. The net expense in the first six months of 2004 resulted primarily from the amortization of the offering costs related to the convertible senior notes.

INCOME TAX PROVISION (BENEFIT) FROM CONTINUING OPERATIONS. The provision for income tax from continuing operations in the second quarter of 2005 was a benefit of $11,000, compared to a $140,000 expense in the same period of 2004. The decrease in expense was primarily due to the lower projected income related to our Japanese subsidiary, Ciphergen Biosystems KK in 2005.

The provision for income tax from continuing operations in the first six months of 2005 was $139,000, compared to $192,000 in the same period of 2004. The decrease was primarily due to lower projected income related to our Japanese subsidiary, Ciphergen Biosystems KK in 2005.

LOSS FROM SALE OF DISCONTINUED OPERATIONS, NET OF TAX. During the second quarter of 2005, the gain on the sale of the BioSepra business in November 2004 was adjusted downward by $67,000 for a post-closing adjustment, in accordance with the Asset Purchase Agreement.

LIQUIDITY AND CAPITAL RESOURCES

From our inception through June 30, 2005, we have financed our operations principally with $197.4 million (as restated) from the sales of products and services to customers and net proceeds from equity financings totaling approximately $145.8 million. This includes net proceeds of $92.4 million from our initial public offering in September 2000 and net proceeds of $26.9 million from our Series E Preferred Stock financing in March 2000. We received $28.1 million of net proceeds from the sale of 4.5% convertible senior notes on August 22, 2003. These notes are due September 1, 2008. We also received net proceeds of $27.0 million from the sale of our BioSepra business in November 2004. Cash, cash equivalents and short-term investments at June 30, 2005 were $23.5 million, compared to $37.6 million at December 31, 2004. Working capital at June 30, 2005 was $22.4 million, compared to $39.9 million at December 31, 2004. The decrease in working capital was principally due to a $14.1 million decrease in cash and investments to fund our operating losses, and a $4.7 million decrease in accounts receivable, reflecting the decline in our revenue during the first six months of 2005. Long-term debt and capital lease balances at June 30, 2005 totaled $29.1 million compared to $29.4 million at December 31, 2004.

Net cash used in operating activities was $11.1 million in the first six months of 2005 compared to $13.5 million in the same period of 2004. Reductions in payroll expense of $2.7 million, other operating and manufacturing overhead expenditures of $4.9 million and inventory purchases of $2.9 million, comparing the first six months of 2005 to the same period of 2004, were partly offset by approximately $9.6 million less in collections from customers in the first six months of 2005 than in the comparable period of 2004, consistent with our declining revenue. Interest expense and interest income did not significantly change comparing the first six months of 2005 to the first six months of 2004. Interest expense in both periods consisted largely of interest accrued on our convertible senior notes, equipment-financing loan and capital leases.

Net cash used in investing activities was $2.8 million in the first six months of 2005 compared to net cash provided by investing activities of $3.3 million in the first six months of 2004. Net cash used in investing activities in the first six months of 2005 consisted of net purchases of property and equipment of approximately $1.3 million, a payment of $1.1 million to Pall Corporation for post-closing adjustments related to the sale of our BioSepra business, and payments totaling $325,000 for a technology license related to our litigation which was settled in 2003. Net cash provided by investing activities in the first six months of 2004 consisted largely of maturities of investment securities of $7.3 million, offset by net property and equipment purchases of $2.3 million, the acquisition of the remaining 30% ownership in Ciphergen Biosystems KK for $1.0 million, and payments totaling $498,000 for a technology license related to our litigation which was settled in 2003. We anticipate capital expenditures of approximately $2 to $3 million in 2005.

Net cash used in financing activities was $58,000 in the first six months of 2005 compared to net cash provided by financing activities of $557,000 in the first six months of 2004. Net cash used in financing activities in the first six months of 2005 was used primarily for debt repayments amounting to $573,000, largely offset by $314,000 received from the repayment of stockholder loans and $201,000 received from the issuance of common stock under our employee stock purchase plan. Net cash provided by financing activities in the first six months of 2004 consisted of the issuance of common stock under our stock option plans of $828,000 and repayment of stockholder loans in the aggregate principal amount of $230,000, partly offset by repayments of an equipment financing loan of $325,000 and repayments of capital lease obligations of $176,000.

We believe that current cash resources, including funds received in July 2005 from Quest Diagnostics, will be sufficient to maintain our operations at least for the next 18 months. We currently expect to fund liquidity needs as well as expenditures for capital requirements from a combination of available cash, proceeds from the alliance with Quest Diagnostics including forgiveness of loan obligations to Quest Diagnostics, sales of equity and/or debt, and the receipt of approximately $1.0 million plus accrued interest from the sale of our BioSepra business to Pall Corporation which is being held in an interest-bearing escrow account. We will be required to raise additional capital at some point in the future, which might be achieved through a variety of sources, including securities issuances and collaborative arrangements. If additional capital is raised through the issuance of equity or securities convertible into

equity, our stockholders may experience dilution, and such securities may have rights, preferences or privileges senior to those of the holders of our common stock or the notes. If we obtain additional funds through arrangements with collaborators or strategic partners, we may be required to relinquish our rights to certain technologies or products that we might otherwise seek to retain. Additional financing may not be available to us on favorable terms, if at all. If we are unable to obtain financing on acceptable terms, we may be unable to execute our business plan and we could be required to delay, reduce the scope of, or eliminate our operations and we may not be able to pay off the convertible senior notes if and when they come due.

The following summarizes Ciphergen s contractual cash obligations at June 30, 2005 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less than 1 Year	1-3 Years	4-5 Years	Beyond 5 Years
Contractual cash obligations:					
Capital lease obligations(1)	$ 76	$ 26	$ 44	$ 6	$
Equipment financing loan(1)	740	740			
Convertible senior notes(2)	30,000			30,000	
Interest payable on convertible senior notes	4,388	1,350	2,700	338	
Non-cancelable collaboration obligation(3)	228	228			
Non-cancelable operating lease obligations	12,236	3,966	7,288	982	
Purchase obligations(4)	657	657			
Total contractual cash obligations	$ 48,325	$ 6,967	$ 10,032	$ 31,326	$

(1) Principal amounts, not including interest.

(2) Excludes the beneficial conversion feature amounting to $2,677, less related amortization of $994.

(3) We have made a commitment to fund a Biomarker Discovery Center laboratory at The Johns Hopkins University School of Medicine which totals $914 for the period December 2004 to November 2005, of which $228 was non-cancelable at June 30, 2005.

(4) Purchase obligations include agreements to purchase inventory that are enforceable and legally binding on Ciphergen and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

Ciphergen has complied with all requirements set forth in its credit agreements.

RECENT ACCOUNTING PRONOUNCEMENTS

See note 2 of the Unaudited Condensed Consolidated Financial Statements for a description of recent accounting pronouncements, including the respective dates of adoption and effects on results of operations and financial condition.

FACTORS THAT MAY AFFECT OUR RESULTS

We expect to continue to incur net losses in 2005 and 2006. If we are unable to significantly increase our revenues or significantly decrease our expenses, we may never achieve profitability.

From our inception in December 1993 through June 30, 2005, we have generated cumulative revenue from continuing operations of approximately $161.5 million (as restated) and have incurred net losses of approximately $179.1 million (as restated). We have experienced significant operating losses each year since our inception and expect these losses to continue for at least the next several quarters. For example, we experienced net losses of approximately $25.8 million in 2001, $29.1 million in 2002, $36.7 million in 2003, $19.8 million in 2004, and $18.7 million (as restated) in the first six months of 2005. Our losses have resulted principally from costs incurred in research and development, sales and marketing, litigation, and general and administrative costs associated with our operations. These costs

have exceeded our gross profit which, to date, has been generated principally from product sales. We expect to incur additional operating losses and these losses may be substantial. We may never achieve profitability. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis.

If we are unable to further establish the utility of our products, our products and services may not achieve market acceptance.

The commercial success of our ProteinChip Systems and Arrays depends upon validating their utility for important biological applications and increasing their market acceptance by researchers in pharmaceutical and biotechnology companies, academic and government research centers and clinical reference laboratories. If our products are not demonstrated to be more effective in providing commercially useful protein information than other existing technologies, it could seriously undermine market acceptance of our products and reduce the likelihood that we will ever achieve profitability.

If we fail to successfully expand sales of our ProteinChip Systems, including the successful commercialization of the Series 4000, and develop new and improved applications for this platform, our revenue will not increase and we will not achieve profitability.

Our success depends on our ability to continue to expand commercial sales of our ProteinChip Systems and Arrays, and develop new and improved applications for this platform. In particular, our success will depend on our success in marketing our next generation ProteinChip System, the Series 4000. If this new system does not perform in accordance with market expectations, it is unlikely that we will be able to expand our sales. We may encounter difficulties in developing new, higher performance products or producing our current proteomic systems on a timely basis, we may not be able to produce them economically, we may fail to achieve expected performance levels, or we may fail to gain industry acceptance of such products.

We may experience increased manufacturing costs or failure rates for our ProteinChip Systems and Arrays that are higher than we anticipated, particularly for newer products that have been introduced, such as the ProteinChip System, Series 4000.

Our products and the components used in our products are based on complex technologies and we are currently in the process of developing new versions of certain products. We may not be able to cost effectively manufacture such new products. In addition, it is difficult to predict the failure rate of new products, such as the ProteinChip System, Series 4000. If our manufacturing costs are higher than anticipated or if the failure rates for our products are higher than anticipated, resulting in increased warranty claims and increased costs associated with servicing those claims, our gross profit will decrease. We may also incur additional costs associated with a planned product retrofit initiated by one of our suppliers for a pump used in older model ProteinChip Systems.

We may not succeed in developing diagnostic products and even if we do succeed in developing diagnostic products, they may never achieve significant commercial market acceptance.

There is considerable risk in developing diagnostic products based on our biomarker discovery efforts; potential tests may fail to validate results in larger clinical studies and may not achieve acceptable levels of clinical sensitivity and specificity. If we do succeed in developing diagnostic tests with acceptable performance characteristics, we may not succeed in achieving significant commercial market acceptance for those tests. Our ability to successfully commercialize diagnostic products that we may develop, such as tests, kits and devices, will depend on several

factors, including:

our ability to convince the medical community of the safety and clinical efficacy of our products and their advantages over existing diagnostic products;

our ability to establish business relationships with other diagnostic companies that can assist in the commercialization of these products; and

the agreement by Medicare and third-party payers to provide full or partial reimbursement coverage for our products, the scope and extent of which will affect patients willingness to pay for our products and will likely heavily influence physicians decisions to recommend our products.

These factors present obstacles to significant commercial acceptance of our potential diagnostic products, which we will have to spend substantial time and money to overcome, if we can do so at all. Our inability to successfully do so would prevent us from generating additional revenue from diagnostic products and we could be unable to develop a profitable business.

Our ability to commercialize our potential diagnostic tests is heavily dependent on our strategic alliance with Quest Diagnostics.

On July 22, 2005, Ciphergen and Quest Diagnostics entered into a strategic alliance which will focus on commercializing up to three assays chosen from Ciphergen s pipeline over the next three years. If this strategic alliance does not continue for its full term

or if Quest Diagnostics fails to proceed to diligently commercialize potential diagnostics tests, our efforts to commercialize our potential diagnostic tests would be seriously harmed. If we elect to increase our expenditures to fund diagnostic development programs or research programs on our own, we will need to obtain additional capital, which may not be available on acceptable terms, or at all.

If we are unable to attract additional clients for our Biomarker Discovery Center services and satisfy these clients, we may not be successful in furthering adoption of our products and technology or generating additional revenue through commercial rights related to biomarker discoveries.

One element of our business strategy is to operate Biomarker Discovery Center laboratories in part through partnerships with academic and government research centers as well as pharmaceutical and biotechnology companies in order to increase adoption of our products and technology. Although we are currently in negotiation with additional potential partners and clients, to date we have entered into only a few such arrangements. Failure to enter into additional arrangements or expand existing relationships could limit adoption of our products and prevent us from generating additional revenue through commercialization of biomarker discoveries.

New product introductions, in particular the ProteinChip System, Series 4000, can result in disruptions to our revenue patterns and increased sales and marketing costs, and may involve manufacturing challenges that can negatively impact our gross margin.

We have introduced, and we plan to introduce in the future, new versions of our ProteinChip Systems, Arrays and Software, including our ProteinChip System, Series 4000. New product introductions entail training and educating our customers and prospective customers about the new features, protocols and technology encompassed by the new products. This could disrupt our revenue patterns or temporarily lengthen our sales cycles to a greater extent than it would at larger companies with broader product offerings. New product introductions may temporarily increase our sales and marketing costs. Manufacturing new products inherently runs the risk that initial costs may be high as new production processes are introduced, and it is possible that new products may involve quality issues that negatively impact our gross margins. In addition, the introduction of new products makes the continuing sales of previous product versions difficult and may require significant price discounts on such products.

If we fail to continue to develop the technologies we base our products on, we may not be able to successfully foster further adoption of our products and services as an industry standard or develop new product offerings.

The technologies we use for our ProteinChip Systems and related product offerings are new and complex technologies, which are subject to change as new discoveries are made. New discoveries and further progress in our field are essential if we are to maintain and expand the adoption of our product offerings. Development of these technologies remains a substantial risk to us due to various factors including the scientific challenges involved, our ability to find and collaborate with others working in our field, and competing technologies, which may prove more successful than ours. In addition, we have reduced our research and development headcount and expenditures, which may adversely affect our ability to further develop our technology.

If we are unable to provide our customers with software that enables the integration and analysis of large volumes of data, the acceptance and use of our products may be limited.

The successful commercial research application of our products requires that they enable researchers to process and analyze large volumes of data and to integrate the results into other phases of their research. The nature of our software enables a level of integration and analysis that is adequate for many projects. However, if we do not continue to develop and improve the capabilities of our ProteinChip Software to perform more complex analyses of customer samples and to meet increasing customer expectations, market acceptance of our products may not increase and we could lose our current customers, which might adversely impact our revenues and we could be unable to develop a profitable business.

Our quarterly operating results may fluctuate significantly due to a number of causes outside our control.

Because the timing of our product orders can vary, we may not be able to reliably predict quarterly revenue and profitability. Our operating results can also vary substantially in any period depending on the mix of products sold. Our quarterly sales and operating results are highly dependent on the volume and timing of orders received during the quarter, as well as the seasonal and cyclical nature of our markets. Historically, a relatively large percentage of our sales have arrived in the last month of each quarter, and often towards the end of such month. Accordingly, a short delay in receiving an order, shipping product, or recognizing revenue from such order may result in substantial quarterly fluctuations in revenue and earnings.

A significant portion of our operating expenses is relatively fixed in nature due to our significant sales, research and development, administration and manufacturing costs. If we cannot adjust spending quickly enough to compensate for a revenue

shortfall, this may magnify the adverse impact of such revenue shortfall on our results of operations. As a result, our quarterly operating results could fluctuate, and such fluctuation could cause the market price of our common stock and convertible senior notes to decline. Results from one quarter should not be used as an indication of future performance.

If we are unable to reduce our lengthy sales cycle, our ability to become profitable will be harmed.

Our ability to obtain customers for our products depends in significant part upon the perception that our products and services can help enable protein biomarker discovery, characterization and assay development. From the time we make initial contact with a potential customer until we receive a binding purchase order typically takes between a few weeks to a year or more. Our sales effort requires the effective demonstration of the benefits of our products and may require significant training, sometimes of many different departments within a potential customer. These departments might include research and development personnel and key management. In addition, we may be required to negotiate agreements containing terms unique to each customer. We may expend substantial funds and management effort and may not be able to successfully sell our products or services in a short enough time to achieve profitability.

We will need to raise additional capital in the future, and if we are unable to secure adequate funds on terms acceptable to us, we may be unable to execute our business plan.

We currently believe that current cash resources, including funds received in July 2005 from Quest Diagnostics, will be sufficient to meet our anticipated financial needs at least for the next 18 months. However, we may need to raise additional capital sooner in order to develop new or enhanced products or services, increase our efforts to discover biomarkers and develop them into diagnostic products, or acquire complementary products, businesses or technologies. If we are unable to obtain financing, or to obtain it on acceptable terms, we may be unable to successfully execute our business plan.

Legislative actions resulting in higher compliance costs are likely to adversely impact our future financial position and results of operations.

Compliance with changing regulation of corporate governance and public disclosure will result in additional expenses. Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq National Market listing requirements, are resulting in increased compliance costs. Specifically, we are undertaking significant efforts and numerous significant expenses to continue to comply with Section 404 of the Sarbanes-Oxley Act of 2002. Compliance with these evolving standards will result in increased general and administrative expenses and may cause a diversion of management time and attention from revenue-generating activities to compliance activities.

Future changes in financial accounting standards or practices may cause adverse unexpected fluctuations and affect our reported results of operations.

Future changes in financial accounting standards, including those currently proposed, will likely affect our reported results of operations. For example, the mandated change effective for us on January 1, 2006 requiring that we record compensation expense in the statement of operations for employee stock options using the fair value method or changes in existing taxation rules related to stock options will have a negative effect

on our reported results. The Financial Accounting Standards Board (FASB) has proposed a choice of valuation models to estimate the fair value of employee stock options. These models, including the Black-Scholes option-pricing model, use varying methods and inputs and may yield significantly different results. If another party asserts that the fair values of our employee stock options are misstated, securities class action litigation could be brought against us and/or the market price of our common stock could decline.

Because our business is highly dependent on key executives, scientists, engineers and sales people, our inability to recruit and retain these people could hinder our business expansion plans.

We are highly dependent on our executive officers, senior scientists, engineers and sales people. In certain countries, a few key individuals are important to our local success. Our product development and marketing efforts could be delayed or curtailed if we lose the services of any of these people. To expand our research, product development and sales efforts, we need people skilled in areas such as bioinformatics, biochemistry, information services, manufacturing, sales, marketing and technical support. Competition for qualified employees is intense. We will not be able to expand our business if we are unable to hire, train and retain a sufficient number of qualified employees. During 2004 and 2005, we took steps to reduce our headcount and our voluntary employee turnover has increased from historic levels. In addition, the FASB has announced changes to generally accepted accounting principles in the U.S. that may require us to change the manner in which we compensate our employees, which could considerably impact our ability to recruit and retain qualified employees.

If we are unable to successfully expand our limited manufacturing capacity for ProteinChip readers and arrays, we may encounter manufacturing and quality control problems as we increase our efforts to meet demand.

We currently have only one manufacturing facility at which we produce limited quantities of our ProteinChip Arrays and ProteinChip Readers. Some aspects of our manufacturing processes may not be easily scalable to allow for production in larger volumes, resulting in higher than anticipated material, labor and overhead costs per unit. As a result, manufacturing and quality control problems may arise as we increase our level of production. We may not be able to increase our manufacturing capacity in a timely and cost-effective manner and we may experience delays in manufacturing new products. If we are unable to consistently manufacture our products on a timely basis because of these or other factors, we will not be able to meet anticipated demand. As a result, we may lose sales and fail to generate increased revenue and become profitable.

We face intense competition in our current and potential markets and if our competitors develop new technologies or products, our products may not achieve market acceptance and may fail to capture market share.

Competition in our existing and potential markets is intense and we expect it to increase. Currently, our principal competition comes from other technologies that are used to perform many of the same functions for which we market our ProteinChip System. The major technologies that compete with our ProteinChip System are liquid chromatography-mass spectrometry and 2D-gel electrophoresis-mass spectrometry. In the life science research market, competitive protein research tools and services are currently provided by a number of companies, including several which are larger than Ciphergen. In the diagnostics market, there are several larger direct competitors. In many instances, our competitors may have substantially greater financial, technical, research and other resources and larger, more established marketing, sales, distribution and service organizations. Additionally, our potential customers may internally develop competing technologies. If we fail to compete effectively with these technologies and products, or if competitors develop significant improvements in protein detection systems, develop systems that are easier to use, or introduce comparable products that are less expensive, our products may not achieve market acceptance and our sales may decrease.

If we are unable to maintain our licensed rights to the SELDI technology, we may lose the right to produce ProteinChip Systems and products based on the SELDI technology and the right to provide services and information related thereto.

Our commercial success depends on our ability to maintain our sublicenses to the SELDI technology. In 2002, 2003, 2004 and the first six months of 2005, all of our revenue from continuing operations was derived from SELDI-based products within the scope of the Baylor SELDI patents. Pursuant to the settlement of the litigation between Ciphergen, Molecular Analytical Systems (MAS), LumiCyte and T. William Hutchens, MAS cannot terminate Ciphergen s rights under the sublicenses. However, Baylor College of Medicine has the right to terminate its license with MAS in case of material breach by MAS. If the agreements between Baylor College of Medicine and MAS were terminated and we were unable to obtain a license to these rights from Baylor College of Medicine, we would be precluded from selling any SELDI-based products within the scope of the Baylor SELDI patents, we would no longer generate revenue from the sale of these products and we would have to revise our business direction and strategy.

If the government grants a license to the SELDI technology to others, it may harm our business.

Some of the inventions covered by our sublicense agreements with MAS were developed under a grant from an agency of the U.S. government and therefore, pursuant to the Bayh-Dole Act and regulations promulgated thereunder, the government has a paid-up, nonexclusive nontransferable license to those inventions and will be able in limited circumstances to grant a license to others on reasonable terms. We are not aware of any basis for the government to exercise such rights, but if circumstances change and the government exercises such rights, our

business could be harmed.

If we fail to maintain our rights to utilize intellectual property directed to diagnostic biomarkers, we may not be able to offer diagnostic tests using those biomarkers.

One aspect of our business plan is to develop diagnostic tests based on certain biomarkers which we have the right to utilize through licenses with our academic collaborators, such as The Johns Hopkins School of Medicine and Eastern Virginia Medical School. In some cases, our collaborators own the entire right to the biomarkers. In other cases we co-own the biomarkers with our collaborator. If, for some reason, we lose our license to biomarkers owned entirely by our collaborators, we may not be able to use those biomarkers in diagnostic tests. If we lose our exclusive license to biomarkers co-owned by us and our collaborators, our collaborators may license their share of the intellectual property to a third party that may compete with us in offering the diagnostic test.

If we draw funds from the $10 million secured line of credit with Quest Diagnostics and fail to achieve the loan forgiveness milestones set forth therein, we will be responsible for full repayment of the loan.

In connection with the strategic alliance with Quest Diagnostics, Quest Diagnostics agreed to provide us with a $10 million secured line of credit. Funds from this secured line of credit will only be used to pay certain costs and expenses directly related to the strategic alliance, with forgiveness of the repayment obligations based upon our achievement of milestones related to the commercialization of laboratory tests and FDA clearance for such tests. Should we fail to achieve these milestones, we would be responsible for the repayment of disbursements made under the line of credit, with interest.

If a competitor infringes our proprietary rights, we may lose any competitive advantage we may have as a result of diversion of management time, enforcement costs and the loss of the exclusivity of our proprietary rights.

Our commercial success depends in part on our ability to maintain and enforce our proprietary rights. We rely on a combination of patents, trademarks, copyrights and trade secrets to protect our technology and brand. In addition to our licensed SELDI technology, we also have submitted patent applications directed to subsequent technological improvements and application of the SELDI technology, including patent applications covering biomarkers that may have diagnostic or therapeutic utility. Our patent applications may not result in additional patents being issued.

If competitors engage in activities that infringe our proprietary rights, our management s focus will be diverted and we may incur significant costs in asserting our rights. We may not be successful in asserting our proprietary rights, which could result in our patents being held invalid or a court holding that the competitor is not infringing, either of which would harm our competitive position. We cannot be sure that competitors will not design around our patented technology.

We also rely upon the skills, knowledge and experience of our technical personnel. To help protect our rights, we require all employees and consultants to enter into confidentiality agreements that prohibit the disclosure of confidential information. These agreements may not provide adequate protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure.

If others successfully assert their proprietary rights against us, we may be precluded from making and selling our products or we may be required to obtain licenses to use their technology.

Our success also depends on avoiding infringing on the proprietary technologies of others. We are aware of third parties whose business involves the use of mass spectrometry and other technologies for the analysis of proteins and DNA, and third parties whose business involves providing diagnostic tests. Certain of these parties have brought their patents to our attention. If these parties assert claims that we are violating their patents, we may incur substantial costs defending ourselves in lawsuits against charges of patent infringement or other unlawful use of another s proprietary technology. Any such lawsuit may not be decided in our favor, and if we are found liable, we may be subject to monetary damages or injunction against using their technology. We may also be required to obtain licenses under their patents and such licenses may not be available on commercially reasonable terms, if at all.

We rely on single-source suppliers for many components of our ProteinChip Systems as well as processing services for our ProteinChip Arrays, and if we are unable to obtain these components and processing services, we would be harmed and our operating results would suffer.

We depend on many single-source suppliers for the necessary raw materials and components required to manufacture our products. We also rely on some single-source subcontractors for certain outsourced manufacturing services. Some of these suppliers are small companies without extensive financial resources. Because of the limited quantities of products we currently manufacture, it is not economically feasible to qualify and maintain alternate vendors for most components of our ProteinChip Readers and processing services for our ProteinChip Arrays. We have occasionally experienced delays in receiving raw materials, components and services, resulting in manufacturing delays. If we are unable to procure the necessary raw materials, components or services from our current vendors, we will have to arrange new sources of supply and our raw materials and components shipments could be delayed, harming our ability to manufacture our products, and our ability to sustain or increase revenue could be harmed. As a result, our costs could increase and our profitability could be harmed.

If we fail to maintain certain distribution and patent license agreements, we may have to stop selling certain products and this may harm our revenue.

We sell certain products under either OEM or distribution or patent license agreements. These include arrangements with Beckman Coulter with respect to selling a customized version of the Biomek 3000 Workstation, with Salford Systems with respect to selling Biomarker Patterns software, and with Applied Biosystems / MDS Sciex with respect to selling our ProteinChip Tandem MS Interfaces. If we fail to maintain or extend after their expiration the underlying agreements with these companies, we would have to stop selling these particular products and may have to seek alternate products to sell, as a result of which our sales may be harmed.

If there are reductions in research funding, the ability of our existing and prospective customers to purchase our products could be seriously harmed.

A significant portion of our products are sold to universities, government research laboratories, private foundations and other institutions where funding is dependent upon grants from government agencies, such as the National Institutes of Health. Government funding for research and development has fluctuated significantly in the past due to changes in congressional appropriations. Research funding by the U.S. government or the governments of other countries may be significantly reduced in the future. Any such reductions may seriously harm the ability of our existing and prospective research customers to purchase our products or may reduce the number of ProteinChip Arrays used. Limitations in funding for commercial, biotechnology and pharmaceutical companies and academic institutions that are the potential customers for our ProteinChip Systems and Arrays, and general cost containment pressures for biomedical research may limit our ability to sell our products and services.

If we or our future potential partners fail to comply with Food and Drug Administration (FDA) requirements, we may not be able to market our products and services and may be subject to stringent penalties; further improvements to our manufacturing operations will be required which may not be accomplished and will entail additional cost.

Currently, the FDA does not actively regulate clinical laboratory tests, or home brews , that have been developed and used by the laboratory to conduct in-house testing. The FDA does regulate as medical devices the active ingredients (known as analyte specific reagents or ASRs) of certain tests developed in-house by clinical laboratories. The FDA s regulations provide that most ASRs are exempt from the FDA s pre-market review requirements. We believe that ASRs that we may provide will fall within those exemptions. However, the FDA has publicly stated it is reevaluating its ASR policy and regulations, and we expect that revisions to these regulations may be implemented in the future that may have the effect of increasing the regulatory burden on manufacturers of these devices. The commercialization of our products and services could be impacted by being delayed, halted or prevented. If the FDA were to view any of our actions as non-compliant, it could initiate enforcement action such as a regulatory warning letter and possible imposition of penalties. Finally, ASRs that we may provide will be subject to a number of FDA requirements, including compliance with the FDA s Quality System Regulations (QSRs), which establish extensive regulations for quality assurance and control as well as manufacturing procedures. Failure to comply with these regulations could result in enforcement action for us or our potential partners. Adverse FDA action in any of these areas could significantly increase our expenses and limit our revenue and profitability. Although we are ISO 9001:2000 certified in our ProteinChip manufacturing processes, we will need to undertake additional steps to bring our operations in line with FDA QSR requirements. Significant additional resources will be required to achieve this quality level. If we are successful in entering the diagnostics market, our manufacturing facilities will be subject to periodic regulatory inspections by the FDA and other federal and state regulatory agencies. We have not yet been subject to an FDA inspection. We may not satisfy such regulatory requirements, and any such failure to do so would have an adverse effect on our diagnostics efforts.

Our diagnostic efforts may cause us to have significant product liability exposure.

The testing, manufacturing and marketing of medical diagnostics entails an inherent risk of product liability claims. Potential product liability claims may exceed the amount of our insurance coverage or may be excluded from coverage under the terms of the policy. Our existing insurance will have to be increased in the future if we are successful at introducing diagnostic products and this will increase our costs. In the event that we are held liable for a claim against which we are not indemnified or for damages exceeding the limits of our insurance coverage, our liabilities could exceed our total assets.

Business interruptions could limit our ability to operate our business.

Our operations as well as those of the collaborators on which we depend are vulnerable to damage or interruption from computer viruses, human error, natural disasters, power shortages, telecommunication failures, international acts of terror and similar events. Although we have certain business continuity plans in place, we have not established a formal comprehensive disaster recovery plan, and our back-up operations and our business interruption insurance may not be adequate to compensate us for losses we may suffer. A significant business interruption could result in losses or damages incurred by us and require us to cease or curtail our operations.

Our business is subject to risks from international operations.

We conduct business globally. Accordingly, our future results could be materially adversely affected by a variety of uncontrollable and changing factors including, among others, foreign currency exchange rates; regulatory, political, or economic conditions in a specific country or region; trade protection measures and other regulatory requirements; and natural disasters. Any or all of these factors could have a material adverse impact on our future international business. In certain countries, a few key individuals are important to our local success. In addition, China does not currently have a comprehensive and highly developed legal

system, particularly with respect to the protection of intellectual property rights. As a result, enforcement of existing and future laws and contracts is uncertain, and the implementation and interpretation of such laws may be inconsistent. Such inconsistency could lead to piracy and degradation of our intellectual property protection.

We are exposed to fluctuations in the exchange rates of foreign currency.

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. With our ownership of Ciphergen Biosystems KK, a significant percentage of our net sales are exposed to foreign currency risk. These exposures may change over time as business practices evolve and could have a material adverse impact on our financial results.

Consolidation in the pharmaceutical and biotechnology industries may reduce the size of our target market and cause a decrease in our revenue.

Consolidation in the pharmaceutical and biotechnology industries is generally expected to occur. Planned or future consolidation among our current and potential customers could decrease or slow sales of our technology and reduce the markets our products target. Any such consolidation could limit the market for our products and seriously harm our ability to achieve or sustain profitability.

We may not successfully resolve problems encountered in connection with any future acquisitions or strategic investments.

In July 2001, we acquired the BioSepra process chromatography business from Invitrogen Corporation, which we subsequently sold in November 2004. In August 2002, we increased our ownership interest in Ciphergen Biosystems KK, the Japanese joint venture we formed with Sumitomo Corporation in 1999, from 30% to 70%, and in March 2004, we further increased our ownership to 100%. In the event of any future acquisitions, joint ventures and other strategic investments, we could:

issue stock that would dilute ownership of our then-existing stockholders;

incur charges for the impairment of the value of investments or acquired assets; or

incur amortization expense related to intangible assets.

If we fail to achieve the financial and strategic benefits of past and future acquisitions or strategic investments, our operating results will suffer. Acquisitions and strategic investments involve numerous other risks, including:

difficulties integrating the acquired operations, technologies or products with ours;

failure to achieve targeted synergies;

unanticipated costs and liabilities;

diversion of management s attention from our core business;

adverse effects on our existing business relationships with suppliers and customers or those of the acquired organization; and

potential loss of key employees, particularly those of the acquired organization.

We are subject to environmental laws and potential exposure to environmental liabilities.

We are subject to various international, federal, state and local environmental laws and regulations that govern our operations, including the handling and disposal of nonhazardous and hazardous wastes, the recycling and treatment of electrical and electronic equipment, and emissions and discharges into the environment. Failure to comply with such laws and regulations could result in costs for corrective action, penalties or the imposition of other liabilities. We also are subject to laws and regulations that impose liability and clean-up responsibility for releases of hazardous substances into the environment. Under certain of these laws and regulations, a current or previous owner or operator of property may be liable for the costs of remediating hazardous substances or petroleum products on or from its property, without regard to whether the owner or operator knew of, or caused, the contamination, as well as incur liability to third parties impacted by such contamination. The presence of, or failure to remediate properly, such substances could adversely affect the value and the ability to transfer or encumber such property. Based on currently available information, although there can be no assurance, we believe that such costs and liabilities have not had and will not have a material adverse impact on our financial results.

Anti-takeover provisions in our charter, bylaws and Stockholder Rights Plan and under Delaware law could make a third party acquisition of us difficult.

Our certificate of incorporation, bylaws and Stockholder Rights Plan contain provisions that could make it more difficult for a third party to acquire us, even if doing so might be deemed beneficial by our stockholders. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. We are also subject to certain provisions of Delaware law that could delay, deter or prevent a change in control of us.

The rights issued pursuant to our Stockholder Rights Plan will become exercisable the tenth day after a person or group announces acquisition of 15% or more of our common stock or announces commencement of a tender or exchange offer the consummation of which would result in ownership by the person or group of 15% or more of our common stock. If the rights become exercisable, the holders of the rights (other than the person acquiring 15% or more of our common stock) will be entitled to acquire, in exchange for the rights exercise price, shares of our common stock or shares of any company in which we are merged, with a value equal to twice the rights exercise price.

Risks Related to Our Convertible Senior Notes and Common Stock

Substantial leverage and debt service obligations may adversely affect our cash flows.

In connection with the sale of the convertible senior notes (the notes), we incurred $30 million of indebtedness. As a result of this indebtedness, our principal and interest payment obligations increased substantially. The degree to which we are leveraged could, among other things:

make it difficult for us to make payments on the notes;

make it difficult for us to obtain financing for working capital, acquisitions or other purposes on favorable terms, if at all;

make us more vulnerable to industry downturns and competitive pressures; and

limit our flexibility in planning for, or reacting to changes in, our business.

Our ability to meet our debt service obligations will depend upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

The notes are unsecured, and future indebtedness could effectively rank senior to the notes.

The notes are unsecured and will rank equal in right of payment with our existing and future unsecured and unsubordinated indebtedness. The notes will be effectively subordinated to any secured debt to the extent of the value of the assets that secure the indebtedness. The notes will also be structurally subordinated to all indebtedness and other liabilities, including trade payables and lease obligations, of our existing and future subsidiaries. In the event of our bankruptcy, liquidation or reorganization or upon acceleration of the notes, payment on the notes could be less, ratably, than on any secured indebtedness. We may not have sufficient assets remaining to pay amounts due on any or all of the notes then outstanding.

The indenture governing the notes does not prohibit or limit us or our subsidiaries from incurring additional indebtedness and other liabilities, or from pledging assets to secure such indebtedness and liabilities. The incurrence of additional indebtedness and, in particular, the granting of a security interest to secure the indebtedness, could adversely affect our ability to pay our obligations on the notes. We anticipate that we may incur additional indebtedness from time to time in the future.

The notes are not protected by restrictive covenants, including financial covenants.

Neither we nor our subsidiaries are restricted from incurring additional debt, including senior debt, or liabilities under the indenture. In addition, the indenture does not restrict us or any of our subsidiaries from paying dividends or issuing or repurchasing securities. If we or our subsidiaries were to incur additional debt or liabilities, our ability to pay our obligations on the notes could be adversely affected.

We may be unable to repay, repurchase or redeem the notes.

At maturity, the entire outstanding principal amount of the notes will become due and payable by us. Upon a change in control, as defined in the indenture, note holders may require us to repurchase all or a portion of their notes. We may not have enough funds or be able to arrange for additional financing to pay the principal at maturity or to repurchase the notes on a change in control. Future credit agreements or other agreements relating to our indebtedness may restrict the redemption or repurchase of the notes and provide that a change in control constitutes an event of default. If the maturity date or a change in control occurs at a time when we are prohibited from repaying or repurchasing the notes, we could seek the consent of our lenders to purchase the notes or we could

attempt to refinance this debt. If we do not obtain the necessary consents or cannot refinance the debt on favorable terms, or at all, we will be unable to repay or repurchase the notes. Our failure to repay the notes at maturity or repurchase tendered notes would constitute an event of default under the indenture, which might constitute a default under the terms of our other debt. Our obligation to offer to purchase the notes upon a change in control would not necessarily afford note holders protection in the event of a highly leveraged transaction, reorganization, merger or similar transaction involving us.

There may not be an active, liquid market for our common stock or the notes.

There is no guarantee that an active trading market for our common stock will be maintained on the Nasdaq Stock Market s National Market. Investors may not be able to sell their shares quickly or at the latest market price if trading in our stock is not active. An active trading market for the notes may not be maintained. If an active market for the notes is not sustained, the trading price of the notes could decline significantly. The notes are eligible for trading on the PORTAL[sm] Market. We do not intend to apply for listing of the notes on any securities exchange.

The notes and the common stock issuable upon conversion of the notes may be subject to restrictions on resale.

We entered into a registration rights agreement with the initial purchasers of the notes, pursuant to which we filed a shelf registration statement covering the resale of the notes and the common stock issuable upon conversion of the notes. If the effectiveness of the registration statement is not maintained, the liquidity and price of the notes and common stock issuable upon conversion of the notes would be adversely affected and note holders could lose all or part of their investment.

At various times during 2003, 2004 and 2005, the price at which our common stock could be purchased on the Nasdaq National Market was lower than the conversion price of the notes, and our stock price may be lower than the conversion price in the future.

Prior to electing to convert notes, the note holder should compare the price at which our common stock is trading in the market to the conversion price of the notes. Our common stock trades on the Nasdaq National Market under the symbol CIPH. The initial conversion price of the notes is approximately $9.19 per share. The market prices of our securities are subject to significant fluctuations. Such fluctuations, as well as economic conditions generally, may adversely affect the market price of our securities, including our common stock and the notes.

The notes may not be rated or may receive a lower rating than anticipated.

We believe it is unlikely that the notes will be rated. However, if one or more rating agencies rates the notes and assigns the notes a rating lower than the rating expected by investors, reduces their rating in the future or indicates that it will have their ratings on the notes under surveillance or review with possible negative implications, the market price of the notes and our common stock would be harmed. In addition, a ratings downgrade could adversely affect our ability to access capital.

Our stock price has been highly volatile, and an investment in our stock could suffer a decline in value, adversely affecting the value of the notes or the shares into which those notes may be converted.

The trading price of our common stock has been highly volatile and could continue to be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including:

actual or anticipated period-to-period fluctuations in financial results;

failure to achieve, or changes in, financial estimates by securities analysts;

announcements of new products or services or technological innovations by us or our competitors;

developments regarding actual or potential discoveries of biomarkers by us or others;

comments or opinions by securities analysts or major stockholders;

conditions or trends in the pharmaceutical, biotechnology and life science industries;

announcements by us of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

developments regarding our patents or other intellectual property or that of our competitors;

litigation or threat of litigation;

additions or departures of key personnel;

sales of our common stock;

limited daily trading volume; and

economic and other external factors or disasters or crises.

In addition, the stock market in general, and the Nasdaq National Market and the market for technology companies in particular, have experienced significant price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Further, there has been significant volatility in the market prices of securities of life science companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs, potential liabilities and the diversion of management s attention and resources.

Future sales of our common stock in the public market could adversely affect the trading price of our common stock, the value of the notes and our ability to raise funds in new stock offerings.

Future sales of substantial amounts of our common stock in the public market, or the perception that such sales are likely to occur, could affect prevailing trading prices of our common stock and the value of the notes. As of June 30, 2005, we had:

29,631,428 shares of common stock outstanding;

5,759,361 shares of common stock reserved for issuance upon exercise of options outstanding under our stock option plans with a weighted average exercise price of $5.30 per share;

in addition to the shares reserved for issuance upon the exercise of options referred to in the preceding bullet point, 1,212,076 shares reserved for future issuance under our stock option and employee stock purchase plans; and

96,750 shares of common stock potentially issuable to Stanford Research Systems, Inc. under a development contract if certain milestones are met.

Because the notes are convertible into common stock only at a specific conversion price, a decline in our common stock price may cause the value of the notes to decline.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have classified our short-term investments as available-for-sale, and have accordingly recorded them on the balance sheet at fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive income (loss). These investments are not leveraged and are held for purposes other than trading.

The following discussion about our market risk involves forward-looking statements. We are exposed to market risk related mainly to changes in interest rates. We do not invest in derivative financial instruments.

INTEREST RATE SENSITIVITY

As of June 30, 2005, our only investment was a fixed rate annuity with a fair value of $2.2 million due to mature on February 28, 2006, with an option to renew for one year at an estimated interest rate of 3.0% per annum. With the exception of the investment in this annuity, we believe that, in the near-term, we will maintain our available funds in short-term, highly liquid securities with original maturities of 90 days or less, and money market accounts.

The primary objective of our investment activities is to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. Our investment policy, which has been approved by our Board of Directors, specifies credit quality standards for our investments and limits the amount of credit exposure to any single issue, issuer or type of investment. We may maintain our portfolio of cash equivalents, short-term investments and long-term investments in a variety of securities, including commercial paper, money market funds, and government and non-government debt securities, subject to our investment policy.

Our exposure to market risk for changes in interest rates relates primarily to the increase or decrease in the amount of interest income we can earn on our available funds for investment. Our long-term debt and capital lease agreements are at fixed interest rates. We do not plan to use derivative financial instruments in our investment portfolio.

FOREIGN CURRENCY EXCHANGE RISK

Most of our revenue is realized in U.S. dollars. However, all our revenue in Japan is realized in Japanese yen. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. Because most of our revenue is currently denominated in U.S. dollars, an increase in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in foreign markets.

The functional currency of Ciphergen Biosystems KK is the yen. Accordingly, the accounts of this operation were translated from yen to the U.S. dollar using the current exchange rate in effect at the balance sheet date for the balance sheet accounts, and using the average exchange rate during the period for revenue and expense accounts. The effects of translation are recorded as a separate component of stockholders equity.

The accounts of all other non-U.S. operations are remeasured to the U.S. dollar, which is the functional currency. Accordingly, all monetary assets and liabilities of these foreign operations are translated into U.S. dollars at current period-end exchange rates, and non-monetary assets and related elements of expense are translated using historical rates of exchange. Income and expense elements are translated to U.S. dollars using average exchange rates in effect during the period. Gains and losses from the foreign currency transactions of these subsidiaries are recorded as other income or expense in the statement of operations.

The net tangible assets of our non-U.S. operations, excluding intercompany debt, were $4.8 million at June 30, 2005.

In 2004 we entered into foreign currency contracts to manage the volatility of currency fluctuations as a result of an intercompany loan of approximately $1.0 million, denominated in yen, to our subsidiary in Japan. The effect of exchange rate changes on the forward exchange contracts largely offset the effect of exchange rate changes on the intercompany loan. Net realized foreign currency gains and losses related to foreign currency forward contracts were not material for the three and six month periods ended June 30, 2004. As of January 1, 2005, there were no forward contracts outstanding and during the three and six month periods ended June 30, 2005, there were no transactions related to forward contracts. Although we will continue to monitor our exposure to currency fluctuations, we cannot provide assurance that exchange rate fluctuations will not harm our business in the future.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that the information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer (Certifying Officers), to allow timely decisions regarding required financial disclosures.

As described in the Introductory Note to this Amendment No. 1 to Form 10-Q and in note 1 to our Unaudited Condensed Consolidated Financial Statements, following the period covered by this report, management identified errors in connection with certain sales transactions that did not qualify for revenue recognition during the second quarter of 2005, and certain other sales transactions for which the Company failed to defer a portion of the revenue that should have been deferred in accordance with the terms of side letter arrangements with customers. The errors in recording these transactions resulted in the restatement of the Company s financial statements for the quarter ended June 30, 2005.

The Company s Certifying Officers had previously concluded that our disclosure controls and procedures, as defined in Exchange Act Rule 13a-15(e), were effective as of June 30, 2005. However, in connection with the restatement of our financial statements for the quarter ended June 30, 2005, as described above, we performed an evaluation, under the supervision of the Certifying Officers, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based upon such evaluation, our

Certifying Officers concluded that our disclosure controls and procedures were not effective because of the material weakness in our internal control over financial reporting described below. Notwithstanding the existence of this material weakness, our management, including our Certifying Officers, believes that the unaudited condensed consolidated financial statements included in this report fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

Material Weakness in Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Exchange Act Rule 13a-15(f). Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. As of the

quarterly reporting period ended June 30, 2005, the Company did not maintain effective controls over the completeness of revenue recognition and deferred revenue. Specifically, the Companys revenue controls over (i) the accounting for transactions in which side letter arrangements have been entered into, and (ii) the determination of the collectability of receivables for certain revenue transactions were not effective to ensure that revenue was recorded in the appropriate period. This control deficiency resulted in the restatement of the Company s previously issued interim financial statements for the quarter ended June 30, 2005. In addition, this control deficiency could result in a misstatement of revenue and deferred revenue that would result in a material misstatement to annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

Changes in Internal Control Over Financial Reporting

The Audit Committee of our Board of Directors conducted an investigation of the accounting errors. As a result of this investigation, under the direction of our Audit Committee, management developed and implemented additional measures designed to ensure that information required to be disclosed in our periodic reports is recorded, processed, summarized and reported accurately. These measures include:

the addition of further controls over shipments of our products for revenue transactions;

the addition of a policy prohibiting entering into side agreements without prior management approval, and a requirement for a written certification by the salesperson at the time of each order exceeding $50,000 confirming all aspects of the sale, including the terms of any otherwise undisclosed side agreements;

strengthening of our credit assessment and accounts receivable processes; and

providing additional training for our sales and marketing staff to minimize the risk of revenue recognition errors.

We believe that, with the additional measures adopted by the Company since June 30, 2005, our system of internal controls and our disclosure controls and procedures will be adequate to provide reasonable assurance that the information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and accurately reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Certifying Officers, as appropriate, to allow for timely decisions regarding required disclosure based closely on the definition of disclosure controls and procedures in Rule 13a-15(e). We cannot be certain that our remediation efforts will sufficiently cure our identified material weakness prior to December 31, 2005. Furthermore, we have not tested the operating effectiveness of the remediated controls. However, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes.

Other than as noted above, there have been no changes in our internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f), that occurred during the quarter ended June 30, 2005 that have materially affected, or are reasonably likely to

materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Our Annual Meeting of Stockholders was held on June 8, 2005 in Fremont, California. Of the 29,475,663 shares outstanding as of the record date, April 11, 2005, 24,133,746 were present or represented by proxy at the meeting. The results of the voting on the matters submitted to the stockholders were as follows:

1. To elect two (2) Class II directors to serve until the 2008 Annual Meeting of Stockholders and until their successors

are duly elected and qualified.

Name	Votes For	Votes Withheld
Rajen K. Dalal	23,893,406	240,340
John A. Young	23,567,050	566,696

2. To ratify the selection of PricewaterhouseCoopers LLP as the independent registered public accounting firm of the Company for the fiscal year ending December 31, 2005.

Votes for:	23,834,297
Votes against:	188,407
Votes abstaining:	111,042

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The following exhibits have been filed with this report:

3.2 *	Amended and Restated Certificate of Incorporation of Registrant
3.4 *	Amended and Restated Bylaws of Registrant
3.5 **	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of Ciphergen Biosystems, Inc.
4.1*	Form of Registrant s Common Stock Certificate
4.2 **	Preferred Shares Rights Agreement dated March 20, 2002 between Ciphergen Biosystems, Inc. and Continental Stock Transfer & Trust Company
31.1	Certification of the Chief Executive Officer Pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 (a) of the Sarbanes-Oxley Act of 2002
32	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Incorporated by reference to exhibits (with same exhibit number) to Ciphergen Biosystems Registration Statement on Form S-1 (File No. 333-32812) declared effective on September 28, 2000.

** Incorporated by reference to our Registration Statement on Form 8-A, filed with the Securities and Exchange Commission on March 21, 2002.

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, thereunto duly authorized.

December 21, 2005

CIPHERGEN BIOSYSTEMS, INC.

(Registrant)

/s/ William E. Rich
William E. Rich
Chief Executive Officer and Director

/s/ Matthew J. Hogan
Matthew J. Hogan
Senior Vice President and Chief Financial Officer

EXHIBIT INDEX

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