

TECHNE CORPORATION
2004 ANNUAL REPORT

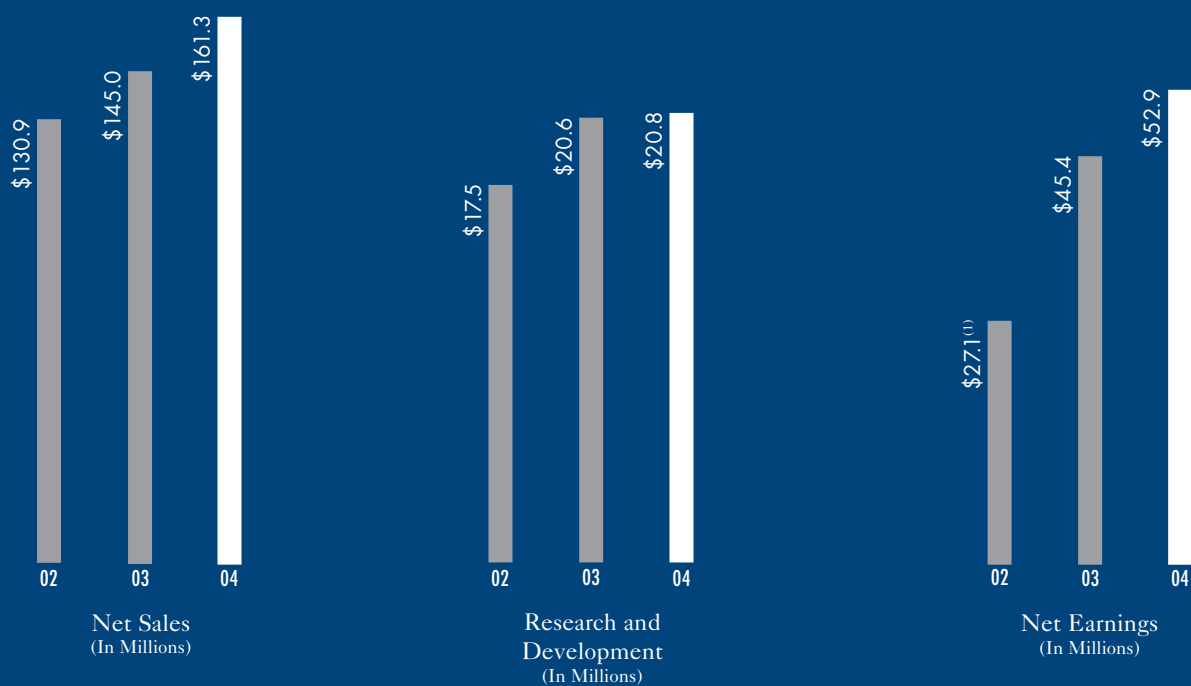


FINANCIAL HIGHLIGHTS

(in thousands, except per share data)

	<i>Year Ended June 30,</i>		
	2004	2003	2002
Net sales	\$ 161,257	\$ 145,011	\$ 130,900
Research and development	\$ 20,773	\$ 20,581	\$ 17,470
Net earnings (1)	\$ 52,928	\$ 45,396	\$ 27,130
Diluted earnings per share (1)	\$ 1.27	\$ 1.08	\$.64

	<i>June 30,</i>		
	2004	2003	2002
Cash, cash equivalents and short-term available-for-sale investments	\$ 176,593	\$ 118,763	\$ 97,064
Working capital	\$ 197,464	\$ 138,707	\$ 114,448
Total assets	\$ 325,460	\$ 263,277	\$ 238,247
Stockholders' equity	\$ 297,425	\$ 236,617	\$ 206,517
Common shares outstanding	41,155	40,913	41,562



On the cover:
Early morning at TECHNE's research, manufacturing and administrative facilities near downtown Minneapolis.

(1) Fiscal 2002 results include a charge of \$11.4 million after tax (\$.27 diluted earnings per share) for settlement of litigation.

TO OUR SHAREHOLDERS

Fiscal 2004 was another record year for TECHNE, despite continued softness in several of our markets. Here are the highlights of our performance during the year:

- After-tax earnings, before the effect of an impairment loss on our investment in Discovery Genomics (DGI), increased 20% over last year. Net earnings were \$52.9 million, or \$1.27 per share, including the DGI impairment loss of \$1.5 million (4 cents per share). This compared with net earnings of \$45.4 million, or \$1.08 per share in fiscal 2003.
- Net sales in fiscal 2004 were \$161.3 million, an increase of 11.2% over sales of \$145.0 million in fiscal 2003.
- We introduced 1,275 new products, bringing our product total to more than 6,800.
- We established new records for gross margin (78.4% of sales), operating margin (51.0% of sales), and return on sales (32.8%). In addition, we contained the growth of operating expenses to 5.3% on a revenue increase of 11.2%. Going forward, we will make every effort to sustain and improve these ratios.
- Net cash provided by operations was a record \$65.6 million and we closed our year with \$176.6 million in cash and short-term investments on our balance sheet.

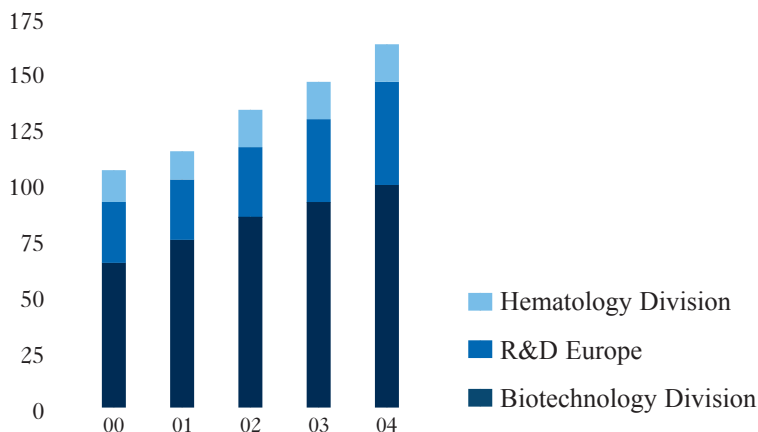
To put the year in perspective, our Biotechnology Division, which represents 61.6% of total sales, grew 9.3% in fiscal 2004. R&D Systems Europe, which represents 27.5% of total sales, grew 8.0% in British pounds, which translated to an 18.8% revenue increase in U.S. dollars for fiscal 2004. Our Hematology Division, which represents 10.8% of total sales, grew 4.9% in fiscal 2004. Hematology has declined as a percentage of total revenues because of the higher growth rate of our biotechnology products.

Taken together, without the benefit of foreign exchange translation, TECHNE's revenues would have increased approximately 8.4% in 2004, making it a good, but not great, year from a revenue perspective. However, our significant improvements in gross margins and expenses gave us our 20% increase in after-tax earnings (net of the DGI write-down).

Chart 1 shows the breakdown of revenues between our biotechnology, hematology and R&D Systems Europe segments.

Chart 1: TECHNE Revenues

In Millions \$



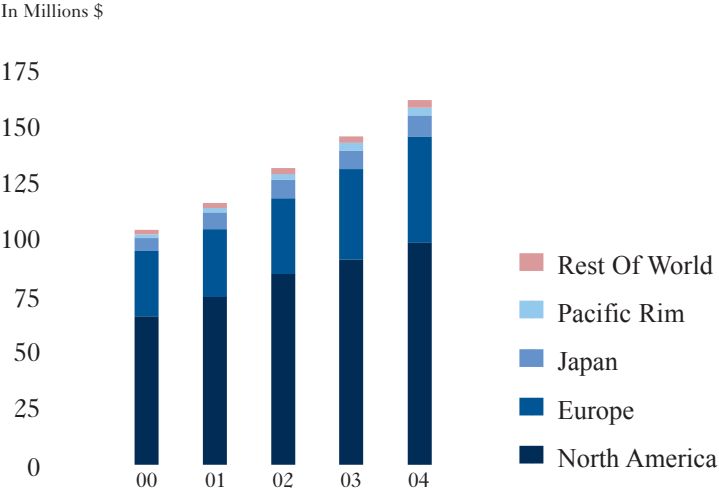
In our U.S Biotechnology Division, sales increases of 11.5% and 10.3% in our second and third quarters were higher than our 8.6% sales growth in the fourth quarter. This was mainly due to flat sales in the Japanese market and a slowdown in the growth of OEM and retail sales in North America. The Japanese market has been affected in the short term by implementation of a new law under which all national universities have been required to clear all debts in the process of becoming independent administrative corporations. This has resulted in a decline in expenditures as available funds have been used to repay existing liabilities. In our OEM and retail markets we are seeing some of the effects of changing purchasing patterns, as companies continue to become more sensitive to research expenses. Projects have become more focused and less speculative, resulting in reduced purchases of some of the research products that we and our competitors produce. This is not unique to TECHNE and may in the long run be to our benefit given our reputation for high-quality products and services.

R&D Systems Europe had a good first half with sales in British pounds up 12.9%. However, second half growth slowed to 3.7%, primarily as the result of a slowdown in clinical trial work by contract research organizations in Great Britain, the merger of two of our large customers in France, budget cuts in Germany, which affected the academic research market, and the European economy in general. As in North America, these conditions were not unique to TECHNE.

Our Hematology Division had double-digit growth in the first half as a new distributor came on line. Second half growth slowed, however, due to a change in European distributors and manufacturing problems with two lots of a major product, which affected OEM and retail sales. We have worked hard to solve these problems and should be back on track in the first quarter of 2005.

Chart 2 shows the geographic revenue mix of our business. Our largest market is North America which represented 60.7% of sales and grew 8.2% in fiscal 2004. Europe represented 29.1% of sales and grew 7.9% (net of foreign exchange gains) in fiscal 2004. Japan, represented 5.7% of sales and grew at 3.3% in fiscal 2004. Our fastest growing market is the Pacific Rim, which represented 2.4% of sales and grew at 24.2% in fiscal 2004. This segment includes China, Taiwan, Australia, New Zealand, Korea, Hong Kong and Thailand.

Chart 2: TECHNE Geographic Revenues



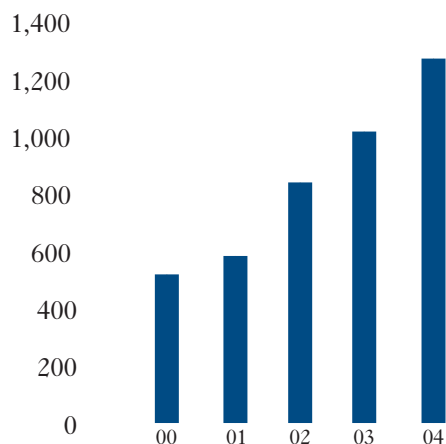
TECHNE in Perspective

From our perspective, life-sciences markets have changed in the last two years. Pre-9/11, market growth rates for life-sciences products, as experienced by our Biotechnology Division, were in the low to mid-teens. Since then, we have seen growth in the mid to high single digits. While our markets were slightly stronger in fiscal 2004 than they were last year, we see no evidence of a return to previous levels in the near-term. Pre-9/11, the world economy had already begun to slow and the terrorist events and subsequent war-time conditions seem to have resulted in slower growth patterns in virtually all segments of life sciences research. Furthermore, we see considerably more volatility in today's markets, making them less predictable on a quarter-to-quarter basis. We would not be at all surprised to see changes in our markets for reasons that may be unclear or unexplainable, due to macro or micro-economic factors that we do not fully understand.

What we can say for certain, however, is that we will continue to closely manage our expenses within the constraints of our revenue growth rate for purposes of increasing year-over-year earnings. We will continue to look at ways to reduce our costs and improve efficiency, and we will work to improve the effectiveness of our sales and marketing efforts.

We cannot over-emphasize the importance of new products to our business, especially with the changes in our markets outlined above. As such, we will continue to expedite development of new products that we believe will give us the best returns. In fiscal 2004, we released 1,275 new products, compared with 1,015 in fiscal 2003. Chart 3 shows the trend of biotechnology new product introductions over the last five years, which increased 25.6% in Fiscal 2004, 21.7% in 2003, 46.3% in 2002 and 13.1% in 2001. Total product offerings exceeded 6,800 at the end of fiscal 2004. We develop and manufacture more than 97% of the products we sell, which allows us to maintain our high gross margins.

Chart 3: Biotechnology Division New Product Releases



New products typically take seven to eight years to attain their full sales potential. Chart 4 shows the sales pattern of new Biotechnology Division products introduced during the period 2000-2004. The color-coded lines show annual sales of each year's new product offerings and the ramp-up for each period. If this chart were extended further, it would clearly show that the growth of these product groups begins leveling off after 7 or 8 years, but subsequent sales do not change materially, thereby producing a significant compounding effect on TECHNE's sales over time. In fiscal 2004, more than 80% of our Biotechnology Division revenue growth was attributable to products released within the last five years. New products released during FY 2004 contributed \$3.1 million (2.6%) of 2004 Biotechnology Division revenues; products released in FY 2003 contributed \$6.8 million (5.7%); products released in FY 2002 contributed \$6.5 million (5.4%); products released in FY 2001 contributed \$7.7 million (6.5%); and products released in FY 2000 contributed \$7.6 million (6.4%) to FY 2004 Biotechnology Division revenues. New products yield good returns on our investments and are the key to our future. They are truly our life-blood.

Chart 4: Biotechnology Division New Product Sales

In Thousands \$

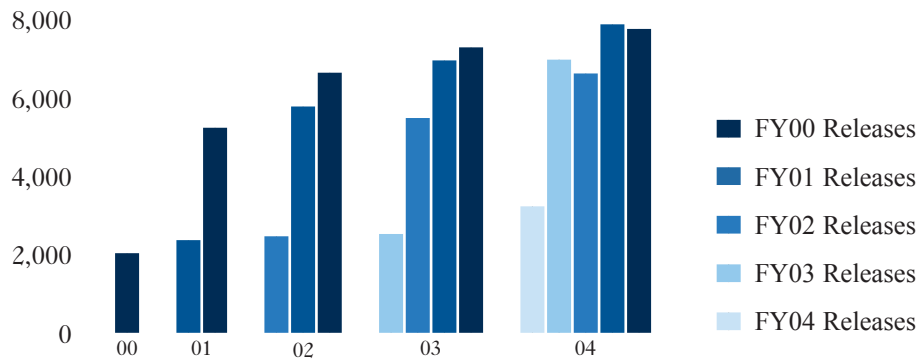
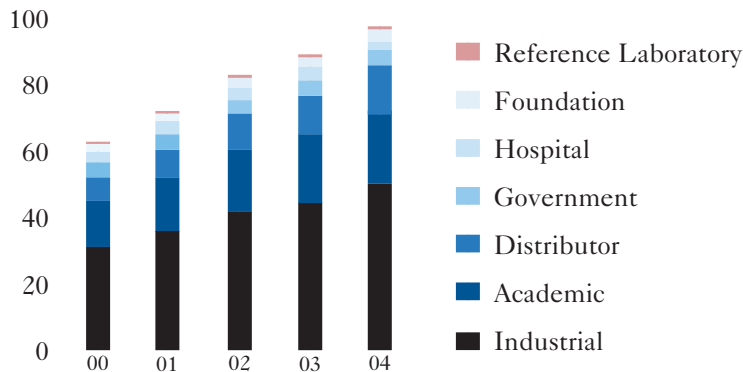


Chart 5 shows the customer sales mix for our U.S. Biotechnology Division product lines for the last five years. While R&D Systems Europe is not shown here, its sales mix is approximately 45% academic and 38% for industrial segments.

Chart 5: Biotechnology Division Customer Mix

In Millions \$



The industrial segment, which represents primarily product development research by biotechnology and pharmaceutical companies, continues to be our largest segment at 47.7% of division sales. University biotechnology research is next largest at 23.6 % of

division sales, and distributor sales, which primarily go to other industrial and academic customers, represent 14.5% of division sales. Taken together, therefore, more than 85% of our biotechnology products are used in commercial and academic research applications. Government research, primarily by the National Institutes of Health, accounts for another 5%, with the remainder of product sales to hospitals, foundations and reference laboratories.

Strategic Focus

Considering the environment we are operating in today, as described above, our primary focus is to reinvest in our own business. Clearly this investment strategy in past years has given us high returns and established us as the leader in our market niche. Fortunately, we have the financial and human resources to invest in the further development and expansion of our product lines during this period of slow market growth. The addition of new products will ensure our leadership position and help to increase our market share. Accordingly, in fiscal 2005 we plan to begin finishing laboratory space in the 78,000 square foot addition we previously made to R&D Systems' Minneapolis facility. We are also planning to add over 20 new full-time positions, including 15 scientists, who will be assigned to work in new product development or support groups. We will also be working on major projects to upgrade our website and databases used by our development and support groups.

In parallel with our new product development efforts, we continue looking for acquisition/investment opportunities in new technologies or products that would complement our current product lines and customer base or open up new markets for us. We have looked at a number of such opportunities this past year and have also been approached by other companies to work with them on various projects. In fiscal 2004 we made commitments with two separate companies to develop *in vitro* diagnostic (IVD) assays. Our deal with one, Beckman Coulter, was announced publicly, and the development of the first two assays under that deal should be released in the first calendar quarter of 2005, followed by two additional assays by calendar year end. These will be the first IVD assays we have developed for a third party for the diagnostic market.

Another area of focus for us is to look for early stage companies in which we can take an equity position in addition to receiving rights to use their technology or research market rights to their discoveries or products. In prior years we have made such investments in ChemoCentryx, Inc. (CCX) and Discovery Genomics, Inc. (DGI). In January 2004 we acquired a 10% interest in Hemerus Medical, LLC (Hemerus) for \$3.0 million.

In May and June 2004, we made an additional \$5.1 million investment in CCX, as part of \$38.1 million in new equity raised by CCX. This actually reduced our ownership position from 26.0% to 19.9% and allowed us to change our accounting for CCX from the equity method to the cost method. This change will have a positive effect on earnings next year, since we no longer will be required to book a portion of CCX losses. This amounted to \$2.4 million (6 cents per share) in fiscal 2004. We are very pleased with CCX's progress and believe that we will see a significant return on our investment over time.

Our investment in Hemerus is doing well. They are currently in the process of conducting a U.S. clinical study on their LeukoSep™ product, which reduces leukocytes in whole blood or packed red cells used in blood transfusions. Hemerus' European distributor received CE approval on LeukoSep™ in July 2004 and began sales of the product in August.

Our investment in DGI has not fared as well. DGI has been unsuccessful in raising additional equity capital and they will exhaust their cash in the next three months. As mentioned earlier, we have evaluated our investment in DGI and have taken a \$1.5 million impairment loss in fiscal 2004, representing the balance of our investment. While we continue to believe that DGI's technology is sound, we recognize that not all of our venture efforts will materialize.

Finally, we will look for opportunities to distribute to our customer base unique, high-quality products developed and manufactured by others. In that regard, we have just entered into a sales and distribution agreement with a Japanese company to distribute their nuclear hormone receptor antibodies on a world-wide basis outside of Japan. We will begin distributing these products by the end of calendar 2004.

The combination of reinvestment in our own products, coupled with other investments and distribution agreements, should help us sustain our revenue growth at or above the current life-science market growth rate.

Conclusion

We did very well in fiscal 2004, in a worldwide biotechnology research market that is growing more slowly than we had come to expect over many years. We expect to keep growing and continue increasing our share of our markets because of our constant flow of highly focused new products, our reputation for providing high-quality products and services, and the refocusing of our worldwide marketing and sales operations. Having said that, we will remain focused on our costs, in order to grow our earnings faster than our sales. We have been very successful at that in the past and will strive to continue that trend in the future.

We had two key early retirements this year: Dr. Marty Kissil, Director of Business Development, who had been with the company 15 years, and Bob Carlson, Managing Director of R&D Systems Europe, who had been with us 13 years. Both made significant contributions to TECHNE and we will miss our association with them. We are in the process of filling these and other key positions in the company.

As always, we thank you for your continued support and confidence.

Thomas E. Oland

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

TECHNE Corporation (the Company) has two operating subsidiaries: Research and Diagnostic Systems, Inc. (R&D Systems) and R&D Systems Europe Ltd. (R&D Europe). R&D Systems, located in Minneapolis, Minnesota, has two operating segments: its Biotechnology Division and its Hematology Division. The Biotechnology Division develops and manufactures purified cytokines (proteins), antibodies and assay kits which are sold to biomedical researchers and clinical research laboratories. The Hematology Division develops and manufactures whole blood hematology controls and calibrators which are sold to hospitals and clinical laboratories to check the performance of hematology instruments to assure the accuracy of hematology test results. R&D Europe, the Company's third operating segment, located in Abingdon, England, is the European distributor of R&D Systems' biotechnology products. R&D Europe has a sales subsidiary, R&D Systems GmbH, in Germany and a sales office in France.

Overall results

Consolidated net earnings increased 17% for fiscal 2004 as compared to fiscal 2003. The primary reasons for the increase were increased net sales and improved gross margins. Net sales increased 11% from fiscal 2003 and gross margins increased from 76% to 78%. The favorable impact on consolidated net earnings of the strengthening of the British pound as compared to the U.S. dollar for R&D Europe results was \$1.1 million for the year ended June 30, 2004.

Consolidated net earnings increased 67% for fiscal 2003 as compared to fiscal 2002. Excluding the litigation settlement discussed below from fiscal 2002 results, consolidated net earnings for fiscal 2003 increased 18%. The increase was due mainly to increased sales (11%) and decreased goodwill amortization of \$6.3 million. The favorable impact on consolidated net earnings of exchange rates used to convert R&D Europe results from British pounds to U.S. dollars was \$0.6 million for the year ended June 30, 2003.

Results of Operations

Net sales (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Hematology Division	\$ 17,478	\$ 16,666	\$ 15,570
Biotechnology Division	99,382	90,965	84,655
R&D Systems Europe	44,397	37,380	30,675
	<u>\$161,257</u>	<u>\$145,011</u>	<u>\$130,900</u>

Net sales for fiscal 2004 were \$161.3 million, an increase of \$16.2 million (11.2%) from fiscal 2003. The increase in consolidated net sales for the fiscal year was due mainly to the increase in sales of proteins and antibodies (\$9.1 million) and immunoassay kits (\$5.0 million). R&D Europe's net sales in fiscal 2004 were affected by favorable exchange rates used in converting British pounds to U.S. dollars. The effect of foreign exchange rates on R&D Europe's net sales for fiscal 2004 was an increase of approximately \$4.0 million. Excluding the effect of exchange rates, R&D Europe's net sales in British pounds increased 8.0% and consolidated net sales increased 8.4% for fiscal 2004, mainly due to increased sales volume.

Net sales for fiscal 2003 were \$145.0 million, an increase of \$14.1 million (10.8%) from fiscal 2002. The increase in consolidated net sales for the fiscal year was due largely to an increase in sales of proteins and antibodies (\$10.5 million). R&D Europe's net sales for fiscal 2003 were also affected by favorable exchange rates. The effect of foreign exchange rates on R&D Europe's net sales for fiscal 2003 was an increase of \$3.4 million. Excluding the effect of exchange rates, R&D Europe's net sales in British pounds increased 10.8% and consolidated net sales increased 8.2%, mainly due to increased sales volume. The Hematology Division net sales increase of 7.0% in fiscal 2003 was higher than historical increases of 3% to 5% as a result of the addition of an incremental new distributor in January 2003.

Gross margins, as a percentage of net sales, were as follows:

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Hematology Division	46.2%	47.2%	45.0%
Biotechnology Division	80.4%	79.0%	79.2%
R&D Systems Europe	51.4%	41.8%	36.1%
Consolidated	<u>78.4%</u>	<u>75.6%</u>	<u>75.2%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS

The majority of the increase in gross margin percentage in fiscal 2004 was the result of R&D Europe's gross margins increasing from 41.8% to 51.4%. Approximately one-half of this increase was due to favorable exchange rates as a result of a weaker U.S. dollar to the British pound and one-half was due to the expiration, on June 30, 2003, of a five-year, 5% royalty agreement associated with the purchase of Genzyme, Inc.'s reagent business in fiscal 1999. R&D Europe expensed \$1.8 million in fiscal 2003 under this agreement. The Biotechnology Division gross margin percentage increase of 1.4% in fiscal 2004, was mainly a result of changes in product/customer mix. The Hematology Division gross margin percentage decrease of 1% in fiscal 2004 was due to changes in customer mix.

Gross margins, as a percentage of net sales, increased slightly in fiscal 2003, mainly as a result of an increase in Hematology Division gross margin percentage and an increase in R&D Europe gross margin percentage. Hematology Division gross margins increased from 45.0% to 47.2% in fiscal 2003 as a result of lower raw material costs. Blood costs increased significantly during fiscal 2002 as a result of a decreased blood supply, but returned to a more normal level by the end of fiscal 2002. R&D Europe gross margins increased from 36.1% to 41.8% in fiscal 2003 mainly as a result of favorable exchange rates due to the weakening of the U.S. dollar to the British pound.

Selling, general and administrative expenses increased \$2.3 million (12%) in fiscal 2004 and decreased \$422,000 (2%) in fiscal 2003. Selling, general and administrative expenses were as follows (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Hematology Division	\$ 1,697	\$ 1,507	\$ 1,626
Biotechnology Division	11,761	10,825	11,647
R&D Systems, Inc.	13,458	12,332	13,273
R&D Systems Europe	7,194	6,355	5,458
Corporate	1,073	690	1,068
	<u>\$21,725</u>	<u>\$19,377</u>	<u>\$19,799</u>

R&D Systems' selling general and administrative expenses increased \$1.1 million in fiscal 2004 and decreased \$940,000 in fiscal 2003, mainly as a result of changes in the amount of profit sharing and stock bonus contributions. Profit sharing and stock bonus expense by R&D Systems was \$1.8 million, \$0.9 million and \$2.0 million in fiscal 2004, 2003 and 2002, respectively.

R&D Europe's selling, general and administrative expenses increased \$839,000 (13%) and \$897,000 (16%) in fiscal 2004 and 2003, respectively. The majority of the increases were the result of the exchange rates to convert expenses from British pounds to U.S. dollars. In British pounds, R&D Europe's selling, general and administrative expenses increased 3% and 6% for fiscal 2004 and 2003, respectively.

Corporate selling, general and administrative expenses increased \$383,000 in fiscal 2004 and decreased \$378,000 in fiscal 2003. The increase in fiscal 2004 was largely the result of increased consulting fees incurred associated with compliance with Sarbanes-Oxley (\$173,000), higher audit and accounting related fees (\$78,000) and higher directors' and officers' liability insurance premiums (\$100,000). The decrease in fiscal 2003 was a result of a decrease in legal expenses as a result of the settlement of litigation with Amgen, Inc. in fiscal 2002.

Research and development expenses increased \$192,000 and \$3.1 million in fiscal 2004 and 2003, respectively. Included in research and development expenses are the Company's share of losses by companies in which the Company has invested. Included are losses by ChemoCentryx, Inc. (CCX) through April 2004, losses by Discovery Genomics, Inc. (DGI), and losses by Hemerus Medical, LLC (Hemerus) beginning in January 2004. Research and development expenses are composed of the following (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Hematology Division	\$ 781	\$ 770	\$ 735
Biotechnology Division	17,139	16,623	14,880
R&D Systems, Inc.	17,920	17,393	15,615
ChemoCentryx, Inc. losses	2,437	2,580	1,350
Discovery Genomics, Inc. losses	364	608	505
Hemerus Medical, LLC losses	52	—	—
	<u>\$20,773</u>	<u>\$20,581</u>	<u>\$17,470</u>

The Company's net investment in CCX at June 30, 2004 was \$5.1 million. As a development stage company, CCX is dependent on its ability to raise additional funds to continue its research and development efforts. If such funding were unavailable or inadequate to fund operations, the Company would potentially recognize an impairment loss to the extent of its remaining net investment.

In May and June 2004, CCX obtained \$38.1 million in additional financing through the issuance of additional preferred stock, including a \$5.1 additional investment by the Company. After the financing the Company holds a 19.9% equity interest in CCX. The Company then evaluated the cost versus equity method of accounting for its investment in CCX and determined that it does not have the ability to exercise significant influence over the operating and financial policies of CCX and therefore, after April 2004, accounted for its investment on a cost basis.

During the fourth quarter of fiscal 2004, the Company determined that its investment in DGI was other than temporarily impaired and wrote off the remaining net investment of \$1.5 million.

The Company's net investment in Hemerus at June 30, 2004 was \$2.9 million. Hemerus' success is dependent in part, upon receiving FDA clearance to market its products. If such clearance is not received, the Company would potentially recognize an impairment loss to the extent of its remaining net investment.

Excluding CCX, DGI and Hemerus losses, research and development expenses by the Company increased \$527,000 and \$1.8 million in fiscal 2004 and 2003, respectively. These increases were primarily the result of the development and release of new cytokines, antibodies and assay kits by R&D Systems' Biotechnology Division. The increase in fiscal 2003 was largely the result of the addition of approximately ten full-time equivalent research positions from the prior year. In fiscal 2004, the Biotechnology Division increased the number of research positions only slightly, but plans on adding up to fifteen positions in fiscal 2005.

Amortization of intangible assets. On July 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, under which goodwill is no longer amortized. Goodwill amortization expense was \$6.3 million in fiscal 2002. As of June 30, 2002 the Company had net unamortized goodwill of \$12.5 million. The Company assessed the recoverability of its goodwill and other intangible assets as of July 1, 2002 (adoption) and determined that no impairment existed. The Company completed its annual impairment testing of goodwill and concluded that no impairment existed as of June 30, 2003 and 2004. The Company used discounted cash flow and other fair value methodologies to assess impairment.

The pro forma effects of implementation of SFAS No. 142 to fiscal 2002 would be as follows (in thousands, except per share data):

	<i>Year ended June 30, 2002</i>
Reported net income	\$27,130
Goodwill amortization, net of tax	<u>4,076</u>
Adjusted net income	<u>\$31,206</u>
Reported basic earnings per share	\$ 0.65
Goodwill amortization	<u>0.10</u>
Adjusted basic earnings per share	<u>\$ 0.75</u>
Reported diluted earnings per share	\$ 0.64
Goodwill amortization	<u>0.09</u>
Adjusted diluted earnings per share	<u>\$ 0.73</u>

Litigation settlement. In fiscal 2002, the Company recorded a \$17.5 million charge as a result of a litigation settlement. In fiscal 2000, Amgen, Inc. had presented invoices in the amount of \$28 million for materials provided to the Company over past years, allegedly pursuant to a contract under which no accounting or invoices were rendered for nine years. In May 2002, the parties agreed to a \$17.5 million cash settlement of the dispute. The settlement was paid in June 2002 with cash on hand and the liquidation of approximately \$15 million of short-term available-for-sale investments. The after-tax amount of the charge to the Company's fiscal 2002 results was approximately \$11.4 million or \$0.27 per diluted share. Excluding the settlement, earnings per diluted share would have been \$0.91 for fiscal 2002.

Other non-operating expense (income) consists of foreign currency transaction gains, rental income, and real estate and utility expenses related to currently unoccupied property as follows (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Foreign currency gains	\$ (64)	\$(356)	\$(352)
Rental income	(131)	(72)	—
Real estate taxes/utilities	<u>977</u>	<u>550</u>	<u>107</u>
	<u>\$ 782</u>	<u>\$ 122</u>	<u>\$(245)</u>

Income taxes for fiscal 2004, 2003 and 2002 were provided at rates of approximately 36%, 35% and 28%, respectively. The increased tax rate in fiscal 2003 was primarily the result of changes in Minnesota income tax regulations which resulted in state tax expense of \$666,000 (\$1,552,000 expense offset by \$886,000 of tax credit carryforwards) in

MANAGEMENT'S DISCUSSION AND ANALYSIS

fiscal 2003 compared to a credit of \$1 million in fiscal 2002. U.S. taxes have been reduced as a result of federal tax-exempt interest income, the federal benefit of extraterritorial income and the federal and state credit for research and development expenditures. Foreign income taxes have been provided at rates which approximate the tax rates in the countries in which R&D Europe operates. Without significant business developments, the Company expects income tax rates for fiscal 2005 to be 35% to 36%.

Liquidity and Capital Resources

Cash, cash equivalents and short-term available-for-sale investments at June 30, 2004 were \$176.6 million compared to \$118.8 million at June 30, 2003. At June 30, 2002, cash, equivalents and short-term available-for-sale investments were \$97.1 million. The Company has an unsecured line of credit of \$750,000 available at June 30, 2004. The line of credit expires on October 31, 2004. The interest rate on the line of credit is at the prime rate (4.0% at June 30, 2004). There were no borrowings on the line in the current or prior fiscal year.

Management of the Company expects to be able to meet its foreseeable future cash and working capital requirements for operations, debt repayment, facility expansion and capital additions through currently available funds, cash generated from operations and maturities of short-term available-for-sale investments.

Cash flows from operating activities. The Company generated cash from operations of \$65.6 million, \$54.1 million and \$27.7 million in fiscal 2004, 2003 and 2002, respectively. The increase in cash generated from operating activities in fiscal 2004 of \$11.5 million was the result of increased net earnings and a \$1.1 million decrease in trade and other accounts payable compared to a \$6.1 million decrease in fiscal 2003. These changes were partially offset by a \$3.3 million increase in income taxes payable compared to a \$6.5 million increase in fiscal 2003. Net earnings in fiscal 2004 increased \$9.1 million before the \$1.5 million impairment loss on the write-off of the Company's investment in DGI, which did not affect the Company's cash balances. The \$6.1 million decrease in trade and other accounts payable in fiscal 2003 was mainly the result of \$3.8 million less in royalties payable to Genzyme, Inc. stemming from the fiscal 1999

acquisition of Genzyme's research product business under which royalties were due through fiscal 2003. The \$2.8 million change in income taxes payable between fiscal 2003 and fiscal 2004 was due to higher U.S. taxable income in fiscal 2004 (\$4 million increase in income taxes payable compared to fiscal 2003) offset by higher U.S. income tax payments in fiscal 2004 (\$7.5 million more than made in fiscal 2003).

The increase in cash generated from operating activities in fiscal 2003 of \$26.4 million was the result of increased net earnings, increased losses by equity method investees and a \$6.5 million increase in income taxes payable compared to a \$4.4 million decrease in fiscal 2002. These changes were partially offset by decreased goodwill amortization and a \$6.1 million decrease in trade and other accounts payable compared to a \$2.8 million decrease in fiscal 2002. Net earnings increased approximately \$18.3 million from fiscal 2002 to fiscal 2003 while losses by equity method investees, which do not affect the Company's cash balances, increased \$1.3 million from fiscal 2002. The change in income taxes payable of \$10.9 million was mainly the result of higher U.S. taxable income in fiscal 2003 (\$3.9 million increase in U.S. income taxes payable compared to fiscal 2002) and lower income tax payments made in fiscal 2003 (\$5.1 less than made in fiscal 2002). Goodwill amortization decreased \$6.3 million in fiscal 2003 as a result of adoption of Statement of Financial Accounting Standards No. 142.

Cash flows from investing activities. Capital additions consist of the following (in thousands):

	Year Ended June 30,		
	2004	2003	2002
Laboratory, manufacturing, and computer equipment	\$1,127	\$ 977	\$ 2,124
Building improvements (Minneapolis)	—	202	522
Construction/property purchase (southeast Minnesota)	2,330	2,705	—
Property purchase (Minneapolis)	—	—	6,015
Renovation/construction (Minneapolis)	253	11,310	13,615
	<u>\$3,710</u>	<u>\$15,194</u>	<u>\$22,276</u>

The Company acquired property in southeast Minnesota in fiscal 2003 and, in fiscal 2004 constructed additional facilities at this site to house

goats used in the production of its antibodies. The renovation/construction costs in fiscal 2004, 2003 and 2002 were for renovation of the Minneapolis property purchased in fiscal 2002, construction of an infill connecting the purchased property to R&D Systems' existing property and construction of a parking ramp. The land and building purchases and construction were all financed through cash on hand, cash generated from operations and maturities of short-term available-for-sale investments. Costs to finish the infill are estimated at \$8 million and are expected to be completed in late fiscal 2005 or early 2006. All construction is expected to be financed through currently available funds and cash generated from operating activities.

Capital additions for laboratory, manufacturing and computer equipment planned for fiscal 2005 are expected to be approximately \$2.0 million and are expected to be financed through currently available cash and cash generated from operations.

The Company's net purchases of (proceeds from) short-term available-for-sale investments in fiscal 2004, 2003 and 2002 was \$47.3 million, \$6.5 million and (\$5.1) million, respectively. The Company's investment policy is to place excess cash in municipal and corporate bonds with the objective of obtaining the highest possible return with the lowest risk, while keeping funds accessible.

In January 2004, the Company purchased a 10% interest in Hemerus Medical, LLC (Hemerus) for \$3 million. Hemerus was formed in March 2001 and has acquired and is developing technology for the separation of leukocytes from blood and blood components. The Company accounts for its investment in Hemerus under the equity method of accounting. The Company's net investment in Hemerus, was \$2.9 million at June 30, 2004.

In May and June, 2004, the Company made additional investments totaling \$5.1 million in ChemoCentryx, Inc. (CCX), a technology and drug development company. After the additional investment, the Company holds a 19.9% equity interest in CCX and will account for the investment under the cost method of accounting as discussed previously. The Company's net investment in CCX was \$5.1 million and \$2.5 million at June 30, 2004 and 2003, respectively.

In fiscal 2002, the Company made an equity investment of \$3 million in Discovery Genomics, Inc. (DGI). DGI holds licenses from the University

of Minnesota to develop technologies used for functional genomics and the discovery of drug targets. The Company holds a 38% equity interest in DGI and accounts for this investment under the equity method of accounting. During the fourth quarter of fiscal 2004, the Company determined that its investment in DGI was other than temporarily impaired and wrote off the remaining net investment of \$1.5 million. The Company's net investment in DGI was \$1.9 million at June 30, 2003.

The Company paid \$2.0 million in March 2002 as a nonrefundable deposit on an option, which expires on January 1, 2005, to purchase additional property adjacent to its Minneapolis facility. The Company may negotiate an extension of the option beyond January 1, 2005, but if unable to do so, plans to exercise the option prior to its expiration date.

Cash flows from financing activities. The Company received \$4.1 million, \$2.4 million and \$332,000 for the exercise of options for 241,000, 265,000 and 87,000 shares of common stock in fiscal 2004, 2003 and 2002, respectively.

In fiscal 2003 and 2002, the Company purchased and retired 1,027,000 and 30,000 shares of Company common stock at market values of \$22.5 million and \$745,000, respectively. In May 1995, the Company announced a plan to purchase and retire its common stock. Since May 1995, the Board of Directors has authorized the purchase of \$40 million of common stock. Through June 30, 2004, \$33.2 million of common stock had been purchased under the plan. Any additional purchases will be funded from currently available cash.

The Company has never paid cash dividends and currently has no plans to do so in fiscal 2005. The Company's net earnings will be retained for reinvestment in the business.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Contractual Obligations

The following table summarizes the Company's contractual obligations and commercial commitments as of June 30, 2004 (in thousands):

	<i>Total</i>	<i>Payments Due by Period</i>			
		<i>Less than 1 Year</i>	<i>1-3 Years</i>	<i>4-5 Years</i>	<i>After 5 Years</i>
Long-term debt	\$15,857	\$1,281	\$2,723	\$2,951	\$ 8,902
Operating leases	6,112	621	1,188	1,061	3,242
Minimum royalty payments	125	125	—	—	—
	<u>\$22,094</u>	<u>\$2,027</u>	<u>\$3,911</u>	<u>\$4,012</u>	<u>\$12,144</u>

Off-Balance Sheet Arrangements

The Company is not a party to any off-balance sheet transactions, arrangements or obligations that have, or are reasonably likely to have, a material effect on the Company's financial condition, changes in the financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies

Management's discussion and analysis of the Company's financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company has identified the policies outlined below as critical to its business operations and an understanding of results of operations. The listing is not intended to be a comprehensive list of all accounting policies.

Valuation of accounts receivable. The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and the customers' current creditworthiness, as determined by management's review of their current credit information. The Company continuously monitors collections and payments from its customers and maintains a provision for estimated credit losses based upon the Company's historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been within the Company's established provisions, if the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Gross trade receivables totaled \$20.5 million and the allowance for doubtful accounts was \$233,000 at June 30, 2004.

Valuation of inventory. Inventories are valued at the lower of cost (first-in, first-out method) or market. The Company regularly reviews inventories on hand for slow-moving and obsolete inventory, inventory not meeting quality control standards and inventory subject to expiration. The manufacturing process for proteins and antibodies has and may continue to produce quantities in excess of forecasted usage. Individual protein and antibody sales volumes can be volatile and the Company believes that forecasting sales volumes for individual products beyond a two-year period is highly uncertain. As a result, the Company values its manufactured protein and antibody inventory based on a two-year sales forecast. Any significant unanticipated changes in product demand or market conditions could have an impact on the value of inventories and the change in value would be reflected in cost of sales in the period of the change. Inventories of proteins and antibodies in excess of the two-year sales forecast were \$8.6 million at June 30, 2004.

Valuation of goodwill. The Company is required to perform an annual review for impairment of goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*. Goodwill is considered to be impaired if it is determined that the carrying value of the reporting unit exceeds its fair value. Assessing the impairment of goodwill requires the Company to make judgments regarding the fair value of the net assets of its reporting units and the allocation of the carrying value of shared assets to the reporting

units. The Company's annual assessment included comparison of the carrying value of the net assets of the Biotechnology Division to its share of the Company's market capitalization at June 30, 2004. A significant change in the Company's market capitalization or in the carrying value of net assets of the Biotechnology Division could result in an impairment charge in future periods. Goodwill at June 30, 2004 was \$12.5 million.

Valuation of intangible and other long-lived assets. The Company periodically assesses the impairment of intangible and other long-lived assets which requires it to make assumptions and judgments regarding the fair value of these asset groups. Asset groups are considered to be impaired if their carrying value exceeds the asset groups' ability to continue to generate income from operations and positive cash flow in future periods. If asset groups are considered impaired, the amount by which the carrying value exceeds its fair value would be written off as an impairment loss. Intangible assets and other long-lived assets at June 30, 2004, were \$2.8 million and \$2.3 million, respectively.

Valuation of investments. The Company has made equity investments in several start-up and early development stage companies, among them CCX, DGI and Hemerus. The accounting treatment of each investment (cost method or equity method) is dependent upon a number of factors, including, but not limited to, the Company's share in the equity of the investee and the Company's ability to exercise significant influence over the operating and financial policies of the investee. In determining which accounting treatment to apply, the Company must make judgments based upon the quantitative and qualitative aspects of the investment.

The Company periodically assesses its equity investments for impairment. Development stage companies, of the type the Company has invested in, are dependent on their ability to raise additional funds to continue research and development efforts and on receiving patent protection and/or FDA clearance to market their products. If such funding were unavailable or inadequate to fund operations or if patent protection or FDA clearance were not received, the Company would potentially recognize an impairment loss to the extent of its remaining net investment. The Company's net investment at June 30, 2004 in CCX and Hemerus were \$5.1 million and \$2.9 million, respectively. During the fourth quarter of fiscal 2004, the Company

determined that its investment in DGI was other than temporarily impaired and wrote off the remaining net investment of \$1.5 million.

Income taxes. The Company operates within multiple taxing jurisdictions and is subject to audit in these jurisdictions. These audits can involve complex issues, which may require an extended period of time to resolve. The Company has received an audit assessment of \$1.75 million, plus interest, from the State of Minnesota for fiscal years 2000 to 2003. The Company has filed an appeal with the Minnesota Department of Revenue for abatement of the assessment. The Company believes that the ultimate resolution of the matter will not materially affect the consolidated financial position or operations of the Company. In management's opinion, adequate provisions for income taxes have been made for all years presented.

Assessment of claims or pending litigation. The Company is routinely subject to claims and involved in legal actions which are incidental to the business of the Company. Although it is difficult to predict the ultimate outcome of these matters, management believes that any ultimate liability will not materially affect the consolidated financial position or results of operations of the Company. As additional information becomes available, the Company will assess the potential liabilities related to claims or pending litigation and revise estimates as needed. Such revisions could materially impact the Company's consolidated financial position or results of operations.

Recent Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 addresses the consolidation by businesses of variable interest entities and requires businesses to consolidate a variable interest entity if it has a variable interest that will absorb a majority of the entity's expected losses if they occur, or receive a majority of the entity's expected returns if they occur, or both. FIN 46 is effective for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 were applicable to the Company for the quarter ended December 31, 2003. The Company assessed its relationships with ChemoCentryx, Inc. (CCX) and Discovery Genomics, Inc. (DGI) and determined that neither

MANAGEMENT'S DISCUSSION AND ANALYSIS

investment was required to be consolidated in the Company's financial statements pursuant to FIN 46. In December 2003, the FASB revised FIN 46. The Company was required to follow the revised FIN 46 guidance effective for the quarter ended March 31, 2004. The Company determined that none of the Company's investments in CCX, DGI and the January 2004 investment in Hemerus Medical, LLC, are required to be consolidated in the Company's financial statements pursuant to the revised FIN 46.

In May 2003, the FASB issued Statement of Financial Accounting Standard No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, which established standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both debt and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. For example, the Statement requires liability classification for a financial instrument issued in the form of shares that are mandatorily redeemable, e.g., includes an unconditional obligation requiring the issuer to redeem it by transferring at a specified or determinable date or dates or upon an event certain to occur. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted SFAS No. 150 and it did not have a significant impact on the Company's financial statements.

Market Risk

At the end of fiscal 2004, the Company had an independently managed investment portfolio of fixed income securities, excluding those classified as cash and cash equivalents, of \$125.4 million (see Note A of Notes to Consolidated Financial Statements). These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase.

The Company operates internationally, and thus is subject to potentially adverse movements in foreign currency rate changes. The Company is exposed to market risk from foreign exchange rate fluctuations of the euro and the British pound to the U.S. dollar as the financial position and operating

results of the Company's U.K. and German subsidiaries are translated into U.S. dollars for consolidation. At the current level of R&D Europe operating results, a 10% increase or decrease in the average exchange rate used to translate operating results into U.S. dollars would have an approximate \$1.1 million effect on consolidated operating income annually.

The Company's exposure to foreign exchange rate fluctuations also arises from transferring funds from the U.K. subsidiary to the U.S. subsidiary and from transferring funds from the German subsidiary and French sales office to the U.K. subsidiary. At June 30, 2004 and 2003, the Company had \$119,000 and \$358,000 dollar denominated intercompany debt at its U.K. subsidiary and the U.K. subsidiary had \$93,000 and \$295,000 dollar denominated intercompany debt from its European operations. These intercompany balances are revolving in nature and are not deemed to be long-term balances. The Company's U.K. subsidiary recognized net foreign currency gains of £36,000 (\$64,000), £224,000 (\$356,000) and £243,000 (\$352,000) for the years ended June 30, 2004, 2003 and 2002, respectively. The Company does not enter into foreign exchange forward contracts to reduce its exposure to foreign currency rate changes on intercompany foreign currency denominated balance sheet positions.

As of June 30, 2004, the Company's long-term debt consisted of a mortgage note payable. The interest rate on the mortgage was fixed at 7% through November 2002. The terms of the note payable were modified in December 2002 to include a floating interest rate at the one month London interbank offered rate (Libor) plus 2.5% with a floor of 4%. The floating interest rate on the mortgage note payable was below the 4% floor as of June 30, 2004.

Forward-looking Information

Statements in this Annual Report, and elsewhere, that are forward-looking involve risks and uncertainties which may affect the Company's actual results of operations. Certain of these risks and uncertainties which have affected and, in the future, could affect the Company's actual results are discussed below.

The Company's biotechnology products are sold primarily to research scientists at pharmaceutical and biotechnology companies and at university and

government research institutions. Changes in spending on research by such companies and in funding of such universities and institutions by government, including the National Institutes of Health, affects the revenues and earnings of the Company. The Company carries essentially no backlog of orders and changes in the level of orders received and filled daily can cause fluctuations in quarterly revenues and earnings.

Approximately one quarter of the Company's sales are made through its European subsidiary, R&D Systems Europe, which makes its sales in foreign currencies. The Company's revenues and earnings are, therefore, affected by fluctuations in currency exchange rates.

The biotechnology industry is subject to rapid and significant technological change. While the hematology controls industry historically has been less subject to rapid change, it too is evolving and is impacted significantly by changes in the automated testing equipment offered by instrument manufacturers. Competitors of the Company are numerous and include, among others, specialized biotechnology firms, medical laboratory instrument and equipment manufacturers and disposables suppliers, major pharmaceutical companies, universities and other research institutions. There can be no assurance that the Company's competitors will not succeed in developing technologies and products that are more effective than any which have been or are being developed by the Company or that would render the Company's technologies and products obsolete or noncompetitive.

The Company's success will depend, in part, on its ability to obtain licenses and patents, maintain trade secret protection and operate without infringing the proprietary rights of others. The Company has obtained and is negotiating licenses to produce a number of cytokines and related products claimed to be owned by others. Since the Company has not conducted a patent infringement study for each of its products, it is possible that products of the Company may unintentionally infringe patents of third parties or that the Company may have to alter its products or processes, pay licensing fees or cease certain activities because of patent rights of third parties, thereby causing additional unexpected costs and delays which may have a material adverse effect on the Company.

The Company's expansion strategies, which include internal development of new products,

collaborations, investments in joint ventures and companies developing new products related to the Company's business, and the acquisition of companies for new products and additional customer base, carry risks that objectives will not be achieved and future earnings will be adversely affected. Under the equity method of accounting, a percentage of the losses of certain companies in which the Company invests will be reported as losses of the Company. The Company may not have control of the expense levels of such companies and their losses may be greater than those anticipated by the Company. Additionally, if the Company determines that its investment in such companies is "other than temporarily" impaired, the Company may write off its entire investment in such company.

Ongoing research and development activities and the production and marketing of certain of the Company's products are subject to regulation by numerous governmental authorities in the United States and other countries. The approval process applicable to clinical diagnostic products of the type that may be developed by the Company may take a year or more. Delays in obtaining approvals could adversely affect the marketing of new products developed by the Company.

Recruiting and retaining qualified scientific and production personnel to perform research and development work and product manufacturing are critical to the Company's success. The Company's anticipated growth and its expected expansion into areas and activities requiring additional expertise will require the addition of new personnel and the development of additional expertise by existing personnel. The failure to attract and retain such personnel could adversely affect the Company's business.

For additional information on risks and uncertainties, see the Company's periodic reports filed with the Securities and Exchange Commission.

SELECTED FINANCIAL DATA

(dollars in thousands, except share and per share data)

*Revenue, Earnings and Cash Flow Data
for the Years Ended June 30*

	2004	2003	2002 ⁽²⁾	2001	2000
Net sales	\$161,257	\$145,011	\$130,900	\$115,357	\$103,838
Gross margin ⁽³⁾	78.4%	75.6%	75.2%	75.4%	74.2%
Selling, general and administrative expenses ⁽³⁾	13.5%	13.4%	15.1%	15.1%	16.4%
Research and development expenses ⁽³⁾	12.9%	14.2%	13.3%	12.6%	10.8%
Operating income ⁽³⁾	51.0%	46.7%	26.8%	40.0%	37.9%
Earnings before income taxes ⁽³⁾	51.2%	48.0%	28.8%	41.4%	38.0%
Net earnings ⁽³⁾	32.8%	31.3%	20.7%	29.5%	25.6%
Return on average equity	19.8%	20.5%	14.1%	21.4%	22.3%
Return on average assets	18.0%	18.1%	12.0%	17.2%	17.5%
Diluted earnings per share	\$ 1.27	\$ 1.08	\$ 0.64	\$ 0.80	\$ 0.63
Capital expenditures	3,710	15,194	22,276	6,815	30,368
Depreciation and amortization ⁽⁴⁾	6,040	6,353	12,688	12,737	12,651
Interest expense	678	974	1,320	1,381	1,441
Net cash provided by operating activities	65,553	54,089	27,667	46,372	38,739

*Balance Sheet, Common Stock and
Employee Data as of June 30*

	2004	2003	2002	2001	2000
Cash, cash equivalents and short-term available-for-sale investments	\$ 176,593	\$ 118,763	\$ 97,064	\$ 97,072	\$ 59,824
Receivables	21,099	19,179	19,414	18,322	15,601
Inventories	7,457	6,332	6,077	5,438	4,652
Working capital	197,464	138,707	114,448	108,300	73,740
Total assets	325,460	263,277	238,247	215,525	180,410
Long-term debt, less current portion	14,576	15,852	17,101	18,050	18,935
Stockholders' equity	297,425	236,617	206,517	177,660	141,145
Average common and common equivalent shares (in thousands)	41,697	42,031	42,523	42,668	42,206
Book value per share ⁽⁵⁾	\$ 7.23	\$ 5.78	\$ 4.97	\$ 4.29	\$ 3.41
Share price:					
High	43.45	34.75	37.05	74.00	70.00
Low	28.11	18.95	25.30	22.50	12.38
Price to earnings ratio	34	28	44	41	103
Current ratio	15.67	13.86	8.82	7.81	6.87
Quick ratio	14.69	12.76	7.96	7.26	6.00
Full-time employees	534	525	509	494	440

(1) The Company acquired the research products business of Genzyme Corporation on July 1, 1998.

(2) Fiscal 2002 results include a \$17.5 million before tax charge (\$11.4 million after tax and \$.27 diluted earnings per share) for settlement of litigation with Amgen, Inc.

(3) As a percent of net sales.

(4) The fiscal 2003 decrease in depreciation and amortization was primarily the result of adoption of Statement of Financial Accounting Standards No. 142.

(5) Total stockholders' equity divided by total shares outstanding at June 30.

The Company has not declared any cash dividends in the past, and it is not anticipated that it will declare any dividends in the foreseeable future.

<u>1999⁽¹⁾</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
\$90,901 69.9%	\$67,291 70.3%	\$60,924 68.7%	\$54,589 65.2%	\$47,716 61.3%	\$40,330 57.9%
18.6%	22.8%	23.9%	23.7%	23.4%	22.9%
13.2%	15.8%	19.2%	19.1%	18.0%	16.0%
27.6%	31.5%	25.1%	22.0%	19.2%	17.5%
28.7%	33.3%	26.2%	23.1%	20.2%	17.9%
18.3%	22.6%	17.9%	15.8%	14.1%	12.6%
20.7%	27.1%	25.0%	25.3%	25.6%	25.0%
16.9%	23.9%	22.1%	22.0%	22.0%	21.6%
\$ 0.40	\$ 0.39	\$ 0.28	\$ 0.22	\$ 0.18	\$ 0.13
5,564	2,780	4,243	6,377	1,311	1,332
11,890	2,303	2,322	1,872	1,655	1,837
—	—	29	2	9	22
28,422	20,875	12,477	9,760	7,314	6,304

<u>1999⁽¹⁾</u>	<u>1998</u>	<u>1997</u>	<u>1996</u>	<u>1995</u>	<u>1994</u>
\$ 29,114	\$41,436	\$24,752	\$19,250	\$15,945	\$10,866
13,250	10,002	9,114	8,380	7,386	6,593
5,715	3,811	4,087	3,653	3,266	2,514
37,388	49,932	34,899	28,260	23,687	17,377
123,801	72,785	53,922	44,393	34,062	26,806
—	—	—	—	—	—
96,838	63,831	48,081	38,874	29,520	22,955
41,373	39,215	38,925	38,886	38,088	38,068
\$ 2.41	\$ 1.67	\$ 1.27	\$ 1.02	\$ 0.79	\$ 0.62
14.75	10.00	7.63	8.25	3.97	4.06
6.13	6.72	5.06	3.31	2.19	2.31
31	25	27	33	19	19
3.78	7.84	8.12	6.62	6.75	5.88
3.17	7.05	6.91	5.49	5.66	4.91
402	356	326	341	315	277

CONSOLIDATED STATEMENTS OF EARNINGS

*TECHNE Corporation and Subsidiaries
(in thousands, except per share data)*

	<i>Year Ended June 30,</i>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Net sales	\$161,257	\$145,011	\$130,900
Cost of sales	<u>34,887</u>	<u>35,396</u>	<u>32,508</u>
Gross margin	126,370	109,615	98,392
Operating expenses:			
Selling, general and administrative	21,725	19,377	19,799
Research and development	20,773	20,581	17,470
Amortization of intangible assets (Note D)	1,599	1,939	8,549
Litigation settlement (Note F)	<u>—</u>	<u>—</u>	<u>17,500</u>
Total operating expenses	<u>44,097</u>	<u>41,897</u>	<u>63,318</u>
Operating income	82,273	67,718	35,074
Other expense (income):			
Interest expense	678	974	1,320
Interest income	(3,251)	(2,933)	(3,737)
Impairment loss on equity investment (Note A)	1,523	—	—
Other non-operating expense (income), net	<u>782</u>	<u>122</u>	<u>(245)</u>
Total other expense (income)	<u>(268)</u>	<u>(1,837)</u>	<u>(2,662)</u>
Earnings before income taxes	82,541	69,555	37,736
Income taxes (Note H)	<u>29,613</u>	<u>24,159</u>	<u>10,606</u>
Net earnings	<u>\$ 52,928</u>	<u>\$ 45,396</u>	<u>\$ 27,130</u>
Earnings per share:			
Basic	\$ 1.29	\$ 1.10	\$ 0.65
Diluted	\$ 1.27	\$ 1.08	\$ 0.64
Weighted average common shares outstanding:			
Basic	41,046	41,237	41,508
Diluted	<u>41,697</u>	<u>42,031</u>	<u>42,523</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

*TECHNE Corporation and Subsidiaries
(in thousands, except share and per share data)*

June 30,

	2004	2003
Assets		
Current assets:		
Cash and cash equivalents	\$ 51,201	\$ 39,371
Short-term available-for-sale investments (Note A)	125,392	79,392
Trade accounts receivable, less allowance for doubtful accounts of \$233 and \$268, respectively	20,262	18,387
Interest receivable on short-term available-for-sale investments	837	792
Inventories (Note B)	7,457	6,332
Deferred income taxes (Note H)	4,820	4,237
Prepaid expenses	954	1,004
Total current assets	210,923	149,515
Property and equipment, net (Note C)	80,504	81,166
Goodwill, net (Note D)	12,540	12,540
Intangible assets, net (Note D)	2,819	4,418
Deferred income taxes (Note H)	7,843	8,715
Investments (Note A)	8,484	4,398
Other long-lived assets (Note F)	2,347	2,525
	\$325,460	\$263,277
Liabilities and Stockholders' Equity		
Current liabilities:		
Trade accounts payable	\$ 2,695	\$ 2,216
Salaries, wages and related accounts	3,416	1,781
Other accounts payable and accrued expenses	1,152	2,605
Income taxes payable	4,915	2,972
Current portion of long-term debt (Note E)	1,281	1,234
Total current liabilities	13,459	10,808
Long-term debt, less current portion (Note E)	14,576	15,852
Total liabilities	28,035	26,660
Commitments and contingencies (Notes F and H)		
Stockholders' equity (Note G):		
Undesignated capital stock, no par; authorized 5,000,000 shares; none issued or outstanding	—	—
Common stock, par value \$.01 a share; authorized 100,000,000 shares; issued and outstanding 41,154,922 and 40,913,226 shares, respectively	412	409
Additional paid-in capital	68,960	63,279
Retained earnings	222,728	169,809
Accumulated other comprehensive income	5,325	3,120
Total stockholders' equity	297,425	236,617
	\$325,460	\$263,277

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

TECHNE Corporation and Subsidiaries
(in thousands)

	<i>Common</i>	<i>Stock</i>	<i>Additional</i>	<i>Retained</i>	<i>Accum.</i>	
	<i>Shares</i>	<i>Amount</i>	<i>Paid-in</i>	<i>Earnings</i>	<i>Other</i>	<i>Total</i>
			<i>Capital</i>		<i>Compre-</i>	
					<i>hensive</i>	
					<i>Income</i>	
					<i>(Loss)</i>	
Balances at June 30, 2001	41,432	\$414	\$57,383	\$121,209	\$(1,346)	\$177,660
Comprehensive income:						
Net earnings	—	—	—	27,130	—	27,130
Other comprehensive income, net of tax:						
Foreign currency translation adjustments	—	—	—	—	1,494	1,494
Comprehensive income						28,624
Common stock issued for exercise of options (Note G)	167	2	555	—	—	557
Surrender and retirement of stock to exercise options (Note L)	(7)	(0)	—	(225)	—	(225)
Repurchase and retirement of common stock	(30)	0	—	(745)	—	(745)
Tax benefit from exercise of stock options	—	—	646	—	—	646
Balances at June 30, 2002	41,562	416	58,584	147,369	148	206,517
Comprehensive income:						
Net earnings	—	—	—	45,396	—	45,396
Other comprehensive income, net of tax:						
Foreign currency translation adjustments	—	—	—	—	2,028	2,028
Unrealized gains on available-for-sale investments	—	—	—	—	944	944
Comprehensive income						48,368
Common stock issued for exercise of options (Note G)	392	4	2,893	—	—	2,897
Surrender and retirement of stock to exercise options (Note L)	(14)	(0)	—	(454)	—	(454)
Repurchase and retirement of common stock	(1,027)	(11)	—	(22,502)	—	(22,513)
Tax benefit from exercise of stock options	—	—	1,802	—	—	1,802
Balances at June 30, 2003	40,913	409	63,279	169,809	3,120	236,617
Comprehensive income:						
Net earnings	—	—	—	52,928	—	52,928
Other comprehensive income, net of tax:						
Foreign currency translation adjustments	—	—	—	—	3,271	3,271
Unrealized losses on available-for-sale investments	—	—	—	—	(1,066)	(1,066)
Comprehensive income						55,133
Common stock issued for exercise of options (Note G)	242	3	4,094	—	—	4,097
Surrender and retirement of stock to exercise options (Note L)	(0)	(0)	—	(9)	—	(9)
Tax benefit from exercise of stock options	—	—	1,587	—	—	1,587
Balances at June 30, 2004	<u>41,155</u>	<u>\$412</u>	<u>\$68,960</u>	<u>\$222,728</u>	<u>\$ 5,325</u>	<u>\$297,425</u>

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (Note L)

*TECHNE Corporation and Subsidiaries
(in thousands)*

	<i>Year Ended June 30,</i>		
<i>2004</i>	<i>2003</i>	<i>2002</i>	
Cash flows from operating activities:			
Net earnings	\$ 52,928	\$ 45,396	\$ 27,130
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation and amortization	6,040	6,353	12,688
Deferred income taxes	317	232	(6,292)
Losses by equity method investees	2,853	3,188	1,855
Impairment loss on equity investment	1,523	—	—
Other	335	539	590
Change in operating assets and operating liabilities:			
Trade accounts and interest receivable	(1,170)	(638)	(855)
Inventories	(1,017)	(173)	(560)
Prepaid expenses	(119)	(62)	(210)
Trade and other accounts payable	(1,069)	(6,082)	(2,830)
Salaries, wages and related accounts	1,614	(1,116)	553
Income taxes payable/receivable	3,318	6,452	(4,402)
Net cash provided by operating activities	65,553	54,089	27,667
Cash flows from investing activities:			
Additions to property and equipment	(3,710)	(15,194)	(22,276)
Purchase of short-term available-for-sale investments	(144,230)	(64,560)	(64,680)
Proceeds from maturities of short-term available-for-sale investments	96,895	58,045	69,812
Real estate deposits	—	—	(1,999)
Increase in investments	(8,462)	—	(3,000)
Increase in other long-term assets	—	—	(259)
Net cash used in investing activities	(59,507)	(21,709)	(22,402)
Cash flows from financing activities:			
Issuance of common stock	4,088	2,443	332
Repurchase of common stock	—	(22,513)	(745)
Payments on long-term debt	(1,229)	(964)	(885)
Net cash provided by (used in) financing activities	2,859	(21,034)	(1,298)
Effect of exchange rate changes on cash and cash equivalents	2,925	1,633	1,157
Net increase in cash and cash equivalents	11,830	12,979	5,124
Cash and cash equivalents at beginning of year	39,371	26,392	21,268
Cash and cash equivalents at end of year	\$ 51,201	\$ 39,371	\$ 26,392

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

TECHNE Corporation and Subsidiaries

Years Ended June 30, 2004, 2003 and 2002

A. Description of business and summary of significant accounting policies:

Description of business: TECHNE Corporation and Subsidiaries (the Company) are engaged domestically in the development and manufacture of biotechnology products and hematology calibrators and controls. These activities are primarily conducted through its wholly-owned subsidiary, Research and Diagnostic (R&D) Systems, Inc. Through its wholly-owned U.K. subsidiary, R&D Systems Europe Ltd., the Company distributes biotechnology products throughout Europe. R&D Systems Europe Ltd. has a sales subsidiary, R&D Systems GmbH, in Germany and a sales office in France.

Estimates: The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risk and uncertainties: There are no concentrations of business transacted with a particular customer or supplier nor concentrations of revenue from a particular product or geographic area that would severely impact the Company in the near term.

Principles of consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany accounts and transactions have been eliminated.

Translation of foreign financial statements: Assets and liabilities of the Company's foreign operations are translated at year-end rates of exchange and the foreign statements of earnings are translated at the average rate of exchange for the year. Gains and losses resulting from translating foreign currency financial statements are not included in operations but are accumulated in other comprehensive income. Foreign currency transaction gains and losses are included in operations.

Revenue recognition: The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable and collectibility is reasonably assured. Payment terms for shipments to end-users are net 30 days. Payment terms for distributor shipments may range from 30 to 90 days. Products are shipped FOB shipping point. Freight charges billed to end-users are included in net sales and freight costs are included in cost of sales. Freight charges on shipments to distributors are paid directly by the distributor. Any claims for credit or return of goods must be made within 10 days of receipt. Revenues are reduced to reflect estimated credits and returns.

Research and development: Research and development expenditures are expensed as incurred. Development activities generally relate to creating new products, improving or creating variations of existing products, or modifying existing products to meet new applications. Included in research and development expense is the Company's share of losses by development stage companies in which it has invested due to the Company obtaining research market rights to products developed by the investee companies. (See Investments below).

Advertising costs: Advertising expenses (including production and communication costs) for fiscal 2004, 2003 and 2002 were \$2.6 million, \$2.5 million and \$2.4 million, respectively. The Company expenses advertising expenses as incurred.

Income taxes: The Company uses the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are recognized to record the income tax effect of temporary differences between the tax basis and financial reporting basis of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Cash and equivalents: Cash and cash equivalents include cash on hand and highly-liquid investments with original maturities of three months or less.

Short-term investments: Short-term investments consist of debt instruments with original maturities of generally greater than three months to three years. The Company considers all of its marketable securities available-for-sale and reports them at fair market value. Fair market values are based on quoted market prices. Unrealized gains and losses on available-for-sale securities are excluded from income, but are included in other comprehensive income. If an “other than temporary” impairment is determined to exist, the difference between the value of the investment security recorded in the financial statements and the Company’s current estimate of the fair value is recognized as a charge to earnings in the period in which the impairment is determined.

At June 30, 2004 and 2003, the amortized cost and market value of the Company’s available-for-sale securities by major security type were as follows (in thousands):

	June 30,			
	2004		2003	
	Cost	Market	Cost	Market
State and municipal securities	\$124,014	\$123,893	\$78,448	\$ 79,392
Corporate securities	1,500	1,499	—	—
	125,514	125,392	78,448	79,392
Unrealized (losses) gains	(122)		944	—
	<u>\$125,392</u>	<u>\$125,392</u>	<u>\$79,392</u>	<u>\$ 79,392</u>

Contractual maturities of available-for-sale securities are shown below (in thousands). Expected maturities may differ from contractual maturities because borrowers may have the right to recall or prepay obligations with or without call or prepayment penalties.

Year Ending June 30:

Due within one year	\$ 41,663
Due in one to three years	<u>83,729</u>
	<u>\$125,392</u>

Proceeds from maturities of available-for-sale securities were \$96.9 million, \$58.0 million and \$69.8 million during fiscal 2004, 2003 and 2002, respectively. There were no material gross realized gains or losses on these sales. Realized gains and losses are determined on the specific identification method.

Inventories: Inventories are stated at the lower of cost (first-in, first-out method) or market. The Company regularly reviews inventory on hand for slow-moving and obsolete inventory, inventory not meeting quality control standards and inventory subject to expiration. The manufacturing process for proteins and antibodies has and may continue to produce quantities in excess of forecasted usage. Individual protein and antibody sales volumes can be volatile and the Company believes that forecasting sales volumes for individual products beyond a two-year period is highly uncertain. As a result, the Company values its manufactured protein and antibody inventory based on a two-year sales forecast.

Depreciation and amortization: Equipment is depreciated using the straight-line method over an estimated useful life of five years. Buildings, building improvements and leasehold improvements are amortized over estimated useful lives of five to forty years.

Goodwill and intangible assets: At June 30, 2004 the Company had net unamortized goodwill of \$12.5 million. The Company completed its annual impairment testing of goodwill and concluded that no impairment existed as of June 30, 2004. The Company used discounted cash flow and other fair value methodologies to assess impairment. Other intangible assets are being amortized over their estimated useful lives. (See Note D.)

Impairment of intangible and other long-lived assets: Management periodically reviews the carrying value of intangible and other long-lived assets based on the estimated discounted future cash flows expected to result from the use of these assets. Should the sum of the expected future net cash flows be less than the carrying value, an impairment loss would be recognized. An impairment loss would be measured by the amount by which the carrying value of the asset group exceeds the fair value of the asset group based on discounted estimated future cash flows. To date, management has determined that no impairment exists.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

TECHNE Corporation and Subsidiaries

Years Ended June 30, 2004, 2003 and 2002

Investments: The Company has invested in the Preferred Stock (Series A and B) of ChemoCentryx, Inc. (CCX), a technology and drug development company. Through April 2004 the Company held 26% of the outstanding stock of CCX and accounted for the investment under the equity method of accounting. In May and June, 2004 CCX obtained \$38.1 million in financing through the issuance of approximately 14.7 million shares of Preferred (Series B) Stock. The financing included a \$5.1 million investment by the Company. After the financing the Company holds a 19.9% equity interest in CCX. The Company then evaluated the cost versus equity method of accounting for its investment in CCX and determined that it does not have the ability to exercise significant influence over the operating and financial policies of CCX and therefore, after April 2004, accounted for its investment on a cost basis. The Company's net investment in CCX was \$5.1 million and \$2.5 million at June 30, 2004 and 2003, respectively. In connection with its original investment in CCX, the Company was issued warrants for 1.7 million shares of CCX Preferred Stock (Series A) which expire on December 31, 2005.

On August 2, 2001, the Company made an equity investment of \$3 million in Discovery Genomics, Inc. (DGI) Series A Preferred Stock. DGI holds licenses from the University of Minnesota to develop technologies used for functional genomics and the discovery of drug targets. The Company holds a 38% equity interest in DGI and accounted for this investment under the equity method of accounting. During the fourth quarter of fiscal 2004, the Company determined that its investment in DGI was other than temporarily impaired and wrote off the remaining net investment of \$1.5 million. The Company's net investment in DGI was \$1.9 million at June 30, 2003. The Company has been issued warrants for 1.5 million shares of DGI Preferred Stock (Series A) which expire on August 2, 2008.

On January 1, 2004, the Company purchased a 10% interest in Hemerus Medical, LLC (Hemerus) for \$3 million. Hemerus was formed in March 2001 and has acquired and is developing technology for the separation of leukocytes from blood and

blood components. Leukoreduced blood is important in blood transfusion. Hemerus owns two patents and has several patent applications pending and is currently pursuing FDA clearance to market its products in the U.S. In parallel with this investment, R&D Systems entered into a Joint Research Agreement with Hemerus. The research will involve joint projects to explore the use of Hemerus's filter technology to applications within R&D Systems' Hematology and Biotechnology Divisions. Such applications, if any, may have commercial potential in other laboratory environments. The Company accounts for its investment in Hemerus under the equity method of accounting. The Company's net investment in Hemerus was \$2.9 million at June 30, 2004.

As a development stage company, CCX is dependent on its ability to raise additional funds to continue its research and development efforts. If such funding were unavailable or inadequate to fund operations, the Company would potentially recognize an impairment loss to the extent of its remaining net investment. Hemerus' success is dependent, in part, upon receiving FDA clearance to market its products. If such clearance is not received, the Company would potentially recognize an impairment loss to the extent of its remaining net investment. The Company does not provide loans, guarantees or other financial assistance to CCX, DGI or Hemerus and has no obligation to provide additional funding.

Stock options: As permitted by Statement of Financial Accounting Standards (SFAS) No. 123, the Company has elected to continue following the guidance of Accounting Principles Board (APB) Opinion No. 25 for measurement and recognition of stock-based transactions with employees. No compensation cost has been recognized for stock options granted to employees under the plans because the exercise price of all options granted was at least equal to the fair value of the common stock at the date of grant.

If compensation cost for employee options granted under the Company's stock option plans had been determined based on the fair value at the grant dates, consistent with the methods provided in SFAS No. 123, *Accounting for Stock-Based*

Compensation, the Company's net earnings and earnings per share would have been as follows (in thousands, except per share data):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Net earnings:			
As reported	\$52,928	\$45,396	\$27,130
Less employee stock-based compensation, net of taxes	3,253	609	1,131
Plus employee stock-based compensation expense included in net earnings	—	—	—
Pro forma	<u>\$49,675</u>	<u>\$44,787</u>	<u>\$25,999</u>
Basic earnings per share:			
As reported	\$ 1.29	\$ 1.10	\$ 0.65
Less employee stock-based compensation, net of taxes	0.08	0.01	0.02
Plus employee stock-based compensation expense included in net earnings	—	—	—
Pro forma	<u>\$ 1.21</u>	<u>\$ 1.09</u>	<u>\$ 0.63</u>
Diluted earnings per share:			
As reported	\$ 1.27	\$ 1.08	\$ 0.64
Less employee stock-based compensation, net of taxes	0.08	0.01	0.03
Plus employee stock-based compensation expense included in net earnings	—	—	—
Pro forma	<u>\$ 1.19</u>	<u>\$ 1.07</u>	<u>\$ 0.61</u>

The fair value of options granted under the Company's stock option plans were estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used:

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Dividend yield	—	—	—
Expected volatility	48%-53%	48%-52%	56%-73%
Risk-free interest rates	3.9%-4.4%	4.2%-4.5%	4.6%-5.3%
Expected lives	7 years	7 years	7 years

Derivative instruments and hedging activities: The Company has determined that it has no free-standing or embedded derivatives. All contracts that contain provisions meeting the definition of a derivative also meet the requirements of, and have been designated as, normal purchases or sales. The Company's policy is to not use free-standing

derivatives and to not enter into contracts with terms that cannot be designated as normal purchases or sales.

Recent accounting pronouncements: In January 2003, the Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46), *Consolidation of Variable Interest Entities*. FIN 46 addresses the consolidation by businesses of variable interest entities and requires businesses to consolidate a variable interest entity if it has a variable interest that will absorb a majority of the entity's expected losses if they occur, or receive a majority of the entity's expected returns if they occur, or both. FIN 46 is effective for variable interest entities created after January 31, 2003. For variable interest entities created prior to January 31, 2003, the provisions of FIN 46 were applicable to the Company for the quarter ended December 31, 2003. The Company assessed its relationships with ChemoCentryx, Inc. (CCX) and Discovery Genomics, Inc. (DGI) and determined that neither investment was required to be consolidated in the Company's financial statements pursuant to FIN 46. In December 2003, the FASB revised FIN 46. The Company was required to follow the revised FIN 46 guidance effective for the quarter ended March 31, 2004. The Company has determined that none of the Company's investments in CCX, DGI and the January 2004 investment in Hemerus Medical, LLC, are required to be consolidated in the Company's financial statements pursuant to the revised FIN 46.

In May 2003, the FASB issued Statement of Financial Accounting Standard No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, which established standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both debt and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. For example, the Statement requires liability classification for a financial instrument issued in the form of shares that are mandatorily redeemable, e.g., includes an unconditional obligation requiring

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

TECHNE Corporation and Subsidiaries

Years Ended June 30, 2004, 2003 and 2002

the issuer to redeem it by transferring at a specified or determinable date or dates or upon an event certain to occur. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has adopted SFAS No. 150 and it did not have a significant impact on the Company's financial statements.

Reclassifications: Certain reclassifications have been made to prior years consolidated financial statements to conform to the current year presentation. These reclassifications had no impact on net earnings or stockholders' equity as previously reported.

B. Inventories:

Inventories consist of (in thousands):

	<i>June 30,</i>	
	<i>2004</i>	<i>2003</i>
Raw materials	\$3,062	\$2,618
Finished goods	4,257	3,595
Supplies	138	119
	<u>\$7,457</u>	<u>\$6,332</u>

C. Property and equipment:

Property and equipment consist of (in thousands):

	<i>June 30,</i>	
	<i>2004</i>	<i>2003</i>
Cost:		
Land	\$ 3,264	\$ 2,999
Buildings and improvements	77,333	64,930
Building construction in progress	8,329	18,310
Laboratory equipment	17,081	16,372
Office and computer equipment	3,367	3,106
Leasehold improvements	627	537
	<u>110,001</u>	<u>106,254</u>
Less accumulated depreciation and amortization	29,497	25,088
	<u>\$ 80,504</u>	<u>\$ 81,166</u>

D. Goodwill and intangible assets:

Goodwill and intangible assets consist of (in thousands):

	<i>Useful Life</i>	<i>June 30,</i>	
		<i>2004</i>	<i>2003</i>
Goodwill	N/A	\$38,846	\$38,846
Less accumulated amortization		26,306	26,306
		<u>\$12,540</u>	<u>\$12,540</u>
Customer list	10 years	\$18,010	\$18,010
Technology licensing agreements	16 years	730	730
		18,740	18,740
Less accumulated amortization		15,921	14,322
		<u>\$ 2,819</u>	<u>\$ 4,418</u>

The pro forma effects of implementation of SFAS No. 142 to prior periods would be as follows (in thousands, except per share data):

	<i>June 30,</i>
	<i>2002</i>
Reported net earnings	\$27,130
Goodwill amortization, net of tax	4,076
Adjusted net earnings	<u>\$31,206</u>
Reported basic earnings per share	\$ 0.65
Goodwill amortization	0.10
Adjusted basic earnings per share	<u>\$ 0.75</u>
Reported diluted earnings per share	\$ 0.64
Goodwill amortization	0.09
Adjusted diluted earnings per share	<u>\$ 0.73</u>

The estimated future amortization expense for other intangible assets as of June 30, 2004 is as follows (in thousands):

<i>Year Ending June 30:</i>	
2005	\$1,221
2006	881
2007	541
2008	176
	<u>\$2,819</u>

E. Debt:

The Company's short-term line of credit facility consists of an unsecured line of credit of \$0.8 million at June 30, 2004. The line of credit expires on October 31, 2004. The interest rate charged on the line of credit is at the prime rate (4.0% at

June 30, 2004). There were no borrowings on the line outstanding as of June 30, 2004 and 2003.

Long-term debt consists of (in thousands):

	<i>June 30,</i>	
	<i>2004</i>	<i>2003</i>
Mortgage note, payable in monthly installments through August 2014	\$15,857	\$17,086
Less current portion	<u>1,281</u>	<u>1,234</u>
	<u>\$14,576</u>	<u>\$15,852</u>

The interest rate on the mortgage note was fixed at 7% through November 2002. The terms of the original note were modified in December 2002 to include a floating interest rate at the one month London interbank offered rate (Libor) plus 2.5% with a floor of 4%. The floating interest rate on the mortgage note payable was below the 4% floor as of June 30, 2004.

Scheduled principal maturities of long-term debt as of June 30, 2004 assuming a 4% interest rate are as follows (in thousands):

Year Ending June 30:

2005	\$ 1,281
2006	1,334
2007	1,389
2008	1,445
2009	1,506
Thereafter	<u>8,902</u>
	<u>\$15,857</u>

F. Commitments and contingencies:

The Company leases buildings, vehicles and various data processing, office and laboratory equipment under operating leases. These leases provide for renewal or purchase options during or at the end of the lease periods. At June 30, 2004, aggregate net minimum rental commitments under noncancelable leases having an initial or remaining term of more than one year are payable as follows (in thousands):

Year Ending June 30:

2005	\$ 621
2006	614
2007	574
2008	543
2009	518
Thereafter	<u>3,242</u>
	<u>\$6,112</u>

Total rent expense was approximately \$594,000, \$554,000, and \$406,000 for the years ended June 30, 2004, 2003 and 2002, respectively.

In fiscal 1999, the Company entered into an option agreement for real estate adjacent to its R&D Systems facility. The purchase price for the property under the option is \$7 million plus capital improvement costs. The option expires on January 1, 2005 and required a nonrefundable deposit of \$2 million. A deposit of \$1,000 was made on the option in fiscal 2000 with the remainder of the deposit made in fiscal 2002. The deposit is included in other long-term assets. The Company may negotiate an extension of the option beyond January 1, 2005, but if unable to do so, plans to exercise the option prior to its expiration date.

The Company is routinely subject to claims and involved in legal actions which are incidental to the business of the Company. Although it is difficult to predict the ultimate outcome of these matters, management believes that any ultimate liability will not materially affect the consolidated financial position or results of operations of the Company.

The litigation settlement in fiscal 2002 arose from a dispute between the Company and Amgen, Inc. Amgen had presented invoices in fiscal 2000 in the amount of \$28 million for materials provided to the Company over past years for which no accounting or invoices were rendered for nine years. The \$17.5 million payment in fiscal 2002 was a full, complete and final cash settlement of the dispute.

G. Stockholders' equity:

Stock option plans: The Company has stock option plans which provide for the granting of stock options to employees (the TECHNE Corporation 1997 and 1987 Incentive Stock Option Plans) and to employees, officers, directors and consultants (the TECHNE Corporation 1998 and 1988 Nonqualified Stock Option Plans). The plans are administered by the Board of Directors, or a committee designated by the Board, which determines the persons who are to receive awards under the plans, the number of shares subject to each award and the term and exercise price of each

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option. The maximum term of options granted under all plans is ten years. The number of shares of common stock authorized to be issued is 3.2 million, 3.2 million, 1.6 million and 2.0 million under the 1997 Plan, the 1987 Plan, the 1998 Plan and the 1988 Plan, respectively. The number of shares available for grant at June 30, 2004 under the 1997 and 1998 Plans were 2.4 million and 1.1 million, respectively. No future grants will be made under the 1987 and 1988 Plans.

Stock option activity during the three years ended June 30, 2004 consists of the following (shares in thousands):

	<i>Shares</i>	<i>Weighted Average Exercise Price</i>
Outstanding at June 30, 2001	1,904	\$16.40
Granted	33	29.42
Canceled	(24)	36.50
Exercised	<u>(167)</u>	3.33
Outstanding at June 30, 2002	1,746	17.62
Granted	34	30.40
Canceled	(31)	36.50
Exercised	<u>(392)</u>	7.40
Outstanding at June 30, 2003	1,357	20.45
Granted	239	36.40
Canceled	(17)	45.83
Exercised	<u>(242)</u>	16.93
Outstanding at June 30, 2004	<u>1,337</u>	23.60
Options exercisable at June 30:		
2002	1,685	17.22
2003	1,350	20.37
2004	1,225	22.36

Currently outstanding and exercisable stock options at June 30, 2004 consist of the following (shares in thousands):

<i>Exercise Prices</i>	<i>Options Outstanding</i>		
	<i>Outstanding</i>	<i>Weighted Avg. Contractual Life (Yrs.)</i>	<i>Weighted Avg. Exercise Price</i>
\$ 3.37-10.00	520	1.83	\$ 5.35
10.01-20.00	89	5.00	19.44
20.01-40.00	662	4.83	35.81
40.01-65.00	<u>66</u>	6.33	50.24
	<u>1,337</u>	3.75	23.60

<i>Exercise Prices</i>	<i>Options Exercisable</i>	
	<i>Exercisable</i>	<i>Weighted Avg. Exercise Price</i>
\$ 3.37-10.00	520	\$ 5.35
10.01-20.00	89	19.44
20.01-40.00	565	35.67
40.01-65.00	<u>51</u>	53.00
	<u>1,225</u>	22.36

Warrants: In fiscal 2000, the Company issued warrants to purchase 120,000 shares of the Company's common stock at \$11.89 per share as a nonrefundable deposit on an option to purchase property adjacent to its R&D Systems' facility. The fair market value of the warrants at issuance was \$0.9 million. The warrants are outstanding as of June 30, 2004 and expire on June 30, 2006.

H. Income taxes:

The provisions for income taxes consist of the following (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Earnings before income taxes consist of:			
Domestic	\$65,716	\$59,216	\$31,214
Foreign	<u>16,825</u>	<u>10,339</u>	<u>6,522</u>
	<u>\$82,541</u>	<u>\$69,555</u>	<u>\$37,736</u>
Taxes (benefits) on income consist of:			
Currently payable:			
Federal	\$22,333	\$19,997	\$15,054
State	2,014	504	11
Foreign	4,977	3,448	1,855
Net deferred:			
Federal	247	112	(5,412)
State	19	161	(1,020)
Foreign	<u>23</u>	<u>(63)</u>	<u>118</u>
	<u>\$29,613</u>	<u>\$24,159</u>	<u>\$10,606</u>

The following is a reconciliation of the federal tax calculated at the statutory rate of 35% to the actual income taxes provided (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Computed expected federal income tax expense	\$28,889	\$24,344	\$13,207
State income taxes, net of federal benefit	1,026	494	8
Extraterritorial income tax benefit	(1,079)	(937)	(892)
Research and development tax credits	(268)	(347)	(373)
Tax-exempt interest	(720)	(735)	(1,005)
Increase in federal deferred tax valuation allowance	1,531	1,116	649
Other	234	224	(988)
	<u>\$29,613</u>	<u>\$24,159</u>	<u>\$10,606</u>

Temporary differences comprising deferred taxes on the consolidated balance sheets are as follows (in thousands):

	<i>June 30,</i>	
	<i>2004</i>	<i>2003</i>
Inventory	\$ 3,297	\$ 2,723
Inventory costs capitalized	961	1,012
Unrealized profit on intercompany sales	438	351
Other	124	151
Current asset	<u>4,820</u>	<u>4,237</u>
Excess of book over tax intangible asset amortization	7,079	7,958
Excess of book over tax research expense	286	309
Excess of book over tax depreciation	534	551
Excess tax basis in equity investments	2,976	1,353
Valuation allowance	(2,976)	(1,353)
Other	(56)	(103)
Noncurrent asset	<u>7,843</u>	<u>8,715</u>
	<u>\$12,663</u>	<u>\$12,952</u>

A deferred tax valuation allowance is required when it is more likely than not that all or a portion of deferred tax assets will not be realized. The Company has provided a valuation allowance for the potential capital loss carryover resulting from the excess tax basis in equity investment. The Company believes that it is more likely than not that the recorded deferred tax asset, net of valuation allowance, will be realized.

Undistributed earnings of the Company's foreign subsidiaries amounted to approximately \$36.9 million as of June 30, 2004. Deferred taxes have not been

provided on such undistributed earnings, as it is the Company's intent to indefinitely reinvest the undistributed earnings in the foreign operations.

The Company's tax returns are subject to audit by various governmental entities in the normal course of business. The Company has received an audit assessment of \$1.75 million, plus interest, from the State of Minnesota for fiscal years 2000 to 2003. The Company has filed an appeal with the Minnesota Department of Revenue for abatement of the assessment. The Company believes that the ultimate resolution of the matter will not materially effect the consolidated financial position or operations of the Company.

I. Earnings per share:

The number of shares used to calculate earnings per share are as follows (in thousands, except per share data):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Net earnings used for basic and diluted earnings per share	\$52,928	\$45,396	\$27,130
Weighted average shares used in basic computation	41,046	41,237	41,508
Dilutive stock options and warrants	651	794	1,015
Weighted average shares used for diluted computation	<u>41,697</u>	<u>42,031</u>	<u>42,523</u>
Basic EPS	\$ 1.29	\$ 1.10	\$ 0.65
Diluted EPS	\$ 1.27	\$ 1.08	\$ 0.64

The dilutive effect of stock options and warrants in the above table excludes all options for which the exercise price was higher than the average market price for the period. The number of potentially dilutive option shares excluded from the calculation were 352,000, 582,000 and 579,000 at June 30, 2004, 2003 and 2002, respectively.

J. Segment information:

The Company has three reportable operating segments based on the nature of products and geographic location: Hematology Division, Biotechnology Division and R&D Systems Europe. The Hematology Division develops and manufactures hematology controls and calibrators for sale world-wide. The Biotechnology Division

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

TECHNE Corporation and Subsidiaries

Years Ended June 30, 2004, 2003 and 2002

develops and manufactures biotechnology research and diagnostic products for sale world-wide. R&D Systems Europe distributes Biotechnology Division products throughout Europe. No customer accounted for more than 10% of the Company's net sales for the years ended June 30, 2004, 2003 and 2002.

The accounting policies of the segments are the same as those described in Note A. In evaluating segment performance, management focuses on sales and earnings before taxes.

Following is financial information relating to the operating segments (in thousands):

	Year Ended June 30,		
	2004	2003	2002
External net sales			
Hematology	\$ 17,478	\$ 16,666	\$ 15,570
Biotechnology	99,382	90,965	84,655
R&D Systems Europe	44,397	37,380	30,675
Total external net sales	<u>\$161,257</u>	<u>\$145,011</u>	<u>\$130,900</u>
Intersegment sales			
Hematology	\$ —	\$ —	\$ —
Biotechnology	19,686	18,131	16,726
R&D Systems Europe	—	40	57
Total intersegment sales	<u>\$ 19,686</u>	<u>\$ 18,171</u>	<u>\$ 16,783</u>
Earnings before taxes			
Hematology	\$ 5,901	\$ 5,938	\$ 5,094
Biotechnology	66,630	58,468	47,777
R&D Systems Europe	16,825	10,339	6,522
Corporate and other	(6,815)	(5,190)	(21,657)
Total earnings before taxes	<u>\$ 82,541</u>	<u>\$ 69,555</u>	<u>\$ 37,736</u>
Assets			
Hematology	\$ 22,093	\$ 21,308	\$ 20,182
Biotechnology	181,610	141,425	132,937
R&D Systems Europe	49,512	33,563	23,641
Corporate and other	73,554	68,329	62,833
Intersegment eliminations	(1,309)	(1,348)	(1,346)
Total assets	<u>\$325,460</u>	<u>\$263,277</u>	<u>\$238,247</u>
Depreciation and amortization			
Hematology	\$ 346	\$ 355	\$ 316
Biotechnology	3,632	4,106	10,780
R&D Systems Europe	275	288	252
Corporate and other	1,787	1,604	1,340
Total depreciation and amortization	<u>\$ 6,040</u>	<u>\$ 6,353</u>	<u>\$ 12,688</u>
Capital purchases			
Hematology	\$ 46	\$ 43	\$ 831
Biotechnology	2,786	7,799	2,332
R&D Systems Europe	144	193	201
Corporate and other	734	7,159	18,912
Total capital purchases	<u>\$ 3,710</u>	<u>\$ 15,194</u>	<u>\$ 22,276</u>

Corporate and other reconciling items include the results of unallocated corporate expenses and assets, the operations of the Company's equity investments in ChemoCentryx, Inc., Discovery Genomics, Inc. and Hemerus, the impairment loss on the equity investment in fiscal 2004 and the litigation settlement in fiscal 2002.

Following is financial information relating to geographic areas (in thousands):

	Year Ended June 30,		
	2004	2003	2002
External sales			
United States	\$ 94,559	\$ 87,774	\$ 80,957
Other areas	66,698	57,237	49,943
Total external sales	<u>\$161,257</u>	<u>\$145,011</u>	<u>\$130,900</u>
Long-lived assets			
United States	\$ 81,870	\$ 82,481	\$ 71,616
Other areas	752	814	835
Total long-lived assets	<u>\$ 82,622</u>	<u>\$ 83,295</u>	<u>\$ 72,451</u>

External sales are attributed to countries based on the location of the customer/distributor. Long-lived assets are comprised of land, buildings and improvements, equipment and deposits on real estate.

K. Benefit plans:

Profit sharing plans: The Company has a Profit Sharing and Savings Plan for non-union U.S. employees, which conforms to IRS provisions for 401(k) plans. The Company may make profit sharing contributions at the discretion of the Board of Directors. Operations have been charged for contributions to the plan of \$902,000, \$440,000 and \$1,022,000 for the years ended June 30, 2004, 2003 and 2002, respectively. The Company operates a defined contribution pension plan for employees of R&D Systems Europe Ltd. Operations have been charged for contributions to the plan of \$105,000, \$84,000 and \$84,000 for the years ended June 30, 2004, 2003 and 2002, respectively.

Stock bonus plans: The Company also has Stock Bonus Plans covering non-union employees. The Company may make contributions to the plans in the form of common stock, cash or other property at the discretion of the Board of Directors. The

Company purchases its common stock at market value for contribution to the plans. For the years ended June 30, 2004, 2003 and 2002 operations have been charged \$947,000, \$463,000 and \$1,081,000, respectively.

Performance incentive program: Under certain employment agreements with executive officers, the Company recorded bonuses of \$66,000, \$68,000 and \$98,000 for the years ended June 30, 2004, 2003 and 2002, respectively. In addition, options for 41,758, 3,460 and 3,108 shares of common stock were granted to the executive officers during fiscal 2004, 2003 and 2002, respectively.

L. Supplemental disclosures of cash flow information and noncash investing and financing activities:

The Company paid and received cash for the following items (in thousands):

	<i>Year Ended June 30,</i>		
	<i>2004</i>	<i>2003</i>	<i>2002</i>
Income taxes paid	\$25,979	\$17,477	\$21,251
Interest paid	672	1,022	1,326
Interest received	3,474	3,380	3,665

In fiscal 2004, stock options for 1,000 shares of common stock were exercised by the surrender of 204 shares of common stock at fair market value of \$9,000. In fiscal 2003, stock options for 126,784 shares of common stock were exercised by the surrender of 14,092 shares of common stock at fair market value of \$454,000. In fiscal 2002, stock options for 80,000 shares of common stock were exercised by the surrender of 7,654 shares of common stock at fair market value of \$225,000.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
TECHNE Corporation
Minneapolis, Minnesota

We have audited the accompanying consolidated balance sheets of TECHNE Corporation and Subsidiaries (the Company) as of June 30, 2004 and 2003, and the related consolidated statements of earnings, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. The accompanying financial statements of TECHNE Corporation and Subsidiaries for the year ended June 30, 2002 were audited by other auditors. Those auditors expressed an unqualified opinion on those consolidated financial statements in their report dated August 13, 2002.

We conducted our audits in accordance the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the fiscal 2004 and 2003 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of TECHNE Corporation and Subsidiaries as of June 30, 2004 and 2003 and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note A to the consolidated financial statements, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on July 1, 2002.

KPMG LLP

Minneapolis, Minnesota
August 10, 2004

MARKET FOR THE COMPANY'S COMMON STOCK

The Company's common stock trades on The NASDAQ Stock Market under the symbol "TECH." The following table sets forth for the periods indicated the range of the closing price per share for the Company as reported by NASDAQ.

	<i>Fiscal 2004 Price</i>		<i>Fiscal 2003 Price</i>	
	<i>High</i>	<i>Low</i>	<i>High</i>	<i>Low</i>
1st Quarter	\$35.40	\$28.11	\$32.79	\$22.79
2nd Quarter	39.00	32.10	34.75	28.42
3rd Quarter	42.20	37.35	28.99	20.76
4th Quarter	43.45	37.48	31.02	18.95

As of September 10, 2004, there were approximately 320 shareholders of record. As of September 10, 2004, there were over 23,000 beneficial shareholders of the Company's common stock. TECHNE Corporation has never paid cash dividends on its common stock. Payment of dividends is within the discretion of TECHNE's Board of Directors, although the Board of Directors plans to retain earnings for the foreseeable future for operating the Company's business.

QUARTERLY FINANCIAL INFORMATION (Unaudited)

(in thousands, except per share data)

	<i>Fiscal 2004</i>				<i>Fiscal 2003</i>			
	<i>First Qtr.</i>	<i>Second Qtr.</i>	<i>Third Qtr.</i>	<i>Fourth Qtr.</i>	<i>First Qtr.</i>	<i>Second Qtr.</i>	<i>Third Qtr.</i>	<i>Fourth Qtr.</i>
Net sales	\$37,993	\$38,264	\$42,542	\$42,459	\$34,548	\$33,300	\$37,737	\$39,426
Gross margin	29,330	29,823	33,595	33,621	25,858	24,929	28,980	29,847
Earnings before taxes	19,357	19,025	22,928	21,231	15,907	14,988	19,118	19,543
Income taxes	6,785	6,655	8,309	7,864	5,462	5,107	6,724	6,866
Net earnings	12,572	12,370	14,619	13,367	10,445	9,881	12,394	12,677
Basic earnings per share	0.31	0.30	0.36	0.33	0.25	0.24	0.30	0.31
Diluted earnings per share	0.30	0.30	0.35	0.32	0.25	0.23	0.30	0.31

INVESTOR INFORMATION

Annual Meeting

The annual meeting of shareholders of TECHNE Corporation will be held at the corporate office, 614 McKinley Place N.E., Minneapolis, Minnesota, on Thursday, October 21, 2004, at 3:30 p.m. (Minneapolis time). A notice of this meeting, proxy statement and form of proxy were sent to all shareholders with this Annual Report.

Form 10-K

The Company's 10-K Annual Report to the Securities and Exchange Commission is available upon written request to the Company or at the Company's website, www.techne-corp.com under financial information.

TECHNE Corporate Office and R&D Systems, Inc.

614 McKinley Place N.E.
Minneapolis, Minnesota 55413-2610
(612) 379-8854
Fax: (612) 379-6580

R&D Systems Europe Ltd.

19 Barton Lane
Abingdon Science Park
Abingdon, Oxon OX14 3NB
United Kingdom
(1235) 529449
Fax: (1235) 533420

R&D Systems GmbH

Borsigstrasse 7
65205 Wiesbaden-Nordenstadt
Germany
(6122) 90980
Fax: (6122) 909819

Counsel

Fredrikson & Byron, P.A.
4000 Pillsbury Center
200 South Sixth St.
Minneapolis, Minnesota 55402-1425

Auditors

KPMG
4200 Wells Fargo Center
90 South Seventh Street
Minneapolis, MN 55402

Registrar and Transfer Agent

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038

CORPORATE INFORMATION

Board of Directors

Thomas E. Oland
Chairman of the Board, President,
Chief Executive Officer, and Treasurer

Roger C. Lucas, Ph.D.
Vice Chairman

Howard O'Connell
Director, Member of Compensation and
Audit Committees

G. Arthur Herbert
Director, Member of Compensation and
Audit Committees,
Principal, CEO Advisors, a management
consulting firm

Randolph C. Steer, M.D., Ph.D.
Director, Member of Compensation and
Audit Committees,
Independent Pharmaceutical Consultant

Christopher S. Henney, Ph.D., D.Sc.
Director, Member of Compensation Committee.

Robert V. Baumgartner
Director, Member of Audit Committee,
CEO, Center For Diagnostic Imaging, Inc.

Officers

Thomas E. Oland
Chairman of the Board, President,
Chief Executive Officer, and Treasurer

James A. Weatherbee, Ph.D.
Vice President and Chief Scientific Officer

Monica Tsang, Ph.D.
Vice President, Research

Marcel Veronneau
Vice President, Hematology Operations

TECHNE
CORPORATION

R&D
SYSTEMS

614 McKinley Place N.E.
Minneapolis, Minnesota 55413
www.techne-corp.com
(612) 379-8854
Fax: (612) 379-6580