

IRIS INTERNATIONAL

Moderator: Cesar Garcia
May 9, 2006
3:30 p.m. CT

Operator: Good afternoon and welcome, ladies and gentlemen, to the IRIS International, Incorporated conference call for a discussion of the company's first quarter 2006 financial results.

Participating in today's call are Cesar Garcia, the IRIS President and Chief Executive Officer; and Martin Paravato, the company's Chief Financial Officer.

At this time, I would like to inform you that this conference is being recorded and that all participants are in a listen-only mode. A PowerPoint presentation is available for those listening via Webcast. At the request of the company, we will open the conference up for questions and answers after the presentation.

This conference call contains forward-looking statements made in reliance upon the Safe Harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include but are not limited to the company's views on future financial performance, market growth, capital requirements, new product introductions and acquisitions and are generally identified by phrases such as thinks, anticipates, believes, estimates, expects, intends, plans and similar words. Forward-looking statements are not guarantees of future performance and are inherently subject to uncertainties and other factors which could cause actual results to differ materially from the forward-looking statement.

These statements are based upon, among other things, assumptions made by and information currently available to management including management's own knowledge and assessment of company's industry, R&D initiatives, competition and capital requirements. Other factors and uncertainties that could affect the company's forward-looking statements include, among other things, the following: identification of feasible new product initiatives, management of R&D efforts, and the results of successful development of new products and product platforms, acceptance by customers of the company's products, integration and acquired businesses, substantial expansion of international sales, reliance on key suppliers, the potential need for changes in long-term strategy, and response to future developments, future advances and diagnostic testing methods and procedures, potential changes in government regulations and healthcare policies both of which could adversely affect the economics of the diagnostic testing procedures automated by the company's products, rapid technological change in the microelectronics and software industries, and competitive factors including pricing pressure, and the introduction by others of new products with similar or better functionality than our products.

These and other risks are more fully described in the company's filings with the Securities and Exchange Commission including the company's most recently filed annual report on Form 10-K and the quarterly report on Form 10-Q which should be read in conjunction herewith for a further discussion of important factors that could cause actual results to differ materially from those in forward-looking statements.

The company undertakes no obligation to publicly update or revise any forward-looking statements whether as a results of new information, future events or otherwise.

At this time, I would like to turn the call over to Mr. Garcia, President and Chief Executive Officer of IRIS International.

Cesar Garcia: Thank you, operator, for reading our forward-looking statements. Good afternoon and welcome, everyone, to our first quarter conference call.

In addition to Marty, I have in the room here Dr. Tom Adams, our Chief Technology Officer who is accompanying us to answer any questions regarding the new Molecular Diagnostics business acquired by us last month. And I'm also pleased to introduce our incoming CFO, Don Mueller.

As you – as you know, we announced in late April that Marty will be retiring soon. Effective with the submission of the 10-Q he will cease to be our official CFO and Don Mueller will take over. Obviously I want to thank Marty for the years of help that he provided to the company and for his significant contributions.

Martin Paravato: Thank you.

Cesar Garcia: At this point in time, I would like to introduce Don Mueller to the audience so he will make a brief introduction of himself. Don, please.

Don Mueller: Thank you, Cesar for your confidence in selecting me for this opportunity and good afternoon to all shareholders and participants on this conference.

As many of you have seen in our press release last week, I bring 21 years of experience in accounting and finance to this position, including most recently my role as Chief Financial Officer and Treasurer at Transportation Technologies, a \$600 million manufacturing business. I also had both corporate and divisional controllership roles at Fisher Scientific International and public accounting experience with Deloitte & Touche.

I'm very happy to be joining a company with such strong growth opportunities, both from its core products and the recently acquired Molecular Diagnostic Technologies. I would also like to say

that I am extremely impressed by the management team that IRIS has built and I am looking forward to helping IRIS to realize the tremendous future that lies ahead. Thank you.

Cesar Garcia: Thank you, Don. We look forward to your contributions in the years to come and also for a very smooth transition between you and Marty.

Going to slide number four, we are very pleased with our results for the first quarter. The first quarter for 2006 is a record quarter – record first quarter for the company. We achieved \$16.1 million dollars in revenue, an increase of 15 percent over the first quarter of 2005; and we achieved a 30 percent in net income. Our EPS increased 29 percent from seven cents to nine cents. These results are very satisfying to us and we are very pleased with the results.

The first quarter was very successful not only in terms of financial performance, but if you go into slide five we have some very significant successes that we have just accomplished in the first quarter, some of them will be informed to our shareholders very soon.

The first one is that we signed last week a group purchasing organization contract with Novation. As most of you know, Novation is the largest group purchasing organization in the nation and they represent about 3,000 members. And more importantly, they represent the University Hospital Consortium, which is where most of the research in this country is done, and they represent significant volume. The contract is a one-year contract with extensions and it would allow us to sell the iQ200s with body fluids.

We have other successes in the company and one of them is we celebrated the 1,000 DNA processing workstation shipped by our Sample Processing Business Unit. That's very encouraging news. We have shipped over a thousand machines in less than 24 months and as you know, we announced that we have signed a supply agreement with Abbott as well as Dako Cytomation, Invitrogen and others.

A thousand DNA processing workstations represents about 18 percent of the available market so there is significant opportunity for growth.

The release of the Express 3 in the third quarter of 2005 had some problems. Those problems are behind us and I am pleased to report that we have shipped over 800 Express 3 centrifuges in the last two quarters. And as a result of that (we –) the first quarter was an excellent quarter for our Sample Processing business unit.

Back to the diagnostics front, our 510K for the iChem100 has been submitted and we heard already from the FDA, they wanted some clarifications in the submission. We have clarified the questions and submitted a response and we are waiting for clearance. That clearance should happen within the next 30 days.

So there is a lot to celebrate in terms of the progress in the company on many fronts – many fronts. And for this conference call I decided to take a different approach. Instead of really getting into a lot of the explanations of what happened in the quarter, I really want to put a lot of emphasis in addressing the questions that have been raised by the shareholders in my recent visits.

As you know, Tom Adams, myself and Marty have been traveling a lot on road shows and we spent about 10 days talking to sell-side analysts, buy-side analysts and shareholders in general. And in addition to that, we spent many, many hours on the phone in conference calls addressing the shareholder concerns and listening to their suggestions.

It is very clear to us that the recent decline in our shareholder – share value is a result of a disconnect between what we're trying to do and what the shareholder perceived to be the reality

in IRIS. (I think) in slide number six I want to recap our major strategic initiatives and we have four:

Back in November of 2003 I had my first conference call as CEO of IRIS. Back then, I stressed to the shareholders that the most important element for IRIS at that point was still to achieve significant penetration. We have done that. We have continued to increase the placements of iQ200 globally, and as I said before and I continue to say now, we are in the razor razorblade business. The more instruments that we place, the more high margin, revenue stream we generate, the more predictable that revenue becomes.

Last year we made a concerted effort to become a complete urinalysis company. And we needed to have more products so we can cover all segments and have a diversity of products in the market. This is one of our major initiatives for 2006 and 2007.

As well, we express our decision (and the need) to move into the high-value testing segment. We have done that with introduction of the body fluids package. They have been very successful. We have been working in the bacteria detection in urine to eliminate urine cultures. And most recently, we bought the Molecular Diagnostics business from the Leucadia Technologies, Incorporated.

The fourth element of the strategy really represents logistical opportunities to strengthen the infrastructure, and now that we have created a massive distribution network, we have 63 countries in distribution. We have technology synergies between all the different business units. We have synergies in manufacturing and obviously we believe that we have an excellent management team. We're leveraging on all of those.

Addressing the first point, I want to refer you to slide number seven. We have done a very good job in penetrating the market. And as of the closing of this quarter we have 878 machines that we have shipped, I am referring to 878 iQ200 microscopy analyzers.

The quarter was a good quarter. We shipped over a hundred machines, 101 to be exact, in the first quarter. And what I hope to do with this presentation is (I want) to reassure you, our shareholders, that the fundamentals of the business are good. The fundamentals haven't changed. In fact, I believe that the fundamentals have improved.

If you look into slide number eight, I pointed out in previous conference calls that we were going to experience seasonality on the instrument side. And what is important is despite seasonality in the instrument sales, the consumables and service continued to generate significant growth and that's why we ended 15 percent ahead in a quarter-to-quarter comparison. Our consumables and service category grew 27 percent.

If you look at the importance of the consumables and service category is exemplified on slide number nine. Based on our projected installed base for 2006, the consumables and service category is going to represent 50 percent – over 50 percent of the Diagnostics business unit revenue and 45 percent of the consolidated revenue. More impressive is that over 80 percent of the consumables and service growth projected is assured by prior-year placements.

As you remember on the prior slide, there were 423 machines (that we) shipped in 2005. All of those systems were under warranty and many of them were not in service. So those systems are now maturing and they will become targets for service contracts, for spare parts, and the most important part is that they're being commissioned to generate a consumable at a full rate.

So in conclusion, the domestic consumables are stronger than we anticipated and later in the presentation I'm going to update you with the latest consumable factors. The service revenue is

beginning to grow rapidly because many of the systems are becoming eligible for service. The number of systems that will be eligible for service contracts and spare parts will more than double during 2006. And obviously, as we continue to drive the penetration, the penetration will result in higher sales in the consumables and service category.

One of the big concerns when I talk to the shareholders is the perception that the company would not be growing and it would not be growing at a fast pace. And again, what I did here on slide number 11, we put together a hypothetical scenario to illustrate the impact of the consumables.

I want to take a few minutes to explain how the model works. What I did is that we put together a very simple model where we assume annual placement of 10 units per year. As you see from the upper table in slide number 11, the important element is penetration. Obviously, if you're going to a market that doesn't have automation, your penetration is going to increase significantly, 10 percent the first year, 20 percent the third year, 30 percent, 40 percent. So the value is in the accumulation of the units.

And again, this is an extreme example. I'm not saying that the company is not going to have growth. What we need is to exemplify the impact of the penetration. We assume flat placements in this example the growth is zero in terms of revenue growth from the instruments but the penetration continue increasing.

And I want you to understand clearly the take-home message here. In the first year placing 10 units domestically only generates \$77,000 per year in consumables. If you continue to place at a rate of 10 per year, that consumable stream grows to over a million dollars in consumables just by placing 10 units per year, and obviously we're placing many more than that.

Very few times you find a company with a recurring revenue stream with 135 percent compounded annual growth rate. And that's what we're talking about here. We're talking about

the razor razorblade, high-compounded growth. In this example, again, the revenue grows from \$77,000 in the first year to over a million.

The model incorporates the lag time between the shipment of the instruments and the generation of the consumables and obviously it considers that the units are being shipped throughout the year. So you don't get the full impact on year one but as you progress – we tried to capture that in the concept of effective units as we sell the effective units going to grow from 25 percent to 81 percent.

Moving on to slide number 13, we wanted to update the consumable factors – actually the recurring – the consumable factors that we gave you back in 2004 and 2005, we really haven't updated those numbers since. We have excellent news in that area.

The original estimate for a domestic iQ200 system was that a system would generate \$27,000 per year in recurring revenue from consumables. The latest numbers show that we're generating about \$31,000 in recurring revenue per year. More interesting is that the driver is the iQ200 microscopy where our latest estimate is going from \$10,000 in consumable revenue per year to \$18,000 in consumable revenue per year.

We are still using the \$29,000 for the Sprint microscopy and the \$5,000 for body fluids, those are budgetary estimates because we do not have a significantly large installed base to change the numbers but the preliminary results are very encouraging.

Not only have we improved domestically, but internationally. The consumable revenue was projected to be \$8,000. The consumable revenue that we have been recording – that we have calculated is about \$8,500 per machine per year.

We did not include in this table for now the Sprint. We don't have, again, estimates for the international market. But the Sprints are being used in large laboratories in Australia and in large medical institutions in Europe and we're very satisfied with the way that that market segment is developing.

Again, another point that needed to be clarified, because I think that it was a very important issue for the shareholders, is our investment in infrastructure and core technology. On slide 14, we call it building our products on a solid foundation because we're convinced that that's what we're doing. We have a very solid foundation in the iQ200 systems and the rest of our product line. The divisions are all contributing. But we needed to make investments in infrastructure to support increased volume and to increase new production lines.

In 2006 – at the end of 2006 we should be producing – beginning to produce the first units of our automated chemistry machine. We needed to invest in our facility in California because it doesn't have the space to do that. As well we invested approximately a million dollars in the Sample Processing facility to move them into a larger location because they have been growing steadily year after year and (they were) – they didn't have any space to grow.

As you see on the picture there, in April of 2006 we started an iQ200 manufacturing facility in Massachusetts because we wanted to have some redundancy because consumable manufacturing is too critical for us and in case of any environmental problems or an earthquake or anything, we wanted to make sure that we have continuity of supply.

Enabling that manufacturing facility cost us about \$450,000. They're up and running. This is the type of investment that we're making.

Now one thing that is very important, is that we're making a 13 percent R&D investment in new product development and core technology. The perception is that we're making these

investments because the iQ200 is a mature product. That is not correct. The reason why we're making these investments is because there are significant market opportunities out there and those opportunities take time. And as you know, developing a new diagnostics instrument takes anywhere between two and five years. And if we don't make the investment now we're going to find out that in the 2009 period the company is going to reach a limit and we have to start developing those new products.

It is unusual for a company of our size to have the number of products that we have in development and the product opportunities in the platforms that we have.

As you see on slide number 15, we have R&D work going into practically every business segment. As I mentioned before, we just have the 510k pending on the semi-automated machine, which we plan to launch in the second quarter. We're working very hard in developing an automated chemistry machine for the international market, which we expect to release in the second half of 2007. We're also working on a next generation iQ200 and our programs on bacteria continue both here and at our Carlsbad facility.

We're doing all of this with our own funding. We're doing all of these investments and still our projected earnings are going to grow 30 percent per year.

I wanted to quantify the impact of new technology investment. As I mentioned before, we have the option of continuing to run the company as a microscopy company in only one segment of the market, the hospital segment. We decided against that because the opportunities are big and hopefully, through the presentation, I'm going to convince you that these opportunities are big and it was the right decision.

If we just wanted to sustain our iQ200 product line and not invest in the automated chemistry and not invest in the molecular diagnostics business, we could have saved \$5 million this year. \$5

million represents 17 cents per share, a 17-cents-per-share investment to guarantee the infrastructure and the products that we need for the future.

Our guidance for 2006 is 45 cents. You add the 17 cents – 17 to the 45 cents on a pro forma basis, the EPS for 2006 for the system business is 62 cents per share. That represents a 77 percent improvement in 2006 over 2005.

One of the things that we will do, we'll continue to separate investments in new core technology from the business that we have today, the best we can, so we can continue to keep you abreast of the progress of the core business.

Some people ask me, why do you have to go into the chemistry market? The answer is simple; it's a big, big market. That market represents about \$500 million and we play in a very small segment of the market – significant market, but we play basically in the automated domestic segment only.

As you see from slide number 17, the market is segmented between the hospital laboratory, the physician's office laboratory and the hospital wards.

In slide number 18 we did another segmentation to illustrate the opportunity that we have. We are the market leader in automated urinalysis in the U.S. The U.S. automated market is a \$28 million market. Last year we achieved 44 percent market share. That is a testament to the success of the company and the ability to take a product, implement it well and to penetrate a market.

What this also points out, that (when you look into the segmentation) we don't have a semi-automated product yet for the domestic market or international market. We don't participate in the physician's office where you need these clear CLIA-waived instruments, and we don't sell

many visual strips. All of those opportunities are colored in blue on this slide and they represent a \$350 million incremental market opportunity for IRIS.

So, here we are. We are the market leader in the U.S. with 40 percent – 44 percent market share but we only own three percent of the total global market. That's the opportunity.

How do we grow from three percent of the total global market to becoming a significant player in the \$350 million market? I don't think that it takes a lot to make a quick calculation and assume that as you take 10 to 15 percent of that market you're talking a \$50 million-revenue realization in a very short timeframe.

As I mentioned – I'm on slide number 19, we have the promotion ready for the iChem100, our first unit chemistry instrument to be sold here in the physician's office lab and internationally at all segments.

I also want to mention that during the second half, we'll be releasing a major marketing and product initiative, but we're not ready to discuss it now for competitive reasons. We will inform the shareholders of our initiatives for the second half. We're very excited with the opportunities that we have identified and we will cover that in our second quarter conference call.

Another area of concern for the shareholders was our investment in Molecular Diagnostics. I believe that many people do not understand the significance of the investment. This is a very important investment for the company because it brings significant enabling technologies.

We're buying two technology platforms, we're buying the Nucleic Acid Detection Immunoassay, which is the most sensitive immunoassay ever invented and that will be the instrumental, or the way, to really penetrate into cancer detection and infectious diseases.

But also it brings the bubble technology that we need for the bacteria programs and also it may represent some other opportunities for our Sample Processing business unit.

So, (we have) with the acquisition of Leucadia, we're entering into the high-value segments. The high-value segments, the reimbursement per test ranges between \$40 per test and \$400 per test depending on the application.

We have near-term commercialization opportunities, which I will cover in the next slide. And obviously, it comes with a strong intellectual property position. We have three patents that have been issued, three patents that are pending. We have a very solid patent opinion as how good the claims are and how they can be protected.

Obviously we're bringing Tom Adams to the company who is a world-renowned scientist and he has significant accomplishment in this area.

Like I said before, the acquisition brings enabling technology both for IRIS Diagnostics and for Sample Processing but they also bring a huge market opportunity on their own. And the program that we have put together is a staged program, considering the difficulty of the development and considering the difficulty – the difficulty to enter in the market. That's why we are addressing the PSA first because we believe it's an opportunity that will be easier to enter and prove the concept. It is not a the bigger market, but it will give us a lot of assurance that this is the right move, and it will give a lot of confidence to the medical practitioners that the technology is sound. (And there) We will evolve that to include more critical applications like circulating cancer cells, HIV relapse and breast cancer.

One thing that we want to make clear to our shareholders is that the acquisition came with a significant earn-out component. And the earn-out is predicated on Leucadia achieving milestones in terms of time to market and in terms of revenue generation per application.

At the same time, we made a commitment in terms of how much money we want to invest, as well, Leucadia made a commitment to us in terms of how much money it's going to take to develop.

So, Dr. Adams, at this point in time, is probably the largest single shareholder in the company and he had a vested interest in making this a successful venture for the company.

In terms of the target, the targets that we have identified for Molecular Diagnostics are within reach. These are the large commercial clinical laboratories. We are there, we have to sell there. We're promoting the iQ200 into the clinical reference labs and there are less than 200 laboratories that dominate about a hundred percent of the domestic market. And obviously this is a specialized sale, it's an esoteric procedure. It's a small niche of laboratories but it brings a significant, a very significant revenue stream.

Another important factor of the acquisition is as we will develop better measurement tools, not only will they be used for diagnostics purposes, they will be used for research. They will be used for pharmaceutical companies to evaluate the effectiveness of their drug therapies.

This is a razorblade business. In this case we do not have to sell an instrument because there are 3,000 real time PCR instruments that are already installed and licensed to perform the PCR process.

So contrary to any other competitor, we will be releasing test kits with no instrumentation. That provides a significant advantage and it facilitates the penetration because you eliminate the cost of the capital equipment.

In summary, if you look in terms of the opportunities that we are working on here... when you take the \$500 million opportunity in urine chemistry, a \$300 million opportunity in the urine culture market, the bacteria program, you add the oncology and the HIV etc, you are approaching a \$2 billion market at end-user prices. That's a very significant jump for IRIS in terms of the addressable market.

In summary, I believe that we have established a leadership position in in-vitro diagnostics. We really are the fastest growing in-vitro diagnostics company in the world. We have a broad pipeline, we're developing now high-value ultra sensitive methods, and (we are –) we have the ability to go into very lucrative markets. We have the infrastructure, we have the management, we have the intellectual property and we have the financial strength to execute. We have a strong balance sheet. We have over (\$80) million in cash, we have no debt, and the company is doing all of this funding on its own. And I say it again, our guidance of 45 cents represents a 30 percent – approximately 30 percent improvement in earnings over 2005 despite the significant investment in technology for the future.

That concludes my remarks and I would like Marty now to go into the financial statements. Marty, please.

Martin Paravato: Thank you, Cesar. First of all, I'd like to express my sincere appreciation to all my fellow employees here at IRIS, our Board of Directors, our shareholders, and especially you, Cesar, who have made my tenure here at IRIS a very rewarding and worthwhile experience which I'll treasure for many, many years.

As I go on that path of turning 65 in a few months, you know, I'm looking forward to retirement, very excited about it and hopefully I can perfect my golf game. So ...

Cesar Garcia: Good luck Marty.

Martin Paravato: Thanks. Now turning to the financial side, and I'm on slide number 27. As Cesar mentioned, revenues for the first quarter were 16.1 million, a 15 percent increase as compared to the 14 million in revenue during the first quarter of 2005.

Net income for the quarter amounted to 1.7 million or nine cents per fully diluted share compared to net income of 1.3 million or seven cents per fully diluted share for the first quarter of 2005.

Fully diluted shares outstanding during the quarter increased six percent to 8.4 million shares as compared to 7.9 million shares as compared to 13.4 million shares during the first quarter of the prior year.

During the first quarter we sold 101 iQ200 microscopy analyzers bringing the total sold to 878 since the analyzer's introduction in August of 2003.

Turning to slide number 29, our revenue distribution for the quarter, revenue for the quarter is broken down as follows: instrument revenue was 5.9 million or 37 percent of consolidated revenue, versus 5.9 million or 43 percent for Q1 of '05.

Consumables and service revenue, however, grew by 27 percent to 7.3 million amounting to 45 percent of consolidated revenue as compared to 5.7 million or 40 percent of consolidated revenue for the prior-year quarter.

Sample Processing revenue increased 26 percent to 2.9 million compared to 2.3 million during the prior-year quarter.

On the international side, slide number 30, international revenues during the quarter amounted to 11.9 million or 26 percent of total revenue as compared to 10.1 million or 27 percent during the first quarter of 2005.

We continue our strong international presence through our international distribution network that now covers over 63 countries.

Slide number 31 talks about our gross profit. During the first – consolidated gross profit – during the first quarter amounted to 8.3 million or 51 percent of revenue compared to 6.9 million or 49 percent of revenue during the first quarter of 2005.

We are experiencing higher service revenues over the 400 units sold in 2005 when they started coming off of the warranty which will be this year. We experienced a 40 percent increase during the first quarter of 2006 as compared to the prior-year first quarter and we expect this trend to continue.

For our Diagnostic division, which would be on slide 32, the Diagnostic division continues to grow as a result of continued demand for the iQ200 product line. Quarterly revenues for the segment grew to 13.2 million, up from 11.6 million during the prior-year quarter. Diagnostic gross profit margins for the quarter amounted to 6.9 million or 52 percent of revenues compared to 5.7 million or 49 percent of revenues during the same quarter a year ago.

Margins on IVD consumables and service decreased by two percent to 57 percent compared to 59 percent last year. And that was primarily as a result of the impact of our chemistry strip manufacturing operation in Germany, which we acquired last year, which is still currently operating below capacity and generated negative gross profit of about \$200,000. Otherwise the margins would have been 60 percent for the current year.

Sample Processing business unit, slide number 33, as I previously mentioned, revenues from our Sample Processing business unit amounted to 2.9 million for the quarter, up from 2.3 million for the first quarter of 2005, a 26 percent increase. The increase in revenue results from continued strong sales of centrifuges and DNA workstations.

As a percentage of revenue, gross profit margins for this unit were 48 percent for the quarter compared to 50 percent for the prior-year quarter. The lower gross profit percentage results from higher sales to OEM customers incorporating our ThermoBrite and Express 2 centrifuges.

Now looking at operating expenses, slide number 34, consolidated operating expenses increased to 5.9 million during the quarter compared to 4.9 million during the year-ago quarter. Some of the reasons for the increases were sales and marketing expenses amounted to 2.3 million or 14 percent of revenues during the first quarter and it was down a little bit from 2.4 million or 17 percent from the prior quarter.

The decrease relates to fewer industry shows and fewer promotional expenses related to product introduction activity. General and administrative expenses increased by 721,000 to 2.1 million during the quarter. G&A expenses were impacted by higher personnel costs plus stock-based compensation expense which commenced January 1st of '06 of approximately \$100,000, plus 119,000 in recruiting costs, which should be a cost that doesn't repeat itself in future quarters.

Research & Development expenditures increased to 1.5 million during the first quarter compared to 1.1 million during the prior-year quarter to support new product initiatives related to our new urine chemistry and microscopy initiatives described by Cesar earlier.

We continue to provide income tax provisions although our tax loss carry forwards continue to eliminate the need for paying income taxes during 2006 and will continue to eliminate income tax payments in the near future. This has had a positive impact on our company's cash flow. As of

March 31st, our tax loss carry forwards amounted to \$18.3 million and the carry forward continues to favorably be affected by tax deductions realized from the exercise of stock options and warrants as well as R&D credits which we are realizing from our increased spending for research and development activities.

Our balance sheet, as Cesar mentioned, continues to be strong. We have 18.4 million in the bank, we have a \$16.5 million line of credit which includes working capital line and a acquisition line. And our working capital has improved to 30 – to approximately 36 million – up from 34 million at the end of 2005.

The reduction in cash results from additional investments in sales type leases during the quarter of approximately \$1 million, increased inventories of 1.7 million, largely driven by our decision to stock higher levels of purchase instruments and strips to safeguard on-time delivery, plus increased payments on payables and accrued expenses during the quarter of 1.6 million. We just sped up the payment of some of our expenses.

In addition, we spent \$720,000 on property and equipment, which Cesar mentioned earlier about our additional consumable manufacturing capacity on the East Coast; plus we improved our customer training facility here at the corporate headquarters. Consumable manufacturing facility will not only reduce freight costs, but ensure delivery of our products as demand for the consumables increase, and of course, in case of natural disaster. Total assets increased to 65.5 million as of March 31st, 2006.

Our guidance, as Cesar mentioned, we reaffirm our guidance as of April 2006 which indicated revenue of between \$72 and \$76 million, operating income expecting to average 16 percent for the year, and fully diluted earnings per share expected to be about 45 cents excluding the effect of expensing our stock-based compensation which we estimated at two cents per share for '06.

Now, for the last time, I'd like to turn the conference call over to Cesar and tell him what a pleasure it's been working for him and for the company. Thank you.

Cesar Garcia: Thank you, thank you, Marty, appreciate it. Operator, we can take questions from the audience now.

Operator: Thank you. If you would like to ask a question, please do so by pressing the star key followed by the digit one on your touch-tone telephone.

Cesar Garcia: OK.

Operator: If you are using a speakerphone, please make sure you're mute function is turned off to allow your signal to reach our equipment.

Cesar Garcia: Operator?

Operator: Yes.

Cesar Garcia: We want to clarify that we will take one question and one qualification per person.

Operator: Yes, only one question and one follow-up question please. Once again, star one if you do have a question.

And we will take our first question from Ernest Andberg with Feltl & Company.

Ernest Andberg: Hello, Cesar, Marty.

Cesar Garcia: Hello, Ernie, how are you doing?

Martin Paravato: Hi, Ernie.

Ernest Andberg: With the doubling of the number of units coming off warranty this quarter and the interaction that that has on selling a new unit, intuitively it seems like we should be seeing a better bump in consumables and service revenues particularly with your iQ200 being higher. Should that accelerate over the rest of the year or what am I missing ...

Cesar Garcia: Ernie, if you will increase this factor into the guidance. Part of the issue is not all the instruments mature at the same time. You see the same situation that we have with the consumables, you place units throughout the year so the warranty period will become – will disappear throughout the year.

Ernest Andberg: So it's backend loaded ...

Cesar Garcia: It's backend loaded.

Ernest Andberg: ... on the – on the 425 you sold last year.

Cesar Garcia: That's correct, yes, correct.

Ernest Andberg: Fair enough. Cesar, while you did talk about seasonality in the business I was – and I tried to factor it into my estimates getting to the annual guidance. I was a little high on revenues. Your operating margins were a lot better than I thought and the bottom line was good.

Can you help at all thinking about the pattern of the quarters in the next three quarters to get to the \$72 to \$74 million?

Cesar Garcia: Well, we expect the second quarter, which is typically what we see, we expect that to happen. Third quarter, again, is the seasonality that we saw last year. And the fourth quarter will be again the strongest quarter. It's important to probably – to give you some color.

There were a few units, probably about five units that we were planning to close in the first quarter that they basically they slid into the – into the first quarter.

Ernest Andberg: How many did you say, Cesar?

Cesar Garcia: We book – we book already I think four of the five that they are ...

Ernest Andberg: OK.

Cesar Garcia: And that happened really at the last minute. So your estimate will not be that far off if we have actually booked those units. All of them were domestic. As you know, they sell for a hundred thousand each.

Ernest Andberg: OK. Fair enough, that's my two. I'll get back in line.

Cesar Garcia: Thank you.

Operator: We'll take our next question from David Taylor with Taylor Capital Management.

David Taylor: Hi. Just asking for a little guidance with respect to the R&D, I know you said roughly you'll be moving towards 13 percent of revenues but in the first quarter it was only nine percent. The way you just answered Ernie's question about the quarterly sales progression, could you address what we might expect in terms of the R&D progression?

Cesar Garcia: The R&D progression obviously depends on Molecular Diagnostics in the – and basically the two major programs. The first quarter doesn't reflect the Molecular Diagnostics' expenses; from the second to the fourth you will have the Molecular Diagnostics' expenses. Those expenses are going to be back-ended. They're going to be more into the third and the fourth quarter.

We're growing now the staff but I believe that – Tom, you agree with me that ...

Tom Adams: That's correct. We're basically staffing up the program now and so the increases are going to be in the third and fourth quarters.

Cesar Garcia: Yes. And there in – here in the diagnostics we're not accelerating in the build of the – of the prototypes of the automated machine. So I believe that here is going to be more smooth in terms of the manpower. Obviously you're going to have fluctuations depending on the prototype build.

So expect probably a more smooth pattern here in diagnostics and a faster acceleration in molecular toward the end of the year.

David Taylor: OK. So my follow-up I guess would be a combination. At what point might you expect the gross margins on the consumable side to turn positive on the year-over-year basis?

Cesar Garcia: That should happen by the end of the year. We have – as Marty mentioned, we have – the margin we have what, 60 percent without the Marburg facility in Germany.

So that – what we did with that problem is we bought the product line. We really haven't been very active in terms of selling the instruments because we're spending 510K we put a lot of investment into improving the device. And then with that we're going to be re-launching both

lines, the semi-automated product line and also the visual read strips. There are many strips that are used by the doctors at the doctor's office without instrumentation. And when you combine both things they will combine enough volume to break even probably in the first quarter.

David Taylor: OK, thank you.

Cesar Garcia: Thank you, David.

Operator: We'll go next to Dennis Kaffel with Brill Securities.

Dennis Kaffel: Congratulations on your excellent quarter.

Cesar Garcia: Thank you.

Dennis Kaffel: Correct me if I'm wrong, your actual earnings, not your GAAP earnings, were 14 cents per share rather than nine cents a share if you add back the tax provision?

Cesar Garcia: That is correct. I don't know the number but we are basically – we're factoring 36 percent tax provision that we don't pay for.

Dennis Kaffel: That's my question, thank you very much.

Cesar Garcia: Thank you.

Operator: We'll go next to Brian Kowalchuk with Westpark Capital.

Brian Kowalchuk: Good afternoon, gentlemen.

Martin Paravato: Good afternoon, Brian.

Cesar Garcia: Hi, Brian.

Brian Kowalchyk: Marty, congratulations, good luck.

Martin Paravato: Thanks, Brian.

Brian Kowalchyk: Little bit more clarification maybe another cut at the R&D question, Cesar. The text says that you'll be going to 13 percent of revenue for the year. Are you saying that 13 percent of total revenues you estimate spending for the full year or at one – at one point in time it will approach that level during a quarter?

Cesar Garcia: No, 13 percent for the total year.

Brian Kowalchyk: That's your total-year budget ...

Cesar Garcia: Total budget.

Brian Kowalchyk: ... is 13 percent of your revenue ...

Cesar Garcia: That's correct.

Brian Kowalchyk: ... for the full year?

Cesar Garcia: That's correct.

Brian Kowalchyk: OK, very good. Additionally, wondering if you could maybe talk a little bit about what the current run rate in consumables and service from your legacy products are and what the run-off rate or the cannibalization rate might be from your new products?

Cesar Garcia: OK. We're down to 275 legacy systems now.

Brian Kowalchyk: OK.

Cesar Garcia: It's down from 400. I don't have the exact number of consumables on hand at this point in time. We could give you an approximation if you call us back. Part of the problem is that some of the consumables are the same so it's kind of difficult to isolate one group from the other. So but we could give you probably a best estimate if you – if you call us later.

Brian Kowalchyk: Actually I'll follow-up offline. Thanks again.

Cesar Garcia: Yes, thank you.

Operator: We'll go next to Barry Posternak with Kensico Capital.

Barry Posternak: Hey, guys. Cesar, the consumables and service gross margin was pro forma for the acquisition, our Xing that out was 60 percent versus 59.3 I believe last year so up 60 basis points year-over-year. Could you just talk about a bit just within that the consumables gross margin what the opportunities are to grow that either through volume growth, or better purchasing, or perhaps a price increase, or whatever opportunities there are there?

Cesar Garcia: I think the bigger opportunity that you have is obviously service because we have massive amount of units that were under warranty last year and when you look in terms of 427 machines

that we carry under warranty that did not generate any service revenue from parts or service contracts – after all, the easiest one to identify.

And also the second one would be volume as we continue to increase the penetration. And that's why it's very important these initiatives that we're going to be talking in July because one of the things that we're trying to do is we're trying to accelerate volume in terms – accelerate penetration as much as we can.

Obviously the new campaign will have a big effect in 2006 but it will definitely have a big effect in 2007. But I would like to delay that discussion until July for competitive reasons.

Barry Posternak: OK. And are some of the units, the iQ200, on a 12-month warranty and some on 15-month?

Cesar Garcia: No. What happens is the warranties will be 12 months from installation or 15 months from shipment. But domestically because we control installation and then it's 12 month, internationally we give them 15 because all the transit time on the distribution pipeline.

Barry Posternak: So 15 months from the shipment of the product?

Cesar Garcia: Fifteen months from shipment.

Barry Posternak: I see. OK, thanks, nice quarter.

Cesar Garcia: Thank you.

Operator: And we'll take our last question from Tom Zeifang with Lucrum Capital.

Tom Zeifang: Good afternoon.

Tom Zeifang: Two quick questions, one, can you expand on the Novation agreement, I missed that?

And then two is about the operating margin assumptions. It looks like if you take out the – because the acquisition wasn't in the first quarter and you go to your previous guidance of 20 percent operating margin targets versus 16 after the 400 basis points in R&D spend, you'd have to – because the first quarter is clean without the acquisition you'd have a significant ramp in operating margin going forward and your revenue assumptions have been flat guidance the last two quarters. Can you give us some idea how that's going to transform over the next three quarters to get to the 20 or the 16, depending on which way you want to attack it?

Cesar Garcia: OK. The first thing that you have is that we do not – the quarters – we're not projecting the quarters to be flat. We're projecting growth going forward. So that's the first element that you have to keep in mind is that you have that.

If you look in terms of the guidance that we – that we have of 16 percent, that incorporates obviously the reduction in the – in gross margin in – excuse me – in operating income from the Leucadia acquisition. And that's about a \$2 million reduction in operating income that translates into, my recollection, is about three percent of the operating income.

And we – when we said the guidance of 20 percent last year was prior to – prior to the release of the acquisition of the chemistry product line. So we adjusted the guidance from 20 – if you want to compare in comparable terms we adjusted that from 20 to 19 percent.

Tom Zeifang: OK. But even, Mr. Garcia, even if you did 14.7 in the first quarter and there's no increase in R&D and it's a clean quarter ex the acquisition, to get to 14.7 and average 19 for the year you would have to have some heroic ...

Cesar Garcia: No, it's not heroic because you're selling – a lot of the growth is from consumables and service.

Tom Zeifang: OK.

Cesar Garcia: Consumables and service they do not generate any expenses. There's no marketing expense ...

Martin Paravato: No commissions.

Cesar Garcia: ... no commissions, there is no selling expense.

Tom Zeifang: OK. So in other words you'd be exiting the fourth quarter at an operating margin pre-acquisition well north of probably 23 percent, correct?

Martin Paravato: It was over 20 percent, you know. When we did our plan it was low in the first quarter, then it started growing as the quarters unfolded.

Cesar Garcia: Yes.

Tom Zeifang: OK. So the only difference in operating margin pre-acquisition and post-acquisition is the increased R&D spend, correct?

Cesar Garcia: That's correct.

Tom Zeifang: OK. And can you touch on the Novation discussion because I missed that whole thing?

Cesar Garcia: Well, Novation is the largest group purchasing organization. OK? And ...

Tom Zeifang: They currently are not a customer?

Cesar Garcia: They're a customer but we're selling our contract. And it's difficult – you have to negotiate every deal separately. So Novation they represent – they have about 3,000 members. And very important is they also represent what is called the University Test Systems Consortium. So basically all the university hospitals they are affiliated into this group purchasing organization. So it's a very important milestone.

Now we have six – the top six - all of them are signed. And the way that we got these approved is that we have a contract for selling iQ200 systems with body fluids because they were all competitors that were approved for chemistry already there.

Tom Zeifang: So is Novation, if you were to take that consortium as a group currently, would they be a 10-percent customer?

Martin Paravato: We don't know. We don't have that information.

Cesar Garcia: I don't really know.

Tom Zeifang: OK. So I guess a different way to ask it, what should we assume for units placed and revenue opportunity for this opportunity.

Cesar Garcia: No, typically I don't get into that discussion. Honestly, it's too risky for us.

Tom Zeifang: OK. Well what penetration rate do you have in this group?

Cesar Garcia: Well I can tell you the penetration rate that we have in total and you basically – you can derive it from there. We have a 26 percent penetration of the domestic market with a significant opportunity for growth in the company. I don't really want to get into segmenting by GPOs because that the some customers they belong to multiple GPOs and they may be buying under different groups and it's difficult for us to make that prediction.

Tom Zeifang: So.

Cesar Garcia: They may be – they may be signed with Novation, they may be signed with MedAssets and other groups. And when you begin to do segmentation it's just too much.

Tom Zeifang: At the – at the risk of asking a difficult question, what does Novation mean if you can't tell us anything?

Cesar Garcia: Well, I'll tell you what it means. It means that you have more access to the market that is just more than talking about saying that we'll sell 10 units or 20 units or 50 units. It's just – that's not the type of things that you can do. You cannot begin to segment the market because in this business you get access any way you can.

Tom Zeifang: So can ...

Cesar Garcia: And you get ...

Tom Zeifang: Can you help us and ...

Tom Zeifang: ... I'll call you back later if you'd like ...

Cesar Garcia: OK.

Tom Zeifang: ... but can you size the opportunity with Novation because you haven't even done that yet?

Cesar Garcia: I told you there are about 3,000 members and they represent a lot of the university hospitals ...

Tom Zeifang: Where there's no penetration?

Cesar Garcia: There's penetration but they open the opportunity of really going there and selling body fluids, selling iQ200 systems. It's an excellent opportunity; you get a lot of coverage.

Tom Zeifang: OK.

Cesar Garcia: OK?

Tom Zeifang: OK, thanks, sir.

Cesar Garcia: Thank you. Well, that concludes our earnings call for today. I want to thank you for participating with us. And one more time I want to thank Marty and I want to wish you a very good retirement.

Martin Paravato: Thanks.

Cesar Garcia: Bye-bye now.

Operator: Ladies and gentlemen, if you wish to access the replay for this call you may do so by dialing 1-888-203-1112, once again that's 1-888-203-1112. International callers should dial 719-457-0820, again that's 719-457-0820. The password ID number is 3410282.

Thank you for your participation, you may now disconnect.

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