Axon Instruments, Inc.
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The Companies Section
The Australian Stock Exchange Limited
530 Collins Street
MELBOURNE VIC 3000

STOCK EXCHANGE ANNOUNCEMENT
29 August, 2003

Axon Instruments' Strategy Leads to Return to Profitability

Union City, CA August 29, 2003. The Board of Axon Instruments, Inc. is pleased to report that the strategy put in place in 2002 to return the company to profitability in 2003 has been successful. Profit after tax for the half-year ended 30 June 2003 was US$0.1 million compared with a loss of US$4.9 million for the same period in 2002. Sales revenue for the half-year period to 30 June 2003 increased 20% to US$16.1 million compared with US$13.4 million in the corresponding period in 2002. The profit figure is after fully expensing R&D of US$4.6 million, compared with US$6.3 million in the same period last year.

In commenting on the June 30 financial results of the company, Axon's CEO, Dr Alan Finkel said :

"The profit for the half year is a major improvement on the loss for the corresponding period in 2002. It is pleasing that this turnaround in financial performance is a direct result of the strategic review of the company's operations, announced in November 2002."

Axon has successfully decreased expenditures across the company and it has also repositioned research and development to concentrate on a smaller number of significant projects that are most likely to yield the highest return on investment and the greatest near-term market potential. The company has also complemented the release of new and upgraded products with expanded marketing exposure directed at increasing market share and on promoting total company image as well as individual products.

"The Board and Management are confident that the full year result will also be significantly improved over the previous full year. This improvement will result from our continued focus on a select number of significant projects, expanded marketing efforts and careful management of expenses", said Axon President Geoff Powell.

The company’s cash and short- and long-term marketable securities, such as state and municipal general obligations, notes and variable rate securities, remained strong at US$25.3 million at 30 June 2003. The company’s cash and marketable securities position declined by US$2.3 million during the half year. The primary cause for the reduction in cash and marketable securities was an increase in inventory in anticipation of new product introductions and an increase in accounts receivable due to increased revenues. The company’s cash reserves continue to provide the capacity to buy or in-license complimentary technology so as to maintain Axon's competitive lead.

The next shareholder update is scheduled to be released in October and will contain details of our recent product releases, product development progress and an update on financial performance.

About Axon Instruments, Inc.
Axon Instruments, Inc., (www.axon.com) located in Union City, California and Melbourne, Australia, was founded in 1984. It produces a broad spectrum of instrumentation and software for genomics, cellular neurosciences and cell-based screening. In genomics and cellular neurosciences, Axon is already widely recognized as one of the world's pre-eminent manufacturers of drug discovery instrumentation. The company's goal is to produce a range of superior yet affordable instrument and software systems for drug discovery aimed at the pharmaceutical industry, biotechnology companies and academic researchers. Axon Instruments is a California corporation listed on the Australian Stock Exchange (symbol: AXN.AX).

Alan Finkel | Geoffrey Powell

Alan Finkel
CEO

Geoff Powell
President

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Rule 4.2A.3

Appendix 4D

Half Year Report

Name of entity

AXON INSTRUMENTS, INC.

ABN or equivalent company reference	Half year ended ('current period')
090 106 844	June 30, 2003

2. Results for announcement to the market

$US'000

2.1 Revenues from ordinary activities	Up	19.9%	to	16,071
2.2 Profit (loss) from ordinary activities after tax attributable to members	Up	%	to	149
2.3 Net profit (loss) for the period attributable to members	Up	%	to	149

2.4 Dividends (distributions)	Amount per security	Franked amount per security
Final dividend Interim dividend	Nil	Nil
Previous corresponding period	Nil	Nil

2.5 Record date for determining entitlements to the dividend.	N/A

2.6 Brief explanation of any of the figures reported above necessary to enable the figures to be understood.

Refer to the Stock Exchange Announcement and the Unaudited Consolidated Financial Statements.

This half yearly report is to be read in conjunction with the most recent annual financial report.

3. Net Tangible Asset Backing

	Current period - $US	Previous corresponding period - $US
Net tangible asset backing per ordinary security	0.090	0.098

4. Control gained or lost over entities having material effect

4.1 Name of entity (or group of entities)	N/A
4.3 Consolidated profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) since the date in the current period on which control was acquired	$
4.2 Date from which such profit has been calculated	
4.3 Profit (loss) from ordinary activities and extraordinary items after tax of the controlled entity (or group of entities) for the whole of the previous corresponding period	$

5. Dividends

Date the dividend (distribution) is payable	N/A
Details of individual and total dividends or distributions and dividend or distribution payments.	

6. Dividend or distribution reinvestment plans in operation

N/A

7. Material interests in entities which are not controlled entities

The economic entity has an interest (that is material to it) in the following entities. *(If the interest was acquired or disposed of during either the current or previous corresponding period, indicate date of acquisition ("from dd/mm/yy") or disposal ("to dd/mm/yy").)*

Name of entity	Percentage of ownership interest held at end of period or date of disposal		Contribution to net profit (loss)	
Equity accounted associates and joint venture entities	Current period	Previous corresponding period	Current period - $US'000	Previous corresponding period - $US'000
	N/A	N/A	N/A	N/A
Total				
Other material interests:				
Optiscan Imaging Limited	12%	15%	Not equity accounted	Not equity accounted
Aviva Biosciences Corporation (from 18/09/02)	8%	-	Not equity accounted	N/A
Total				

8. For foreign entities, which set of accounting standards is used in compiling the report.

U.S. GAAP

9. For all entities, if the accounts are subject to audit dispute or qualification, a description of the dispute or qualification.

N/A

UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Axon Instruments, Inc.
As of June 30, 2003 and December 31, 2002
For the six months ended June 30, 2003 and 2002

Axon Instruments, Inc.

Unaudited Consolidated Financial Statements

As of June 30, 2003 and December 31, 2002
and for the six months ended June 30, 2003 and 2002

Contents

ERNST & YOUNG

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Review Report of Ernst & Young LLP, Independent Auditors

The Board of Directors and Shareholders
Axon Instruments, Inc.

We have reviewed the accompanying consolidated balance sheet of Axon Instruments, Inc. as of June 30, 2003 and the related consolidated statements of operations, shareholders' equity, and cash flows for the six-month periods ended June 30, 2003 and 2002. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of Axon Instruments, Inc. as of December 31, 2002 and the related consolidated statements of operations, shareholders' equity, and cash flows for the year then ended, and in our report dated February 7, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of December 31, 2002, is fairly stated, in all material respects.

Ernst & Young LLP

August 1, 2003

Axon Instruments, Inc.

Consolidated Balance Sheets

	June 30, 2003	**December 31, 2002**
	(unaudited)	**(audited)**
Assets		
Current assets:		
Cash and cash equivalents	**$ 14,173,633**	$ 12,902,736
Marketable securities	**6,225,188**	11,673,658
Accounts receivable, net of allowance of $350,853 in 2003 and $294,266 in 2002	**5,176,264**	4,292,434
Income taxes receivable	**569,988**	565,950
Inventories	**7,663,461**	5,846,428
Deferred income taxes	**183,572**	660,203
Prepaid expenses	**721,533**	688,589
Total current assets	**34,713,639**	36,629,998
Long-term marketable securities	**4,943,472**	3,068,679
Investment in Aviva Biosciences Corporation	**3,500,000**	3,500,000
Investment in Optiscan Imaging Limited	**2,735,173**	1,907,750
Equipment and leasehold improvements, net	**2,346,434**	2,685,824
Deferred income taxes – noncurrent	**843,298**	28,497
Deposits and other assets	**311,954**	318,948
Total assets	**$ 49,393,970**	$ 48,139,696
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	**$ 969,124**	$ 1,166,372
Accrued liabilities	**2,267,110**	2,238,823
Advances from customers	**607,717**	555,055
Deferred revenue	**687,263**	596,421
Extended warranties	**513,239**	462,873
Lease obligation	**142,905**	142,908
Capital lease obligation	**–**	7,281
Total current liabilities	**5,187,358**	5,169,733
Sublease deposits	**10,904**	10,904
Deferred tax liability	**1,026,870**	688,700
Lease obligation – noncurrent	**59,542**	130,993
Commitments and contingencies		
Shareholders' equity:		
Common stock, no par value: 800,000,000 shares authorized, 481,115,117 and 480,350,275 shares issued and outstanding in 2003 and 2002, respectively	**37,472,576**	37,445,277
Additional paid-in capital	**3,524,793**	3,514,523
Accumulated other comprehensive income	**1,922,947**	1,139,180
Retained earnings	**188,980**	40,386
Total shareholders' equity	**43,109,296**	42,139,366
Total liabilities and shareholders' equity	**$ 49,393,970**	$ 48,139,696

See accompanying notes.

Axon Instruments, Inc.

Unaudited Consolidated Statements of Operations

	Six months ended June 30	
	2003	**2002**
Net sales	**$ 16,070,706**	$ 13,405,255
Cost of sales	**7,748,550**	7,880,398
Gross profit	**8,322,156**	5,524,857
Operating expenses:		
Research and development	**4,638,226**	6,278,203
Selling, general and administrative	**3,828,566**	4,125,287
Loss on sublease	**–**	345,352
Total operating expenses	**8,466,792**	10,748,842
Loss from operations	**(144,636)**	(5,223,985)
Other income and expenses:		
Interest income, net	**198,027**	379,419
Foreign exchange gain (loss)	**83,704**	(19,185)
Other income	**17,972**	3,649
Income (loss) before provision for income taxes	**155,067**	(4,860,102)
Provision for income taxes	**6,473**	–
Net income (loss)	**$ 148,594**	$ (4,860,102)
Basic net income (loss) per share	**$ 0.0003**	$ (0.0103)
Diluted net income (loss) per share	**$ 0.0003**	$ (0.0103)
Shares used in computing basic net income (loss) per share	**480,815,805**	470,800,916
Shares used in computing diluted net income (loss) per share	**489,979,597**	470,800,916

See accompanying notes.

Axon Instruments, Inc.

Consolidated Statements of Shareholders' Equity

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total Shareholders' Equity
	Shares	**Amount**				
Audited balances at December 31, 2001	467,778,888	$37,065,245	$ 3,211,480	$ 2,473,286	$9,490,538	$52,240,549
Issuance of common stock upon exercise of stock options	12,310,793	352,234	–	–	–	352,234
Issuance of common stock upon exercise of entitlement options	260,594	27,798	–	–	–	27,798
Compensation expense on nonemployee stock options	–	–	303,043	–	–	303,043
Comprehensive loss:						
Net loss for the year ended December 31, 2002	–	–	–	–	(9,450,152)	(9,450,152)
Other comprehensive income (loss), net of tax:						
Net unrealized gain on foreign exchange translation	–	–	–	33,475	–	33,475
Net unrealized loss on available-for-sale securities	–	–	–	(1,367,581)	–	(1,367,581)
Total comprehensive loss						(10,784,258)
Audited balances at December 31, 2002	480,350,275	37,445,277	3,514,523	1,139,180	40,386	42,139,366
Issuance of common stock upon exercise of stock options	**764,642**	**27,272**	**–**	**–**	**–**	**27,272**
Issuance of common stock upon exercise of entitlement options	**200**	**27**	**–**	**–**	**–**	**27**
Compensation expense on nonemployee stock options	**–**	**–**	**10,270**	**–**	**–**	**10,270**
Comprehensive income:						
Net income for the six months ended June 30, 2003	**–**	**–**	**–**	**–**	**148,594**	**148,594**
Other comprehensive income (loss), net of tax:						
Net unrealized loss on foreign exchange translation	**–**	**–**	**–**	**(15,968)**	**–**	**(15,968)**
Net unrealized gain on available-for-sale securities	**–**	**–**	**–**	**799,735**	**–**	**799,735**
Total comprehensive income						**932,361**
Unaudited balances at June 30, 2003	**481,115,117**	**$37,472,576**	**$ 3,524,793**	**$ 1,922,947**	**$ 188,980**	**$43,109,296**

See accompanying notes.

Axon Instruments, Inc.

Unaudited Consolidated Statements of Cash Flows

	Six months ended June 30 2003	2002
Operating activities		
Net income (loss)	**$ 148,594**	$ (4,860,102)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	**510,754**	617,323
Gain on disposal of equipment, leasehold improvements, and other assets	**(17,447)**	(3,512)
Foreign exchange remeasurement	**(83,704)**	7,783
Deferred income taxes	**9,712**	922,316
Compensation expense on nonemployee options	**10,270**	40,728
Deferred loss on lease obligation	**–**	345,352
Changes in operating assets and liabilities:		
Accounts receivable	**(883,830)**	(113,947)
Inventories	**(1,817,033)**	571,173
Income taxes receivable and payable	**(3,239)**	(934,316)
Prepaid expenses	**(32,944)**	(200,504)
Other assets	**6,000**	–
Accounts payable	**(197,249)**	812,964
Accrued liabilities	**27,487**	154,479
Advances from customers	**52,662**	167,711
Deferred revenue	**90,842**	152,506
Extended warranties	**50,366**	10,882
Lease obligation	**(71,454)**	–
Net cash used in operating activities	**(2,200,213)**	(2,309,164)
Investing activities		
Acquisition of equipment and leasehold improvements	**(218,248)**	(482,856)
Proceeds from sale of equipment and leasehold improvements	**65,325**	11,032
Purchases and maturities of available-for-sale securities	**3,536,279**	(2,679,674)
Deposits and other assets	**–**	(96,500)
Net cash provided by (used in) investing activities	**3,383,356**	(3,247,998)
Financing activities		
Principal payments under a capital lease	**(7,281)**	(6,568)
Sale of common stock	**27,299**	359,846
Net cash provided by financing activities	**20,018**	353,278
Effect of exchange rate changes on cash	**67,736**	17,390
Net increase (decrease) in cash and cash equivalents	**1,270,897**	(5,186,494)
Cash and cash equivalents at beginning of period	**12,902,736**	20,222,205
Cash and cash equivalents at end of period	**$ 14,173,633**	$ 15,035,711

See accompanying notes.

Axon Instruments, Inc.

Notes to Unaudited Consolidated Financial Statements

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES

Organization

Axon Instruments, Inc. (the "Company") is a California corporation that designs, manufactures, and markets electronic instrumentation equipment and software for cellular neurosciences and biophysical research. The Company's current business strategy focuses on expansion of its core technologies into broader scientific, pharmaceutical, and diagnostic markets.

Basis of Presentation

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and include the results of operations of the Company and its wholly owned subsidiary, Axon Research Pty. Limited, an Australian corporation. All significant intercompany accounts and transactions have been eliminated upon consolidation. All amounts in the consolidated financial statements and the accompanying notes are in U.S. dollars unless otherwise noted.

Interim Financial Information

The interim financial information as of and for the six months ended June 30, 2003 is unaudited but includes all adjustments, consisting only of normal recurring adjustments that the Company considers necessary for a fair presentation of its consolidated financial position at that date and its consolidated results of operations and cash flows for that period. Operating results for the six months ended June 30, 2003 are not necessarily indicative of results that may be expected for any future period.

Use of Estimates

The preparation of the 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 amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation of the financial statements. These reclassifications have not changed previously reported operating or net loss. Most notably, on the balance sheet extended warranties have been segregated from deferred revenues, and on the statement of operations the loss on sublease has been disclosed separate from selling, general and administrative expenses, and bad debt expense is more appropriately classified as an operating expense versus a cost of sale.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash, Cash Equivalents, and Marketable Securities

The Company considers all cash deposits and highly liquid investments purchased with an original maturity of three months or less at the date of purchase to be cash equivalents. The Company's investments are comprised of state and municipal government obligations and corporate securities. Investments with maturities of less than one year are considered short term and investments with maturities greater than one year are considered long term.

To date, all marketable securities have been classified as available-for-sale and are carried at fair value, with unrealized gains and losses, when material, reported net of tax as a separate component of other shareholders' equity. Realized gains and losses on available-for-sale securities are included in interest income. The cost of securities sold is based on specific identification. Premiums and discounts are amortized over the period from acquisition to maturity and are included in investment income, along with interest and dividends.

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of trade receivables. The Company markets its products primarily to universities, research institutions, and pharmaceutical companies in the United States and internationally. The Company performs ongoing evaluations of its customers' financial condition and generally requires no collateral. The Company maintains reserves for potential credit losses, and such losses have historically been insignificant.

Dependence on Key Suppliers

The Company outsources primarily all subassembly to two suppliers. Any significant interruption to these arrangements could require the Company to qualify a new subassembler, if available, and could have a material adverse effect on the Company's results of operations and financial condition due to an inability to supply finished products in a timely manner.

Foreign Currency Accounting

Assets and liabilities of the Company's foreign subsidiary are remeasured in U.S. dollars at current rates of exchange, and revenues and expenses are remeasured using the average rate for the reporting period. Foreign currency transaction gains and losses are included in the consolidated statements of operations.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery or customer acceptance has occurred, the fee is fixed or determinable, and collection is reasonably assured. The Company generally recognizes revenue upon product shipment and transfer of title. The estimated costs of insignificant post-shipment obligations, including telephone support for certain products, are accrued at the time of shipment. If significant post-shipment obligations exist, such as acceptance or installation obligations, or there are concerns regarding collection at the time of shipment, all revenue is deferred until obligations are met or collection occurs. Cash received in advance of product shipment or fulfillment of post-shipment obligations is recorded as advances from customers and recognized upon performance. Most international sales are made through distributors. Shipments to distributors are generally in fulfillment of customers' orders. Distributors have a right of return of 60 days (domestic sales) and 90 days (international sales) from the original ship date. Estimates of product returns and allowances, based on actual historical experience, are recorded at the time revenue is recognized.

Included in the sale of certain of the Company's products is a limited one-year field service/warranty arrangement, which provides for on-site repairs and maintenance and software updates. These field service/warranty arrangements are included in deferred revenue and are recognized ratably over the warranty term. Customers may elect to extend their warranty at the end of the original warranty period.

Certain of the Company's products include a software element that is more than incidental. In accordance with Statement of Position 97-2, *Software Revenue Recognition*, and Statement of Position 98-4, *Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition*, software revenues are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed or determinable, and collection is probable. Certain of the Company's software products have been sold with maintenance agreements which, among other things, allow for the customer to receive software upgrades on an if-and-when available basis during the term of the agreement. The Company defers the fair value of maintenance sold under these arrangements and recognizes this amount over the maintenance period of twelve months.

Research and Development

The Company charges research and development costs to expense as incurred. Research and development costs consist primarily of salaries and related personnel costs, material cost of prototypes and test units, fees paid to consultants and outside service providers, and other expenses related to the design, development, testing, and enhancement of the Company's products.

Advertising Expense

The cost of advertising is expensed as incurred. The Company incurred \$103,311 and \$59,977 in advertising costs during the six months ended June 30, 2003 and 2002, respectively.

Income Taxes

The Company accounts for income taxes under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ("SFAS 109"). Under SFAS 109, the liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories are stated at the lower of cost or market. Cost is computed on a currently adjusted standard basis, which approximates actual cost on a current average or first-in, first-out basis. The Company makes inventory provisions for potential excess and obsolete inventory based on backlog and forecast demand. However, such forecasts and the estimated demand are subject to revisions, cancellations, and rescheduling. Actual demand will inevitably differ from such backlog and forecast demand, and such differences may be material to the consolidated financial statements.

Inventories consist of the following:

	June 30, 2003	December 31, 2002
Raw material	**$ 3,239,002**	$ 2,583,304
Work-in-process	**3,793,434**	2,494,741
Finished goods	**631,025**	768,383
	$ 7,663,461	$ 5,846,428

The above inventory balances at June 30, 2003 and December 31, 2002 are net of reserves for potential excess quantities and obsolescence of $1,344,000 and $1,235,596, respectively.

Equipment and Leasehold Improvements

Equipment and leasehold improvements are stated at cost, less accumulated depreciation and amortization. Depreciation of equipment is provided on the double-declining balance method over the estimated useful lives of the assets, which range from three to five years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful life or the lease term.

Equipment and leasehold improvements consist of the following:

	June 30, 2003	December 31, 2002
Machinery and equipment	**$ 2,879,347**	$ 2,805,585
Office furniture and fixtures	**475,445**	475,445
Computer equipment	**2,287,534**	2,260,385
Leasehold improvements	**1,574,831**	1,574,832
	7,217,157	7,116,247
Less accumulated depreciation and amortization	**(4,870,723)**	(4,430,423)
	$ 2,346,434	$ 2,685,824

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Long-Lived Assets

The Company accounts for the impairment of long-lived assets in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. For long-lived assets used in operations, the Company records impairment losses when events and circumstances indicate that these assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. If less, the impairment losses are based on the excess of the carrying amounts of these assets over their respective fair values. For assets held for sale, impairment losses are measured at the lower of the carrying amount of the assets or the fair value of the assets less costs to sell. For assets to be disposed of other than by sale, impairment losses are measured as their carrying amount less salvage value, if any, at the time the assets cease to be used. During the six months ended June 30, 2003 and 2002, the Company did not experience an impairment of any of its long-lived assets.

Warranties

The Company offers a one-year limited warranty with the sale of all of its products. The specific terms and conditions of those warranties vary depending upon the product sold and country in which the product is placed. The warranty covers the cost of parts and labor to repair the product. The Company estimates the costs that may be incurred under its basic limited warranty and records a liability in the amount of such costs at the time product revenue is recognized. Factors that affect the Company's warranty liability include the number of installed units, historical and anticipated rates of warranty claims, and cost per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liability are as follows:

	June 30	
	2003	**2002**
Balance, beginning of the period	**$ 257,300**	$ 263,000
Warranties issued during the period	**91,527**	76,443
Changes in liability for pre-existing warranties during the period, including expirations	**(166,327)**	(127,943)
Balance, end of the period	**$ 182,500**	$ 211,500

The Company also offers extended warranty contracts to customers on a limited number of its products for an additional fee. Customers may elect to extend their warranty at the end of the original warranty period. Revenue related to extended warranties is deferred and recognized ratably over the warranty term.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Warranties (continued)

Changes in the Company's deferred extended warranty revenue are as follows:

	June 30 2003	June 30 2002
Balance, beginning of the period	**$ 462,873**	$ 331,067
Extended warranties issued during the period	**328,864**	121,728
Extended warranty revenue recognized during the period	**(278,498)**	(110,846)
Balance, end of the period	**$ 513,239**	$ 341,949

Software Development Costs

Product development costs include costs related to software products that are expensed as incurred until the technological feasibility of the product is established. After technological feasibility is established, any additional costs may be capitalized in accordance with Statement of Financial Accounting Standards No. 86, *Accounting for the Cost of Computer Software to be Sold, Leased, or Otherwise Marketed*. Based on the Company's product development process, technological feasibility is established upon the completion of a working model. Costs incurred by the Company between the completion of the working model and the point at which the product is ready for general release have been insignificant. Therefore, for the periods presented, the Company has charged all such costs to research and development expense in the period incurred.

Stock-Based Compensation

The Company uses the intrinsic value method to account for stock options issued to its employees under its stock option plans and amortizes deferred compensation, if any, over the vesting period of the options. Compensation expense resulting from the issuance of fixed-term stock option awards is measured as the difference between the exercise price of the option and the fair market value of the underlying share of Company stock subject to the option on the award's grant date.

For purposes of pro forma disclosures, the Company estimates the fair value of its stock-based awards to employees using a Black-Scholes option pricing model. The Black-Scholes valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected life and exercise date of each option. Because the Company's incentive and nonstatutory stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the Company believes the existing model does not necessarily provide a reliable single measure of the fair value of its employee stock options.

For the six months ended June 30, 2003, the fair value for the Company's employee stock options was estimated with the following weighted-average assumptions: risk-free interest rate of 3.2%, no dividend yield, volatility of 0.78, and an expected life of the options of seven years. For the six months ended June 30, 2002, the fair value was estimated with the following weighted-average assumptions: risk-free interest rate of 4.5%, no dividend yield, volatility of 0.64, and an expected life of the options of 6.7 years.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Stock-Based Compensation (continued)

The pro forma effect on net income (loss) and net income (loss) per share are as follows:

	Six months ended June 30 2003	2002
Net income (loss)	**$ 148,594**	$ (4,860,102)
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	**(754,921)**	(840,312)
Pro forma net loss	**$ (606,327)**	$ (5,700,414)
Net income (loss) per share:		
Basic – as reported	**$ 0.0003**	$ (0.0103)
Basic – pro forma	**$ (0.0013)**	$ (0.0121)
Diluted – as reported	**$ 0.0003**	$ (0.0103)
Diluted – pro forma	**$ (0.0013)**	$ (0.0121)

The weighted-average fair value of options granted for the six months ended June 30, 2003 and 2002 was $0.08 and $0.20 per share, respectively.

Because pro forma fair value accounting is applicable only to options granted subsequent to December 31, 1994, the pro forma effect will not be fully reflected until subsequent years. The effects on pro forma disclosures are not likely to be representative of the effects on pro forma disclosures in future years.

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on the Company's available-for-sale securities and foreign currency translations that are excluded from net income (loss). Total comprehensive income (loss) has been disclosed in the consolidated statements of shareholders' equity.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Income (Loss) Per Share

The following table sets forth the computation of basic and diluted net income (loss) per share:

	Six months ended June 30	
	2003	**2002**
Net income (loss) attributable to common shareholders	**$ 148,594**	$ (4,860,102)
Shares used in computing basic net income (loss) per share	**480,815,805**	470,800,916
Basic net income (loss) per share	**$ 0.0003**	$ (0.0103)
Calculation of shares outstanding for computing diluted net income (loss) per share:		
Shares used in computing basic net income (loss) per share	**480,815,805**	470,800,916
Shares used to reflect the effect of the assumed exercise of employee stock options	**9,163,792**	–
Shares used in computing fully diluted net income (loss) per share	**489,979,597**	470,800,916
Diluted net income (loss) per share	**$ 0.0003**	$ (0.0103)

Due to the net loss incurred during the six months ended June 30, 2002, no adjustment was made for the assumed exercise of stock options, as the effect would be antidilutive. Had the effect not been antidilutive, an adjustment would have been made of 35,006,701 common equivalent shares.

For the six months ended June 30, 2003, diluted earnings per share include the weighted-average number of common share equivalents outstanding during the period. Dilutive common share equivalents consist of stock options and are calculated using the treasury stock method.

Recent Accounting Pronouncements

In November 2002, the Emerging Issues Task Force ("EITF") published Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"). EITF 00-21 addresses how to account for arrangements that may involve delivery or performance of multiple products, services and/or rights to use assets, and when and, if so, how an arrangement involving multiple deliverables should be divided into separate units of accounting. It does not change otherwise applicable revenue recognition criteria. It applies to arrangements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted. The Company does not expect the adoption of EITF 00-21 to have a material impact on the Company's operating results or financial condition.

NOTE 1 – SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent Accounting Pronouncements (continued)

In January 2003, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51* ("FIN 46"). FIN 46 requires the consolidation of entities in which an enterprise absorbs a majority of the entity's expected losses, receives a majority of the entity's expected residual returns, or both, as a result of ownership, contractual, or other financial interests in the entity. Currently, entities are generally consolidated by an enterprise when it has a controlling financial interest through ownership of a majority voting interest in the entity. FIN 46 immediately applies to variable interest entities created after January 31, 2003, and to variable interest entities in which an enterprise obtains an interest after that date. The provisions of this interpretation will apply in the first fiscal year or interim period beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. FIN 46 requires disclosure of certain information in financial statements initially issued after January 31, 2003, if it is reasonably possible that an enterprise will consolidate or disclose information about a variable interest entity when FIN 46 becomes effective. The Company does not expect the adoption of FIN 46 to have a material impact on the Company's results of operations or financial condition.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, ("SFAS 150") which addresses how to classify and measure certain financial instruments with characteristics of both liabilities (or an asset in some circumstances) and equity – as either debt or equity in the balance sheet. SFAS 150 requirements apply to issuers' classification and measurement of freestanding financial instruments, including those that comprise more than one option or forward contract. SFAS 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 does not expect the adoption of SFAS 150 to have a material impact on the Company's results of operations or financial condition.

NOTE 2 – INVESTMENT IN OPTISCAN IMAGING LIMITED

The Company's investment in Optiscan Imaging Limited ("Optiscan") is classified as an available-for-sale security and is carried at fair value. Unrealized gains and losses are reported as a separate component of shareholders' equity, net of tax. As a result, the Company's investment in Optiscan, as well as the Company's shareholders' equity, will continue to fluctuate at each balance sheet date as the market price of Optiscan's stock fluctuates. The Company does not believe that the investment in Optiscan could be readily sold at its reported fair value of $2.7 million (cost basis of $168,000) as reported by the Australian Stock Exchange as of June 30, 2003, given the thinly traded nature of Optiscan's stock and the size of the Company's investment. However, no evidence of a loss in value of the investment exists as of June 30, 2003, as the quoted market price is considered the best evidence of fair value, as promulgated by Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. The Company's equity interest in Optiscan at June 30, 2003 was approximately 12%.

NOTE 3 – INVESTMENT IN AVIVA BIOSCIENCES CORPORATION

In June 2002, the Company entered into a license and development agreement (the "Agreement") with Aviva Biosciences Corporation ("Aviva"). The Agreement contains a provision which grants the Company the right to make a $3,500,000 equity investment in Aviva at the same terms of the lead investor of Aviva's Series B Preferred Stock, should such financing occur. In September 2002, the Company exercised its right and acquired 2,916,667 shares of Aviva's Series B Preferred Stock at the same terms as other Series B Preferred Stock investors. The Company's equity interest in Aviva at June 30, 2003 was approximately 8% and the Company accounts for this investment under the cost method.

Due to the fact that there is currently no available market for Aviva's equity securities, the Company's ability to recover its investment and to earn a return on this investment is largely dependent on equity market conditions and the occurrence of liquidity events, such as initial public offerings, mergers, and private sales. All of these factors are difficult to predict, particularly in the current economic environment. In addition, under the Company's accounting policy, it is required to review all investments for impairment. For non-marketable equity securities, this requires significant judgment, including assessment of the investee's financial condition, the existence of subsequent rounds of financing and the impact of any relevant contractual preferences, as well as the investee's historical results of operations, and projected cash flows. The Company has determined that there is no evidence of impairment as of June 30, 2003.

The Agreement conveys exclusive distribution rights to certain technology owned and developed by Aviva. In June 2002, the Company made $100,000 of the total required $500,000 payment to obtain those rights, and classified the payment as a noncurrent other asset at June 30, 2002, which would be amortized over the life of the product. Subsequently, and after payment of the remaining $400,000 in August 2002, the Company determined that additional development was required in order to bring the product to market and to adequately match the product's features to the requirements of the Company's products. Therefore, the entire $500,000 license fee was expensed during the year ended December 31, 2002.

In addition, the Agreement has a provision for additional technology development by Aviva, which may be partially funded by the Company, in an amount not to exceed $1,000,000 over a three-year period. As of June 30, 2003, no obligations have been incurred under this provision.

NOTE 4 – STRATEGIC ALLIANCE WITH ZYOMYX, INC.

In April 2001, the Company entered into a strategic alliance and joint development agreement (the "Development Agreement") with Zyomyx, Inc. ("Zyomyx") to jointly develop laser scanners for protein biochips. The terms of the Development Agreement stipulate that Zyomyx would reimburse 50% of certain of the Company's costs related to development of the joint product. During the six months ended June 30, 2002, the Company received $350,000 in cost reimbursement from Zyomyx, which the Company recorded as an offset to research and development expenses. As of June 30, 2003, the Company has not entered into any additional collaboration agreements with Zyomyx.

NOTE 5 – ACCRUED LIABILITIES

Accrued liabilities consist of the following:

	June 30, 2003	December 31, 2002
Payroll	**$ 815,554**	$ 791,490
Deferred rent	**697,183**	606,758
Customer support	**241,800**	275,200
Warranty	**182,500**	257,300
Royalties	**122,629**	113,983
Other	**207,444**	194,092
	$ 2,267,110	$ 2,238,823

NOTE 6 – COMMITMENTS AND CONTINGENCIES

Leases

The Company enters into various noncancelable operating and capital leases for its facilities and equipment purchases. As of June 30, 2003, the Company was not a party to any capital leases. Certain operating leases require the Company to pay property taxes, insurance, and routine maintenance, and include escalation clauses. Rent expense was $1,111,582 and $1,218,170 for the six months ended June 30, 2003 and 2002, respectively, net of sublease income of $402,132 and $332,010, respectively.

At June 30, 2003, future minimum lease commitments under noncancelable operating leases are as follows:

	Operating Leases
2003	$ 1,487,312
2004	2,565,870
2005	2,044,236
2006	2,077,790
2007	2,158,419
Thereafter	7,303,515
Total minimum lease payments	$ 17,637,142

Sublease income netted from the amounts in the above schedule for the years ending 2003 and 2004 is $816,982 and $471,036, respectively.

NOTE 6 – COMMITMENTS AND CONTINGENCIES (continued)

Financial Guarantees

The Company routinely enters into distribution agreements whereby the Company indemnifies distributors of its products from certain liabilities arising from potential infringements of intellectual property rights as well as potential damages caused by limited product defects. In addition, the Company routinely enters into product development or joint research projects in which it provides similar indemnifications to the counterparty. There are no recourse provisions contained in the Company's indemnification agreements. The Company has not recorded any liability in connection with such indemnifications, as it believes the maximum amount of future payments is not material and the likelihood of incurring such payments is remote. Further, due to the broad nature of the indemnification agreements, the Company is unable to estimate a maximum amount of future payments.

NOTE 7 – STOCK OPTION PLANS

The Company has two stock option plans under which officers, key employees, nonemployee directors, and nonemployee consultants may be granted options to purchase shares of the Company's common stock. In addition to the 1987 Employee Stock Option Plan, as amended and restated in 1993, the board of directors approved the 2001 Equity Incentive Plan on May 9, 2001, with 25,000,000 shares of common stock reserved for issuance under this plan. Under both plans, the option exercise price is no less than 100% of the fair market value of the stock at the date of grant for incentive stock options, and 85% of the fair market value at the date of grant for nonstatutory stock options. Generally, and subject to continued service, stock options under the 2001 Equity Incentive Plan and the 1987 Employee Stock Option Plan (the "Plans") vest over a maximum period of five years and four years, respectively. Stock options under the Plans expire ten years from the date of grant.

Further, the Company granted 4,100,000 options, not pursuant to the Plans, in conjunction with the March 3, 2000 listing on the Australian Stock Exchange. These options were granted primarily to officers and directors at an exercise price equal to the initial public offering (A$0.20 per share). The vested portion of these options may be exercised at any time on or before five years from the date of grant of the option. The options generally vest over a four-year period.

In conjunction with the March 3, 2000 listing on the Australian Stock Exchange, the Company's board of directors approved the offer and sale of 12,997,845 options to shareholders of Circadian Technologies Limited, a significant shareholder of the Company (the "Circadian Options"). The options were priced at A$0.01 each and gave the Circadian shareholders the right to buy one share of common stock in the Company for A$0.20 at any time on or before five years after the date of grant of the option, for every 2.5 shares held in Circadian at the record date (the date ten business days after the initial Australian Stock Exchange quotation of the Company's securities). Of the 12,997,845 options offered, 12,379,283 options were issued on June 5, 2000. For the six months ended June 30, 2003 and the year ended December 31, 2002, 200 and 260,594 options were exercised, respectively. As of June 30, 2003 6,578,479 options are outstanding.

At June 30, 2003, the Company has 31,635,849 shares of common stock available for issuance under the Plans.

NOTE 7 – STOCK OPTION PLANS (continued)

The following table summarizes the Company's stock option activity, exclusive of the Circadian Options, and related information:

		Options Outstanding		
	Shares Available for Grant	Number of Shares	Range of Exercise Prices	Weighted-Average Exercise Price
Balance at December 31, 2001	31,791,709	57,454,913	$0.011-$0.934	$0.224
Options granted	(5,473,000)	5,473,000	$0.095-$0.515	$0.131
Options exercised	–	(12,310,793)	$0.011-$0.127	$0.029
Options canceled	4,363,205	(4,363,205)	$0.045-$0.934	$0.447
Balance at December 31, 2002	30,681,914	46,253,915	$0.019-$0.922	$0.243
Options granted	**(190,000)**	**190,000**	**$0.100-$0.115**	**$0.104**
Options exercised	**–**	**(764,642)**	**$0.023-$0.127**	**$0.036**
Options canceled	**1,143,935**	**(1,143,935)**	**$0.019-$0.844**	**$0.476**
Balance at June 30, 2003	**31,635,849**	**44,535,338**	**$0.023-$0.922**	**$0.240**

The following table summarizes information about all stock options outstanding, exclusive of the Circadian Options, at June 30, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life	Number of Shares	Weighted-Average Exercise Price
			(In years)		
$0.023-$0.050	11,639,413	$0.032	4.8	11,639,413	$0.032
$0.051-$0.124	5,327,989	$0.101	9.0	333,323	$0.110
$0.125-$0.140	16,445,155	$0.129	5.0	12,548,561	$0.129
$0.141-$0.600	2,447,704	$0.473	7.8	1,191,857	$0.489
$0.601-$0.922	8,675,077	$0.751	7.2	5,327,285	$0.752
$0.023-$0.922	44,535,338	$0.240	6.0	31,040,439	$0.213

The Company occasionally issues nonqualified stock options to individuals, typically consultants, who are neither employees nor directors of the Company at the fair market value of the stock as of the date of grant. Of the total options outstanding as of June 30, 2003 and December 31, 2002, 3,414,371 and 3,631,031, respectively, were held by nonemployees and nondirectors. In accordance with the provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), the Company has recorded as expense the fair value of these options as they vest. These options typically vest over three or four years. During the six months ended June 30, 2003 and 2002, the Company recorded compensation expense of $10,270 and $40,728, respectively. In future years, the annual compensation expense computed in accordance with SFAS 123 may increase or decrease due to changes in the estimated fair value of the option grants.

NOTE 8 – SALE OF PRODUCT LINE

In April 2002, the Company sold the assets and intellectual property associated with its microelectrode guidance systems instruments for use in humans. Future service of installed instruments will be provided by the buyer as part of the contract. The amounts included in sales and cost of sales with respect to this product line sale for the six months ended June 30, 2002 are $185,000 and $508,391, respectively.

NOTE 9 – LOSS ON SUBLEASE

In June 2002, the Company entered into a sub-sublease with an unrelated party to occupy office and research space in Foster City, California previously occupied by the Company. During the six months ended June 30, 2002, the Company recognized a total loss of $345,352 on the contract. The loss was calculated by subtracting anticipated lease payments to be received from the Company's sub-tenant from the Company's remaining lease obligations.

NOTE 10 – 401(k) PLAN

The Company has a retirement savings plan, commonly known as a 401(k) plan, that allows participating U.S. employees to contribute from one percent to 15 percent of their pre-tax salary subject to Internal Revenue Service limits. The Company may make contributions to the 401(k) plan at the discretion of the board of directors. The Company's contributions for the six months ended June 30, 2003 and 2002 were approximately $61,192 and $75,574, respectively.

NOTE 11 – OPERATING SEGMENTS AND GEOGRAPHIC INFORMATION

The Company has determined that, in accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, it operates in one segment as it only reports operating results on an aggregate basis to the chief operating decision makers of the Company. Operating gains and losses generated by the foreign operations of the Company and the corresponding identifiable assets were not material in any period presented.

The Company markets its products in the United States and foreign countries through its sales personnel and distributors. Substantially all of the Company's assets are in the United States. All sales are denominated in U.S. dollars and are accepted and approved in the United States. The Company's foreign and domestic sales were as follows:

	Six months ended June 30			
	2003		**2002**	
United States	**$ 9,037,358**	**56%**	$ 7,482,143	56%
Western Europe	**2,959,368**	**19%**	2,437,046	18%
Asia	**1,803,340**	**11%**	1,261,026	10%
Japan	**1,145,783**	**7%**	1,462,028	11%
Canada and Mexico	**634,053**	**4%**	572,010	4%
Other foreign countries	**490,804**	**3%**	191,002	1%
	$ 16,070,706	**100%**	$ 13,405,255	100%

There were no customers representing 10% or more of total revenue for the six months ended June 30, 2003 and 2002.

NOTE 12 – INCOME TAXES

The components of the provision for income taxes consist of the following:

	Six months ended June 30 2003	2002
Current:		
U.S. Federal	**$ 5,673**	$ (992,006)
U.S. State and Local	**800**	800
	6,473	(991,206)
Deferred:		
U.S. Federal	**–**	227,446
U.S. State and Local	**–**	763,760
	–	991,206
Provision for income taxes	**$ 6,473**	$ –

Deferred income taxes reflect the net tax effects of tax carryovers and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the deferred tax assets and liabilities as of June 30, 2003 and December 31, 2002 are as follows:

	June 30, 2003	December 31, 2002
Deferred tax assets:		
Tax credit carryovers	**$ 2,890,318**	$ 2,698,292
Net operating loss carryovers	**1,515,178**	1,611,629
Inventory reserves	**689,650**	643,210
Book/tax depreciation differences	**207,726**	207,726
Accrued expenses not currently deductible	**302,290**	282,481
Total deferred tax assets	**5,605,162**	5,443,338
Less valuation allowance	**(4,578,292)**	(4,754,638)
Deferred tax liability:		
Unrealized gain on investment	**(1,026,870)**	(688,700)
Net deferred taxes	**$ –**	$ –

The valuation allowance decreased by $176,346 during the six months ended June 30, 2003. Realizability of the deferred tax assets will be reviewed on a semiannual basis.

NOTE 12 – INCOME TAXES (continued)

The following is a reconciliation between statutory federal income taxes and the total provision for income taxes:

	Six months ended June 30	
	2003	**2002**
Statutory federal income tax provision (benefit)	**$ 52,723**	$ (1,652,435)
State taxes, net of federal tax	**528**	504,610
Increase in valuation allowance	**–**	1,137,601
Other	**(46,778)**	10,224
	$ 6,473	$ –

NOTE 13 – RELATED PARTY TRANSACTIONS

In August 2001, the Company's wholly owned subsidiary, Axon Research Pty. Limited, commenced a three-year lease for its primary facilities in Melbourne, Australia with an entity in which an officer and director of the Company holds a financial interest. The lease agreement contains usual and customary terms and provides for a three-year renewal at the end of the initial lease term. Rent expense for these facilities for the six months ended June 30, 2003 and 2002 was $58,102 and $34,827, respectively.

During the six months ended June 30, 2003, the Company purchased materials valued at $210,554 from Aviva in connection with a license and development agreement more fully described in Note 3. Accounts payable to Aviva as of June 30, 2003 and December 31, 2002 were $20,435 and $46,572, respectively. There were no purchases from Aviva during the six months ended June 30, 2002.

During the six months ended June 30, 2003, the Company made sales of $120,793 to a company of which a director of the Company was also a director. The products were sold to this related party at standard pricing and terms consistent with sales to nonrelated parties. Accounts receivable from related parties as of June 30, 2003 and December 31, 2002 were $19,830 and $2,694, respectively. There were no sales to related parties during the six months ended June 30, 2002.