

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

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

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

Commission file number: 000-53252

**WaferGen Bio-systems, Inc.**

(Exact Name of Registrant as Specified in its Charter)

**Nevada**

(State or other jurisdiction of incorporation or organization)

**90-0416683**

(IRS Employer Identification No.)

**7400 Paseo Padre Parkway, Fremont, CA**

(Address of principal executive offices)

**94555**

(Zip Code)

**(510) 651-4450**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The Registrant had 41,679,402 shares of common stock outstanding as of May 9, 2012.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

<u>Assets</u>	<u>March 31, 2012</u> (Unaudited)	<u>December 31, 2011</u>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 11,949,347	\$ 15,117,172
Accounts receivable, net of zero allowance for doubtful accounts	83,479	29,382
Inventories, net	737,637	745,008
Prepaid expenses and other current assets	115,245	186,138
<b>Total current assets</b>	<b>12,885,708</b>	<b>16,077,700</b>
Property and equipment, net	1,462,081	1,714,090
Other assets	835,645	852,093
<b>Total assets</b>	<b>\$ 15,183,434</b>	<b>\$ 18,643,883</b>
<b><u>Liabilities and Stockholders' Equity</u></b>		
<b>Current liabilities:</b>		
Accounts payable	\$ 668,637	\$ 772,411
Accrued payroll and related costs	735,125	646,715
Other accrued expenses	531,979	682,284
<b>Total current liabilities</b>	<b>1,935,741</b>	<b>2,101,410</b>
Long-term debt, net of current portion	1,752,397	1,405,967
Derivative liabilities	4,890,609	5,967,330
<b>Total liabilities</b>	<b>8,578,747</b>	<b>9,474,707</b>
Commitments and contingencies (Note 13)	—	—
<b>Stockholders' equity:</b>		
Series A, B and C convertible preference shares of subsidiary	6,117,134	6,117,134
Preferred Stock, \$0.001 par value, 10,000,000 shares authorized, 2,937,500 shares issued and outstanding at March 31, 2012 and December 31, 2011	9,838,569	9,838,569
Common Stock: \$0.001 par value; 300,000,000 shares authorized; 41,679,402 and 41,619,402 shares issued and outstanding at March 31, 2012 and December 31, 2011	41,679	41,619
Additional paid-in capital	49,609,974	49,504,516
Accumulated deficit	(59,299,930)	(56,395,235)
Accumulated other comprehensive income	297,261	62,573
<b>Total stockholders' equity</b>	<b>6,604,687</b>	<b>9,169,176</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 15,183,434</b>	<b>\$ 18,643,883</b>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations and Comprehensive Loss (Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Revenue	\$ 73,233	\$ 351,032
Cost of revenue	<u>90,405</u>	<u>140,949</u>
Gross profit (loss)	<u>(17,172)</u>	<u>210,083</u>
Operating expenses:		
Sales and marketing	254,553	765,912
Research and development	2,010,864	2,060,715
General and administrative	<u>1,176,433</u>	<u>1,413,581</u>
Total operating expenses	<u>3,441,850</u>	<u>4,240,208</u>
Operating loss	<u>(3,459,022)</u>	<u>(4,030,125)</u>
Other income and (expenses):		
Interest income	4,282	745
Interest expense	(363,055)	(108,883)
Gain on revaluation of derivative liabilities, net	1,076,721	381,829
Miscellaneous expense	<u>(149,546)</u>	<u>(47,395)</u>
Total other income and (expenses)	<u>568,402</u>	<u>226,296</u>
Net loss before provision for income taxes	(2,890,620)	(3,803,829)
Provision for income taxes	<u>14,075</u>	<u>—</u>
Net loss	(2,904,695)	(3,803,829)
Accretion on Series A and B convertible preference shares of subsidiary associated with premium	—	(64,120)
Series A-1 preferred dividend	<u>(196,665)</u>	<u>—</u>
Net loss attributable to common stockholders	<u>\$ (3,101,360)</u>	<u>\$ (3,867,949)</u>
Net loss per share - basic and diluted	<u>\$ (0.07)</u>	<u>\$ (0.09)</u>
Shares used to compute net loss per share - basic and diluted	<u>41,648,633</u>	<u>41,181,493</u>
<b>Comprehensive Loss:</b>		
Net loss	\$ (2,904,695)	\$ (3,803,829)
Foreign currency translation adjustments	<u>234,688</u>	<u>56,832</u>
Total comprehensive loss	<u>\$ (2,670,007)</u>	<u>\$ (3,746,997)</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net loss	\$ (2,904,695)	\$ (3,803,829)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	268,032	218,257
Stock-based compensation	105,518	282,553
Gain on revaluation of derivative liabilities, net	(1,076,721)	(381,829)
Provision for excess and obsolete inventory	69,307	—
Interest converted to principal on convertible promissory notes	196,692	—
Amortization of debt discount	149,738	—
Change in operating assets and liabilities:		
Restricted cash	—	(58)
Accounts receivable	(54,050)	227,855
Inventories	(61,937)	(398,888)
Prepaid expenses and other assets	87,996	7,511
Accounts payable	(103,717)	48,512
Accrued payroll and related costs	88,050	130,907
Other accrued expenses	(150,533)	36,075
Net cash used in operating activities	<u>(3,386,320)</u>	<u>(3,632,934)</u>
<b>Cash flows from investing activities:</b>		
Purchase of property and equipment	<u>(2,509)</u>	<u>(276,208)</u>
Net cash used in investing activities	<u>(2,509)</u>	<u>(276,208)</u>
<b>Cash flows from financing activities:</b>		
Repayment of capital lease obligations	—	(3,265)
Net proceeds from issuance of Series C convertible preference shares of subsidiary	—	4,993,728
Proceeds from exercise of stock options	<u>—</u>	<u>9,200</u>
Net cash provided by financing activities	<u>—</u>	<u>4,999,663</u>
Effect of exchange rates on cash	<u>221,004</u>	<u>10,917</u>
Net increase (decrease) in cash and cash equivalents	(3,167,825)	1,101,438
Cash and cash equivalents at beginning of the period	<u>15,117,172</u>	<u>2,209,941</u>
Cash and cash equivalents at end of the period	<u>\$ 11,949,347</u>	<u>\$ 3,331,379</u>

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements (Unaudited)

**NOTE 1. The Company**

**General** – WaferGen Bio-systems, Inc. and its subsidiaries (the “Company”) are engaged in the development, manufacture and sales of systems for gene expression, genotyping and stem cell research for the life sciences, pharmaceutical drug discovery and biomarker discovery and diagnostic products industries. The Company’s products are aimed at professionals who perform genetic analysis and cell biology, primarily at pharmaceutical and biotech companies, academic and private research centers, and diagnostics companies involved in biomarker research. Through the SmartChip products, the Company plans to provide new performance standards with significant savings of time and cost for professionals in the field of gene expression research facilitating biomarker discovery, toxicology, and clinical research.

Wafergen, Inc. was incorporated in the State of Delaware on October 22, 2002, and was acquired by WaferGen Bio-systems, Inc. in a reverse merger on May 31, 2007.

On January 24, 2008, the Company formed a new subsidiary in Malaysia. This subsidiary, WaferGen Biosystems (M) Sdn. Bhd. (“WGBM”), is involved in various initiatives to support a number of the Company’s ongoing development and commercialization goals. The parent company owns 100% of the common stock and 8.2% (including all shares that have been assumed by the parent company pursuant to exercises of exchange rights for which the Company has received notice from investors) of the preference shares of this entity. The Company expects that all of the subsidiary’s preference shares will be redeemed or converted into shares of the parent company, however if all preference shares were converted into common stock of WGBM, the parent company would own 72.8% of WGBM’s common stock. See Note 5 below.

On August 30, 2011, the Company formed a new wholly owned subsidiary in Luxembourg to establish a presence for its marketing and research activities in Europe.

**NOTE 2. Summary of Significant Accounting Policies**

**Basis of Presentation** – The Company has prepared the accompanying condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to these rules and regulations. These condensed consolidated financial statements should be read in conjunction with our audited financial statements and footnotes related thereto for the year ended December 31, 2011, included in our Form 10-K filed with the SEC. In the opinion of management, the unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the Company’s financial position and the results of its operations and cash flows.

The results of operations for such interim periods are not necessarily indicative of the results to be expected for the full year.

**Basis of Consolidation** – The condensed consolidated financial statements include the financial statements of WaferGen Bio-systems, Inc. and its subsidiaries. All significant transactions and balances between the WaferGen Bio-systems, Inc. and its subsidiaries have been eliminated in consolidation.

**Use of Estimates** – Preparing condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results and outcomes could differ from these estimates and assumptions.

**Foreign Currencies** – Assets and liabilities of non-U.S. subsidiaries for which the local currency is the functional currency are translated into U.S. dollars at the exchange rate on the balance sheet date. Revenues and expenses are translated at the average rates of exchange prevailing during each reporting period. Remeasurement adjustments resulting from this process are charged or credited to other comprehensive income (loss). Foreign exchange gains and losses for assets and liabilities of the Company’s non-U.S. subsidiaries for which the functional currency is the U.S. dollar are recorded in miscellaneous income (expense) in the Company’s condensed consolidated statements of operations.

**Inventory** – Inventory is recorded at the lower of cost (first-in, first-out) or market value. Additionally, the Company evaluates its inventory in terms of excess and obsolete exposures.

**WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES****Notes to the Condensed Consolidated Financial Statements (Unaudited)**

**Stock-Based Compensation** – The Company measures the fair value of all stock-based awards to employees, including stock options, on the grant date and records the fair value of these awards, net of estimated forfeitures, to compensation expense over the service period. The fair value of awards to consultants is measured on the dates on which performance of services is completed, with interim valuations recorded at balance sheet dates while performance is in progress. The fair value of options is estimated using the Black-Scholes valuation model, and of restricted stock is based on the Company’s closing share price on the measurement date.

**Change in Fair Value of Derivatives** – The Company recognizes its warrants with certain anti-dilution protection, the Series A convertible preference shares of its Malaysian subsidiary, and the conversion element of its convertible promissory notes and of the Series B convertible preference shares of its Malaysian subsidiary as derivative liabilities. Such liabilities are valued when the financial instruments are initially issued or the derivative first requires recognition and are also revalued at each reporting date, with the change in their respective fair values being recorded as a gain or loss on revaluation within other income and expenses in the statement of operations. The Company determines the fair value of all of its derivative liabilities using a Monte Carlo Simulation approach, with key input variables provided by management.

**Warranty Reserve** – The Company’s standard warranty agreement is one year from shipment of certain products. The Company accrues for anticipated warranty costs upon shipment of these products. The Company’s warranty reserve is based on management’s judgment regarding anticipated rates of warranty claims and associated repair costs, and is updated quarterly.

**Net Income (Loss) Per Share** – Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding plus common share equivalents from conversion of dilutive stock options, warrants, and restricted stock using the treasury method, and convertible securities using the as-converted method, except when antidilutive. In the event of a net loss, the effects of all potentially dilutive shares are excluded from the diluted net loss per share calculation as their inclusion would be antidilutive.

**Recent Accounting Pronouncements**

In May 2011, the FASB issued ASU 2011-04, “Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs” (“ASU 2011-04”). ASU 2011-04 results in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. The Company adopted this guidance effective January 1, 2012, and its adoption did not have a material impact on the Company’s consolidated financial condition or results of operations.

**NOTE 3. Inventories**

Inventories, net of provisions for potentially excess, obsolete or impaired goods, consisted of the following at March 31, 2012, and December 31, 2011:

	<u>March 31, 2012</u>	<u>December 31, 2011</u>
Raw materials	\$ 127,676	\$ 167,765
Work in process	282,204	191,450
Finished goods	<u>327,757</u>	<u>385,793</u>
Inventories, net	<u>\$ 737,637</u>	<u>\$ 745,008</u>

**NOTE 4. Long Term Obligations**

On December 7, 2010, the Company entered a \$2,000,000 Loan and Security Agreement (“LSA”) with Oxford Finance Corporation (“Oxford”). Borrowings under this term loan were at an interest rate of approximately 13%, and for the first six months, interest only was repayable, after which the balance of principal and interest were repayable in equal monthly installments over a thirty month period. The Company granted Oxford a first priority security interest in substantially all of its assets, excluding its intellectual property.

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements (Unaudited)

The Company issued a total of 95,368 warrants to Oxford in connection with the LSA. These warrants have a term of five years, and an exercise price of \$1.468. Utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.41, an expected term of four years, estimated volatility of 43.96%, a zero dividend rate and a risk-free interest rate of 1.305%, the Company determined the total allocated fair value of the warrants to be \$46,230.

Further, the Company incurred initial costs of \$157,240 to obtain the LSA, which contained a provision providing for a termination fee of \$95,000. The total financing costs of \$298,470 were amortized as a non-cash interest expense over the period of the loan using the effective interest method. The loan was repaid in full on May 27, 2011. At this date, the unamortized financing costs of \$222,275 plus additional costs of \$83,585 arising from early termination were expensed as interest.

On May 27, 2011, the Company sold convertible promissory notes in the aggregate principal amount of \$15,275,000, convertible into an aggregate of approximately 2,679,824 shares of Series A-2 Convertible Preferred Stock at a price of \$5.70 per share, with each share being convertible into ten shares of common stock. The convertible promissory notes were sold along with convertible preferred stock and warrants for aggregate gross proceeds of \$30,550,000, which after deducting issuance costs of \$2,524,963 left net proceeds of \$28,025,037. Interest on the convertible promissory notes accrues at a rate of 5% per annum, and may either be paid on the last day of each fiscal quarter, or added to the principal amount of the notes, at the Company's option.

Using the relative fair value of the securities issued, the Company initially allocated the gross proceeds of \$30,550,000 to the convertible promissory notes (\$10,072,592), the Series A-1 convertible preferred stock (\$10,724,991 - see Note 6) and the warrants (\$9,752,417 - see Note 8). However, until September 30, 2011, the convertible promissory notes contained features that adjusted the number of shares issuable to investors in the event the Company requested conversion of the convertible promissory notes in certain circumstances. They also contain features affording the holder additional shares in the event of certain organic changes to the Company. Because these features result in the embedded conversion element not being considered indexed to the Company's equity, the Company recognizes the conversion element of the convertible promissory notes as a derivative liability at its fair value. A liability of \$11,495,163 was thus recognized on the date of issuance, and this is marked to its fair value through income in all subsequent periods (see Note 9). Because the fair value of the conversion element exceeded the net proceeds initially allocated to the convertible promissory notes, the Company recognized a loss of \$2,255,074 at the date the convertible promissory notes were issued. The loss is reflected as additional interest expense.

The debt discount related to the debt element of the convertible promissory notes of \$14,442,497 is being amortized as non-cash interest expense using the effective yield method over the 3.5 year contractual term of the convertible promissory notes. The \$832,502 in issuance costs allocated to the convertible promissory notes was recorded as a deferred financing cost, which is also being amortized as a non-cash interest expense using the effective yield method over the 3.5 year contractual term of the promissory notes.

On September 30, 2011, Company and the note holders modified the convertible promissory notes to eliminate the feature that adjusted the number of shares issuable to investors in the event the Company requested conversion of the convertible promissory notes in certain circumstances. This modification reduced the fair value of the conversion element derivative by \$573,923. The gain from that reduction in value of the conversion element derivative was recognized as an increase in stockholders' equity.

The Company values the derivative liability for the conversion element of the convertible promissory notes using a Monte Carlo Simulation approach, using critical assumptions provided by management reflecting conditions at the valuation dates. The fair value of this derivative liability at May 27, 2011, included assumptions of the fair value of common stock of \$0.68, estimated volatility of 64.31%, a risk-free interest rate of 0.21%, a zero dividend rate and a contractual term of 3.50 years, and was estimated to be \$11,495,163. The fair value of this derivative liability at December 31, 2011, included assumptions of the fair value of common stock of \$0.16, estimated volatility of 82.82%, a risk-free interest rate of 0.18%, a zero dividend rate and a contractual term of 2.91 years, and was estimated to be \$1,931,295. The fair value of this derivative liability at March 31, 2012, included assumptions of the fair value of common stock of \$0.15, estimated volatility of 94.40%, a risk-free interest rate of 0.25%, a zero dividend rate and a contractual term of 2.66 years, and was estimated to be \$1,081,869. The decrease in the fair value of this derivative liability of \$849,426 during the three months ended March 31, 2011, was recorded as a revaluation gain (see Note 9).



**WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES****Notes to the Condensed Consolidated Financial Statements (Unaudited)**

The balance of the convertible promissory notes comprises the following at March 31, 2012 and December 31, 2011:

	<u>March 31, 2012</u>	<u>December 31, 2011</u>
Convertible Promissory Notes Payable:		
Face value	\$ 15,275,000	\$ 15,275,000
Interest added to principal	657,075	460,383
Stated value	15,932,075	15,735,383
Debt discount – conversion element, net of accumulated amortization of \$262,819 and \$113,081 respectively	14,179,678	14,329,416
Notes payable, net of debt discount	<u>\$ 1,752,397</u>	<u>\$ 1,405,967</u>

The Company leased equipment under a capital lease on which the final installment was paid in August 2011 and has no future obligations under capital leases as of March 31, 2012.

**NOTE 5. Convertible Preference Shares of Subsidiary**

On July 18, 2008, the Company's Malaysian subsidiary, WGBM, received \$1,000,000, less issuance costs totaling \$30,000, in exchange for the issuance of Series A redeemable convertible preference shares ("CPS") of WGBM in a private placement to Malaysian Technology Development Corporation Sdn. Bhd. ("MTDC"), a venture capital and development firm in Malaysia. WGBM sold 444,444 Series A CPS in this private placement at the U.S. dollar equivalent of \$2.25 per share. A second closing occurred on November 27, 2008, and WGBM received \$1,000,000, less issuance costs totaling \$30,000, from the sale of an additional 444,444 shares of Series A CPS.

On June 8, 2009, WGBM received \$250,000, less an exchange loss of \$18,029 and issuance costs totaling \$19,393, in exchange for the issuance of 111,111 Series B CPS to Expedient Equity Ventures Sdn. Bhd. ("EEV"), in a private placement at the U.S. dollar equivalent of \$2.25 per share. On March 9, 2010, WGBM received \$250,000, less an exchange loss of \$3,005 and issuance costs totaling \$8,929, in exchange for the issuance of a further 111,111 Series B CPS to EEV, in a private placement at the U.S. dollar equivalent of \$2.25 per share. On September 23, 2009, WGBM received \$500,000, less issuance costs totaling \$7,500, in exchange for the issuance of 222,222 Series B CPS to Prima Mahawangsa Sdn. Bhd. ("PMSB"), in a private placement at the U.S. dollar equivalent of \$2.25 per share. On May 13, 2010, WGBM received \$500,000, less issuance costs totaling \$5,000, in exchange for the issuance of a further 222,222 Series B CPS to PMSB, in a private placement at the U.S. dollar equivalent of \$2.25 per share. These transactions represent the full subscription under a Share Subscription Agreement dated April 3, 2009, ("Series B SSA") to sell 444,444 and 222,222 Series B CPS to PMSB and EEV, respectively, both venture capital and development firms in Malaysia.

On September 18, 2009, WGBM received \$423,128, less issuance costs totaling \$11,319, in exchange for the issuance of 188,057 Series B CPS to Kumpulan Modal Perdana Sdn. Bhd. ("KMP"), in a private placement at the U.S. dollar equivalent of \$2.25 per share. This represents the full amount receivable under a Share Subscription Agreement dated July 1, 2009, to sell Series B CPS to KMP, a venture capital and development firm in Malaysia.

Under the terms of a Deed of Adherence dated April 3, 2009 (and under the Series C SSA, as defined below), certain rights of the holders of the Series A CPS were modified. In addition, under the terms of the Series B SSA, the use of funds raised through the issuance of both Series A and Series B CPS was restricted, requiring at least 60% of the total to be utilized for the Company's operations in Malaysia.

Following these modifications, the rights of the holders of Series A and B CPS included, but were not limited to, the right:

- (a) to put to the Company their CPS (or ordinary shares in WGBM received on conversion of those CPS under paragraph (c) below) at any time during the year 2011 that the share price of the Company's common stock is below \$2.25 in order to redeem for cash (or, at the holder's option, shares of Company common stock of equivalent value) the amount originally invested in USD plus a premium of 8%, compounded annually, with yearly rests (each year's accrued interest would be forfeited in the event of redemption prior to the anniversary of the initial investment) (the "Redemption Option," since amended for Series A and expired for Series B, see below);

**WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES**

**Notes to the Condensed Consolidated Financial Statements (Unaudited)**

- (b) to cause the Company to exchange their CPS for common stock of the Company at an exchange rate of US\$2.25 per share of common stock, provided, in the case of Series B CPS, that commencing on August 1, 2010, if during the 10-day trading period immediately prior to the holder's exercise notice the average closing price of the Company's common stock is less than US\$2.647, then the holder may exchange CPS at an exchange rate equal to 85% of such 10-day average closing price. This option expires on May 8, 2013, for MTDC's Series A CPS, on April 3, 2014, for EEV's and PMSB's Series B CPS and on July 1, 2014, for KMP's Series B CPS (the "Conversion Option," since exercised by EEV and KMP);
- (c) to convert their CPS into ordinary shares of the subsidiary, WGBM, at any time, at a conversion rate of three ordinary shares per \$100 invested in CPS;
- (d) to cause the subsidiary, WGBM, to redeem the CPS in whole or in part at any time after December 31, 2011, for the principal paid plus a premium of 20% per annum, not compounding, from funds legally available for distribution (i.e. retained earnings; there is presently an accumulated deficit in WGBM in excess of \$2 million);
- (e) of first offer on any transfers or new issuance of subsidiary shares; and
- (f) for each of Series A and Series B CPS, to appoint one of the seven directors of the subsidiary (see below also).

On August 1, 2010, an event occurred affording the investors in Series B CPS the option to convert their holdings into a number of shares in the Company at an exchange rate equal to 85% of the previous 10 days' average closing price. This conversion feature was recorded as a derivative liability and a reduction in CPS, which was immediately amortized as accretion expense. Utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.21, estimated volatility of 64.30%, a risk-free interest rate of 0.14%, a zero dividend rate and an expected term of one day, the Company determined the fair value of the put option derivative liability to be \$428,787.

On August 17, 2010, EEV provided notice of exercise of its option to sell to the Company its holding of 222,222 Series B CPS in exchange for 458,483 shares of the Company's common stock, with shares to be issued on September 16, 2010. Utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.25, estimated volatility of 64.02%, a risk-free interest rate of 0.16%, a zero dividend rate and an expected term of one day, the Company determined the fair value of the remaining put option derivative liability relating to EEV's shares to be \$73,105, and for the remaining CPS to be \$208,077.

On September 29, 2010, KMP provided notice of exercise of its option to sell to the Company its holding of 188,057 Series B CPS in exchange for 328,579 shares of the Company's common stock, with shares to be issued on October 29, 2010. Utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.51, estimated volatility of 50.94%, a risk-free interest rate of 0.12%, a zero dividend rate and an expected term of one day, the Company determined the fair value of the remaining put option derivative liability relating to KMP's shares to be \$73,027, and for the remaining CPS to be \$172,588.

On December 31, 2010, the Company revalued the put option derivative liability utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.22, estimated volatility of 55.40%, a risk-free interest rate of 0.07%, a zero dividend rate and an expected remaining term of one day, and determined the fair value of the derivative liability to be \$194,088.

On March 31, 2011, the Company revalued the put option derivative liability utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$1.00, estimated volatility of 64.31%, a risk-free interest rate of 0.05%, a zero dividend rate and an expected term of one day, and determined the fair value of the derivative liability to be \$302,847. The increase in the fair value of this derivative liability of \$108,759 during the three months ended March 31, 2011, was recorded as a revaluation loss (see Note 9).

On December 31, 2011, the Series B CPS Redemption Option lapsed. The Series B CPS recorded in temporary equity was transferred to permanent equity and the value of the derivative liability for the conversion element, now the only substantive right available to PMSB, increased significantly as a result. The Company revalued this put option derivative liability utilizing a Monte Carlo Simulation and assumptions of the fair value of common stock of \$0.16, estimated volatility of 81.69%, a risk-free interest rate of 0.28%, a zero dividend rate and an expected term of 1.81 years, and determined the fair value of the derivative liability to be \$1,245,101.

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On March 31, 2012, the Company revalued the put option derivative liability utilizing a Monte Carlo Simulation and assumptions of the fair value of common stock of \$0.15, estimated volatility of 90.76%, a risk-free interest rate of 0.27%, a zero dividend rate and an expected term of 1.61 years, and determined the fair value of the derivative liability to be \$1,248,385. The increase in the fair value of this derivative liability of \$3,284 during the three months ended March 31, 2012, was recorded as a revaluation loss (see Note 9).

On December 9, 2011, the terms of the Series A CPS were amended by a Letter Agreement with MTDC (the "MTDCLA") to extend the period during which MTDC could exercise the Redemption Option from December 31, 2011 to April 3, 2014. In addition, the holder's option to elect to receive shares of Company common stock of equivalent value (see above) was amended to give the Company the option, upon the exercise of the Redemption Option, to pay in shares of its common stock at an Applicable Stock Price ("ASP"), calculated as 85% of the average closing price of that stock during the 10-day trading period immediately prior to MTDC's exercise notice. Further, the ASP is subject to a ceiling of \$1.55 and a floor of \$0.10.

The amendment that allows the Company to settle the Redemption Option in a variable number of shares causes the Redemption Option to no longer be considered indexed to the Company's equity. As a result, the Company recognized the Redemption Option as an embedded derivative requiring bifurcation effective December 9, 2011. The Company valued the Redemption Option utilizing a Monte Carlo Simulation and assumptions of the fair value of common stock of \$0.16, estimated volatilities of 78.02% to 80.22%, risk-free interest rates of 0.27%, a zero dividend rate and expected remaining terms of 1.61 to 1.96 years; the fair value of the Redemption Option was estimated to be \$2,198,828. The host instrument (the Series A CPS absent the Redemption Option) is not redeemable and therefore should be classified as part of permanent equity. Accordingly, this modification to the Series A CPS resulted in (1) the recognition of a derivative liability of \$2,198,828, (2) the elimination of temporary equity of \$2,519,424, and (3) an increase in permanent equity of \$320,596. As the fair value of the amended Series A CPS was \$320,390 less than the carrying amount of the accreted Series A CPS prior to the amendment, \$320,390 of the amount transferred to permanent equity was treated as reversal of prior accretion of the Series A CPS.

On December 31, 2011, the Company revalued the derivative liability for Series A CPS utilizing a Monte Carlo Simulation and assumptions of the fair value of common stock of \$0.16, estimated volatilities of 81.15% to 82.83%, risk-free interest rate of 0.28%, a zero dividend rate and expected remaining terms of 1.55 to 1.90 years; the total fair value was estimated to be \$2,135,715.

On March 31, 2012, the Company revalued the derivative liability for Series A CPS utilizing a Monte Carlo Simulation and assumptions of the fair value of common stock of \$0.15, estimated volatilities of 89.99% to 96.41%, risk-free interest rates of 0.23% to 0.28%, a zero dividend rate and expected remaining terms of 1.30 to 1.66 years; the total fair value was estimated to be \$2,204,365. The increase in the fair value of this derivative liability of \$68,650 during the three months ended December March 31, 2012, was recorded as a revaluation loss (see Note 9).

On March 10, 2011, WGBM received \$5,000,000, less issuance costs totaling \$6,272, in exchange for the issuance of 3,233,734 Series C convertible preference shares ("CPS") to MTDC, in a private placement at the U.S. dollar equivalent of \$1.5462 per share, representing the first subscription under a Share Subscription Agreement dated December 14, 2010, ("Series C SSA") to sell 3,233,734 Series C CPS at an initial closing and, should MTDC so elect within 36 months of the initial closing, to sell 1,077,911 shares of Series C CPS at a subsequent closing at the U.S. dollar equivalent of US\$2.3193 per share. MTDC may also elect to convert their Series C CPS into ordinary shares of the subsidiary, WGBM, at any time, at a conversion rate of one ordinary share per 100 CPS. MTDC may appoint one of the seven directors of the subsidiary (in addition to the director they may appoint as the holder of Series A CPS), and an additional independent director may be jointly appointed by MTDC and the Company.

Each Series C CPS issued at the initial closing can convert into one share of the Company on April 3, 2014 (this was extended from December 20, 2011, by the MTDCLA), and each Series C CPS issued at the subsequent closing will convert into one share of the Company on the anniversary of that closing, but the Series C may convert at any earlier date following each closing at MTDC's option.

WGBM is authorized to issue 200,000,000 preference shares with a par value of RM0.01. There were 4,977,345 preference shares (including 410,279 Series B CPS held by the Company upon exercise by EEV and KMP of their options) issued and outstanding at March 31, 2012, and December 31, 2011.

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**NOTE 6. Preferred Stock**

The Company has 10,000,000 shares of preferred stock authorized. Effective May 26, 2011, the Company designated 4,500,000 shares as Series A-1 Convertible Preferred Stock and 4,500,000 shares as Series A-2 Convertible Preferred Stock (together, the "Series A Preferred Stock"). Each share of Series A Preferred Stock is convertible into ten shares of common stock, subject to an ownership cap whereby conversion may not occur to the extent the holder would own more than 9.985% of the common stock following conversion, and entitles the holder to receive dividends, as, when and if declared by the Company's Board of Directors, at an annual rate of 5% of the stated value per share of the respective series. Such dividends accrue, compounding quarterly, and accumulate on each share of Series A Preferred Stock from the date of issuance, whether or not declared, until November 27, 2014, when the right to further dividends ceases. The Series A Preferred Stock has no voting rights, and in the event of liquidation ranks senior to common stock.

Effective May 27, 2011, the Company sold an aggregate of 2,937,499.97 shares of Series A-1 Convertible Preferred Stock with a stated value of \$5.20 per share. The Company recorded the allocated valuation of \$10,724,991 (see Note 4), less allocated issuance costs of \$886,422, as Series A-1 Convertible Preferred Stock within permanent equity. As of March 31, 2012, \$654,873 of undeclared dividends had been accrued with respect to the outstanding Series A-1 Convertible Preferred Stock, of which \$196,665 relates to the three months ended March 31, 2012.

**NOTE 7. Stock Awards**

In 2003, Wafergen, Inc.'s Board of Directors adopted the 2003 Incentive Stock Plan (the "2003 Plan"). The 2003 Plan authorized the Board of Directors to grant incentive stock options and non-statutory stock options to employees, directors, and consultants for up to 1,500,000 shares of common stock. Under the Plan, incentive stock options and nonqualified stock options could be granted. Incentive stock options were to be granted at a price that is no less than 100% of the fair value of the stock at the date of grant. Options vested over a period according to the Option Agreement, and are exercisable for a maximum period of ten years after date of grant. Options granted to stockholders who own more than 10% of the outstanding stock of WaferGen at the time of grant must be issued at an exercise price no less than 110% of the fair value of the stock on the date of grant. In November 2006, WaferGen increased the aggregate number of shares of Common Stock that may be issued under the 2003 Plan to a total authorized reserve of 2,500,000 shares, a 1,000,000 share increase. The 2003 Plan was frozen when the 2007 Plan was adopted, resulting in no further options available for grant.

In January 2007, the Company's Board of Directors and stockholders adopted the 2007 Stock Option Plan (the "2007 Plan"). The purpose of the 2007 Plan was to provide an incentive to retain the employment of directors, officers, consultants, advisors and employees of the Company, to attract new personnel whose training, experience and ability are considered valuable, to encourage the sense of proprietorship, and to stimulate the active interest of such persons in the Company's development and financial success. Under the 2007 Plan, the Company was authorized to issue incentive stock options intended to qualify under Section 422 of the Code, non-qualified stock options and restricted stock. The 2007 Plan was frozen when the 2008 Plan was adopted, resulting in no further options available for grant.

On June 5, 2008, the Company's stockholders adopted the 2008 Stock Incentive Plan (the "2008 Plan") following approval of the 2008 Plan by the Board of Directors. The 2008 Plan initially authorized the issuance of up to 2,000,000 shares of common stock pursuant to the terms of the 2008 Plan. On December 4, 2009, the Company's stockholders approved an amendment to the 2008 Plan following approval of the 2008 Plan by the Board of Directors, adding an additional 1,500,000 shares, bringing the total to 3,500,000 shares of the Company's common stock available for issuance under the 2008 Plan. On September 16, 2010, the Company's stockholders approved a further amendment to the 2008 Plan following approval of the 2008 Plan by the Board of Directors, adding an additional 3,000,000 shares, bringing the total to 6,500,000 shares of the Company's common stock available for issuance under the 2008 Plan. On December 30, 2011, the Company's stockholders approved a further amendment to the 2008 Plan following approval of the 2008 Plan by the Board of Directors, adding an additional 8,000,000 shares, bringing the total to 14,500,000 shares of the Company's common stock available for issuance under the 2008 Plan. Notwithstanding the foregoing, no more than 7,250,000 shares of the Company's common stock may be granted pursuant to awards of restricted stock and restricted stock units. The number of shares of the Company's common stock available under the 2008 Plan will be subject to adjustment in the event of a stock split, stock dividend or other extraordinary dividend, or other similar change in the Company's common stock or capital structure. The purpose of the 2008 Plan is to provide an incentive to retain the employment of directors, officers, consultants, advisors and employees of the Company, to attract new personnel whose training, experience and ability are considered valuable, to encourage the sense of proprietorship, and to stimulate the active interest of such persons in the Company's development and financial success. Under the 2008 Plan, the Company is authorized to issue incentive stock options intended to qualify under Section 422 of the Code,

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non-qualified stock options and restricted stock. Awards may vest over varying periods, as specified by the Company's Board of Directors for each grant, and have a maximum term of seven years from the grant date. The 2008 Plan is administered by the Company's Board of Directors.

The Company has issued both options and restricted stock under these Plans. Restricted stock grants afford the recipient the opportunity to receive shares of common stock, subject to certain terms, whereas options give them the right to purchase common stock at a set price. Both the Company's options and restricted stock issued to employees generally have vesting restrictions that are eliminated over a four-year period, although vesting may be over a shorter period, or may occur on the grant date, depending on the terms of each individual award.

A summary of stock option and restricted stock transactions in the three months ended March 31, 2012, is as follows:

	Stock Options			Restricted Stock	
	Shares Available for Grant	Number of Options Outstanding	Weighted Average Exercise Price	Number of Shares Outstanding	Weighted Average Grant-Date Fair Value
Balance at January 1, 2012	10,305,071	4,306,900	\$ 1.3978	5,000	\$ 1.2500
Granted	(3,405,000)	3,345,000	\$ 0.1419	60,000	\$ 0.1400
Vested	—	—	\$ —	(35,000)	\$ 0.2986
Forfeited	133,125	(133,125)	\$ 1.5533	—	\$ —
Canceled	85,615	(137,615)	\$ 1.5430	—	\$ —
Balance at March 31, 2012	7,118,811	7,381,160	\$ 0.8231	30,000	\$ 0.1400

No options were exercised during the three months ended March 31, 2012. The Company received \$39,297 for the 183,782 options exercised during the three months ended March 31, 2011, which had an intrinsic value of \$164,752.

The aggregate intrinsic value of options outstanding and exercisable at March 31, 2012, was \$46,908 and \$15,708, respectively, based on our common stock closing price of \$0.15. Aggregate intrinsic value is the total pretax amount (i.e., the difference between the Company's stock price and the exercise price) that would have been received by the option holders had all their in-the-money options been exercised.

The weighted-average grant date fair value of options awarded in the three months ended March 31, 2012 and 2011, was \$0.10 and \$0.48, respectively. Fair values were estimated using the following assumptions:

	Three Months Ended March 31,	
	2012	2011
Risk-free interest rate	0.73% - 1.46%	1.90% - 2.24%
Expected term	4.75 Years	4.75 Years
Expected volatility	65.02% - 96.56%	42.44% - 42.88%
Dividend yield	0%	0%

The amounts expensed for stock-based compensation totaled \$105,518 and \$282,553 for the three months ended March 31, 2012 and 2011, respectively. The expense in the three months ended March 31, 2011, included \$82,600 for restricted stock awards to consultants; there were no such awards in the three months ended March 31, 2012.

At March 31, 2012, the total stock-based compensation cost not yet recognized, net of estimated forfeitures, was \$525,555. This cost is expected to be recognized over an estimated weighted average amortization period of 2.58 years. No amounts related to stock-based compensation costs have been capitalized. The tax benefit and the resulting effect on cash flows from operating and financing activities related to stock-based compensation costs were not recognized as the Company currently provides a full valuation allowance for all of its deferred taxes.

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**NOTE 8. Warrants**

The Company has incurred liabilities for the estimated fair value of derivative warrant instruments. The estimated fair value of the derivative warrant instruments has been calculated using a Monte Carlo Simulation approach, with key input variables provided by management, as of each issuance date, with the valuation offset against additional paid in capital, and at each reporting date, with changes in fair value recorded as gains or losses on revaluation in non-operating income (expense).

In connection with the fundraising in May 27, 2011, members of management, with warrants to purchase a total of 1,051,074 shares with an estimated fair value of \$315,803 following anti-dilution adjustments as of that date, waived their right to any future anti-dilution adjustments, so this estimated fair value was transferred to stockholders' equity.

During the three months ended March 31, 2012, a decrease in the fair value of the warrant derivative liability of \$299,229 was recorded as a revaluation gain. During the three months ended March 31, 2011, a decrease in the fair value of the warrant derivative liability of \$490,588 was recorded as a revaluation gain. A summary of activity in warrant derivative liabilities is included in Note 9.

The fair value of warrants ranged from \$0.01 to \$0.06 at March 31, 2012, from \$0.02 to \$0.10 at December 31, 2011, and from and from \$0.19 to \$0.54 at March 31, 2011.

Fair values at March 31, 2012 and 2011, were estimated using the following assumptions:

	<u>March 31, 2012</u>	<u>March 31, 2011</u>
Risk-free interest rate	0.21% – 0.36%	0.67% – 1.26%
Expected remaining term	1.14 – 2.19 Years	1.71 – 2.99 Years
Expected volatility	86.75% – 100.11%	62.92% – 87.27%
Dividend yield	0%	0%

A summary of outstanding common stock warrants as of March 31, 2012, is as follows:

<u>Securities Into Which Warrants are Convertible</u>	<u>Warrants Outstanding</u>	<u>Warrants Subject to Anti-Dilution</u>	<u>Exercise Price</u>	<u>Expiration Date</u>
Common stock	56,173,248	—	\$0.6200	May 2016
Common stock	4,487,656	3,718,425	\$0.7800	June and August 2014
Common stock	2,875,736	2,774,050	\$0.8400	December 2014 and January 2015
Common stock	2,265,071	2,084,914	\$0.8400	May 2013
Common stock	95,368	—	\$1.4680	December 2015
Common stock	203,500	—	\$1.5000	July 2015
Common stock	3,000,830	—	\$1.5500	July 2015
Common stock	2,666,459	—	\$2.2500	May and June 2012
Common stock	200,000	—	\$3.0000	December 2014 and November 2015
Subtotal	71,967,868	8,577,389		
Series C CPS	1,077,911	—	\$2.3193	March 2014
Total	<u>73,045,779</u>	8,577,389		

The warrants expiring in May 2016 were issued in conjunction with the May 2011 Private Placement, and were recorded at an allocated valuation of \$9,752,417 (see Note 4), less allocated issuance costs of \$806,039, at the time of issuance utilizing the Black-Scholes valuation model and assumptions of the fair value of common stock of \$0.68, an exercise price of \$0.62, estimated volatility of 89.58%, a risk free interest rate of 1.03%, a zero dividend rate and an expected term of 3.50 years. These warrants include the right to receive consideration for the unexercised portion of the warrant, based on a Black-Scholes model set forth in the warrants, in the event of certain substantial changes in ownership or trading status of the Company. This contingent embedded derivative will be accounted for only if such an event should occur.

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The warrants expiring in June and August 2014 were originally issued in June and August 2009 with an exercise price of \$2.00 and entitled the holders thereof to purchase an aggregate of 1,750,185 shares. As a result of anti-dilution adjustments with respect to such warrants pursuant to their terms, such warrants, as of December 31, 2011, had an exercise price of \$0.78 and entitled the holders thereof to purchase an aggregate of 4,487,656 shares. In connection with the May 2011 Private Placement, members of management with warrants to purchase a total of 769,231 shares (after giving effect to prior anti-dilution adjustments) waived their right to further anti-dilution adjustments.

The warrants expiring in December 2014 and January 2015 were originally issued in December 2009 and January 2010 with an exercise price of \$2.50 and entitled the holders thereof to purchase an aggregate of 966,247 shares. As a result of anti-dilution adjustments with respect to such warrants pursuant to their terms, such warrants, as of December 31, 2011, had an exercise price of \$0.84 and entitled the holders thereof to purchase an aggregate of 2,875,736 shares. In connection with the May 2011 Private Placement, members of management with warrants to purchase a total of 101,686 shares (after giving effect to prior anti-dilution adjustments) waived their right to further anti-dilution adjustments.

The warrants expiring in May 2013 were originally issued in May 2008 with an exercise price of \$3.00 and entitled the holders thereof to purchase an aggregate of 634,220 shares. As a result of weighted-average anti-dilution adjustments with respect to such warrants pursuant to their terms, such warrants, as of December 31, 2011, had an exercise price of \$0.84 and entitled the holders thereof to purchase an aggregate of 2,265,071 shares. In connection with the May 2011 Private Placement, members of management with warrants to purchase a total of 180,157 shares (after giving effect to prior anti-dilution adjustments) waived their right to further anti-dilution adjustments.

The 95,368 warrants expiring in December 2015 were issued in December 2010 in conjunction with obtaining a term loan (see Note 4).

The Series C SSA (see Note 5) grants the holders of the Series C CPS the right to subscribe for a further 1,077,911 CPS at a price of \$2.3193. Since these Series C CPS would convert into common stock of the Company within one year of the subscription date, this right is, for accounting purposes, equivalent to a warrant to purchase the Company's common stock.

**NOTE 9. Fair Value of Financial Instruments**

Fair value measurements are determined under a three-level hierarchy for fair value measurements that prioritizes the inputs to valuation techniques used to measure fair value, distinguishing between market participant assumptions developed based on market data obtained from sources independent of the reporting entity ("observable inputs") and the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances ("unobservable inputs").

Fair value is the price that would be received to sell an asset or would be paid to transfer a liability (i.e., the "exit price") in an orderly transaction between market participants at the measurement date. In determining fair value, the Company primarily uses prices and other relevant information generated by market transactions involving identical or comparable assets ("market approach"). The Company also considers the impact of a significant decrease in volume and level of activity for an asset or liability when compared with normal activity to identify transactions that are not orderly.

The highest priority is given to unadjusted quoted prices in active markets for identical assets (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Securities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The three hierarchy levels are defined as follows:

Level 1 – Quoted prices in active markets that are unadjusted and accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2 – Quoted prices for identical assets and liabilities in markets that are not active, quoted prices for similar assets and liabilities in active markets or financial instruments for which significant inputs are observable, either directly or indirectly;

Level 3 – Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

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Credit risk adjustments are applied to reflect the Company's own credit risk when valuing all liabilities measured at fair value. The methodology is consistent with that applied in developing counterparty credit risk adjustments, but incorporates the Company's own credit risk as observed in the credit default swap market.

The following tables present the Company's assets and liabilities that are measured at fair value on a recurring basis at March 31, 2012 and December 31, 2011:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>March 31, 2012</b>				
Financial Assets:				
Cash and cash equivalents	\$ 11,949,347	\$ —	\$ —	\$ 11,949,347
Total assets	<u>\$ 11,949,347</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 11,949,347</u>
Financial Liabilities:				
Warrant derivative liabilities	\$ —	\$ —	\$ 355,990	\$ 355,990
Conversion element of promissory notes	—	—	1,081,869	1,081,869
Conversion element of Series B CPS	—	—	1,248,385	1,248,385
Series A CPS derivative liabilities	—	—	2,204,365	2,204,365
Total liabilities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 4,890,609</u>	<u>\$ 4,890,609</u>

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>December 31, 2011</b>				
Financial Assets:				
Cash and cash equivalents	\$ 15,117,172	\$ —	\$ —	\$ 15,117,172
Total assets	<u>\$ 15,117,172</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 15,117,172</u>
Financial Liabilities:				
Warrant derivative liabilities	\$ —	\$ —	\$ 655,219	\$ 655,219
Conversion element of promissory notes	—	—	1,931,295	1,931,295
Conversion element of Series B CPS	—	—	1,245,101	1,245,101
Series A CPS derivative liabilities	—	—	2,135,715	2,135,715
Total liabilities	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,967,330</u>	<u>\$ 5,967,330</u>

The following tables present a reconciliation of all liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2012 and 2011:

	<u>Warrant Derivatives</u>	<u>Conversion Element of Promissory Notes</u>	<u>Conversion Element of Series B CPS</u>	<u>Series A CPS Derivatives</u>	<u>Total</u>
Balance at January 1, 2012	\$ 655,219	\$ 1,931,295	\$ 1,245,101	\$ 2,135,715	\$ 5,967,330
Issuances	—	—	—	—	—
Revaluation (gains) losses included in other income and expenses	(299,229)	(849,426)	3,284	68,650	(1,076,721)
Settlements	—	—	—	—	—
Balance at March 31, 2012	<u>\$ 355,990</u>	<u>\$ 1,081,869</u>	<u>\$ 1,248,385</u>	<u>\$ 2,204,365</u>	<u>\$ 4,890,609</u>
Total gains (losses) included in other income and expenses attributable to liabilities still held as of March 31, 2012	<u>\$ 299,229</u>	<u>\$ 849,426</u>	<u>\$ (3,284)</u>	<u>\$ (68,650)</u>	<u>\$ 1,076,721</u>



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	<u>Warrant Derivatives</u>	<u>Conversion Element of Promissory Notes</u>	<u>Conversion Element of Series B CPS</u>	<u>Series A CPS Derivatives</u>	<u>Total</u>
Balance at January 1, 2011	\$ 2,240,962	\$ —	\$ 194,088	\$ —	\$ 2,435,050
Issuances	—	—	—	—	—
Revaluation (gains) losses included in other income and expenses	(490,588)	—	108,759	—	(381,829)
Settlements	—	—	—	—	—
Balance at March 31, 2011	<u>\$ 1,750,374</u>	<u>\$ —</u>	<u>\$ 302,847</u>	<u>\$ —</u>	<u>\$ 2,053,221</u>
Total gains (losses) included in other income and expenses attributable to liabilities still held as of March 31, 2011	<u>\$ 490,588</u>	<u>\$ —</u>	<u>\$ (108,759)</u>	<u>\$ —</u>	<u>\$ 381,829</u>

Assumptions used in evaluating the warrant derivative liabilities, the conversion element of the promissory notes, the conversion element of the Series B CPS and the Series A CPS derivative liabilities are discussed in Notes 8, 4, 5 and 5, respectively. The principal assumptions used, and their impact on valuations, are as follows:

*Risk-Free Interest Rate.* This is the U.S. Treasury rate for the measurement date having a term equal to the weighted average expected remaining term of the instrument. An increase in the risk-free interest rate will increase the fair value and the associated derivative liability.

*Expected Remaining Term.* This is the period of time over which the instrument is expected to remain outstanding and is based on management's estimate, taking into consideration the remaining contractual life, and historical experience. For the convertible promissory notes, the Company considers a blend of expected remaining terms prior to partial conversion into Series A-2 Convertible Preferred Stock, giving consideration to the likelihood of conversion under various scenarios, and a further blend of expected remaining terms prior to partial conversion into common stock, all based on management's projections of when such conversions would occur within the contractual term. An increase in the expected remaining term will increase the fair value and the associated derivative liability.

*Expected Volatility.* This is a measure of the amount by which the Company's common stock price has fluctuated or is expected to fluctuate. To the extent that the Company's common stock has not been traded for as long as the expected remaining term of the instrument, the Company uses a weighted-average of the historic volatility of a group of publicly traded companies over the retrospective period corresponding to the expected remaining term of the instrument on the measurement date. The group of publicly traded companies is selected from the same industry or market index, with extra weighting attached to those companies most similar in terms of business activity, size and financial leverage. To the extent that the Company's common stock has been traded for longer than the expected remaining term of the instrument, this weighted average is used to determine 50% of the volatility, with the Company's own historic volatility used to determine the remaining 50%. An increase in the expected volatility will increase the fair value and the associated derivative liability.

*Dividend Yield.* The Company has not made any dividend payments and does not plan to pay dividends in the foreseeable future. An increase in the dividend yield will decrease the fair value and the associated derivative liability.

**NOTE 10. Cash Flow Information**

Cash paid during the three months ended March 31, 2012 and 2011, is as follows:

	<u>Three Months Ended March 31,</u>	
	<u>2012</u>	<u>2011</u>
Interest	<u>\$ —</u>	<u>\$ 64,776</u>
Income taxes	<u>\$ 11,722</u>	<u>\$ —</u>

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements (Unaudited)

Supplemental disclosure of non-cash investing and financing activities for the three months ended March 31, 2012 and 2011, is as follows:

	<u>Three Months Ended March 31,</u>	
	<u>2012</u>	<u>2011</u>
Interest converted to principal on convertible promissory notes	\$ 196,692	\$ —
Accretion on Series A and B convertible preference shares of subsidiary associated with premium	\$ —	\$ 64,120
Inventory transferred to property and equipment	\$ —	\$ 662,300

**NOTE 11. Net Loss Per Share**

Basic and diluted net loss per share are shown on the statement of operations.

No adjustment has been made to the net loss for charges, gains, losses and accretion related to Series A, B and C CPS, Series A-1 Convertible Preferred Stock and convertible promissory notes, as the effect would be anti-dilutive due to the net loss. The following outstanding stock options and warrants (on an as-converted into common stock basis) and shares issuable or contingently issuable upon conversion of restricted stock, Series A, B and C CPS, Series A-1 Convertible Preferred Stock and convertible promissory notes were excluded from the computation of diluted net loss per share attributable to holders of common stock as they had antidilutive effects for the three months ended March 31, 2012 and 2011:

	<u>Three Months Ended March 31,</u>	
	<u>2012</u>	<u>2011</u>
Common share equivalents issuable upon exercise of common stock options	220,864	375,238
Shares issuable upon vesting of restricted stock	29,451	112,486
Shares issuable upon conversion of Series A CPS	20,312,694	2,317,425
Shares issuable upon conversion of Series B CPS	7,739,938	1,176,471
Shares issuable upon conversion of Series C CPS	3,233,734	790,468
Shares issuable upon conversion of Series A-1 Convertible Preferred Stock	30,256,183	—
Shares issuable upon conversion of convertible promissory notes	27,950,999	—
Total common share equivalents excluded from denominator for diluted earnings per share computation	<u>89,743,863</u>	<u>4,772,088</u>

**NOTE 12. Concentrations**

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and accounts receivable. The Company places its cash in commercial banks. Accounts in the United States are secured by the Federal Deposit Insurance Corporation. Accounts in Malaysia are also guaranteed by the Malaysian government. The Company's total deposits at commercial banks usually exceed the balances insured.

The Company generally requires no collateral from its customers.

At March 31, 2012, four customers accounted for 33%, 18%, 13% and 12%, respectively, of accounts receivable. At December 31, 2011, one of these customers accounted for 33% of accounts receivable and two different customers accounted for 38% and 10%, respectively.

WAFERGEN BIO-SYSTEMS, INC. AND SUBSIDIARIES

Notes to the Condensed Consolidated Financial Statements (Unaudited)

During the three months ended March 31, 2012, three customers accounted for 38%, 20% and 17%, respectively, of total revenues. During the three months ended March 31, 2011, two different customers accounted for 61% and 13%, respectively, of total revenues.

**NOTE 13. Contingencies**

From time to time the Company may be involved in claims arising in connection with its business. Based on information currently available, the Company believes that the amount, or range, of reasonably possible losses in connection with any pending actions against it, including the matter described below, in excess of established reserves, in the aggregate, not to be material to its consolidated financial condition or cash flows. However, losses may be material to the Company's operating results for any particular future period, depending on the level of income or loss for such period.

*Coalesce v. WaferGen.* On April 24, 2012, an action entitled Coalesce Corporation ("Coalesce") v. WaferGen Bio-systems, Inc. was filed in the Alameda County Superior Court. Coalesce, a company that had been providing marketing services, sued the Company for a total of \$100,000 for alleged non-payment of sums due either subsequent to termination of a contract or under alleged verbal agreements in late 2009 and early 2010. The case is in the discovery stage. The Company believes the claim to be substantially without merit, and that any sums ultimately payable will be immaterial to the Company's financial position and results of operations. Related legal costs are being expensed as incurred.

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

*The following discussion highlights the principal factors that have affected our financial condition and results of operations as well as our liquidity and capital resources for the periods described.*

*The information contained in this Form 10-Q is intended to update the information contained in our annual report on Form 10-K for the year ended December 31, 2011 (the "Form 10-K"), as filed with the Securities and Exchange Commission, and presumes that readers have access to, and will have read, the "Management's Discussion and Analysis of Financial Condition and Results of Operations," our consolidated financial statements and the notes thereto, and other information contained in the Form 10-K. The following discussion and analysis also should be read together with our condensed consolidated financial statements and the notes thereto included elsewhere in this Form 10-Q.*

### **Forward-Looking Statements**

Information included in this Form 10-Q may contain forward-looking statements. Except for the historical information contained in this discussion of the business and the discussion and analysis of financial condition and results of operations, the matters discussed herein are forward looking statements. These forward looking statements include but are not limited to the Company's plans for sales growth and expectations of gross margin, expenses, new product introduction, and the Company's liquidity and capital needs. This information may involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from future results, performance or achievements expressed or implied by any forward-looking statements. Forward-looking statements, which involve assumptions and describe our future plans, strategies and expectations, are generally identifiable by use of the words "may," "will," "should," "expect," "anticipate," "estimate," "believe," "intend" or "project" or the negative of these words or other variations on these words or comparable terminology. In addition to the risks and uncertainties described in "Risk Factors" contained in the Form 10-K, these risks and uncertainties may include consumer trends, business cycles, scientific developments, changes in governmental policy and regulation, currency fluctuations, economic trends in the United States and inflation. Forward-looking statements are based on assumptions that may be incorrect, and there can be no assurance that any projections or other expectations included in any forward-looking statements will come to pass. Our actual results could differ materially from those expressed or implied by the forward-looking statements as a result of various factors. Except as required by applicable laws, we undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

### **Company Overview and Background**

Since beginning operations in 2003, we have been engaged in the development, manufacture and sale of systems for gene expression, genotyping and stem-cell research for the life sciences, pharmaceutical drug discovery and biomarker discovery and diagnostic products industries. Our products are aimed at professionals who perform genetic analysis and cell biology, primarily at pharmaceutical and biotech companies, academic and private research centers and diagnostics companies involved in biomarker research. We plan to provide new performance standards with significant savings of time and cost for professionals in the field of gene expression research and to facilitate biomarker discovery, toxicology and clinical research through the SmartChip products and services.

Our revenue is subject to fluctuations due to the timing of sales of high-value products and service projects, the impact of seasonal spending patterns, the timing and size of research projects our customers perform, changes in overall spending levels in the life science industry and other unpredictable factors that may affect customer ordering patterns. Any significant delays in the commercial launch or any lack or delay of commercial acceptance of new products, unfavorable sales trends in existing product lines, or impacts from the other factors mentioned above, could adversely affect our revenue growth or cause a sequential decline in quarterly revenue. Due to the possibility of fluctuations in our revenue and net income or loss, we believe that quarterly comparisons of operating results are not a good indication of future performance.

Since inception, we have incurred substantial operating losses. As of March 31, 2012, our accumulated deficit was \$59,299,930. Losses have principally occurred as a result of the substantial resources required for the research, development and manufacturing scale-up effort required to commercialize our initial products and services. We expect to continue to incur substantial costs for research and development activities for at least the next year as we enhance our efforts to support our new strategy of engaging key opinion leaders in the life science research market to address its rapidly changing needs and to anticipate its future needs.

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**Results of Operations**

The following table presents selected items in the condensed consolidated statements of operations for the three months ended March 31, 2012 and 2011, respectively:

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
Revenue	\$ 73,233	\$ 351,032
Cost of revenue	90,405	140,949
Gross profit	(17,172)	210,083
Operating expenses:		
Sales and marketing	254,553	765,912
Research and development	2,010,864	2,060,715
General and administrative	1,176,433	1,413,581
Total operating expenses	3,441,850	4,240,208
Operating loss	(3,459,022)	(4,030,125)
Other income and (expenses):		
Interest income	4,282	745
Interest expense	(363,055)	(108,883)
Gain on revaluation of derivative liabilities, net	1,076,721	381,829
Miscellaneous expense	(149,546)	(47,395)
Total other income (expense)	568,402	226,296
Net loss before provision for income taxes	(2,890,620)	(3,803,829)
Provision for income taxes	14,075	—
Net loss	<u>\$ (2,904,695)</u>	<u>\$ (3,803,829)</u>

*Revenue*

The following table presents our revenue for the three months ended March 31, 2012 and 2011, respectively:

	<b>Three Months Ended March 31,</b>		
	<b>2012</b>	<b>2011</b>	<b>% Change</b>
	\$ 73,233	\$ 351,032	(79)%

For the three months ended March 31, 2012, revenue decreased by \$277,799, or 79%, as compared to the three months ended March 31, 2011. The decrease is primarily due to the absence of sales of any SmartChip Real-Time PCR Systems in 2012, compared to one sale in 2011 which accounted for 61% of our revenue for the quarter. There were also decreases in sales of our Real-Time PCR Chip panels and in service revenue. Since March 31, 2011, commercialization efforts for the SmartChip Real-Time PCR Systems product line have not produced meaningful results because of the relatively small amount of sales and marketing resources, more entrenched competition, the limited number of applications, the length of the sales cycle and the small installed base of systems from which to generate recurring revenue from consumables.

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*Cost of Revenue*

The following table presents the cost of revenue for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 90,405	\$ 140,949	(36)%

Cost of revenue includes the cost of products paid to third party vendors and raw materials, labor and overhead for products manufactured internally, and reserves for warranty and inventory obsolescence.

For the three months ended March 31, 2012, cost of revenue decreased by \$50,544, or 36%, as compared to the three months ended March 31, 2011. The decrease related primarily to the 79% decrease in revenue, offset by added provisions for excess inventory of \$69,307.

*Sales and Marketing*

The following table presents the sales and marketing expenses for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 254,553	\$ 765,912	(67)%

Sales and marketing expenses consist primarily of compensation costs of our sales and marketing team, commissions, and the costs associated with various marketing programs.

For the three months ended March 31, 2012, sales and marketing expenses decreased by \$511,359, or 67%, as compared to the three months ended March 31, 2011. The decrease resulted primarily from decreases in headcount.

We expect selling expenses will decrease further in the near future as we establish the commercial viability of our SmartChip products and services through cooperation with key opinion leaders, and subsequently to rise as the number of sales personnel, and their commissions, increase.

*Research and Development*

The following table presents the research and development expense for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 2,010,864	\$ 2,060,715	(2)%

Research and development expenses consist primarily of salaries and other personnel-related expenses, laboratory supplies and other expenses related to the design, development, testing and enhancement of our products. Research and development expenses are expensed as they are incurred.

For the three months ended March 31, 2012, research and development expenses decreased \$49,851, or 2%, as compared to the three months ended March 31, 2011. The decrease resulted primarily from a decrease in expensed materials and reagents, offset by small increases in personnel and depreciation costs.

We expect research and development costs to be lower in the near term due to a reduction in headcount in April 2012; nevertheless, we believe a substantial investment in research and development is essential in the long term to remain competitive and expand into additional markets. Accordingly, we expect our research and development expenses to remain at a high level of total expenditures.

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*General and Administrative*

The following table presents the general and administrative expenses for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 1,176,433	\$ 1,413,581	(17)%

General and administrative expenses consist primarily of personnel costs for finance, human resources, business development, and general management, as well as professional fees, such as expenses for legal and accounting services.

For the three months ended March 31, 2012, general and administrative expenses decreased \$237,148, or 17%, as compared to the three months ended March 31, 2011. The decrease resulted primarily from decreases in investor relations costs, professional fees and personnel costs, mainly for senior management, offset by a one-time expense for severance costs related to the termination of our former Chief Operating Officer and Chief Financial Officer.

We expect our general and administrative expenses to be lower in 2012 due to reduced personnel, consultancy and other outside service costs.

*Interest Income*

The following table presents the interest income for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 4,282	\$ 745	475%

The interest income is solely earned on cash balances held in interest-bearing bank accounts.

For the three months ended March 31, 2012, interest income increased by \$3,537, or 475%, as compared to the three months ended March 31, 2011. The increase was mainly due to the increase in the average cash invested in interest-bearing accounts as a result of our private placement closed in May 2011 (the "May 2011 Private Placement").

*Interest Expense*

The following table presents the interest expense for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 363,055	\$ 108,883	233%

For the three months ended March 31, 2012, interest expense increased \$254,172, or 233%, as compared to the three months ended March 31, 2011. The increase was due to interest related to the convertible promissory notes in the aggregate principal amount of \$15,275,000 issued in the May 2011 Private Placement, and comprises both interest at 5% of principal (which we presently pay in kind via addition to principal on the last day of each quarter) and amortization of the related debt discount. This was offset by the absence of interest related to a term loan of \$2,000,000 obtained in December 2010 and repaid in May 2011. We expect that the 5% interest on the convertible promissory notes, along with the effective yield amortization of debt discount, which weights the interest charges towards the latter stages of their contractual term, will result in interest expense of approximately \$2.1 million in 2012, with increased expense in 2013 and 2014.

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*Gain on Revaluation of Derivative Liabilities, Net*

The following table represents the gain on revaluation of derivative liabilities, net for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 1,076,721	\$ 381,829	182%

Our derivative liabilities arise due to the variable number of shares of our common stock that may be issued upon the exercise of those warrants with certain anti-dilution protection, upon the exchange of Series A and Series B CPS of our Malaysian subsidiary, and under the conversion element of our convertible promissory notes.

The net gain from revaluation of derivative liabilities for the three months ended March 31, 2012, was \$1,076,721, compared to \$381,829 for the three months ended March 31, 2011. Gains and losses are directly attributable to revaluations of all of our derivatives and result primarily from a net decrease or increase, respectively, in our stock price in the period. Our closing stock price was \$0.15 on March 31, 2012, compared to \$0.16 on December 31, 2011, and was \$1.00 on March 31, 2011, compared to \$1.22 on December 31, 2010. In the three months ended March 31, 2012, the majority of the revaluation gain related to our convertible promissory notes, which had no impact in the three months ended March 31, 2011, as they had not been issued.

Future gains or losses on revaluation will result primarily from net decreases or increases, respectively, in our stock price during the reporting period. Derivative liabilities will also decrease as the remaining term of each instrument diminishes.

*Miscellaneous Expense*

The following table presents the miscellaneous expense for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 149,546	\$ 47,395	216%

For the three months ended March 31, 2012, we recorded miscellaneous expense of \$149,546, compared to an expense of \$47,395 for the three months ended March 31, 2011. Miscellaneous income or expense is the result of net foreign currency exchange gains or losses, mainly in our Malaysian subsidiary, WaferGen Biosystems (M) Sdn. Bhd. ("WGBM"), principally due to revaluation of the inter-company account at the balance sheet date. WGBM presently has a net receivable on its dollar denominated balances, so if the value of the Malaysian Ringgit decreases against the dollar, income is recorded, whereas if it increases against the dollar, an expense is recorded. Foreign currency exchange gains and losses also arise on our subsidiary in Luxembourg, and on U.S. expenses denominated in foreign currencies.

*Provision for Income Taxes*

The following table presents the provision for income taxes for the three months ended March 31, 2012 and 2011, respectively:

<b>Three Months Ended March 31,</b>		
<b>2012</b>	<b>2011</b>	<b>% Change</b>
\$ 14,075	\$ —	N/A

For the three months ended March 31, 2012, we recorded a charge of \$14,075 for income taxes. This charge comprises \$10,401 for Malaysian taxes payable on interest income, mostly due to a loan to the U.S. parent, and \$3,674 for U.S. state income taxes. We have provided a full valuation allowance against our net deferred tax assets.

*Headcount*

Our consolidated headcount as of May 9, 2012, comprised 34 regular employees, 32 of whom were employed full-time, compared to 54 regular employees as of December 31, 2011, 52 of whom were employed full-time.



## Liquidity and Capital Resources

From inception through March 31, 2012, the Company has raised a total of \$3,665,991 from the issuance of notes payable, \$66,037 from the sale of Series A Preferred Stock, \$1,559,942 from the sale of Series B Preferred Stock, \$31,226,191, net of offering costs, from the sale of common stock and warrants, \$8,842,256, net of offering costs, from the sale of CPS of our Malaysian subsidiary, \$1,842,760, net of origination fees, from a secured term loan, and \$27,492,876, net of offering costs and liquidated damages for late registration, from the sale of the Series A-1 Convertible Preferred Stock, convertible promissory notes and warrants in the May 2011 Private Placement. As of March 31, 2012, the Company had \$11,949,347 in unrestricted cash and cash equivalents, and working capital of \$10,949,967.

### *Net Cash Used in Operating Activities*

The Company experienced negative cash flow from operating activities for the three months ended March 31, 2012 and 2011, in the amounts of \$3,386,320 and \$3,632,934, respectively. The cash used in operating activities in the three months ended March 31, 2012, was due to cash used to fund a net loss of \$2,904,695, adjusted for non-cash expenses related to depreciation and amortization, stock-based compensation, gains on revaluation of derivative liabilities, inventory provision, interest converted to principal on convertible promissory notes and amortization of debt discount totaling \$287,434, and cash used by a change in working capital of \$194,191. The cash used in operating activities in the three months ended March 31, 2011, was due to cash used to fund a net loss of \$3,803,829, adjusted for non-cash expenses related to depreciation and amortization, stock-based compensation and gains on revaluation of derivative liabilities totaling \$118,981, and cash provided by a change in working capital of \$51,914. The decrease in cash used in the three months ended March 31, 2012, compared to 2011, was driven primarily by the decrease in the net operating loss from \$4,030,125 to \$3,459,022, offset by the use of cash in working capital and by a reduction in non-cash operating expenses, most notably stock compensation expense.

### *Net Cash Used in Investing Activities*

The Company used \$2,509 in the three months ended March 31, 2012, and \$276,208 in the three months ended March 31, 2011, to acquire property and equipment.

### *Net Cash Provided by Financing Activities*

There were no financing activities in the three months ended March 31, 2012.

Cash provided by financing activities in the three months ended March 31, 2011, was \$4,999,663. The Company's Malaysian subsidiary received \$4,993,728, net of issuance costs, in exchange for the issuance of 3,233,734 Series C RCPS, and the Company received \$9,200 from the exercise of stock options. This was offset by payments of \$3,265 on capital lease obligations.

### *Availability of Additional Funds*

We believe funds available at March 31, 2012, along with our revenue, will fund our operations at least into the third quarter of 2013. We expect we will need to raise further capital, through the entry into a debt facility, the sale of additional securities or otherwise, to support our future operations. Our operating needs include the planned costs to operate our business, including amounts required to fund working capital and capital expenditures. At the present time, we have no material commitments for capital expenditure. Our future capital requirements and the adequacy of our available funds will depend on many factors, including our ability to successfully commercialize our SmartChip products and services, competing technological and market developments, and the need to enter into collaborations with other companies or acquire other companies or technologies to enhance or complement our product and service offerings.

While we believe we have sufficient cash to fund our operating, investing, and financing activities in the near term, we expect that additional working capital will be needed to sustain our operations. We may be unable to raise sufficient additional capital when we need it or to raise capital on favorable terms. The conversion of our convertible promissory notes and CPS of our Malaysian subsidiary, and the sale of equity or convertible debt securities in the future, may be dilutive to our stockholders, and debt financing arrangements may require us to pledge certain assets and enter into covenants that could restrict certain business activities or our ability to incur further indebtedness, and may contain other terms that are not favorable to us or our stockholders. If we are unable to obtain adequate funds on reasonable terms, we may be required to curtail operations significantly or to obtain funds by entering into financing agreements on unattractive terms.

## Principles of Consolidation

The consolidated financial statements of WaferGen Bio-systems, Inc. include the accounts of Wafergen, Inc., WaferGen Biosystems (M) Sdn. Bhd., our Malaysian subsidiary, and WaferGen Biosystems Europe S.a.r.l., our Luxembourg subsidiary. All significant inter-company transactions and balances are eliminated in consolidation.

## Critical Accounting Policies and Estimates

### *Deferred Tax Valuation Allowance*

We believe sufficient uncertainties exist regarding the future realization of deferred tax assets, and, accordingly, a full valuation allowance is required, amounting to approximately \$24,700,000 at December 31, 2011. In subsequent periods, if and when we generate pre-tax income, a tax expense will not be recorded to the extent that the remaining valuation allowance can be used to offset that expense. Once a consistent pattern of pre-tax income is established or other events occur that indicate that the deferred tax assets will be realized, additional portions or all of the remaining valuation allowance will be reversed back to income. Should we generate pre-tax losses in subsequent periods, a tax benefit will not be recorded and the valuation allowance will be increased.

### *Inventory Valuation*

Inventories are stated at the lower of cost and market value. We perform a detailed assessment of inventory on a regular basis, which includes, among other factors, a review of projected demand requirements, product pricing, product expiration and product lifecycle. As a result of this assessment, we record provisions for potentially excess, obsolete or impaired goods, when appropriate, in order to reduce the reported amount of inventory to its net realizable value. If actual demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

### *Warranty Reserve*

Our standard warranty agreement is one year from shipment for SmartChip cyclers and nano-dispensers. We accrue for anticipated warranty costs upon shipment of these products. Our warranty reserve is based on management's judgment regarding anticipated rates of warranty claims and associated repair costs, and we update our assessment quarterly.

### *Stock-Based Compensation*

We measure the fair value of all stock option and restricted stock awards to employees on the grant date, and record the fair value of these awards, net of estimated forfeitures, as compensation expense over the service period. The fair value of options is estimated using the Black-Scholes valuation model, and of restricted stock is based on the Company's closing share price on the measurement date. Amounts expensed with respect to options were \$100,016 and \$135,360, net of estimated forfeitures, for the three months ended March 31, 2012 and 2011, respectively. These sums exclude the compensation expense for restricted stock awards, for which the fair value is based on our closing stock price on the grant date for directors and employees, and on the dates on which performance of services is recognized for consultants.

The weighted-average grant date fair value of options awarded in the three months ended March 31, 2012 and 2011, was \$0.10 and \$0.48, respectively. Fair values were estimated using the following assumptions:

	Three Months Ended March 31,	
	2012	2011
Risk-free interest rate	0.73% - 1.46%	1.90% - 2.24%
Expected term	4.75 Years	4.75 Years
Expected volatility	65.02% - 96.56%	42.44% - 42.88%
Dividend yield	0%	0%

**Risk-Free Interest Rate.** This is the U.S. Treasury rate for the day of the grant having a term equal to the expected term of the option. An increase in the risk-free interest rate will increase the fair value and the related compensation expense.

**Expected Term.** This is the period of time over which the award is expected to remain outstanding and is based on management's estimate, taking into consideration the vesting terms, the contractual life, and historical experience. An increase in the expected term will increase the fair value and the related compensation expense.

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**Expected Volatility.** This is a measure of the amount by which our common stock price has fluctuated or is expected to fluctuate. To the extent that our common stock has not been traded for as long as the expected remaining term of the options, we use a weighted-average of the historic volatility of a group of publicly traded companies over the retrospective period corresponding to the expected remaining term of the options on the measurement date. The group of publicly traded companies is selected from the same industry or market index, with extra weighting attached to those companies most similar in terms of business activity, size and financial leverage. To the extent that our common stock has been traded for longer than the expected remaining term of the options, this weighted average is used to determine 50% of the volatility, with our own historic volatility used to determine the remaining 50%. An increase in the expected volatility will increase the fair value and the related compensation expense.

**Dividend Yield.** We have not made any dividend payments and do not plan to pay dividends in the foreseeable future. An increase in the dividend yield will decrease the fair value and the related compensation expense.

**Forfeiture Rate.** This is a measure of the amount of awards that are expected to not vest. An increase in the estimated forfeiture rate will decrease the related compensation expense.

### *Derivative Liabilities*

Our derivative liabilities arise due to the variable number of shares of our common stock that may be issued upon the exercise of those warrants with certain anti-dilution protection, upon the exchange of Series A and Series B CPS of our Malaysian subsidiary, and under the conversion element of our convertible promissory notes. We evaluate the liability for all of our derivatives using a Monte Carlo Simulation approach, using critical assumptions provided by management reflecting conditions at the valuation dates.

The fair value of the derivative liability for the conversion element of convertible promissory notes at March 31, 2012, included assumptions of the fair value of common stock of \$0.15, estimated volatility of 94.40%, a risk-free interest rate of 0.25%, a zero dividend rate and a contractual term of 2.66 years, and was estimated to be \$1,081,869. The fair value of this derivative liability at December 31, 2011, included assumptions of the fair value of common stock of \$0.16, estimated volatility of 82.82%, a risk-free interest rate of 0.18%, a zero dividend rate and a contractual term of 2.91 years, and was estimated to be \$1,931,295. The fair value of this derivative liability when the notes were issued on May 27, 2011, included assumptions of the fair value of common stock of \$0.68, estimated volatility of 64.31%, a risk-free interest rate of 0.21%, a zero dividend rate and a contractual term of 3.50 years, and was estimated to be \$11,495,163.

The fair value of the derivative liability for warrants at March 31, 2012, included assumptions of the fair value of common stock of \$0.15, estimated volatilities of 86.75% to 100.11%, risk-free interest rates of 0.21% to 0.36%, a zero dividend rate and expected remaining terms of 1.14 to 2.19 years; the total fair value was estimated to be \$355,990. The fair value of this derivative liability at March 31, 2011, included assumptions of the fair value of common stock of \$1.00, estimated volatilities of 62.92% to 87.27%, risk-free interest rates of 0.67% to 1.26%, a zero dividend rate and expected remaining terms of 1.71 to 2.99 years; the total fair value was estimated to be \$1,750,374.

The fair value of the derivative liability for the conversion element of Series B CPS of our Malaysian subsidiary at March 31, 2012, included assumptions of the fair value of common stock of \$0.15, estimated volatility of 90.76%, a risk-free interest rate of 0.27%, a zero dividend rate and an expected remaining term (following lapse of the redemption option) of 1.61 years, and was estimated to be \$1,248,385. The fair value of this derivative liability at December 31, 2011, included assumptions of the fair value of common stock of \$0.16, estimated volatility of 81.69%, a risk-free interest rate of 0.28%, a zero dividend rate and an expected remaining term (following lapse of the redemption option) of 1.81 years, and was estimated to be \$1,245,101. The fair value of this derivative liability at March 31, 2011, included assumptions of the fair value of common stock of \$1.00, estimated volatility of 64.31%, a risk-free interest rate of 0.05%, a zero dividend rate and an expected remaining term (prior to lapse of the redemption option) of one day, was estimated to be \$302,847. The fair value of this derivative liability at December 31, 2010, included assumptions of the fair value of common stock of \$1.22, estimated volatility of 55.40%, a risk-free interest rate of 0.07%, a zero dividend rate and an expected remaining term (prior to lapse of the redemption option) of one day, and was estimated to be \$194,088.

The fair value of the derivative liability for Series A CPS of our Malaysian subsidiary at March 31, 2012, included assumptions of the fair value of common stock of \$0.15, estimated volatilities of 89.99% to 96.41%, risk-free interest rate of 0.23% to 0.28%, a zero dividend rate and expected remaining terms of 1.30 to 1.66 years; the total fair value was estimated to be \$2,204,365. The fair value of this derivative liability at December 31, 2011, included assumptions of the fair value of common stock of \$0.16, estimated volatilities of 81.15% to 82.83%, risk-free interest rate of 0.28%, a zero dividend rate and expected remaining terms of 1.55 to 1.90 years; the total fair value was estimated to be \$2,135,715. The fair value of this derivative liability at December 9, 2011, when terms were amended giving rise to the

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derivative liability, included assumptions of the fair value of common stock of \$0.16, estimated volatilities of 78.02% to 80.22%, risk-free interest rates of 0.27%, a zero dividend rate and expected remaining terms of 1.61 to 1.96 years; the total fair value was estimated to be \$2,198,828.

**Risk-Free Interest Rate.** This is the U.S. Treasury rate for the measurement date having a term equal to the weighted average expected remaining term of the instrument. An increase in the risk-free interest rate will increase the fair value and the associated derivative liability.

**Expected Remaining Term.** This is the period of time over which the instrument is expected to remain outstanding and is based on management's estimate, taking into consideration the remaining contractual life, and historical experience. For our convertible promissory notes, we consider a blend of expected remaining terms prior to partial conversion into the Company's Series A-2 Convertible Preferred Stock, giving consideration to the likelihood of conversion under various scenarios, and a further blend of expected remaining terms prior to partial conversion into common stock, all based on management's projections of when such conversions would occur within the contractual term. An increase in the expected remaining term will increase the fair value and the associated derivative liability.

**Expected Volatility.** This is a measure of the amount by which our common stock price has fluctuated or is expected to fluctuate. To the extent that our common stock has not been traded for as long as the expected remaining term of the instrument, we use a weighted-average of the historic volatility of a group of publicly traded companies over the retrospective period corresponding to the expected remaining term of the instrument on the measurement date. The group of publicly traded companies is selected from the same industry or market index, with extra weighting attached to those companies most similar in terms of business activity, size and financial leverage. To the extent that our common stock has been traded for longer than the expected remaining term of the instrument, this weighted average is used to determine 50% of the volatility, with our own historic volatility used to determine the remaining 50%. An increase in the expected volatility will increase the fair value and the associated derivative liability.

**Dividend Yield.** We have not made any dividend payments and do not plan to pay dividends in the foreseeable future. An increase in the dividend yield will decrease the fair value and the associated derivative liability.

## **Recent Accounting Pronouncements**

See the "Recent Accounting Pronouncements" in Note 2 to the Condensed Consolidated Financial Statements in Part I, Item 1 for information related to the adoption of new accounting standards in the first quarter of 2012, none of which had a material impact on our condensed consolidated financial statements.

## **Item 4. Controls and Procedures**

### **Management's Report on Internal Control over Financial Reporting**

As of the end of the period covered by this Quarterly Report, management performed, with the participation of our principal executive officer and principal financial officer, an evaluation of the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934 (the "Exchange Act"). Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the report we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's forms, and that such information is accumulated and communicated to our management including our principal executive officer and principal financial officer, to allow timely decisions regarding required disclosures. Based on the evaluation and the identification of the material weakness in internal control over financial reporting described below, our principal executive officer and principal financial officer concluded that, as of March 31, 2012, the Company's disclosure controls and procedures were not effective.

We identified the following material weakness in our internal controls over financial reporting as of March 31, 2012:

We have not adequately divided, or compensated for, incompatible functions among personnel to reduce the risk that a potential material misstatement of the financial statements would occur without being prevented or detected.

The material weakness described above was previously identified in Item 9A in our Report on Form 10-K for the year ended December 31, 2011.

### **Changes in Internal Control over Financial Reporting**

There was no material change in the Company's internal control over financial reporting that occurred during the quarter ended March 31, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II OTHER INFORMATION

### Item 1. Legal Proceedings

From time to time we may be involved in claims arising in connection with our business. Based on information currently available, we believe that the amount, or range, of reasonably possible losses in connection with any pending actions against us, in excess of established reserves, in the aggregate, not to be material to our consolidated financial condition or cash flows. However, losses may be material to the Company's operating results for any particular future period, depending on the level of income for such period.

*Coalesce v. WaferGen.* On April 24, 2012, an action entitled Coalesce Corporation ("Coalesce") v. WaferGen Bio-systems, Inc. was filed in the Alameda County Superior Court. Coalesce, a company that had been providing marketing services, sued the Company for a total of \$100,000 for alleged non-payment of sums due either subsequent to termination of a contract or under alleged verbal agreements in late 2009 and early 2010. The case is in the discovery stage. We believe the claim to be substantially without merit, and that any sums ultimately payable will be immaterial to our financial position and results of operations.

### Item 1A. Risk Factors

There are no material changes from the risk factors set forth in Part I, Item 1A, in our Annual Report on Form 10-K for the year ended December 31, 2011.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

**Item 6. Exhibits**

<b>Exhibit No.</b>	<b>Description</b>
31.1*	Rule 13a-14(a)/15d-15(e) Certification of principal executive officer
31.2*	Rule 13a-14(a)/15d-15(e) Certification of principal financial officer
32.1*	Section 1350 Certification of principal executive officer ( <i>This certification is being furnished and shall not be deemed “filed” with the SEC for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.</i> )
32.2*	Section 1350 Certification of principal financial officer ( <i>This certification is being furnished and shall not be deemed “filed” with the SEC for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the Registrant specifically incorporates it by reference.</i> )
101 §	The following financial information from the Company’s Quarterly Report on Form 10-Q for the period ended March 31, 2012, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Balance Sheets at March 31, 2012 and December 31, 2011, (ii) the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the three months ended March 31, 2012 and 2011, (iii) the Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011, and (iv) Notes to Condensed Consolidated Financial Statements.

\* Filed/furnished herewith

§ Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be “filed” for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

WAFERGEN BIO-SYSTEMS, INC.

Dated: May 11, 2012

By: /s/ IVAN TRIFUNOVICH

Ivan Trifunovich  
Chief Executive Officer  
(principal executive officer)



EXHIBIT INDEX

<b>Exhibit No.</b>	<b>Description</b>
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† Indicates a management contract or compensatory plan or arrangement.

§ Pursuant to Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be "filed" for purposes of Section 18 of the Exchange Act, or otherwise subject to the liability of that section, and shall not be deemed part of a registration statement, prospectus or other document filed under the Securities Act or the Exchange Act, except as shall be expressly set forth by specific reference in such filings.

CERTIFICATION

I, Ivan Trifunovich, certify that:

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

Date: May 11, 2012

/s/ IVAN TRIFUNOVICH  
Ivan Trifunovich  
Chief Executive Officer  
(principal executive officer)

CERTIFICATION

I, John Harland, certify that:

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

Date: May 11, 2012

/s/ JOHN HARLAND

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John Harland  
Interim Chief Financial Officer  
(principal financial officer)

CERTIFICATION  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ENACTED BY  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), I, Ivan Trifunovich, certify that:

1. The Quarterly Report of WaferGen Bio-systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2012 (the "Report") as filed with the Securities and Exchange Commission as of the date hereof, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 11, 2012

/s/ IVAN TRIFUNOVICH  
Ivan Trifunovich  
Chief Executive Officer  
(principal executive officer)

*A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to WaferGen Bio-systems, Inc., and will be retained by WaferGen Bio-systems, Inc., and furnished to the Securities and Exchange Commission or its staff upon request.*

CERTIFICATION  
PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ENACTED BY  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), I, John Harland, certify that:

1. The Quarterly Report of WaferGen Bio-systems, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2012 (the "Report") as filed with the Securities and Exchange Commission as of the date hereof, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: May 11, 2012

/s/ JOHN HARLAND  
John Harland  
Interim Chief Financial Officer  
(principal financial officer)

*A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to WaferGen Bio-systems, Inc., and will be retained by WaferGen Bio-systems, Inc., and furnished to the Securities and Exchange Commission or its staff upon request.*