

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS**

**QUARTER ENDED JUNE 30, 2008**

**INFORMATION REGARDING FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

- the marketing and sales of our products and services;
- the declaration and distribution of any future dividends;
- our ability to sustain licensing and other contract-based revenues;
- the impact of our contracts with the NIH and The Wellcome Trust on future business;
- the value of, and expenses associated with, our intellectual property;
- the impact of our restructuring efforts;
- the requirements of pharmaceutical and biotechnology companies;
- the benefits of knockout mice programs and, in particular, our technologies and products, to the pharmaceutical industry;
- the increasing competition we face in the field of knockout mice from both commercial and government organizations;
- failures in the drug discovery, development and approval processes by our partners and collaborators;
- our ability to successfully execute our business plan and to meet contractual obligations, in view of the Company's limited staff; and
- liquidity and capital resources.

In some cases, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements. These statements reflect our current views with respect to future events and are based on assumptions and subject to risks and uncertainties. Given these uncertainties, you should not place undue reliance on these forward-looking statements. These forward-looking statements represent our estimates and assumptions only as of the date of this report.

You should read this report completely and with the understanding that our actual future results may be materially different from what we expect. We qualify all of our forward-looking statements by these cautionary statements.

**YOU SHOULD READ THE FOLLOWING DISCUSSION AND ANALYSIS IN CONJUNCTION WITH OUR FINANCIAL STATEMENTS AND THE NOTES ACCOMPANYING THE FINANCIAL STATEMENTS.**

## **1. Overview**

Deltagen (or the “Company” or “We”) is a provider of research tools to the biopharmaceutical industry and to the academic research community. Deltagen has generated an inventory of “knockout mice” in which a single gene has been deleted (“knocked out”). The knockout mice have been analyzed to determine the phenotypic changes associated with that gene deletion. This phenotypic data has been organized in an integrated database known as DeltaBase. DeltaBase contains phenotypic data on 750 different knockout mouse lines. In addition to those 750 knockout mouse lines, Deltagen has approximately 150 additional knockout mouse lines that have not been characterized phenotypically. Deltagen also has approximately 450 knockout lines at the embryonic stem (ES) cell stage.

Our customers and partners/collaborators have included some of the world’s largest pharmaceutical companies, including GlaxoSmithKline plc, Merck & Co., Inc., Pfizer Inc., Eli Lilly and Company and Schering-Plough Research Institute.

We have historically generated revenue from our DeltaBase and DeltaOne products and programs.

DeltaBase is our proprietary database that provides information, based on knockout mouse studies, on gene function and validated gene targets for drug discovery. Each knockout mouse underwent a standardized, detailed and extensive analysis in order to determine the function and role that a particular gene plays in the mouse and that gene’s suitability as a drug target.

DeltaOne offers access to our portfolio of knockout mice and/or accompanying phenotypic data, as well as any corresponding intellectual property, on a gene-by-gene basis.

We derive substantially all of our revenues from a narrow and limited range of sources. Substantially all of our revenues are currently derived from the licensing of knockout mouse lines and related phenotypic data to the biopharmaceutical industry and academic institutions under our DeltaOne program. Because of continuing consolidation in the biopharmaceutical industry and the finite number of knockout lines in the Company’s inventory, significant uncertainty exists with respect to the Company’s future revenues.

Our operating results have fluctuated in the past and are likely to do so in the future, and we do not believe that period-to-period comparisons of our operating results are a good indication of our future performance.

## **2. Critical Accounting Policies and Estimates**

The consolidated financial statements of Deltagen for the three-month period ended June 30, 2008 are unaudited, but have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). These consolidated financial statements have been prepared so that they present fairly, in the opinion of management, the Company’s financial position and its results of operations and its cash flows for the period presented.

Under our revenue recognition policy, revenues are recognized when a definitive agreement with a determinable price exists, product delivery and/or invoicing (in each case where there is reasonable assurance of meeting customer-specified criteria) have occurred, and collectibility is reasonably assured. A change in our revenue recognition policy or changes in the terms of contracts under which we recognize revenues could have an impact on the amount and timing of our recognition of revenues.

The preparation of consolidated financial statements in conformity with GAAP requires the Company to make estimates and assumptions that affect the amounts that are reported in the consolidated financial statements and accompanying disclosures. Although these estimates are based on the Company’s best knowledge of current events and actions that the Company may undertake in the future, actual results may differ materially from the estimates.

### 3. Results of Operations

The Company's consolidated revenues for the three months ended June 30, 2008 totaled \$1.207 million. The revenues were attributable primarily to \$0.713 million of license fees associated with the provision of knockout mice and related phenotypic data to The Wellcome Trust (the "Trust") pursuant to an order placed by the Trust on September 13, 2007, together with orders by other customers under the Company's DeltaOne™ program.

The Company had interest income of \$0.019 million for the three months ended June 30, 2008.

Total consolidated expenses for the three months ended June 30, 2008 were \$0.927 million. The operating expenses were attributable primarily to labor costs and other general and administrative expenses, including \$0.348 million in royalty and commission expenses. The labor costs included a cumulative total of \$0.206 million in annual performance-based bonuses paid to the Company's officers and directors, which were paid in July 2008 pursuant to the management and director compensation plan implemented effective July 1, 2007 (the "Comp Plan") for the twelve-month period from July 1, 2007 through June 30, 2008 (the "Period"). The Comp Plan and payments made thereunder are described in greater detail below.

Net loss before provision for income taxes for the three months ended June 30, 2008 was \$0.299 million.

As of June 30, 2008, the Company had \$4.981 million in consolidated cash and cash equivalents (compared to \$4.598 million as of March 31, 2008) and \$1.224 million in accounts receivable (compared to \$1.053 million as of March 31, 2008). The change in cash and cash equivalents amount does not include receipt by Deltagen Europe, S.A., the Company's wholly-owned French subsidiary, of 130,818 euros relating to a tax refund from the French tax authorities for tax year 2001, which had been expected to be received during the second quarter. The tax refund of 130,818 euros for tax year 2001 was received in July 2008 and will be reflected in the financial results for the third quarter of 2008. In addition, the Company received \$0.723 million from the Trust in August 2008, which will be reflected in the financial results for the third quarter of 2008.

### 4. Compensation Plan and Payments

In July 2007, in response to the Company's significantly reduced deal flow (e.g., the Company had entered into only three contracts with new customers, worth approximately \$0.080 million in the aggregate, during the second quarter of 2007) and reduced revenues expectations, the Company implemented certain restructuring changes in an effort to reduce the fixed operating expenses of the Company. These changes are described in greater detail in Management's Discussion and Analysis of Financial Conditions and Results of Operations for the second quarter of 2007, which is posted on the Company's website ([www.deltagen.com](http://www.deltagen.com)).

As part of the restructuring changes, the Company implemented a new Comp Plan for the Period. The principal goals of the Comp Plan were to: (1) reduce the fixed operating expenses of the Company; (2) reduce the risk of a net loss for the Company during the Period; and (3) change the compensation structure for officers and directors to reduce fixed compensation and to make additional variable compensation available only in the event that the Company is profitable during the Period.

Under the Comp Plan, the base salaries of the Company's officers were voluntarily reduced by 50%. The officers were eligible to receive original base salary restoration amounts and performance-based bonuses in the event that the Company realized a profit during the Period. In the aggregate, the Company's officers shared 32% of the Company's first \$0.969 million in profits (the level at which original base salaries would be restored), 20% of the next \$0.980 million in profits and 10% of any profits in excess of the foregoing amounts. Under the Comp Plan, portions of these profit-sharing amounts could be paid to the officers in interim payments during the Period. In February 2008, based on the Company's actual financial performance in the first seven

months of the Period and the Company's forecasted financial performance for the remainder of the Period, the Company's directors authorized payment of base salary restoration amounts (totaling \$0.310 million) to the Company's officers.

The Comp Plan also reduced annual director's fees from \$40,000 each to a base director fee of \$15,000 each. The directors were eligible to each receive 0.5% of the Company's profits, up to a maximum bonus of \$10,000 each.

During the Period, the Company realized \$1.816 million in profits, not including base salary restoration and performance-based bonus amounts earned during the Period. As a result, in addition to the base salary restoration amounts paid in February 2008 for the Company having surpassed \$0.969 million in profits, the officers shared in the aggregate 20% of the additional \$0.847 million in profits earned by the Company during the Period. The directors each received a bonus equal to 0.5% of the Company's profits, amounting to \$9,080 each.

The total compensation received during the Period by each of the Company's officers, according to category, was:

1. Robert J. Driscoll, J.D., Ph.D.  
President, Chief Executive Officer and Secretary  
  
Base Salary: \$150,000  
Base Salary Restoration Amount: \$150,000  
Performance-Based Bonus: \$103,744  
Payment of Deferred Retention and Incentive Bonuses: \$185,275 (1)
  
2. Winston Thomas, Ph.D.  
Chief Operating Officer  
  
Base Salary: \$116,000  
Base Salary Restoration Amount: \$116,000  
Performance-Based Bonus: \$50,143  
Payment of Deferred Retention and Incentive Bonuses: \$74,110 (1)
  
3. Daniel Ratto  
Chief Financial Officer  
  
Base Salary: \$45,000  
Base Salary Restoration Amount: \$45,000  
Performance-Based Bonus: \$15,562  
Payment of Deferred Retention and Incentive Bonuses: \$14,822 (1)

- (1) These bonuses were paid pursuant to the retention and incentive bonus plan adopted by the Company's Board in February 2007 for the Company's officers in exchange for the termination of the officers' stock options. The Board determined that the options, following distribution of a significant cash dividend in December 2006 and the possibility of future dividend distributions, no longer provided an effective retention mechanism or performance incentive to the Company's management team. Payment of the retention and incentive bonuses is made as follows: one-third on the dividend distribution date and one-third paid on each of the subsequent two anniversaries of the dividend distribution date.

## **RISK FACTORS AFFECTING FUTURE OPERATING RESULTS**

There are numerous risks and uncertainties related to both our business and our industry that could cause actual results or events to differ materially from those indicated by forward-looking statements.

For a list of additional risk factors that may affect our future operating results, refer to the “Risk Factors” section of “Management’s Discussion and Analysis of Financial Conditions and Results of Operations” for the year ended December 31, 2005, as posted on the Company’s website ([www.deltagen.com](http://www.deltagen.com)). The risk factors listed there are not the only ones we face and additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair or otherwise affect our business operations.