FORM 10-Q

CEPHEID - CPHD

Filed: August 09, 2007 (period: June 30, 2007)

Quarterly report which provides a continuing view of a company's financial position

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

OR

☐ **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 000-30755

CEPHEID

(Exact Name of Registrant as Specified in its Charter)

California	**77-0441625**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
904 Caribbean Drive, Sunnyvale, California	**94089-1189**
(Address of Principal Executive Office)	(Zip Code)

(408) 541-4191
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer.

Large Accelerated Filer ☐ Accelerated Filer ☑ Non-Accelerated Filer ☐

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

☐ Yes ☑ No

As of July 31, 2007 there were 55,347,496 shares of the registrant's common stock outstanding.

REPORT ON FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2007

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CEPHEID
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)

	June 30, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,176	$ 17,186
Marketable securities	38,250	77,750
Accounts receivable, net	23,592	15,246
Inventory	17,602	10,240
Prepaid expenses and other current assets	2,473	1,390
Total current assets	89,093	121,812
Property and equipment, net	15,831	14,097
Restricted cash	661	661
Other non-current assets	331	666
Intangible assets, net	42,634	30,425
Goodwill	14,630	—
Total assets	$ 163,180	$ 167,661
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,096	$ 8,977
Accrued compensation	4,999	3,319
Accrued royalties	4,122	3,516
Accrued collaboration profit sharing	1,762	3,497
Accrued other liabilities	4,310	4,107
Accrued expense for patent-related matter	—	3,350
Current portion of deferred revenue	5,486	3,913
Current portion of license fees payable	—	447
Current portion of equipment financing	59	313
Current portion of note payable	4	11
Total current liabilities	31,838	31,450
Long-term portion of deferred revenue	3,244	2,663
Long-term portion of equipment financing	—	3
Long-term portion of note payable	2	41
Deferred rent	806	798
Total liabilities	35,890	34,955
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value; 100,000,000 shares authorized, 55,259,962 and 54,950,284 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively	252,655	251,132
Additional paid-in capital	19,583	15,065
Accumulated other comprehensive loss	(68)	(5)
Accumulated deficit	(144,880)	(133,486)
Total shareholders' equity	127,290	132,706
Total liabilities and shareholders' equity	$ 163,180	$ 167,661

See accompanying notes.

CEPHEID

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Revenues:				
Instrument sales	$ 9,394	$ 4,030	$ 16,231	$ 8,568
Reagent and disposable sales	14,190	14,852	29,420	29,586
Total product sales	23,584	18,882	45,651	38,154
Contract revenues	1,894	677	3,784	1,288
Grant and government sponsored research revenue	1,695	288	3,282	566
Total revenues	27,173	19,847	52,717	40,008
Costs and operating expenses:				
Cost of product sales	13,879	11,683	27,756	23,076
Collaboration profit sharing	2,731	3,843	6,228	7,654
Research and development	7,439	5,807	14,361	11,636
Selling, general and administrative	9,105	6,921	17,533	13,067
Total costs and operating expenses	33,154	28,254	65,878	55,433
Loss from operations	(5,981)	(8,407)	(13,161)	(15,425)
Other income (expense):				
Interest income	642	1,380	1,554	1,892
Interest expense	(4)	(106)	(14)	(325)
Other income	102	91	227	144
Other income, net	740	1,365	1,767	1,711
Net loss	$ (5,241)	$ (7,042)	$ (11,394)	$ (13,714)
Basic and diluted net loss per share	$ (0.10)	$ (0.13)	$ (0.21)	$ (0.28)
Shares used in computing basic and diluted net loss per share	55,149	54,518	55,081	49,758

See accompanying notes.

CEPHEID
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six Months Ended June 30,	
	2007	2006
Cash flows from operating activities:		
Net loss	$ (11,394)	$ (13,714)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,558	2,273
Amortization of intangible assets	2,050	1,317
Amortization of imputed interest	—	180
Amortization of prepaid compensation expense	125	—
Stock-based compensation related to employees and non-employees	4,299	3,637
Deferred rent	8	54
Changes in operating assets and liabilities:		
Accounts receivable	(6,884)	3,230
Inventory	(5,352)	(1,167)
Prepaid expenses and other current assets	(764)	(975)
Other non-current assets	210	—
Accounts payable and other current liabilities	545	(434)
Accrued compensation	393	67
Accrued expense for patent-related matter	(3,350)	—
Deferred revenue	1,921	(868)
Net cash used in operating activities	(15,635)	(6,400)
Cash flows from investing activities:		
Capital expenditures	(2,955)	(3,565)
Payments for technology licenses	(4,737)	(2,100)
Cost of Sangtec acquisition, net of cash acquired	(27,341)	—
Proceeds from maturities of marketable securities	39,500	15,250
Purchases of marketable securities	—	(74,550)
Net cash provided by (used in) investing activities	4,467	(64,965)
Cash flows from financing activities:		
Net proceeds from the issuance of common shares, exercise of stock options, awards and ESPP	1,523	94,144
Principal payment of line of credit	—	(4,000)
Principal payments under equipment financing	(257)	(3,469)
Payment of note payable	(44)	—
Net cash provided by financing activities	1,222	86,675
Effect of exchange rate change on cash	(64)	62
Net increase (decrease) in cash and cash equivalents	(10,010)	15,372
Cash and cash equivalents at beginning of period	17,186	16,072
Cash and cash equivalents at end of period	$ 7,176	$ 31,444

See accompanying notes.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization and Business

Cepheid (the "Company") was incorporated in the State of California on March 4, 1996. The Company is a molecular diagnostics company that develops, manufactures, and markets fully-integrated systems for genetic analysis in the Clinical Molecular Diagnostic, Industrial and Bio-threat markets. The Company's systems enable rapid, sophisticated genetic testing for organisms and genetic-based diseases by automating otherwise complex manual laboratory procedures.

The condensed consolidated balance sheet at June 30, 2007, the condensed consolidated statements of operations for the three and six months ended June 30, 2007 and 2006, and the condensed consolidated statements of cash flows for the six months ended June 30, 2007 and 2006 are unaudited. In the opinion of management, these condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) that are necessary for a fair presentation of the results for and as of the periods shown. The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States. However, certain information or footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The results of operations for such periods are not necessarily indicative of the results expected for the remainder of 2007 or for any future period. The condensed consolidated balance sheet as of December 31, 2006 is derived from audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 filed with the SEC.

Principles of Consolidation

The condensed consolidated financial statements of Cepheid include the accounts of the Company and its wholly-owned subsidiaries after elimination of intercompany transactions and balances. In August 2006, the Company's French subsidiary acquired Actigenics SA ("Actigenics"). In February 2007, the Company acquired Sangtec Molecular Diagnostics AB ("Sangtec"). The condensed consolidated financial statements include the results of operations of Actigenics and Sangtec subsequent to their respective acquisition dates of August 8, 2006 and February 14, 2007. The functional currency of the French subsidiary is the Euro, and the functional currency of the Swedish subsidiary is the Swedish Krona; accordingly, all gains and losses arising from foreign currency transactions in currencies other than the functional currency are included in the condensed consolidated statements of operations. Adjustments resulting from translating the financial statements of foreign subsidiaries into U.S. Dollars are reported as a separate component of accumulated other comprehensive loss in shareholders' equity.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

Inventory

Inventory is stated at the lower of standard cost (which approximates actual cost) or market, with cost determined on the first-in-first-out method. Allocation of fixed production overheads to conversion costs is based on normal capacity of the production. Abnormal amounts of idle facility expense, freight, handling costs and spoilage are expensed as incurred and not included in overhead.

The components of inventories were as follows (in thousands):

	June 30, 2007	December 31, 2006
Raw Materials	$ 7,849	$ 4,910
Work in Process	6,095	2,587
Finished Goods	3,658	2,743
	$ 17,602	$ 10,240

Intangible Assets

Intangible assets related to licenses are recorded at cost, less accumulated amortization. Intangible assets related to technology acquired in acquisitions and other intangible assets are recorded at fair value at the date of acquisition, less accumulated amortization. Intangible assets are amortized over their estimated useful lives, ranging from 3 to 20 years, on a straight-line basis, except for intangible assets acquired in the acquisition of Sangtec, which are amortized on the basis of economic useful life. The Company reviews its intangible assets for impairment under Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". The Company conducts the impairment review when events or circumstances indicate the carrying value of a long-lived asset may be impaired by estimating the future undiscounted cash flows to be derived from an asset to assess whether or not a potential impairment exists. If the carrying value exceeds the Company's estimate of future undiscounted cash flows, an impairment value is calculated as the excess of the carrying value of the asset over the Company's estimate of its fair market value. Events or circumstances which could trigger an impairment review include a significant adverse change in the business climate, an adverse action or assessment by a regulator, unanticipated competition, significant changes in the Company's use of acquired assets, the Company's overall business strategy, or significant negative industry or economic trends. There were no impairment charges recorded in any of the periods presented.

The recorded value and accumulated amortization of major classes of intangible assets at June 30, 2007 were as follows (in thousands):

	Recorded Value	Accumulated Amortization	Net Book Value
Licenses	$ 40,678	$ 8,420	$ 32,258
Technology acquired in acquisitions	8,613	160	8,453
Other	2,170	247	1,923
	$ 51,461	$ 8,827	$ 42,634

Included in licenses was $19.9 million in connection with a patent license agreement with F. Hoffman-La Roche Ltd., effective July 1, 2004. The net book value of this license was $16.1 million and $16.7 million at June 30, 2007 and December 31, 2006, respectively.

Amortization expense of intangible assets was $1.0 million and $0.7 million for the three months ended June 30, 2007 and 2006, respectively, and $2.1 million and $1.3 million for the six months ended June 30, 2007 and 2006, respectively. The expected future annual amortization expense of intangible assets recorded on our condensed consolidated balance sheet as of June 30, 2007 is as follows, assuming no impairment charges (in thousands):

For the Years Ending December 31,	Amortization Expense
2007 (remaining six months)	$ 2,182
2008	4,560
2009	4,866
2010	4,825
2011	4,731
Thereafter	21,470
Total expected future annual amortization	$ 42,634

Warranty Provision

The Company warrants its instrument products to be free from defects for a period of 12 to 15 months from the date of sale and its disposable products to be free from defects. Accordingly, a provision for the estimated cost of warranty repair or replacement is recorded at the time revenue is recognized. The Company's warranty provision is established using management's estimates of future failure rates and of the future costs of repairing any instrument failures during the warranty period or replacing any disposable products with defects. The activities in the warranty provision for the three and six months ended June 30, 2007 and 2006 consisted of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Balance at beginning of period	$ 316	$ 205	$ 256	$ 470
Costs incurred and charged against reserve	(53)	(27)	(94)	(379)
Provision for warranty	145	17	246	104
Balance at end of period	$ 408	$ 195	$ 408	$ 195

Revenue Recognition

The Company recognizes revenue from product sales and contract arrangements. From time to time, the Company enters into revenue arrangements with multiple deliverables. Multiple element revenue agreements entered into on or after July 1, 2003 are evaluated under Emerging Issues Task Force ("EITF") Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"), to determine whether the delivered item has value to the customer on a stand-alone basis and whether objective and reliable evidence of the fair value of the undelivered item exists. Deliverables in an arrangement that do not meet the separation criteria in EITF 00-21 must be treated as one unit of accounting for purposes of revenue recognition. Advance payments received in excess of amounts earned, such as funds received in advance of products to be delivered or services to be performed, are classified as deferred revenue until earned.

In accordance with Staff Accounting Bulletin No. 104, "Revenue Recognition", the Company recognizes revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed or determinable and collectibility is reasonably assured. No right of return exists for the Company's products except in the case of damaged goods. The Company has not experienced any significant returns of its products. Contract revenues include fees for technology licenses and research and development services, royalties under license and collaboration agreements. Contract revenue related to technology licenses is generally fully recognized only after the license period has commenced, the technology has been delivered and no further involvement of the Company is required. When the Company has continuing involvement related to a technology license, revenue is recognized over the license term. Royalties are typically based on licensees' net sales of products that utilize the Company's technology, and royalty revenues are recognized as earned in accordance with the contract terms when the royalties can be reliably measured and their collectibility is reasonably assured, such as upon the receipt of a royalty statement from the customer. Shipping and handling costs are included in cost of product sales.

Grant and government sponsored research revenue and contract revenue related to research and development services are recognized as the related services are performed based on the performance requirements of the relevant contract. Under such agreements, the Company is required to perform specific research and development activities and is compensated either based on the costs or costs plus a mark-up associated with each specific contract over the term of the agreement or when certain milestones are achieved.

Stock-Based Compensation

The Company follows the accounting provisions of SFAS No.123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), for share-based awards granted to employees and directors, including employee stock option awards, restricted stock and employee stock purchases made under our Employee Stock Purchase Plan ("ESPP"), using the estimated grant date fair value method of accounting in accordance with SFAS No. 123(R). The Company recognizes the fair value of its stock option awards on a straight-line basis over the requisite service period of each award, which is generally four years. Stock-based compensation to non-employees is determined in accordance with SFAS No. 123(R) and EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods, or Services".

The stock-based compensation expense in the condensed consolidated statement of operations for the three and six months ended June 30, 2007 and 2006 was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Cost of product sales	$ 36	$ 204	$ 302	$ 378
Research and development	1,047	725	1,791	1,318
Selling, general and administrative	1,215	985	2,206	1,941
Total stock-based compensation expense	$ 2,298	$ 1,914	$ 4,299	$ 3,637

The impact of stock-based compensation expense on basic and diluted net loss per share was $0.04 and $0.04 for the three months ended June 30, 2007 and 2006, respectively, and $0.08 and $0.07 for the six months ended June 30, 2007 and 2006, respectively. In addition, stock-based compensation cost of approximately $0.4 million and $0.2 million was included in inventory as of June 30, 2007 and December 31, 2006, respectively.

The fair value of stock options granted to employees and shares purchased by employees under the ESPP for the three and six months ended June 30, 2007 and 2006 was estimated using the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
OPTION SHARES:				
Expected Term (in years)	5.00	5.00	5.00	5.00
Volatility	0.66	0.97	0.67	0.97
Expected Dividends	0.00%	0.00%	0.00%	0.00%
Risk Free Interest Rates	4.57%	4.93%	4.58%	4.90%
Estimated Forfeitures	14.55%	13.00%	14.55%	13.00%
Weighted Average Fair Value	$ 7.03	$ 6.81	$ 6.82	$ 6.82
ESPP SHARES:				
Expected Term (in years)	1.25	1.25	1.25	1.25
Volatility	0.48	0.50	0.48	0.50
Expected Dividends	0.00%	0.00%	0.00%	0.00%
Risk Free Interest Rates	5.05%	4.54	5.05%	4.54
Weighted Average Fair Value	$ 3.08	$ 3.94	$ 3.08	$ 3.94

Income Taxes

In June 2006, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As a result of the implementation of FIN 48 on January 1, 2007, the Company recognized no material adjustment in the liability for unrecognized income tax benefits. On January 1, 2007 and June 30, 2007, the Company had an immaterial amount of unrecognized tax benefits, none of which would affect its effective tax rate if recognized.

The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. For the three and six months ended June 30, 2007, the Company did not recognize any interest or penalties related to uncertain tax positions in the condensed consolidated statements of operations, and at June 30, 2007, the Company had no accrued interest or penalties.

The Company is subject to U.S. federal income tax as well as income tax of multiple state jurisdictions. The Company has substantially concluded all U.S. federal income tax matters for years through December 31, 2002. Substantially all material state, local and foreign income tax matters have been concluded for years through December 31, 2001.

The Company anticipates that the total unrecognized tax benefits will not significantly change due to the settlement of audits and the expiration of statute of limitations prior to June 30, 2008.

Net Loss per Share

Basic net loss per share has been calculated based on the weighted-average number of common shares outstanding during the period. Common stock equivalents consisting of stock options and awards have been excluded from the computation of diluted net loss per share, as their inclusion would be antidilutive for all periods presented, and were 8,825,305 and 7,425,104 at June 30, 2007 and 2006, respectively.

Comprehensive Loss

Comprehensive loss includes net loss as well as other comprehensive income or loss. Other comprehensive income or loss consists of foreign currency translation adjustments and unrealized gains and losses on available-for-sale securities. The following table presents the calculation of comprehensive loss, including components of other comprehensive loss (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net loss	$ (5,241)	$ (7,042)	$ (11,394)	$ (13,714)
Other comprehensive loss:				
Foreign currency translation adjustments	(11)	70	(63)	57
Unrealized gain on available-for-sale securities	—	29	—	5
Comprehensive loss	$ (5,252)	$ (6,943)	$ (11,457)	$ (13,652)

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, rather, it applies under existing accounting pronouncements that require or permit fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS 157 as required. The Company is currently evaluating the impact of SFAS 157 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS 159"). The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments. SFAS 159 is effective as of the beginning of fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 159 on its consolidated financial statements.

2. Segment and Significant Concentrations

The Company and its wholly owned subsidiaries operate in only one business segment.

The Company currently sells its products through its direct sales force and through third-party distributors. There was one direct customer that accounted for 39% and 46% of total product sales for the three and six months ended June 30, 2007. There was one direct customer that accounted for 64% and 63% of total product sales for the three and six months ended June 30, 2006. The Company has distribution agreements with Fisher Scientific Company L.L.C. and VWR International to market the Cepheid SmartCycler system in the U.S. and Canada. The Company also has several regional distribution arrangements throughout Europe, Japan, South Korea, China, Mexico and other parts of the world. The following table provides a breakdown of product sales by geographic region for the three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(As a percent of total product sales)			
Product Sales Geographic information:				
North America	77%	91%	79%	91%
Europe	22%	8%	20%	7%
Japan and other	1%	1%	1%	2%
Total revenues	100%	100%	100%	100%

The change in product sales by geographic regions for the three and six months ended June 30, 2007 compared to the same periods in 2006 was primarily due to increases in both instrument and reagent and disposable sales in the Clinical Molecular

Diagnostic market in Europe. No single country outside of the United States represented more than 10% of the Company's total revenues, total net assets or total net property, plant and equipment in any period presented.

3. Patent License Agreement

On January 16, 2007, Cepheid entered into a sublicense agreement with bioMerieux S.A. ("bioMerieux"), pursuant to which bioMerieux granted Cepheid a non-exclusive, worldwide, irrevocable sublicense to certain patents that relate to the diagnosis of methicillin resistant staphylococcus aureus. The patents are owned by Kainos Laboratories Inc. and Professor Keiichi Hiramatsu and have been exclusively licensed to bioMerieux with the right for bioMerieux to sub-license.

Under the sublicense agreement, and subject to certain limitations set forth therein, Cepheid will be able to use the licensed rights to develop and sell products for use in connection with its GeneXpert and SmartCycler platforms. In exchange for such rights, Cepheid agreed to pay an initial license fee of 3.0 million euros (approximately $4.0 million) and quarterly royalties based on net product sales during the term of the sublicense agreement, which expires when the last of the patents licensed under the agreement expires. The license fee was paid in the first quarter of 2007 and is being amortized on a straight-line basis over the useful life of approximately 9 years, with the amortization recorded as part of the cost of product sales.

4. Collaboration Profit Sharing

Collaboration profit sharing represents the amount that we pay to Applied Biosystems Group under our collaboration agreement to develop reagents for use in the Biohazard Detection System developed for the United States Postal Service. Under the agreement, computed gross margin on anthrax cartridge sales are shared equally between the two parties. As of June 30, 2007 and December 31, 2006, the accrued profit sharing liability was $1.8 million and $3.5 million, respectively. Collaboration profit sharing expense was $2.7 million and $3.8 million for the three months ended June 30, 2007 and 2006, respectively, and $6.2 and $7.7 million for the six months ended June 30, 2007 and 2006, respectively. The total revenues and cost of sales related to these cartridge sales are included in the respective balances in the condensed consolidated statement of operations.

5. Collaboration Agreements

On January 16, 2007, the Company entered into a collaboration agreement with bioMerieux for the development, production and marketing of a line of sepsis and hospital acquired pneumonia ("HAP") products, based upon the Company's real-time polymerase chain reaction ("PCR") technologies. Both companies will jointly develop the products, with the initial development program relating to sepsis products for bacterial and fungal identification assays, as well a series of genetic markers for antibiotic resistance. Cepheid will exclusively manufacture these Cepheid products. bioMerieux will market and distribute these products on an exclusive worldwide basis. Each party will bear its own costs of joint development. Cepheid will sell the products to bioMerieux at an agreed upon price. The term of the collaboration agreement is 15 years following the latest date that a sepsis product or HAP product is successfully launched and may be terminated earlier under certain circumstances.

6. Settlement Agreement

A complaint filed on December 22, 2005, in the United States District Court for the District of Utah by Idaho Technology, Inc. ("Idaho Technology") and University of Utah Research Foundation was served on the Company in March 2006. The complaint alleged that the Company infringed certain patents licensed by the University of Utah Research Foundation to Idaho Technology.

On January 2, 2007, the Company entered into a Settlement and Cross-License Agreement (the "Settlement Agreement") with Idaho Technology regarding certain Company and Idaho Technology intellectual property (the "Intellectual Property"). The Settlement Agreement provided that the parties dismiss with prejudice litigation related to the Intellectual Property. In addition, the Settlement Agreement provides each of the parties with a non-exclusive, worldwide, fully paid, non-terminable, irrevocable license to certain of the other's patents for use in their respective lines of products and contains certain covenants by each of the parties not to sue the other. Pursuant to the Settlement Agreement, the Company made a payment of $3.35 million to Idaho Technology in January 2007. As of December 31, 2006, the settlement amount was accrued and recorded as an expense in the consolidated statement of operations. Although the Company believed it would not be held liable for infringement had the issue ultimately gone to litigation, it came to the conclusion to settle the litigation. The Company made the Settlement Agreement and payment to avoid incurring significant legal costs to defend its case. The Company's belief that it did not infringe Idaho Technology's patents was based on the Company's detailed legal analysis by outside counsel that the patents referenced in the litigation were either not being infringed and/or that the patents referenced were potentially invalid, due to prior art not specified or referenced in the patents. Due to the fact that the Company did not believe there to be any validity to the patent infringement case, it did not ascribe any value to future product sales and recorded the whole amount as fiscal 2006 expense.

7. Acquisition

On February 14, 2007, Cepheid completed the purchase of 100% of the outstanding stock of Sangtec, a company located in Bromma, Sweden, from Nycomed-owned Altana Technology Projects GmbH. Sangtec is a broad-based PCR molecular diagnostics company that develops and manufactures products for standardized nucleic acid testing of infectious diseases. The acquisition will allow Cepheid to provide a line of products for potential use in managing infections of immuno-compromised patients, a research and development operation to develop and expand its clinical test products, and a reagent manufacturing base in Europe. Subsequent to the acquisition, Sangtec's name was changed to Cepheid AB.

The acquisition was accounted for as a purchase transaction in accordance with SFAS No. 141, "Business Combinations", and accordingly, the tangible and intangible assets acquired and liabilities assumed were recorded at their estimated fair value at the date of the acquisition. The aggregate purchase price of the acquisition was approximately $27.3 million, including $26.5 million cash (net of $0.6 million cash acquired) and $0.8 million direct acquisition costs. The following table summarizes the preliminary allocation of the purchase price based on the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands).

Current assets	$ 3,571
Property, plant and equipment	1,337
Intangible assets	9,970
Current liabilities	(2,197)
Goodwill	14,630
	$27,311

The acquired intangible assets consisted of the following:

	Fair Value (in thousands)	Weighted Average Useful Life (in years)
Existing technology	$ 7,800	9
Contract manufacturing agreement	1,700	5
Distributor relationships	400	9
Trademark	70	3
	$ 9,970	

The amortization expense related to the existing technology and contract manufacturing will be recorded as cost of product sales, and the amortization expense related to distributor relationships and trademark will be recorded as selling, general and administrative expense. Total amortization expense recorded for the three and six months ended June 30, 2007 was $0.1 million and $0.3 million, respectively.

The following table provides pro forma financial information assuming the acquisition of Sangtec had occurred at the beginning of each period presented (in thousands, except per share data):

	2007	2006	2007	2006
Total revenues	$27,173	$22,614	$ 53,915	$ 45,331
Net loss	$ (5,241)	$ (7,009)	$(11,997)	$(13,497)
Basic and diluted net loss per share	$ (0.10)	$ (0.13)	$ (0.22)	$ (0.27)

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements that are based upon current expectations. These statements are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. In some cases, you can identify forward-looking statements by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "intend", "potential" or "continue" or the negative of these terms or other comparable terminology. Forward-looking statements involve risks and uncertainties. Our actual results and the timing of events could differ materially from those anticipated in our forward-looking statements as a result of many factors, including, but not limited to, the following: the scope and timing of actual United States Postal Service ("USPS") funding of the Biohazard Detection System ("BDS"); the rate of environmental testing using the BDS conducted by the USPS, which will affect the amount of consumable products sold; unforeseen development and manufacturing problems; the need for additional licenses for new tests and other products and the terms of such licenses; lengthy sales cycles in certain markets; the performance and market acceptance of our new products; our ability to obtain regulatory approvals and introduce new products into the Clinical Molecular Diagnostic market; our ability to successfully develop and sell products in the Clinical Molecular Diagnostic market; the success of our development agreements with third parties; our reliance on distributors and other third parties to market, sell and support our products; the occurrence of unforeseen expenditures, acquisitions or other transactions; our ability to integrate the businesses, technologies, operations and personnel of acquired companies; our success in increasing our direct sales; the impact of competitive products and pricing; our ability to manage geographically-dispersed operations; underlying market conditions worldwide and the other risks set forth under "Risk Factors" and elsewhere in this report, and we can not guarantee future results, levels of activity, performance or achievements. We assume no obligation to update any of the forward-looking statements after the date of this report or to conform these forward-looking statements to actual results.

OVERVIEW

We are a broad-based molecular diagnostics company that develops, manufactures, and markets fully-integrated systems for testing in the Clinical Molecular Diagnostics, Industrial and Biothreat markets. Our systems enable rapid, sophisticated molecular testing for organisms and genetic-based diseases by automating otherwise complex manual laboratory procedures. Molecular testing involves a number of complicated and time-intensive steps, including sample preparation, DNA amplification and detection. Our easy-to-use systems integrate these steps and analyze complex biological samples in our proprietary test cartridges. We are currently the only company to have obtained Clinical Laboratory Improvement Amendments (CLIA) moderate complexity categorization for an amplified molecular test system and an associated specific infectious disease test on the market in the United States. Our efforts are currently focused on those applications where rapid molecular testing is particularly important, such as identifying infectious diseases and cancer in the Clinical Molecular Diagnostic market; food, agricultural and environmental testing in the Industrial market; and identifying bio-terrorism agents in the Biothreat market.

Our two principal system platforms are the SmartCycler and GeneXpert systems. The SmartCycler system integrates DNA amplification and detection to allow rapid analysis of a sample. The GeneXpert system integrates sample preparation in addition to DNA amplification and detection. The GeneXpert system is designed for a broad range of user types ranging from reference laboratories and hospital central laboratories to satellite testing locations, such as ER and ICU units within hospitals, and doctors' offices.

The GeneXpert system represents a paradigm shift in the automation of molecular analysis, producing accurate results in a timely manner with minimal risk of contamination. Our GeneXpert system can provide rapid results with superior test specificity and sensitivity over comparable systems on the market today that are integrated but have open architectures.

We currently have available a relatively broad menu of tests and reagents for use on our respective systems. Our reagents and tests are marketed along with our systems on a worldwide basis.

Sales for products within our specific markets are conducted through both direct sales and distribution channels worldwide. Clinical Molecular Diagnostic market sales in the United States are handled primarily on a direct basis, while sales in all markets for Europe and our markets in the rest of the world are handled almost exclusively on a distributor basis. Our marketing programs are managed on a direct basis.

On February 14, 2007, we completed the purchase of 100% of the outstanding stock of Sangtec Molecular Diagnostics AB ("Sangtec"), a company located in Bromma, Sweden, from Nycomed-owned Altana Technology Projects GmbH. Sangtec is a PCR molecular diagnostics company that develops and manufactures products for standardized nucleic acid testing of infectious diseases. The acquisition will allow us to provide a line of products for potential use in managing infections of immuno-compromised patients,

a research and development operation to develop and expand our clinical test products, and a reagent manufacturing base in Europe. Subsequent to the acquisition, Sangtec's name was changed to Cepheid AB. The acquisition has been accounted for as a purchase transaction in accordance with SFAS No. 141, "Business Combinations"; accordingly, the results of Cepheid AB operations have been included in our consolidated results of operations from the date of acquisition. The purchase price of the acquisition was approximately $27.3 million, including $26.5 million cash (net of cash acquired) and $0.8 million direct acquisition costs.

In January 2007, we entered into two agreements with bioMerieux S.A. ("bioMerieux"), a sublicense agreement and a collaboration agreement. Pursuant to the sublicense agreement, bioMerieux granted us a non-exclusive, worldwide, irrevocable sublicense to certain patents that relate to the diagnosis of methicillin resistant staphylococcus aureus ("MRSA"). We will be able to use the licensed rights to develop and sell products for use in connection with our GeneXpert and SmartCycler platforms. In exchange for such rights, we agreed to pay an initial license fee of approximately $4.0 million and quarterly royalties based on net product sales during the term of the sublicense agreement. The collaboration agreement is for the development, production and marketing of a line of sepsis and hospital acquired pneumonia ("HAP") products, based upon our real-time polymerase chain reaction ("PCR") technologies. Both companies will jointly develop the products. We will exclusively manufacture these Cepheid products at an agreed upon price for bioMerieux, who will market and distribute the products on an exclusive worldwide basis.

In March 2007, we received clearance from the U.S. Food & Drug Administration ("FDA") to market our GeneXpert enterovirus ("EV") test, which runs on the GeneXpert platform, for the presumptive qualitative detection of EV RNA in cerebrospinal fluid ("CSF") as an aid in the laboratory diagnosis of EV infection in patients with a clinical suspicion of meningitis. The Xpert EV test, designed to detect EV RNA in CSF by reverse-transcription real-time polymerase chain reaction ("RT-PCR"), is the first test of its type to receive FDA clearance. GeneXpert EV is the first and only RT-PCR test that delivers EV results in less than two and a half hours compared to up to three and six days for standard culture testing. This was our third clinical in vitro diagnostic test following the FDA 510(k) clearances of the Xpert Group B Streptococcus ("GBS") and Smart GBS tests in 2006.

In April 2007, we received clearance from the FDA to market our GeneXpert MRSA test, which runs on the GeneXpert platform, for the rapid detection of MRSA. GeneXpert MRSA results are delivered in just over one hour, identifying carriers of the potential pathogen and enabling healthcare organizations to promptly implement the proper infection control measures, leading to lower hospital acquired infection rates while improving patient care. This was our fourth clinical in vitro diagnostic test.

Sales Channels

We sell our products both directly and through other distribution channels. In the United States, we sell through our direct sales force in the Industrial and Clinical Molecular Diagnostic markets, as well as through non-exclusive distributors, Fisher Scientific Company L.L.C. and VWR International, in the Industrial market. In Europe, our products are sold primarily through distributors. In Japan and other parts of the world, we sell solely through distributors. Through our French subsidiary, Cepheid SA, distributors have been established in Europe, the Middle East, Western Asia and Africa. We expect to continue expanding our sales efforts into other territories throughout the world.

Revenues

Currently, we derive our revenues primarily from the sales of our two instrument platforms and associated reagents and disposables in the Clinical Molecular Diagnostic, Industrial, and Biothreat markets, and to a lesser extent from contract and government sponsored research.

Research and Development

We devote significant resources to research and development, particularly in developing the technologies for our SmartCycler and GeneXpert platforms and developing tests for use on those platforms. Research and development expenses were approximately $23.9 million for the year ended December 31, 2006 and $7.4 million and $14.4 million for the three and six months ended June 30, 2007. We expect that our research and development expenses in 2007 will increase in line with our product development pipeline, our contract and collaborator revenues and as we complete clinical trials for our MRSA/SA and factor 2/factor 5 hemostasis tests and begin research on other tests.

CRITICAL ACCOUNTING POLICIES, ESTIMATES AND ASSUMPTIONS

We consider our accounting policies related to revenue recognition, impairment of intangible assets, inventory reserve, warranty accrual, and stock based compensation to be critical accounting policies. A number of significant estimates, assumptions, and judgments are inherent in our determination of when to recognize revenue, how to evaluate our intangible assets, and the calculation of our inventory reserve, warranty accrual, and stock-based compensation expense. These estimates, assumptions, and judgments

include deciding whether the elements required to recognize revenue from a particular arrangement are present, estimating the fair value of an intangible asset, which represents the future undiscounted cash flows to be derived from the intangible asset, and estimating the amount of inventory obsolescence and warranty costs associated with shipped products and estimating the useful life and volatility of stock awards granted. We base our estimates and judgments on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates. Management believes that there have been no significant changes during the three and six months ended June 30, 2007 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operation in our 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission. For a description of those critical accounting policies, please refer to our 2006 Annual Report on Form 10-K.

RESULTS OF OPERATIONS

Comparison of the Three and Six Months Ended June 30, 2007 and 2006

Revenues

Product Sales

	Three Months Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
	(Amounts in thousands)			(Amounts in thousands)		
Revenues:						
Instrument sales	$ 9,394	$ 4,030	133%	$ 16,231	$ 8,568	89%
Reagent and disposable sales	14,190	14,852	(4)%	29,420	29,586	(1)%
Total product sales	23,584	18,882	25%	45,651	38,154	20%
Contract revenues	1,894	677	180%	3,784	1,288	194%
Grant and government sponsored research revenue	1,695	288	489%	3,282	566	480%
Total Revenues	$ 27,173	$ 19,847	37%	$ 52,717	$ 40,008	32%

We operate in three market areas: Clinical Molecular Diagnostic, Industrial and Biothreat markets. The following table illustrates product sales in the three market areas as a percentage of total product sales for three and six months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(As a % of total product sales)			
Product sales by market:				
Clinical Molecular Diagnostic	45%	21%	39%	20%
Biothreat	38%	64%	45%	64%
Industrial	17%	15%	16%	16%
Total Product Sales	100%	100%	100%	100%

Total product sales increased 25% to $23.6 million in the second quarter of 2007 from $18.9 million in the second quarter of 2006 and increased 20% to $45.7 million for the six months ended June 30, 2007 from $38.2 million for the same period in 2006. The increase in product sales for the three and six months ended June 30, 2007 was primarily due to instrument sales in Europe and to a lesser extent from North America. Service revenue also increased with the substantial portion being from North America. The increase in product sales was the result of a change in product mix due to an increase in sales in the Clinical Molecular Diagnostic market partially offset by an anticipated decrease in GeneXpert test cartridge sales to Northrop Grumman/USPS in the Biothreat market. Product sales to Northrop Grumman/USPS represented 39% and 64% of our total product sales for the second quarter of 2007 and 2006, respectively, and 46% and 63% of our total product sales for the six months ended June 30, 2007 and 2006, respectively. We expect that biothreat product sales will continue to decrease as a percentage of total product sales as compared to 2006.

The following table provides a breakdown of our product sales by geographic regions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
	(As a % of total product sales)			
Product Sales by Geographic Regions:				
North America	77%	91%	79%	91%
Europe	22%	8%	20%	7%
Japan and other	1%	1%	1%	2%
Total Product Sales	100%	100%	100%	100%

The change in product sales by geographic regions for the three and six months ended June 30, 2007 compared to the same periods in 2006 was primarily due to increases in both instrument and reagent and disposable sales in the Clinical Molecular Diagnostic market in Europe.

No single country outside of the United States represented more than 10% of our total revenues in any period presented.

Contract Revenues

Contract revenues were $1.9 million in the second quarter of 2007 and $0.7 million in the second quarter 2006 and were $3.8 million and $1.3 million for the six months ended June 30, 2007 and 2006, respectively. The increase in revenues for the three and six months ended June 30, 2007 was primarily due to collaboration agreements that began in the second half of 2006.

Grant and Government Sponsored Research Revenue

Grant and government sponsored research revenue increased to $1.7 million in the second quarter of 2007 from $0.3 million in the second quarter of 2006 and increased to $3.3 million in the first six months of 2007 from $0.6 million for the first six months of 2006. Revenue for the three and six months ended June 30, 2007 revenue were derived from programs with the Centers for Disease Control and Prevention and National Institutes of Health, revenues for which started in the first quarter of 2007. Such revenue increases were partially offset by decreased revenue from the National Cancer Institute program, which was substantially completed in the fourth quarter of 2006.

Costs and Operating Expenses

	Three Months Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
	(Amounts in thousands)			(Amounts in thousands)		
Costs and operating expenses:						
Cost of product sales	$ 13,879	$ 11,683	19%	$ 27,756	$ 23,076	20%
Collaboration profit sharing	2,731	3,843	(29)%	6,228	7,654	(19)%
Research and development	7,439	5,807	28%	14,361	11,636	23%
Selling, general and administrative	9,105	6,921	32%	17,533	13,067	34%
Total costs and operating expenses	$ 33,154	$ 28,254	17%	$ 65,878	$ 55,433	19%

Cost of Product Sales

Cost of product sales consists of raw materials, direct labor and stock-based compensation expense, manufacturing overhead, facility costs and warranty costs. Cost of product sales also includes royalties on product sales and amortization of intangible assets related to technology licenses and intangibles acquired in the purchase of Sangtec. As a result of the increased product sales discussed above, cost of product sales increased 19% to $13.9 million in the second quarter of 2007 compared to $11.7 million in the second quarter of 2006 and increased 20% to $27.8 million from $23.1 million for the first six months of 2007 and 2006, respectively. Our product gross margin percentage increased to 41% in the second quarter of 2007 from 38% in the same period in 2006. The increase in gross margin percentage was primarily due to increased manufacturing efficiencies and reduced stock based compensation expense. Our product gross margin percentage declined to 39% for the six months ended June 30, 2007 from 40% in the same period in 2006. This change in product gross margin was primarily due to the amortization of intangible assets associated with the acquisition of Sangtec.

Collaboration Profit Sharing

Collaboration profit sharing represents the amount that we pay to Applied Biosystems Group under our collaboration agreement to develop reagents for use in the USPS BDS. Under the agreement, computed gross margin on anthrax cartridge sales are shared equally between the two parties. The collaboration profit sharing expense was $2.7 million and $3.8 million in the second quarter of 2007 and 2006, respectively, and $6.2 million and $7.7 million for the six months ended June 30, 2007 and 2006, respectively. The decrease in collaboration profit sharing was the result of decreased anthrax cartridge sales under the USPS BDS program, and this expense will remain proportional to the sales of anthrax cartridges under the USPS BDS program.

Research and Development Expenses

Research and development expenses consist of salaries and employee-related expenses, including stock-based compensation, clinical trials, research and development materials, facility costs and depreciation. Research and development expenses increased 28% to $7.4 million in the second quarter of 2007 from $5.8 million in the second quarter of 2006. The increase in research and development expenses of $1.6 million is primarily due to a $0.9 million increase in salaries and employee-related expenses resulting from our operational expansion in Europe, a $0.3 million increase in consulting and a $0.3 million increase in facility-related costs. Research and development expenses increased 23% to $14.4 million in the six months ended June 30, 2007 from $11.6 million in the same period of 2006. The increase in research and development expenses of $2.8 million was primarily due to a $1.7 million increase in salaries and employee-related expenses resulting from our operational expansion in Europe, a $0.5 million increase in consulting and a $0.5 million increase in facility-related costs. The increases for the three and six months ended June 30, 2007 also reflect expansion in our contract, grant and government sponsored research activities. We expect that our quarterly research and development expenses will increase during the remainder of 2007 as we increase our assay development and incur additional costs associated with other development arrangements.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and employee-related expenses, including stock-based compensation, travel, facility, legal, accounting and other professional fees. Selling, general and administrative expenses increased 32% to $9.1 million in the second quarter of 2007 from $6.9 million in the second quarter of 2006. The increase of $2.2 million included a $1.5 million increase in salaries and employee-related expenses, including stock-based compensation expense and a $0.3 million increase in legal, accounting, and other professional expenses. Selling, general and administrative expenses increased 34% to $17.5 million in the six months ended June 30, 2007 from $13.1 million in the same period of 2006. The increase of $4.4 million included a $2.3 million increase in salaries and employee-related expenses, including stock-based compensation expense, a $1.1 million increase in legal, accounting, and other professional expenses, and a $0.5 million increase in facility-related expenses. The increases for the three and six months ended June 30, 2007 also reflect expansion in Europe. We expect our selling and marketing expenses to increase during the remainder of 2007 as we increase our direct sales force in the United States and as we expand our efforts to market our Xpert EV and Xpert MRSA tests.

Other Income (Expense), Net

	Three Months Ended June 30,			Six Months Ended June 30,		
	2007	2006	% Change	2007	2006	% Change
	(Amounts in thousands)			(Amounts in thousands)		
Other income (expenses), net:						
Interest income	$ 642	$ 1,380	(53)%	$ 1,554	$ 1,892	(18)%
Interest expense	(4)	(106)	(96)%	(14)	(325)	(96)%
Other income	102	91	12%	227	144	58%
Total other income, net	$ 740	$ 1,365	(46)%	$ 1,767	$ 1,711	3%

Other income, net consists of interest income, interest expense and other income. In the second quarter of 2007, interest income decreased to $0.6 million from $1.4 million in the second quarter of 2006 primarily to use of marketable securities in the first quarter of 2007 for the acquisition of Sangtec. Such use of marketable securities was also the primarily factor in interest income decreasing $0.3 million to $1.6 million for the six months ended June 30, 2007 compared to the same period of 2006. The decrease in interest expense of $0.1 million and $0.3 million in the three and six months ended June 30, 2007, respectively, as compared to the same periods of 2006 was primarily due to repayment of the line of credit during the first quarter of 2006.

LIQUIDITY AND CAPITAL RESOURCES

Cash and Cash Flow

As of June 30, 2007, we had $46.1 million in cash and cash equivalents and marketable securities (including $0.7 million in restricted cash). Our total cash and marketable securities used in the six months ended June 30, 2007 was $49.5 million, which consisted of $15.6 million used for operating activities, $27.3 million for the acquisition of Sangtec, $4.7 million for purchases of technology licenses and intangible assets, and $3.0 million for capital expenditures, offset by $1.2 million provided by financing activities. We maintain our portfolio of cash equivalents and marketable securities in short-term commercial paper, auction rate securities and money market funds in order to minimize market risk, preserve principal and provide liquidity.

Net cash used in operating activities was $15.6 million and $6.4 million for the six months ended June 30, 2007 and 2006, respectively. For the six months ended June 30, 2007, net cash used in operating activities primarily consisted of a $11.4 million net loss, which was partially offset by $4.6 million of depreciation expense and amortization of intangible assets and $4.3 million of stock based compensation. In addition, the decrease of $13.3 million attributable to changes in operating assets and liabilities consisted primarily of increases in receivables of $6.9 million and in inventory of $5.4 million and payments of $3.4 million for patent-related matters, which were partially offset by $1.9 million increase in deferred revenue. For the six months ended June 30, 2006, net cash used in operating activities primarily consisted of a $13.7 million net loss, which was partially offset by $3.6 million of depreciation expense and amortization of intangible assets and $3.6 million of stock-based compensation. In addition, the decrease of $0.1 million attributable to changes in operating assets and liabilities consisted primarily of $1.2 million for inventory, $1.0 million for prepaid expenses and other current assets and $1.2 million for deferred revenue, which were partially offset by $3.2 million related to accounts receivable.

Net cash provided by (used in) investing activities was $4.7 million and $(65.0) million for the six months ended June 30, 2007 and 2006, respectively. In the first six months of 2007, net cash provided by investing activities consisted of $39.5 million proceeds from maturities of marketable securities, which was partially offset by $27.3 million used to acquire Sangtec (net of acquired cash), $4.7 million used for technology licenses and $3.0 million in capital expenditures. In the first six months of 2006, net cash used in investing activities consisted of $3.6 million in capital expenditures, $2.1 million payments for technology licenses and $59.3 million in net marketable securities purchased.

Net cash provided by financing activities was $1.2 million and $86.7 million for the six months ended June 30, 2007 and 2006, respectively. In the first six months of 2007, cash provided by financing activities consisted of $1.5 million in net proceeds from the sale of common stock under our employee equity incentive plans that was partially offset by repayments of $0.3 million on our equipment and other loans. In the six months of 2006, cash provided by financing activities consisted of $94.1 million from the sale of common stock, including $80.6 million from our March 2006 common stock offering, $11.3 million from the underwriter's exercise of its over-allotment option in April 2006, and $2.5 million from the sales of common stock under our employee equity incentive plans. This increase was partially offset by the repayment of $7.5 million related to our line of credit and equipment financing.

Off-Balance-Sheet Arrangements

As of June 30, 2007, we did not have any off-balance-sheet arrangements, as defined in Item 303(a) (4) (ii) of Regulation S-K promulgated under the Securities Act of 1933.

Financial Condition Outlook

We plan to continue to make expenditures to expand our manufacturing capacity, to support our activities in sales and marketing and research and development, and to support our working capital needs. In addition to the acquisition of Sangtec, we expect to spend approximately $5.0 million for capital equipment for the remainder of 2007. We used $50.6 million in cash (excluding proceeds of $39.5 million from maturities of marketable securities) in our operations and investing activities for the six months ended June 30, 2007. We anticipate that our existing capital resources will enable us to maintain currently planned operations. This expectation is based on our current and long-term operating plan and may change as a result of many factors, including our future capital requirements and our ability to increase revenues and reduce expenses, which, in many instances, depend on a number of factors outside our control. For example, our future cash use will depend on, among other things, market acceptance of our products, the resources we devote to developing and supporting our products, continued progress of our research and development of potential products, the need to acquire licenses to new technology or to use our technology in new markets, expansion through acquisitions and the availability of other financing.

In the future, we may seek additional funds to support our strategic business needs and may seek to raise such additional funds through private or public sales of securities, strategic relationships, bank debt, lease financing arrangements, or other available means.

If additional funds are raised through the issuance of equity or equity-related securities, stockholders may experience additional dilution, or such equity securities may have rights, preferences, or privileges senior to those of the holders of our common stock. If adequate funds are not available or are not available on acceptable terms to meet our business needs, our business may be harmed.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Our investments in interest- bearing assets are subject to interest rate risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our interest-bearing portfolio, which consists of cash and cash equivalents, in taxable auction variable rate notes and money market funds. Due to the short-term nature of the investments, we believe we have no material exposure to interest rate risk arising from our investments. Therefore we have not included quantitative tabular disclosure in this Form 10-Q.

We do not enter into financial investments for speculation or trading purposes and are not a party to financial or commodity derivatives.

We operate primarily in the United States and a majority of our revenues, costs, expenses and capital purchasing activities are transacted in U.S. Dollars. While our exposure to foreign currency fluctuations will increase as our foreign operations grow, we believe based on our current planned operations that such exposure will not be material.

ITEM 4. CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Regulations under the Securities Exchange Act of 1934 require public companies, including our company, to maintain “disclosure controls and procedures”, which are defined to mean a company’s controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Our Chief Executive Officer and our Chief Financial Officer, based on their evaluation of our disclosure controls and procedures as of the end of the period covered by of this report, concluded that our disclosure controls and procedures were effective for this purpose.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

Regulations under the Securities Exchange Act of 1934 require public companies, including our company, to evaluate any change in our “internal control over financial reporting”, which is defined as a process to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States. In connection with their evaluation of our disclosure controls and procedures as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer did not identify any change in our internal control over financial reporting during the six months ended June 30, 2007, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not currently a party to any material legal proceedings.

ITEM 1A. RISK FACTORS

You should carefully consider the risks and uncertainties described below, together with all of the other information included in this Report, in considering our business and prospects. The risks and uncertainties described below are not the only ones facing Cepheid. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. The occurrence of any of the following risks could harm our business, financial condition or results of operations.

We may not achieve profitability.

We have incurred operating losses in each year since our inception. We experienced net losses of approximately $13.8 million in 2004, $13.6 million in 2005, $26.0 million in 2006 and $11.4 million for the first six months of 2007. As of June 30, 2007, we had an accumulated deficit of approximately $144.9 million. Our ability to become profitable will depend on our ability to increase our revenues, which is subject to a number of factors including our ability to successfully penetrate the Clinical Molecular Diagnostic market, our ability to successfully market the GeneXpert system and develop effective GeneXpert tests, the extent of our participation in the USPS BDS program and the operating parameters of the USPS BDS program, which will affect the rate of our consumable products sold, the success of our other collaborative programs, our ability to compete effectively against current and future competitors, global economic and political conditions and the impact of SFAS 123(R). Our ability to become profitable also depends on our expense levels and product gross margin, which are also influenced by a number of factors, including the resources we devote to developing and supporting our products, the continued progress of our research and development of potential products, the ability to gain FDA clearance for our products, our ability to improve manufacturing efficiencies, license fees or royalties we may be required to pay, our ability to integrate acquired businesses and technologies, acquisition-related costs and expenses and the potential need to acquire licenses to new technology or to use our technology in new markets, which could require us to pay unanticipated license fees and royalties in connection with these licenses. Our expansion efforts may prove more expensive than we currently anticipate, and we may not succeed in increasing our revenues to offset higher expenses. These expenses, among other things, may cause our net income and working capital to decrease. If we fail to grow our revenue and manage our expenses and improve our product gross margin, we may never achieve profitability. If we fail to do so, the market price of our common stock will likely decline.

Our participation in the USPS BDS program may not result in predictable contracts or revenues in the future.

Our participation in the USPS BDS program involves significant uncertainties related to governmental decision-making and timing of deployment, and is highly sensitive to changes in national and international priorities and budgets. Budgetary pressures may result in reduced allocations to government agencies such as the USPS, sometimes without advanced notice. We cannot be certain that actual funding and operating parameters, or product purchases, will occur at currently expected levels or in the currently expected timeframe. We are currently in negotiations to extend purchases for the BDS for a longer period. However, we cannot assure you that these negotiations will result in an extended purchase commitment. There is no current obligation on the part of the USPS to buy a minimum number of tests, purchase decisions are currently made on a year by year basis, and we are subject to future spending patterns and budgetary cycles.

If we cannot successfully commercialize our products, our business could be harmed.

If our tests for use on the SmartCycler and GeneXpert platforms do not gain market acceptance, we will be unable to generate significant sales, which will prevent us from achieving profitability. While we have received FDA clearance for our GBS, GeneXpert enterovirus and MRSA tests, these products may not achieve commercial success. Many factors may affect the market acceptance and commercial success of our products, including:

- timely development of a menu of tests and reagents;
- the results of clinical trials needed to support any regulatory approvals of our tests;
- our ability to obtain requisite FDA or other regulatory clearances or approvals for our tests under development on a timely basis;
- demand for the tests and reagents we are able to introduce;

- the timing of market entry for various tests for the GeneXpert and the SmartCycler systems;
- our ability to convince our potential customers of the advantages and economic value of our systems and tests over competing technologies and products;
- the breadth of our test menu relative to competitors;
- the extent and success of our marketing and sales efforts; and
- publicity concerning our systems and tests.

In particular, we believe that the success of our business will depend in large part on our ability to introduce additional tests for the Clinical Molecular Diagnostic market. We have had substantial revenue concentrations in recent periods resulting from the USPS BDS program. We believe that successfully building our business in the Clinical Molecular Diagnostic market is critical to our long-term goals and success. We have limited ability to forecast future demand for our products in this market. In addition, we have committed substantial funds to licenses that are required for us to enter the Clinical Molecular Diagnostic market. If we cannot successfully penetrate the Clinical Molecular Diagnostic market to exploit these licenses, these investments may not yield significant returns, which could harm our business.

The regulatory approval process is expensive, time-consuming, and uncertain and may prevent us from obtaining required approvals for the commercialization of some of our products.

In the Clinical Molecular Diagnostic market, our products may generally be regulated as medical devices by the FDA and comparable agencies of other countries. In particular, FDA regulations govern activities such as product development, product testing, product labeling, product storage, premarket clearance or approval, manufacturing, advertising, promotion, product sales, reporting of certain product failures and distribution. Some of our products, depending on their intended use, will require premarket approval ("PMA") or 510(k) clearance from the FDA prior to marketing. The 510(k) clearance process usually takes from three to six months from submission but can take longer. The PMA process is much more costly, lengthy, and uncertain and generally takes from one to two years or longer from submission. Clinical trials are generally required to support both PMA and 510(k) submissions. Certain of our products for use on our SmartCycler and GeneXpert systems, when used for clinical purposes, may require PMA, and all such tests will most likely, at a minimum, require 510(k) clearance. We are planning clinical trials for other proposed products. Clinical trials are expensive and time-consuming. In addition, the commencement or completion of any clinical trials may be delayed or halted for any number of reasons, including product performance, changes in intended use, changes in medical practice and issues with evaluator Institutional Review Boards.

Failure to comply with the applicable requirements can result in, among other things, warning letters, administrative or judicially imposed sanctions such as injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, refusal to grant premarket clearance or PMA for devices, withdrawal of marketing clearances or approvals, or criminal prosecution. To date, we have received FDA clearance on our GBS test, effective July 25, 2006, our Enterovirus GeneXpert test, effective March 19, 2007, and our MRSA GeneXpert test, effective April 17, 2007. With regard to future products for which we seek 510(k) clearance or PMA from the FDA, any failure or material delay to obtain such clearance or approval could harm our business. If the FDA were to disagree with our regulatory assessment and conclude that approval or clearance is necessary to market the products, we could be forced to cease marketing the products and seek approval or clearance. With regard to those future products for which we will seek 510(k) clearance or PMA from the FDA, any failure or material delay to obtain such clearance or approval could harm our business. In addition, it is possible that the current regulatory framework could change or additional regulations could arise at any stage during our product development or marketing, which may adversely affect our ability to obtain or maintain approval of our products and could harm our business.

Our manufacturing facilities located in Sunnyvale, California and Bromma, Sweden, where we assemble and produce the SmartCycler system and the GeneXpert system, cartridges and other molecular diagnostic kits and reagents, are subject to periodic regulatory inspections by the FDA and other federal and state regulatory agencies. For example, these facilities are subject to Quality System Regulations ("QSR") of the FDA and are subject to annual inspection and licensing by the State of California and European regulatory agencies. If we fail to maintain these facilities in accordance with the QSR requirements, international quality standards or other regulatory requirements, our manufacturing process could be suspended or terminated, which would prevent us from being able to provide products to our customers in a timely fashion and therefore harm our business.

The U.S. Food and Drug Administration has issued a draft interpretation of the regulations governing the sale of Analyte Specific Reagent products which could prevent or delay our sales of these products and harm our business.

In September 2006, the FDA published "Draft Guidance for Industry and FDA Staff: Commercially Distributed Analyte Specific Reagents ("ASRs"): Frequently Asked Questions" clarifying the FDA's interpretation of the regulations governing the sale of Analyte Specific Reagent, or ASR, products. Based upon public meetings conducted by the FDA since the September 2006 draft guidance policy publication, it appears the FDA is willing to take up comments from the public and modify this draft guidance policy. ASRs are a class of products that do not require regulatory clearance or approval. The draft guidance document contains an interpretation of the ASR regulations that is a departure from what we believe to be the existing FDA practice and policy regarding products that can be characterized as ASRs. If this draft guidance document becomes the final guidance document, and if the FDA begins enforcing this interpretation of the ASR regulations as is, some of our current ASR products may not meet the regulatory definition of an ASR, e.g., duplex target products. If this were to occur, we might have to stop selling these duplex target ASR products until the products receive, if possible, the applicable FDA approval or clearance. Furthermore, the enforcement of this new interpretation might prevent us from developing any new products that would qualify as ASRs.

We rely on licenses of key technology from third parties and may require additional licenses for many of our new product candidates.

We rely on third-party licenses to be able to sell many of our products, and we could lose these third-party licenses for a number of reasons, including, for example, early terminations of such agreements due to breaches or alleged breaches by either party to the agreement. If we are unable to enter into a new agreement for licensed technologies, either on terms that are acceptable to us or at all, we may be unable to sell some of our products or access some geographic or industry markets. We also need to introduce new products and product features in order to market our products to a broader customer base and grow our revenues, and many new products and product features could require us to obtain additional licenses and pay additional license fees and royalties. Furthermore, for some markets, we intend to manufacture reagents and tests for use on our instruments. We believe that manufacturing reagents and developing tests for our instruments is important to our business and growth prospects but may require additional licenses, which may not be available on commercially reasonable terms or at all. Our ability to develop, manufacture and sell products, and our strategic plans and growth, could be impaired if we are unable to obtain these licenses or if these licenses are terminated or expire and cannot be renewed. We may not be able to obtain or renew licenses for a given product or product feature or for some reagents on commercially reasonable terms, if at all. Furthermore, some of our competitors have rights to technologies and reagents that we do not have which may put us at a competitive disadvantage in certain circumstances and could adversely affect our performance.

We may face risks associated with acquisitions of companies, products and technologies, and our business could be harmed if we are unable to address these risks.

If we are presented with appropriate opportunities, we intend to acquire or make other investments in complementary companies, products or technologies. For example, in August 2006, we acquired Actigenics SA, a French micro RNA research and services company, and in February 2007 we acquired Sangtec Molecular Diagnostics AB ("Sangtec"), a Swedish PCR molecular diagnostics company. We may not realize the anticipated benefit of any acquisition or investment. We will likely face risks, uncertainties and disruptions associated with the integration process, including difficulties in the integration of the operations and services of an acquired company, integration of acquired technology with our products, diversion of our management's attention from other business concerns, the potential loss of key employees or customers of the acquired businesses and impairment charges if future acquisitions are not as successful as we originally anticipate. If we fail to successfully integrate other companies, products or technologies that we acquire, our business could be harmed. Furthermore, we may have to incur debt or issue equity securities to pay for any additional future acquisitions or investments, the issuance of which could be dilutive to our existing shareholders. In addition, our operating results may suffer because of acquisition-related costs or amortization expenses or charges relating to acquired intangible assets.

We expect that our operating results will fluctuate significantly, and any failure to meet financial expectations may result in a decline in our stock price.

We expect that our quarterly operating results will fluctuate in the future as a result of many factors, such as those described elsewhere in this section, many of which are beyond our control. Because our revenue and operating results are difficult to predict, we believe that period-to-period comparisons of our results of operations are not a good indicator of our future performance. Our operating results may be affected by the inability of some of our customers to consummate anticipated purchases of our products, whether due to changes in internal priorities or, in the case of governmental customers, problems with the appropriations process and variability and timing of orders, or manufacturing inefficiencies. If revenue declines in a quarter, whether due to a delay in recognizing expected revenue, unexpected costs or otherwise, our results of operations will be harmed because many of our expenses are relatively fixed. In particular, research and development and selling, general and administrative expenses are not significantly

affected by variations in revenue. If our quarterly operating results fail to meet or exceed the expectations of securities analysts or investors, our stock price could drop suddenly and significantly.

If we are unable to manufacture our products in sufficient quantities and in a timely manner, our operating results will be harmed and our ability to generate revenue could be diminished.

Our revenues and other operating results will depend in large part on our ability to manufacture and assemble our products in sufficient quantities and in a timely manner. Any interruptions we experience in the manufacturing or shipping of our products could delay our ability to recognize revenues in a particular quarter. We have limited experience in manufacturing large volumes of products, and manufacturing problems can and do arise or we may be unable to adequately scale-up manufacturing in a timely manner or on a commercially reasonable basis if we experience increased demand. In the past, we have experienced problems and delays in production that have impacted our product yield and caused delays in our ability to ship finished products, and we may experience such delays in the future. We may not be able to react quickly enough to ship products and recognize anticipated revenues for a given period if we experience significant delays in the manufacturing process. If we are unable to manufacture our products consistently and on a timely basis, our revenues from product sales, gross margins and our other operating results will be materially and adversely affected.

If certain single source suppliers fail to deliver key product components in a timely manner, our manufacturing ability would be impaired and our product sales could suffer.

We depend on certain single source suppliers that supply components used in the manufacture of our instruments and our disposable reaction tubes and cartridges. If we need alternative sources for key component parts for any reason, these component parts may not be immediately available to us. If alternative suppliers are not immediately available, we will have to identify and qualify alternative suppliers, and production of these components may be delayed. We may not be able to find an adequate alternative supplier in a reasonable time period or on commercially acceptable terms, if at all. Shipments of affected products have been limited or delayed as a result of such problems in the past, and similar problems could occur in the future. Our inability to obtain our key source supplies for the manufacture of our products may require us to delay shipments of products, harm customer relationships or force us to curtail or cease operations.

If certain of our products fail to obtain an adequate level of reimbursement from third-party payers, our ability to sell products in the Clinical Molecular Diagnostic market would be harmed.

Our ability to sell our products in the Clinical Molecular Diagnostic market will depend in part on the extent to which reimbursement for tests using our products will be available from:

- government health administration authorities;
- private health coverage insurers;
- managed care organizations; and
- other organizations.

There are efforts by governmental and third-party payers to contain or reduce the costs of health care through various means. Additionally, third-party payers are increasingly challenging the price of medical products and services. If purchasers or users of our products are not able to obtain adequate reimbursement for the cost of using our products, they may forego or reduce their use. Significant uncertainty exists as to the reimbursement status of newly approved health care products and whether adequate third-party coverage will be available.

If our competitors and potential competitors develop superior products and technologies, our competitive position and results of operations would suffer.

We face intense competition from a number of companies that offer products in our target markets. These competitors include:

- companies developing and marketing sequence detection systems for industrial research products;
- healthcare companies that manufacture laboratory-based tests and analyzers;
- diagnostic companies; and
- companies developing or offering biothreat detection technologies.

Several companies provide instruments and reagents for DNA amplification or detection. ABI and Roche sell systems integrating DNA amplification and detection (sequence detection systems) to the commercial market. Roche, Abbott Laboratories, Becton, Dickinson and Company, Qiagen, Celera and GenProbe sell sequence detection systems, some with separate robotic batch DNA purification systems and sell reagents to the Clinical Molecular Diagnostic market. Other companies, including Siemens, Third Wave Technologies and bioMerieux, offer molecular tests.

If our products do not perform as expected or the reliability of the technology on which our products are based is questioned, we could experience lost revenue, delayed or reduced market acceptance of our products, increased costs and damage to our reputation.

Our success depends on the market's confidence that we can provide reliable, high-quality molecular test systems. We believe that customers in our target markets are likely to be particularly sensitive to product defects and errors. Our reputation and the public image of our products or technologies may be impaired if our products fail to perform as expected or our products are perceived as difficult to use. Despite testing, defects or errors could occur in our products or technologies. Furthermore, with respect to the BDS program, our products are incorporated into larger systems that are built and delivered by others; we cannot control many aspects of the final product.

In the future, if our products experience a material defect or error, this could result in loss or delay of revenues, delayed market acceptance, damaged reputation, diversion of development resources, legal claims, increased insurance costs or increased service and warranty costs, any of which could harm our business. Any failure in the overall BDS, even if it is unrelated to our products, could harm our business. Even after any underlying concerns or problems are resolved, any widespread concerns regarding our technology or any manufacturing defects or performance errors in our products could result in lost revenue, delayed market acceptance, damaged reputation, increased service and warranty costs, and claims against us.

If product liability lawsuits are successfully brought against us, we may face reduced demand for our product and incur significant liabilities.

We face an inherent risk of exposure to product liability claims if our technologies or systems are alleged to have caused harm or do not perform in accordance with specifications, in part because our products are used for sensitive applications. We cannot be certain that we would be able to successfully defend any product liability lawsuit brought against us. Regardless of merit or eventual outcome, product liability claims may result in:

- decreased demand for our products;
- injury to our reputation;
- costs of related litigation; and
- substantial monetary awards to plaintiffs.

If we become the subject of a successful product liability lawsuit, we could incur substantial liabilities, which could harm our business.

We rely on relationships with collaborative partners and other third parties for development, supply and marketing of certain products and potential products, and such collaborative partners or other third parties could fail to perform sufficiently.

We believe that our success in penetrating our target markets depends in part on our ability to develop and maintain collaborative relationships with other companies. Relying on collaborative relationships is risky to our future success for these products because, among other things:

- our collaborative partners may not devote sufficient resources to the success of our collaboration;
- our collaborative partners may not obtain regulatory approvals necessary to continue the collaborations in a timely manner;
- our collaborative partners may be acquired by another company and decide to terminate our collaborative partnership or become insolvent;
- our collaborative partners may develop technologies or components competitive with our products;
- components developed by collaborators could fail to meet specifications, possibly causing us to lose potential projects and subjecting us to liability;

- disagreements with collaborators could result in the termination of the relationship or litigation;
- collaborators may not have sufficient capital resources;
- collaborators may pursue tests or other products that will not generate significant volume for us, but may consume significant research and development and manufacturing resources; and
- we may not be able to negotiate future collaborative arrangements, or renewals of existing collaborative agreements, on acceptable terms.

Because these and other factors may be beyond our control, the development or commercialization of these products may be delayed or otherwise adversely affected.

If we or any of our collaborative partners terminate a collaborative arrangement, we may be required to devote additional resources to product development and commercialization or we may need to cancel some development programs, which could adversely affect our product pipeline and business.

If our direct selling efforts for our products fail, our business expansion plans could suffer, and our ability to generate revenue will be diminished.

We have a relatively small sales force compared to our competitors. If our direct sales force is not successful, we may not be able to increase market awareness and sales of our products. If we fail to establish our systems in the marketplace, it could have a negative effect on our ability to sell subsequent systems and hinder the planned expansion of our business.

If our distributor relationships are not successful, our ability to market and sell our products would be harmed and our financial performance will be adversely affected.

We depend on relationships with distributors for the marketing and sales of our products in the Industrial and Clinical Molecular Diagnostic markets in various geographic regions, and we have a limited ability to influence their efforts. We expect to continue to rely substantially on our distributor relationships for sales into other markets or geographic regions, which is key to our long-term growth potential. Relying on distributors for our sales and marketing could harm our business for various reasons, including:

- agreements with distributors may terminate prematurely due to disagreements or may result in litigation between the partners;
- we may not be able to renew existing distributor agreements on acceptable terms;
- our distributors may not devote sufficient resources to the sale of products;
- our distributors may be unsuccessful in marketing our products;
- our existing relationships with distributors may preclude us from entering into additional future arrangements with other distributors; and
- we may not be able to negotiate future distributor agreements on acceptable terms.

We may be subject to third-party claims that require additional licenses for our products and we could face costly litigation, which could cause us to pay substantial damages and limit our ability to sell some or all of our products.

Our industry is characterized by a large number of patents, claims of which appear to overlap in many cases. As a result, there is a significant amount of uncertainty regarding the extent of patent protection and infringement. Companies may have pending patent applications, which are typically confidential for the first eighteen months following filing, that cover technologies we incorporate in our products. Accordingly, we may be subjected to substantial damages for past infringement or be required to modify our products or stop selling them if it is ultimately determined that our products infringe a third party's proprietary rights. Moreover, from time to time, we receive correspondence and other communications from companies that ask us to evaluate the need for a license of patents they hold, and indicating or suggesting that we need a license to their patents in order to offer our products and services or to conduct our business operations. Even if we are successful in defending against claims, we could incur substantial costs in doing so. Any litigation related to claims of patent infringement could consume our resources and lead to significant damages, royalty payments or an injunction on the sale of certain products. Any additional licenses to patented technology could obligate us to pay substantial additional royalties, which could adversely impact our product costs and harm our business.

If we fail to maintain and protect our intellectual property rights, our competitors could use our technology to develop competing products and our business will suffer.

Our competitive success will be affected in part by our continued ability to obtain and maintain patent protection for our inventions, technologies and discoveries, including our intellectual property that includes technologies that we license. Our ability to do so will depend on, among other things, complex legal and factual questions. We have patents related to some technology and have licensed some of our technology under patents of others. We cannot assure you that our patents and licenses will successfully preclude others from using our technology. Our pending patent applications may lack priority over applications submitted by third parties or may not result in the issuance of patents. Even if issued, our patents may not be sufficiently broad to provide protection against competitors with similar technologies and may be challenged, invalidated or circumvented.

In addition to patents, we rely on a combination of trade secrets, copyright and trademark laws, nondisclosure agreements, licenses and other contractual provisions and technical measures to maintain and develop our competitive position with respect to intellectual property. Nevertheless, these measures may not be adequate to safeguard the technology underlying our products. For example, employees, consultants and others who participate in the development of our products may breach their agreements with us regarding our intellectual property, and we may not have adequate remedies for the breach. We also may not be able to effectively protect our intellectual property rights in some foreign countries, as many countries do not offer the same level of legal protection for intellectual property as the United States. Furthermore, for a variety of reasons, we may decide not to file for patent, copyright or trademark protection outside of the United States. Our trade secrets could become known through other unforeseen means. Notwithstanding our efforts to protect our intellectual property, our competitors may independently develop similar or alternative technologies or products that are equal or superior to our technology. Our competitors may also develop similar products without infringing on any of our intellectual property rights or design around our proprietary technologies. Furthermore, any efforts to enforce our proprietary rights could result in disputes and legal proceedings that could be costly and divert attention from our business.

We may need to initiate lawsuits to protect or enforce our patents, which would be expensive and, if we lose, may cause us to lose some, if not all, of our intellectual property rights, and thereby impair our ability to compete.

We rely on patents to protect a large part of our intellectual property. To protect or enforce our patent rights, we may initiate patent litigation against third parties, such as infringement suits or interference proceedings. These lawsuits could be expensive, take significant time and divert management's attention from other business concerns. They would also put our patents at risk of being invalidated or interpreted narrowly, and our patent applications at risk of not issuing. We may also provoke these third parties to assert claims against us. Patent law relating to the scope of claims in the technology fields in which we operate is still evolving and, consequently, patent positions in our industry are generally uncertain. We cannot assure you that we would prevail in any of these suits or that the damages or other remedies awarded, if any, would be commercially valuable. During the course of these suits, there may be public announcements of the results of hearings, motions and other interim proceedings or developments in the litigation. Any public announcements related to these suits could cause our stock price to decline.

Our sales cycle can be lengthy, which can cause variability and unpredictability in our operating results.

The sales cycles for our systems products can be lengthy, which makes it more difficult for us to accurately forecast revenues in a given period, and may cause revenues and operating results to vary significantly from period to period. Sales of our products to the Industrial market often involve purchasing decisions by large public and private institutions, and any purchases can require many levels of pre-approval. In addition, many of these sales depend on these institutions receiving research grants from various federal agencies, which grants vary considerably from year to year in both amount and timing due to the political process. As a result, we may expend considerable resources on unsuccessful sales efforts or we may not be able to complete transactions on the schedule anticipated.

Our international operations subject us to additional risks and costs.

Our international operations have expanded recently. These operations are subject to a number of difficulties and special costs, including:

- compliance with multiple, conflicting and changing governmental laws and regulations;
- laws and business practices favoring local competitors;
- potential for exchange and currency risks;
- potential difficulty in collecting accounts receivable;

- import and export restrictions and tariffs;
- difficulties staffing and managing foreign operations;
- difficulties and expense in enforcing intellectual property rights;
- business risks, including fluctuations in demand for our products and the cost and effort to conduct international operations and travel abroad to promote international distribution, and global economic conditions;
- multiple conflicting tax laws and regulations; and
- political and economic instability.

We intend to expand our international sales and marketing activities, including through our subsidiary in France, and enter into relationships with additional international distribution partners. We may not be able to attract international distribution partners that will be able to market our products effectively.

Our international operations could also increase our exposure to international laws and regulations. If we cannot comply with foreign laws and regulations, which are often complex and subject to variation and unexpected changes, we could incur unexpected costs and potential litigation. For example, the governments of foreign countries might attempt to regulate our products and services or levy sales or other taxes relating to our activities. In addition, foreign countries may impose tariffs, duties, price controls or other restrictions on foreign currencies or trade barriers, any of which could make it more difficult for us to conduct our business.

The nature of some of our products may also subject us to export control regulation by the US Department of State and the Department of Commerce. Violations of these regulations can result in monetary penalties and denial of export privileges.

Our SmartCycler and GeneXpert products are distributed in Europe under the CE IVD mark, and we intend to introduce additional products under the CE IVD mark as we pursue our expansion plans. Our use of the CE IVD mark is based on self declarations of conformity with stated directives and standards of the European Parliament and Council and is subject to review by competent authorities in Europe. Our recently acquired subsidiary, Sangtec, successfully introduced CE IVD-marked products that require independent third party review recognized by competent authorities, for example, a CMV test for use on our SmartCycler instrument. Any finding of non-conformity under such a review could prevent or otherwise adversely affect our ability to distribute products in Europe and result in other consequences, including both criminal sanctions, such as the imposition of fines or penalties, and civil claims for damages from persons suffering damage as a result of the non-conformity.

If we fail to retain key members of our staff, our ability to conduct and expand our business would be impaired.

We are highly dependent on the principal members of our management and scientific staff. The loss of services of any of these persons could seriously harm our product development and commercialization efforts. In addition, we will require additional skilled personnel in areas such as microbiology, clinical and sales and marketing. Attracting, retaining and training personnel with the requisite skills remains challenging, and, as general economic conditions improve, is becoming increasingly competitive, particularly in the Silicon Valley area of California where our main office is located. If at any point we are unable to hire, train and retain a sufficient number of qualified employees to match our growth, our ability to conduct and expand our business could be seriously reduced.

If we become subject to claims relating to improper handling, storage or disposal of hazardous materials, we could incur significant cost and time to comply.

Our research and development processes involve the controlled storage, use and disposal of hazardous materials, including biological hazardous materials. We are subject to federal, state and local regulations governing the use, manufacture, storage, handling and disposal of materials and waste products. We may incur significant costs complying with both existing and future environmental laws and regulations. In particular, we are subject to regulation by the Occupational Safety and Health Administration (“OSHA”) and the Environmental Protection Agency (“EPA”), and to regulation under the Toxic Substances Control Act and the Resource Conservation and Recovery Act. OSHA or the EPA may adopt regulations that may affect our research and development programs. We are unable to predict whether any agency will adopt any regulations that would have a material adverse effect on our operations.

The risk of accidental contamination or injury from hazardous materials cannot be eliminated completely. In the event of an accident, we could be held liable for any damages that result, and any liability could exceed the limits or fall outside the coverage of our insurance. We may not be able to maintain insurance on acceptable terms, if at all. We could be required to incur significant costs to comply with current or future environmental laws and regulations.

If a catastrophe strikes our manufacturing facilities, we may be unable to manufacture our products for a substantial amount of time and we would experience lost revenue.

Our manufacturing facilities are located in Sunnyvale, California, Bromma, Sweden, and Bothell, Washington. Although we have business interruption insurance, our facilities and some pieces of manufacturing equipment are difficult to replace and could require substantial replacement lead-time. Various types of disasters, including earthquakes, fires, floods and acts of terrorism, may affect our manufacturing facilities. Earthquakes are of particular significance since our primary manufacturing facilities in California are located in an earthquake-prone area. In the event our existing manufacturing facilities or equipment is affected by man-made or natural disasters, we may be unable to manufacture products for sale or meet customer demands or sales projections. If our manufacturing operations were curtailed or ceased, it would seriously harm our business.

We might require additional capital to support business growth, and such capital might not be available.

We may need to engage in additional equity or debt financing to support business growth and respond to business challenges, which include the need to develop new products or enhance existing products, conduct clinical trials, enhance our operating infrastructure and acquire complementary businesses and technologies. Equity and debt financing, however, might not be available when needed or, if available, might not be available on terms satisfactory to us. In addition, to the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of these securities could result in dilution to our shareholders. In addition, these securities may be sold at a discount from the market price of our common stock and may include right preferences or privileges senior to those of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

Compliance with regulations governing public company corporate governance and reporting is complex and expensive.

Many laws and regulations, notably those adopted in connection with the Sarbanes-Oxley Act of 2002 by the SEC and the NASDAQ Stock Market, impose obligations on public companies, such as ours, which have increased the scope, complexity, and cost of corporate governance, reporting, and disclosure practices. Our implementation of these reforms and enhanced new disclosures has required and will continue to require substantial management time and oversight and requires us to incur significant additional accounting and legal costs.

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

Not Applicable

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not Applicable

ITEM 4. SUBMISSION OF MATTERS TO VOTE OF SECURITY HOLDERS

We held our 2007 Annual Meeting of Shareholders (“Annual Meeting”) on April 26, 2007.At the Annual Meeting, shareholders voted on two matters: the election of three Class II directors to serve three year terms and the ratification of the appointment of Ernst & Young LLP as our independent auditors for the fiscal year ending December 31, 2007.

At the Annual Meeting, Thomas L. Gutshall, Cristina H. Kepner and David H. Persing were elected as Class II directors in an uncontested election.

Name	Shares For	Shares Against	Shares Abstaining	Shares Withheld
Thomas L Gutshall	47,587,620	—	—	902,586
Cristina H. Kepner	47,751,790	—	—	738,416
David H. Persing	47,662,091	—	—	828,115

At the Annual Meeting, the appointment of Ernst & Young LLP was ratified by the following vote:

Shares For	Shares Against	Shares Abstaining	Shares Withheld
48,250,480	196,882	42,844	—

ITEM 5. OTHER INFORMATION

Not Applicable

ITEM 6. EXHIBITS

(a) Exhibits

Exhibit Number	Exhibit Description	Incorporated by Reference			Filing Date	Filed Herewith
		Form	File No.	Exhibit		
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					X
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*					X

* This certification accompany this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934 (whether made before or after the date of the Report), irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, in the City of Sunnyvale, State of California on this 9th day of August 2007.

CEPHEID
(Registrant)

/s/ JOHN L. BISHOP
John L. Bishop
Chief Executive Officer and Director
(Principal Executive Officer)

/s/ JOHN R. SLUIS
John R. Sluis
Senior Vice President, Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

Exhibit Index

Exhibit Number	Exhibit Description
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
32.2*	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* This certification accompanying this report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934 (whether made before or after the date of the Report), irrespective of any general incorporation language contained in such filing.

Exhibit 31.1

Certification of Chief Executive Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, John L. Bishop, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cepheid;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financing reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/s/ JOHN L. BISHOP
John L. Bishop
Chief Executive Officer

Exhibit 31.2

Certification of Chief Financial Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, John R. Sluis, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cepheid;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in the Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financing reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/s/ JOHN R. SLUIS
John R. Sluis
Senior Vice President of Finance and
Chief Financial Officer

Exhibit 32.1

Certification of Chief Executive Officer Pursuant to
18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Cepheid (the Company) on Form 10-Q for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, John L. Bishop, as Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 9, 2007

/s/ JOHN L. BISHOP
John L. Bishop
Chief Executive Officer

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934 (whether made before or after the date of the Report), irrespective of any general incorporation language contained in such filing.

Exhibit 32.2

Certification of Chief Financial Officer Pursuant to
18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Cepheid (the Company) on Form 10-Q for the quarter ended June 30, 2007, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, John L. Bishop, as Chief Executive Officer of the Company, hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 9, 2007

/s/ JOHN R. SLUIS
John R. Sluis
Senior Vice President of Finance and
Chief Financial Officer

This certification accompanies this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933 or the Securities Exchange Act of 1934 (whether made before or after the date of the Report), irrespective of any general incorporation language contained in such filing.