

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-QSB

(Mark One)

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

For the quarterly period ended September 30, 2000

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

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

Commission file number: 001-13467

COMMONWEALTH BIOTECHNOLOGIES, INC.

(Exact name of small business issuer as specified in its charter)

Virginia (State or other jurisdiction of incorporation or organization) 54-1641133 (I.R.S. Employer Identification No.)

601 Biotech Drive, Richmond, Virginia 23235 (Address of principal executive offices)

(804) 648-3820 (Issuer's telephone number)

Check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

As of November 10, 2000, 2,076,164 shares of common stock, no par value, of the registrant were outstanding.

Transitional Small Business Disclosure Format (Check one) Yes: No: X

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

<TABLE> <CAPTION>

Commonwealth Biotechnologies, Inc. Balance Sheets

December 31, 1999 September 30, 2000

(Unaudited)

<S> <C> <C>

Assets Current Assets Cash and cash equivalents \$ 2,135,747 \$ 31,630 Accounts receivable 705,927 458,677 Prepaid expenses and inventory 134,678 70,269

Total current assets 2,976,352 560,576

Property and Equipment, net	7,184,675
7,019,109	
Other Assets	
Restricted cash	434,607
418,047	
Bond issue costs, net	241,379
249,437	
Accounts receivable	70,638
-	
Deposits	3,200
3,200	
-----	
Total other assets	749,824
670,684	
-----	
	\$10,910,851
\$ 8,250,369	
-----	
-----	
Liabilities and Stockholders' Equity	
Current Liabilities	
Demand note payable	\$ 149,680
\$ 199,680	
Line of credit	-
282,000	
Current portion of capital lease	119,063
-	
Accounts payable and other current liabilities	397,800
480,726	
Deferred revenue	8,857
5,460	
-----	
Total current liabilities	675,400
967,866	
-----	
Deferred Revenue	70,638
-	
Long Term Debt	
Bonds payable	4,000,000
4,000,000	
Capital lease	194,230
-	
-----	
Total long term debt	4,194,230
4,000,000	
-----	
Stockholders' Equity	
Common stock, no par value, 10,000,000 shares authorized	-
-	
September 30, 2000 - 2,084,045; December 31,	
1999 - 1,643,727 shares issued and outstanding	
Additional paid-in capital	11,913,270
8,925,742	
Accumulated deficit	(5,942,687)
(5,643,239)	
-----	
Total stockholders' equity	5,970,583
3,282,503	
-----	
	\$10,910,851
\$ 8,250,369	
-----	
-----	

See notes to financial statements.

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	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September
	2000	1999	2000	1999
	(Unaudited)		(Unaudited)	
<S>	<C>	<C>	<C>	<C>
Revenue				
Short term projects	\$ 383,973	\$ 286,364	\$ 877,516	\$ 718,958
Long term projects	592,496	509,122	2,341,605	928,263
Research grants	20,154	17,863	82,838	160,264
AccuTrac	3,010	8,460	8,800	39,260
<b>Total revenue</b>	<b>999,633</b>	<b>821,809</b>	<b>3,310,759</b>	<b>1,846,745</b>
Costs and Expenses				
Cost of services	640,744	530,098	1,804,348	1,208,354
Sales, general & administrative	558,541	490,699	1,446,203	1,741,432
Research and development	30,641	92,703	132,410	339,809
<b>Total costs and expenses</b>	<b>1,229,926</b>	<b>1,113,500</b>	<b>3,382,961</b>	<b>3,289,595</b>
Operating loss	(230,293)	(291,691)	(72,202)	(1,442,850)
Other income (expenses)				
Interest expense	(86,152)	(74,543)	(252,994)	(224,960)
Interest income	8,087	7,597	25,748	74,823
<b>Total other income (expense)</b>	<b>(78,065)</b>	<b>(66,946)</b>	<b>(227,246)</b>	<b>(150,137)</b>
Net loss	\$ (308,358)	\$ (358,637)	\$ (299,448)	\$ (1,592,987)
Basic loss per common share	\$ (0.18)	\$ (0.22)	\$ (0.17)	\$ (0.97)

See notes to financial statements.

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Commonwealth Biotechnologies, Inc.  
Statements of Cash Flows

	Nine Months Ended	
	September 30, 2000	September 30, 1999
	(Unaudited)	
<S>	<C>	<C>
Cash Flows from Operating Activities		
Net income (loss)	\$ (299,448)	\$ (1,592,987)
Adjustments to reconcile net income (loss) to net cash used in operating activities		
Depreciation and amortization	449,784	405,732
Changes in:		
Accounts receivable	(317,888)	(220,526)
Prepaid expenses and inventory	(64,410)	(81,272)
Accounts payable and accrued expenses	(82,926)	(238,823)
Deferred revenue	74,035	(59,681)

Net cash used in operating activities	(240,853)	(1,787,557)
Cash Flows from Investing Activities		
Purchases of property, plant and equipment	(210,466)	(271,618)
Net cash used in investing activities	(210,466)	(271,618)
Cash Flows from Financing Activities		
Proceeds from issuance of common stock	2,987,528	63,078
Principal payments on demand note payable	(415,532)	(40,000)
Restricted cash	(16,560)	(9,540)
Net cash provided by financing activities	2,555,436	13,538
Net increase (decrease) in cash and cash equivalents	2,104,117	(2,045,637)
Cash and cash equivalents, beginning of period	31,630	2,091,586
Cash and cash equivalents, end of year	\$2,135,747	\$ 45,949
Supplemental Disclosure of Cash Flow Information		
Capital lease obligation	\$ 378,825	\$ -
Cash payments for interest	226,865	220,241

See notes to financial statements.

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Commonwealth Biotechnologies, Inc.  
Notes To Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited financial statements (except for the balance sheet at December 31, 1999, which is derived from audited financial statements) have been prepared in accordance with generally accepted accounting principles for interim financial statements and Regulation S-B. Accordingly, they do not include all of the information required by generally accepted accounting principles for complete financial statements. In the opinion of the Company, all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position and the results of operations for the periods presented have been included. The results of operations for the three and nine months ended September 30, 2000 are not necessarily indicative of the results that may be expected for the year ending December 31, 2000.

Note 2. Earnings (Loss) Per Share

The Company follows the guidance provided in SFAS 128, Earnings Per Share, which establishes standards for computing and presenting earnings per share and applies to entities with publicly held common stock or potential common stock. Those entities that have only common stock outstanding are required to present only basic per share amounts. Diluted per share amounts assume the conversion, exercise or issuance of all potential common stock instruments such as warrants and convertible securities, unless the effect is to reduce a loss or increase earnings per share. At September 30, 2000, the Company had stock options and warrants outstanding that were anti-dilutive since the Company incurred a net loss for all periods presented.

Note 3. Proposed Business Acquisition

On May 30, 2000, the Company signed a letter of intent to acquire the drug development business of SRA Life Sciences, Inc. (SRA). On October 2, 2000, the Company announced that it has withdrawn its offer to acquire SRA.

Note 4. Sale of Common Stock

On September 27, 2000, the Company completed a private placement of 348,000 shares of common stock at a purchase price of \$7.471 per share and warrants to purchase an additional 348,000 shares of common stock. The warrants are divided into two equal portions with one half having the right to purchase one share of common stock at a price of \$6.50 per share for a period of eighteen months, and the other half having the right to purchase one share of common stock at a purchase price of \$6.50 per share for a period of five years. The purchase agreement requires the Company to use its best efforts to prepare and file with the Securities and Exchange Commission as soon as practicable a registration statement under the Securities Act with respect to the resale of

these securities. Net proceeds to the Company from this private placement amounted to \$2,384,803 and are to be used to pay off the line of credit and for general working capital needs. The purchaser of the common stock and warrants is a significant stockholder of the Company and is the lender on the line of credit to be paid off by the proceeds.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following should be read in conjunction with the Company's Financial Statements and Notes included herein.

### Business Considerations

In October 1997, the Company closed its initial public offering (IPO) and received net proceeds of \$5,417,578, net of underwriting and other costs. In connection with the IPO, the underwriters purchased warrants for 101,500 shares of common stock. The warrants are exercisable for a period of five years at an exercise price of \$9.90 per share.

Since 1997 and through 1999, the Company incurred recurring operating losses due to increased operating costs without corresponding increases in revenues. Through 1999, these deficits were substantially funded through use of funds obtained from the private placement and IPO. The Company has also used proceeds from its offerings for capital acquisitions, which were primarily funded through its issuance of Industrial Revenue Development Bonds. At December 31, 1999, the Company had used virtually all of the funds received in connection with its offerings and is currently relying on operations for future cash flows.

Management believes that the Company will be able to overcome the 1999 working capital deficit and generate positive net cash flows. The following highlights describe significant factors that have occurred in the third quarter of 2000 with respect to continued operations:

- o On September 27, 2000, the Company completed a private placement of common stock and warrants to purchase common stock and received net proceeds of \$2,384,803 (see notes to financial statements). The proceeds are to be used to pay off the line of credit and for general working capital needs.
- o In the fourth quarter of 1999, the Company was awarded a five-year subcontract valued at \$8.5 million with the Illinois Institute of Technology Research Institute. During the third quarter of 2000, the second year of this contract was awarded to the Company and is expected to provide revenues of approximately \$1.5 million. This revenue will be recognized during the fourth quarter of 2000 and the first three-quarters of 2001.
- o At September 30, 2000, the Company has approximately twenty-four contracts out for bid with various potential customers. These contracts, if awarded, would provide the Company with approximately \$3.8 million to \$6.5 million in revenues over the next two to three years.
- o Management continues to monitor and reduce operating costs.

### Overview

The Company's revenues are derived principally from providing macromolecular synthetic and analytical services to researchers in the biotechnology industry or who are engaged in life sciences research in government or academic labs throughout the world. Development of innovative technologies for biotechnology requires sophisticated laboratory techniques and the Company provides these

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services to customers on a contract basis. The Company's customers consist of private companies, academic institutions and government agencies, all of which use biological processes to develop products for health care, agricultural, and other purposes.

The Company generally derives revenue from two types of customers: those who require a discrete set of services ("short-term projects"), and those who contract with the Company on an extended basis for performance of a variety of integrated services ("long-term projects"). More often than not, the Company's customers provide repeat business to the Company. Historically, a majority of the Company's revenues have been earned under short-term projects. However, the Company views long-term projects as the more important source of revenue, and has continued to focus its efforts on identifying long-term customers. Long-term projects generally range from a few months to more than a year. Revenues are generally recognized as services are rendered or as products are delivered. In addition, revenue is also recognized with performance-based installments payable over the contract duration as milestones are achieved.

The Company also derives revenues from government grants that partially fund the Company's research efforts for its proprietary technologies. All government grants are expense reimbursement grants which provide for reimbursement on a monthly basis of the Company's direct costs incurred in a research project, plus indirect costs stated as a percentage of direct costs.

The Company realized a loss from operations for the three months and nine months ended September 30, 2000 of \$308,358 and \$299,448, respectively. These results are consistent with the Company's business plan for 2000. The nine month results for 2000 is improved over the loss in the same period in 1999 of \$1,592,987 due to an increase of \$1,413,342 in revenues from long-term contracts. This improvement reflects managements continuing efforts to identify and obtain long-term contracts.

#### Results of Operations

Three Months Ended September 30, 2000 Compared with Three Months Ended September 30, 1999.

#### Revenues

The Company experiences fluctuations in all revenue categories. Continuation of existing projects, or engagement for future projects is usually dependent upon the customer's satisfaction with the scientific results provided in initial phases of the scientific program. Continuation of existing projects or engagement of future projects also often depends upon factors beyond the Company's control, such as the timing of product development and commercialization programs of the Company's customers. The combined impact of commencement and termination of research contracts from several large customers and unpredictable fluctuations in revenue for laboratory services can result in very large fluctuations in financial performance.

Gross revenues increased by \$177,824 or 21.6% from \$821,809 during the third quarter of 1999 ("the 1999 Quarter") to \$999,633 during the third quarter of 2000 ("the 2000 Quarter").

Revenues realized from short-term projects increased \$97,609 or 34.1% from \$286,364 during the 1999 Quarter to \$383,973 during the 2000 Quarter. Even with management's decision to focus on long-term projects, the Company stills views short-term work as a potential revenue source. Historically, net revenues have been earned under short-term projects, however, the Company views long-term

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projects as the more important source of revenue, (as mentioned below) and has continued to focus its efforts on identifying long-term customers.

Revenues realized from various long-term projects increased by \$83,374 or 16.4%, from \$509,122 during the 1999 Quarter to \$592,496 during the 2000 Quarter. This increase is primarily due to work being done on nineteen individual projects compared to fourteen projects in progress during the 1999 Quarter. Of the \$592,496 in long-term contracts, one major client represents 37.2% of the revenue earned during the quarter. This project was awarded from the Illinois Institute of Technology Research Institute (see "Business Considerations") During the third quarter of 2000, the second year of this contract was awarded to the Company and is expected to provide revenues of approximately \$1.5 million. This revenue will be recognized during the fourth quarter of 2000 and the first three-quarters of 2001. The Company's management continues to take an active role in negotiating new contracts.

The Company experienced a modest increase in revenue realized from government grants in the amount of \$2,291, or 12.8%, from \$17,863 during the 1999 Quarter to \$20,154 during the 2000 Quarter. Despite this small increase in revenues from government grants, such revenues are declining as all outstanding grants will be completed in the fourth quarter 2000.

The Company experienced a decrease in revenue realized from AccuTrac in the amount of \$5,450, or 64.4%, from \$8,460 during the 1999 Quarter to \$3,010 during the 2000 Quarter. This decrease is primarily due to purchases in 1999 after the initiation of the product into the market which has not continued in 2000.

#### Expenses

Cost of Services. Cost of services consists primarily of labor, laboratory supplies and miscellaneous indirect costs. The cost of services increased by \$110,646, or 20.9%, from \$530,098 during the 1999 Quarter to \$640,744 during 2000 Quarter. The cost of services as a percentage of revenue was 64.1% and 64.5% during 2000 and 1999, respectively.

Labor costs increased by \$167,542, or 88.7%, from \$188,957 during the 1999 Quarter to \$356,499 during the 2000 Quarter. This increase reflects a reallocation of the Company's resources to the general operations of the business from the research and development and General and Administrative areas. This reallocation is necessary to support the additional long-term projects currently in progress. The costs for direct materials decreased by \$92,423, or

30.2%, from \$306,301 during the 1999 Quarter, to \$213,878 during the 2000 Quarter. These decreased costs are directly attributable to the winding down of year 1 of the Illinois Institute of Technology Research Institute project. This project during the quarter was more labor intensive and less dependant on materials. Other costs increased by \$35,526, or 102.1%, from \$34,840 during the 1999 Quarter to \$70,366 during the 2000 Quarter. This increase in costs is due to additional postage, repair of general equipment and lease expenditures on equipment.

Sales, General and Administrative. Sales, general and administrative expenses ("SGA") consist primarily of compensation and related costs for administrative, marketing and sales personnel, facility expenditures, professional fees, consulting, taxes, and depreciation. Total SGA costs increased by \$67,842, or 13.8%, from \$490,699 during the 1999 Quarter to \$558,541 during 2000 Quarter. As a percentage of revenue, these costs were 55.8% and 59.7% during 2000 and 1999, respectively.

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Total Compensation and Benefits decreased by \$10,323 or 6.9% from \$150,050 during the 1999 Quarter to \$139,727 during the 2000 Quarter. This decrease is primarily attributable to the reallocation of personnel in the administrative area to work on the subcontract from the Illinois Institute of Technology Research Institute.

Facility costs increased by \$16,005 or 40.0% from \$39,989 during the 1999 Quarter to \$55,994 during the 2000 quarter. This increase is primarily due to higher expenditures related to utility costs during the quarter.

Professional fees increased by \$48,849, or 98.2%, from \$49,722 during the 1999 Quarter to \$98,571 during the 2000 Quarter. This increase is primarily due to the additional expenditures associated with management's proposed acquisition of SRA Life Sciences, Inc. and production costs associated with the annual report. As discussed in note 3 of the notes to the financial statements, management decided in the third quarter to not acquire SRA.

Taxes increased by \$7,044, or 34.4%, from \$20,463 during the 1999 Quarter to \$27,507 during the 2000 Quarter. This increase is primarily due to the revaluation of real estate taxes on the company's facility.

Marketing costs decreased by \$11,841 or 29.8%, from \$39,745 during the 1999 Quarter to \$27,904 during the 2000 Quarter. Reductions in advertising, public relations and payments for consulting services contributed to the decrease in marketing costs.

Research and Development. Research and development costs within the Company fall into two general categories: grant-related research and development and in-house research and development. These categories are distinguished by those performed in support of government grant-sponsored programs, and those performed in the absence of such grants which are funded from working capital. Total expenditures for these two categories decreased by \$62,062, or 66.9%, from \$92,703 during the 1999 Quarter to \$30,641 during the 2000 Quarter. Total grant-related research and in-house research as a percentage of revenue were 3.1% and 11.3% during 2000 and 1999, respectively.

Expenditures to perform grant-related research activities decreased by \$41,253 or 87.8%, from \$46,973 during the 1999 Quarter to \$5,720 during the 2000 Quarter. This decrease is primarily due to the elimination of two of the three grants. The Company anticipates completion of the remaining project by November 2000.

Expenditures made by the Company for in-house research activities decreased by \$20,808 or 45.4%, from \$45,730 during the 1999 Quarter to \$24,922 during the 2000 Quarter. This decrease is primarily attributable to the reallocation of personnel in the research and development area to work on the subcontract from the Illinois Institute of Technology Research Institute.

#### Other Income (Expenses)

Interest income to the Company remained relatively flat showing a modest increase of \$490 or 6.4% from \$7,597 during the 1999 Quarter to \$8,087 during

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the 2000 Quarter. Interest income is derived from investing the unused portion of the funds-realized by the Company from the successful sale (March, 1998) of Industrial Revenue Bonds (IRBs) for construction of the Company's new facility. Interest income is also derived from overnight investments.

Interest costs incurred by the Company during the 1999 and 2000 Quarter's included (1) interest paid to financial institutions for loans made to the Company; 2) interest paid for the Company's IRBs; and 3) amortization of costs incurred as a consequence of the completion of the Company's IRB financing. Interest expense increased by \$11,609 or 15.6% from \$74,543 during the 1999 Quarter to \$86,152 during the 2000 Quarter.

## Results of Operations

Nine Months Ended September 30, 2000 Compared with Nine Months Ended September 30, 1999.

### Revenues

Gross revenues increased by \$1,464,014 or 79.3% from \$1,846,745 for the nine months ended September 30, 1999 ("the 1999 Period") to \$3,310,759 for the nine months ended September 30, 2000. ("the 2000 Period").

Revenues realized from short-term projects increased by \$158,558, or 22.1% from \$718,958 during the 1999 Period to \$877,516 during the 2000 Period. This increase is primarily due to the startup of Paternity testing. Revenues realized from this activity have amounted to \$181,159 during the 2000 period compared to \$8,550 in the 1999 Period. Historically, a majority of the Company's net revenues have been earned under short-term projects. However, the Company stills views long-term projects as the more important source of revenue, (as mentioned below) and has continued to focus its efforts on identifying long-term customers.

Revenues realized from various long-term projects increased by \$1,413,342 or 152.3%, from \$928,263 during the 1999 Period to \$2,341,605 during the 2000 Period. Of the total revenue in long-term contracts, one major client represents 50.5% of the revenue earned during the period. This project was awarded from the Illinois Institute of Technology Research Institute (see "Business Considerations"). This five-year subcontract provided approximately \$1.1 million in gross cash flow during this fiscal year. During the third quarter of 2000, the second year of this contract was awarded to the Company and is expected to provide revenues of \$1.5 million. This revenue will be recognized during the fourth quarter of 2000 and the first three-quarters of 2001. At September 30, 2000, the Company has approximately twenty-four contracts out for bid with various potential customers. These contracts, if awarded, would provide the Company with approximately \$3.8 million to \$6.5 million in revenues over the next two to three years.

The Company experienced a decrease in revenue realized from government grants in the amount of \$77,426, or 48.3%, from \$160,264 during the 1999 Period to \$82,838 during the 2000 Period. This decrease is primarily due to the elimination of two of the three grants. The Company anticipates completion of the remaining project by November 2000.

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The Company experienced a decrease in revenue realized from AccuTrac in the amount of \$30,460, or 77.6%, from \$39,260 during the 1999 Period to \$8,800 during the 2000 Period. This decrease is primarily due to purchases in 1999 after the initiation of the product into the market which was not continued in 2000.

### Expenses

Cost of Services. Cost of services consists primarily of labor, laboratory supplies and miscellaneous indirect costs. The cost of services increased by \$595,994, or 49.3%, from \$1,208,354 during the 1999 Period to \$1,804,348 during 2000 Period. The cost of services as a percentage of revenue was 54.5% and 65.4% during 2000 and 1999, respectively.

Labor costs increased by \$454,446, or 84.2%, from \$539,995 during the 1999 Period to \$994,441 during the 2000 Period. This increase reflects a reallocation of the Company's resources to the general operations of the business from the research and development and General and Administrative areas. This reallocation is necessary to support the additional long-term projects currently in progress. The costs for direct materials increased by \$83,474, or 14.2%, from \$589,656 during the 1999 Period, to \$673,130 during the 2000 Period. These increased costs are directly attributable to the increase in revenues. Other costs increased by \$58,024, or 73.7%, from \$78,753 during the 1999 Period to \$136,777 during the 2000 Period. This increase in costs is due to increases in additional postage, maintenance and repairs of equipment and lease expenditures on equipment.

Selling, General and Administrative. Sales, general and administrative expenses ("SGA") consist primarily of compensation and related costs for administrative, marketing and sales personnel, facility expenditures, professional fees, consulting, taxes, and depreciation. Total SGA costs decreased by \$295,229, or 17.0%, from \$1,741,432 during the 1999 Period to \$1,446,203 during 2000 Period. As a percentage of revenue, these costs were 43.7% and 94.3% during 2000 and 1999, respectively.

Total Compensation and Benefits decreased by \$229,623 or 45.4% from \$505,705 during the 1999 Period to \$276,082 during the 2000 Period. This decrease is primarily attributable to the reallocation of personnel in the administrative area to work on the subcontract from the Illinois Institute of Technology Research Institute.

Professional fees increased by \$72,838, or 40.8%, from \$178,633 during the 1999 Period to \$251,471 during the 2000 Period. This increase is primarily due to the additional expenditures associated with management's proposed acquisition of SRA Life Sciences, Inc. and production costs associated with the annual report. As discussed in note 3 of the notes to the financial statements, management decided in the third quarter to not acquire SRA.

Taxes increased by \$13,378, or 21.6%, from \$62,014 during the 1999 Period to \$75,392 during the 2000 Period. This increase is primarily due to the revaluation of real estate taxes on the Company's facility.

Depreciation increased by \$26,179, or 6.6%, from \$397,652 during the 1999 Period to \$423,831 during the 2000 Period. This increase is primarily due to the purchases of new equipment during the period.

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Office expenses increased by \$21,580, or 28.5%, from \$75,736 during the 1999 Period to \$97,316 during the 2000 Period. This increase is primarily due to additional supplies needed to support the operations of the Company.

Marketing costs decreased by \$168,527 or 71.4%, from \$236,157 during the 1999 Period to \$67,630 during the 2000 Period. Reductions in advertising, public relations and payments for consulting services contributed to the decrease in marketing costs.

Sales costs decreased by \$34,447 or 56.6%, from \$60,815 during the 1999 Period to \$26,368 during the 2000 Period. Reorganization of the sales department contributed to the decrease in costs.

Research and Development. Research and development costs within the Company fall into two general categories: grant-related research and development and in-house research and development. These categories are distinguished by those performed in support of government grant-sponsored programs, and those performed in the absence of such grants which are funded from working capital. Total expenditures for these two categories decreased by \$207,399, or 61.0%, from \$339,809 during the 1999 Period to \$132,410 during the 2000 Period. Total grant-related research and in-house research as a percentage of revenue were 4.0% and 18.4% during 2000 and 1999, respectively.

Expenditures to perform grant-related research activities decreased by \$112,669 or 64.9%, from \$173,656 during the 1999 Period to \$60,987 during the 2000 Period. This decrease is primarily due to the elimination of two of the three grants. The Company anticipates completion of the remaining project by November 2000.

Expenditures made by the Company for in-house research activities decreased by \$94,730 or 57.0%, from \$166,153 during the 1999 Period to \$71,423 during the 2000 Period. This decrease is primarily attributable to the reallocation of personnel in the research and development area to work on the subcontract from the Illinois Institute of Technology Research Institute.

#### Other Income (Expenses)

Interest income to the Company decreased by \$49,075, or 65.6% from \$74,823 during the 1999 Period to \$25,748 during the 2000 Period. Interest income has been derived from investing the unused portion of the funds realized by the Company from the successful sale (March 1998) of Industrial Revenue Bonds (IRBs) for construction of the Company's new facility. Interest income on this segment decreased due to the reduction in funds used for the completion of the project. Other income decreased primarily due to the termination of funding from the Virginia Business Assistance Program (Workforce Services) for the training of new employees.

Interest costs incurred by the Company during the 1999 and 2000 Period's included (1) interest paid to financial institutions for loans made to the

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Company; 2) interest paid for the Company's IRBs; and 3) amortization of costs incurred as a consequence of the completion of the Company's IRB financing. Interest expense increased by \$28,034 or 12.5% from \$224,960 during the 1999 Period to \$252,994 during the 2000 Period.

#### Liquidity and Capital Resources

The 2000 Period reflected a decrease in cash of \$240,853 from operating activities, as compared to a decrease of \$1,787,557 from operating activities during the 1999 Period. The significant cash outflow for 1999 was primarily due to substantial investments made by the Company in facility costs, personnel, equipment, sales, and marketing efforts. The cost outlays in 1999 were made possible by capital realized from the Company's private placement of convertible notes and initial public offering of public stock.

Net working capital (deficit) as of September 30, 2000 and December 31, 1999 was \$2,300,952 and (\$407,290) respectively. This increase is a direct result of additional record revenues for the Company as well as significant cost cutting measures adopted by management. In addition, on September 27, 2000, the Company completed a private placement of common stock and warrants to purchase common stock and received net proceeds of \$2,384,803 (see notes to financial statements). The proceeds are to pay off the line of credit and for general working capital needs.

The Company continues to search for long-term projects as the more important source of revenue and has continued to focus its efforts on identifying long-term customers. Long-term projects generally range from a few months to more than a year. In the fourth quarter of 1999, the Company was awarded a five-year subcontract with the Illinois Institute of Technology Research Institute. The contract is valued at approximately \$8.5 million and has provided approximately \$1.1 million in gross cash flow for the 2000 Period. During the third quarter of 2000, the second year of this contract was awarded to the Company and is expected to provide revenues of approximately \$1.5 million. This revenue will be recognized during the fourth quarter of 2000 and the first three-quarters in 2001.

At September 30, 2000, the Company has approximately twenty-four contracts out for bid with various potential customers. These contracts, if awarded, would provide the Company with approximately \$3.8 million to \$6.5 million in revenues over the next two to three years.

#### Forward Looking Statements

Management has included herein certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. When used, statements that are not historical in nature, including the words "anticipated", "estimate", "should", "expect", "believe", "intend", and similar expressions are intended to identify forward-looking statements. Such statements are, by their nature, subject to certain risks and uncertainties.

Among the factors that could cause the actual results to differ materially from those projected are the following:

- o business conditions and the general economy,
- o the development and implementation of the Company's long-term business goals,
- o federal, state, and local regulatory environment,
- o lack of demand for the Company's services,
- o the ability of the Company's customers to perform services similar to those offered by the Company "in-house,"
- o potential cost containment by the Company's customers resulting in fewer research and development projects,
- o the Company's ability to receive accreditation to provide various services, including, but not limited to paternity testing, and
- o the Company's ability to hire and retain highly skilled employees,

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Other risks, uncertainties, and factors that could cause actual results to differ materially from those projected are detailed from time to time in reports filed by the company with the Securities and Exchange Commission, including Forms 8-K, 10-QSB, and 10-KSB.

## PART II OTHER INFORMATION

### Item 1. Legal Proceedings

The Company is not currently involved in any legal proceedings.

### Item 2. Changes in Securities and Use of Proceeds

Not applicable.

### Item 3. Defaults Upon Senior Securities

On September 27, 2000, the Company completed a private placement of 348,000 shares of common stock at a purchase price of \$7.471 per share and warrants to purchase an additional 348,000 shares of common stock. The

warrants are divided into two equal portions with one half having the right to purchase one share of common stock at a price of \$6.50 per share for a period of eighteen months, and the other half having the right to purchase one share of common stock at a purchase price of \$6.50 per share for a period of five years.

This transaction was exempt from federal securities registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

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<TABLE>  
<CAPTION>

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits.

Exhibit Number	Description of Exhibit
<S>	<C>
3.1	Amended and Restated Articles of Incorporation (1)
3.2	Amended and Restated Bylaws (1)
4.1	Form of Common Stock Certificate (1)
4.2	Form of Underwriter's Warrant, as amended (1)
4.3	Form of Management Warrant, as amended (1)
4.4	Indenture of Trust by and between the Virginia Small Business Financing Authority and Crestar Bank relating to the issuance of industrial revenue bonds for the benefit of the Company (2)
10.1	Placement Agreement by and between the Company and Anderson & Strudwick, Incorporated (1)
10.2	Warrant Agreement between the Company and Anderson & Strudwick, Incorporated (1)
10.3	Warrant Agreement between the Company and Richard J. Freer, as amended (1)
10.4	Warrant Agreement between the Company and Thomas R. Reynolds, as amended (1)
10.5	Warrant Agreement between the Company and Robert B. Harris, as amended (1)
10.6	Employment Agreement for Richard J. Freer (1)
10.7	Employment Agreement for Thomas R. Reynolds (1)
10.8	Employment Agreement for Robert B. Harris (1)
10.9	Executive Severance Agreement for Richard J. Freer (1)
10.10	Executive Severance Agreement for Thomas R. Reynolds (1)
10.11	Executive Severance Agreement for Robert B. Harris (1)
10.12	1997 Stock Incentive Plan, as amended (1)
10.13	Form of Incentive Stock Option Agreement (1)
10.14	Loan Agreement by and between the Virginia Small Business Financing Authority and the Company (2)
27.1	Financial Data Schedule (3)

</TABLE>

- 
- (1) Incorporated by reference to the Company's Registration Statement on Form SB-2, Registration No. 333-31731, as amended.
  - (2) Incorporated by reference to the Company's Current Report on Form 8-K, dated April 6, 1998, File No. 001-13467.
  - (3) Filed herewith.

(b) Reports on Form 8-K. On September 27, 2000, a report on Form 8-K was filed in reference to the completion of the \$2.6 million private placement of common stock and warrants to purchase common stock.

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

By: /s/ James H. Brennan

-----  
James H. Brennan  
Controller and Principal Accounting Officer

November 14, 2000

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EXHIBIT INDEX

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<TABLE> <S> <C>

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This schedule contains summary financial information extracted from the balance sheet at September 30, 2000 and the statement of operations for the nine months ended September 30, 2000 and is qualified in its entirety by reference to such financial statements.

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