

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

QUARTER AND YEAR ENDED DECEMBER 31, 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 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 and year ended December 31, 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 and year ended December 31, 2008 totaled \$0.458 million and \$2.926 million, respectively. The revenues in the fourth quarter were attributable primarily to license fees associated with the provision of knockout mice and related phenotypic data pursuant to orders placed by customers under the Company's DeltaOne™ program.

The Company had interest income of \$0.020 million and \$0.086 million for the three months and year ended December 31, 2008, respectively.

Total consolidated expenses for the three months and year ended December 31, 2008 were \$0.747 million and \$2.857 million, respectively. The operating expenses in the fourth quarter were attributable primarily to labor costs and other general and administrative expenses, including \$0.164 million in royalty and commission expenses. As of December 31, 2008, the Company had paid to Lexicon Pharmaceuticals, Inc. ("Lexicon") an aggregate total of \$4.412 million in royalty payments pursuant to a March 2005 settlement agreement between Lexicon and the Company. Under the settlement, the maximum, aggregate amount of royalty payments due to Lexicon is \$6 million. Accordingly, up to \$1.588 million in contingent royalty payments remained owed to Lexicon as of December 31, 2008.

Net loss before provision for income taxes for the three months ended December 31, 2008 was \$0.269 million. Net income before provision for income taxes for the year ended December 31, 2008 was \$0.155 million.

As of December 31, 2008, the Company had \$5.085 million in consolidated cash and cash equivalents (compared to \$3.064 million as of December 31, 2007) and \$0.414 million in accounts receivable. The cash and cash equivalents amount as of December 31, 2008 does not reflect the last of three annual deferred incentive and retention payments, totaling \$0.214 million, relating to the Company's December 2006 dividend, which became payable on December 30, 2008 and were paid in January 2009 to the Company's executives.

In the fourth quarter of 2008, the Company's directors decided to retain the management compensation plan originally implemented effective July 1, 2007 (the "Comp Plan") for the twelve-month period from July 1, 2008 through June 30, 2009 (the "Period"). Under the Comp Plan, the Company's officers voluntarily had their base salaries reduced by 50%, but remain eligible to receive original base salary restoration amounts and, along with the directors, performance-based bonuses, in the event that the Company realizes a profit during the Period. The Comp Plan is described in greater detail in Management's Discussion and Analysis of Financial Conditions and Results of Operations for the second quarter of 2008, which are posted on Deltagen's website (www.deltagen.com).

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). 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.