

LABONE INC/
Form 10-Q
November 13, 2003

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For quarterly period ended September 30, 2003

Commission file number: 0-16946

LabOne, Inc.

10101 Renner Blvd.

Lenexa, Kansas 66219

(913) 888-1770

Incorporated in Missouri

I.R.S. Employer Identification Number: 43-1039532

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 /X/ No / /

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes /X/ No / /

Number of shares outstanding of the only class of Registrant's common stock, \$.01 par value, as of October 31, 2003 - 12,843,152.

LabOne, Inc.

Form 10-Q for the Third Quarter, 2003

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PART I. FINANCIAL INFORMATION

ITEM 1 - Financial Statements

LabOne, Inc. and Subsidiaries
Consolidated Balance Sheets

September 30, December 31,

	2003	2002
	(unaudited)	<u> </u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 9,673,197	8,107,554
Accounts and notes receivable - trade, net of allowance for doubtful accounts of \$9,171,391 in 2003 and \$7,075,748 in 2002	57,751,207	48,669,148
Inventories	5,139,741	4,739,423
Prepaid expenses and other current assets	5,206,750	3,967,757
Deferred income taxes	<u>5,608,726</u>	<u>3,865,539</u>
Total current assets	83,379,621	69,349,421
Property, plant and equipment	112,513,420	106,946,090
Less accumulated depreciation	<u>66,697,302</u>	<u>60,094,949</u>
Net property, plant and equipment	45,816,118	46,851,141
Other assets:		
Goodwill	97,647,999	96,309,148
Other intangible assets	6,766,621	1,967,282
Debt issue costs, net of accumulated amortization of \$898,269 in 2003 and \$395,262 in 2002	1,028,464	1,522,552
Deposits and other assets	<u>675,855</u>	<u>691,980</u>
Total assets	\$ <u>235,314,678</u>	<u>216,691,524</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 17,869,698	15,373,393
Accrued payroll and benefits	12,252,192	9,148,323
Other accrued expenses	3,619,500	2,000,703
Income taxes payable	560,481	454,206
Current portion of long-term debt	<u>1,915,158</u>	<u>2,005,596</u>
Total current liabilities	36,217,029	28,982,221
Long-term debt	56,225,772	63,050,455
Deferred income taxes - noncurrent	4,655,486	4,598,957
Stockholders' equity:		
Preferred stock, \$.01 par value per share; 3,000,000 total authorized shares: Series B-1: 8% convertible; 45,000 shares authorized; 32,744 shares issued in 2003, and 38,865 shares issued in 2002	32,743,756	38,865,492
Common stock, \$.01 par value per share; 40,000,000 shares authorized, 14,050,071 shares issued in 2003, and 13,050,020 shares issued in 2002	140,500	130,500
Additional paid-in capital	50,436,247	48,865,813

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Accumulated comprehensive loss - equity adjustment from foreign currency translation	(486,960)	(867,147)
Retained earnings	70,851,949	58,217,280
Less treasury stock of 1,220,212 shares in 2003 and 1,756,027 shares in 2002	<u>(15,469,101)</u>	<u>(25,152,047)</u>
Total stockholders' equity	<u>138,216,391</u>	<u>120,059,891</u>
Total liabilities and stockholders' equity	<u>\$ 235,314,678</u>	<u>216,691,524</u>

See accompanying notes to consolidated financial statements.

LabOne, Inc. and Subsidiaries
Consolidated Statements of Operations
(Unaudited)

See accompanying notes to consolidated financial statements.

LabOne, Inc. and Subsidiaries
Consolidated Statement of Stockholders' Equity
Nine Months Ended September 30, 2003
(Unaudited)

	<u>Common stock</u>	<u>Convertible preferred stock</u>	<u>Additional paid-in capital</u>	<u>Accumulated comprehensive income (loss)</u>	<u>Retained earnings</u>	<u>Treasury stock</u>	<u>Total stockholders' equity</u>
Balance at December 31, 2002	\$ 130,500	38,865,492	48,865,813	(867,147)	58,217,280	(25,152,047)	120,059,891
Comprehensive income:							
Net earnings					14,983,492		14,983,492
Equity adjustment from foreign currency translation				380,187			380,187
Preferred stock dividend		2,348,823			(2,348,823)		
Directors' stock issued (875 shares)			159			17,393	17,552
Stock options exercised (246,566 shares)			(397,152)			4,079,059	3,681,907
Tax benefit from exercise of options			646,311				646,311
Purchase of treasury stock (79,476 shares)						(1,552,699)	(1,552,699)
Conversion of preferred stock (7,214 shares) to common stock (1,018,095 shares)	10,000	(8,470,559)	8,240,438			220,106	(15)
WCAS warrants exercised (350,000 shares)			(6,919,322)			6,922,822	3,500
Purchase of treasury stock (194 shares)-WCAS warrants						<u>(3,735)</u>	<u>(3,735)</u>

exercised

Balance at September 30, 2003 \$ 140,500 32,743,756 50,436,247 (486,960) 70,851,949 (15,469,101) 138,216,391

See accompanying notes to consolidated financial statements.

LabOne, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
(Unaudited)

	<u>Nine months ended</u>	
	<u>September 30,</u>	
	<u>2003</u>	<u>2002</u>
Cash provided by (used for) operations:		
Net earnings	\$ 14,983,492	10,481,293
Adjustments to reconcile net earnings to net cash provided by operations:		
Depreciation and amortization	8,511,660	7,104,736
Provision for loss on accounts receivable	5,074,242	4,053,178
Gain on disposal of property and equipment	(11,782)	(22,132)
Directors' stock compensation	17,552	19,419
Provision for deferred taxes	(1,681,469)	(115,680)
Changes in:		
Accounts and notes receivable - trade	(13,018,407)	(10,647,558)
Income taxes	106,275	(807,482)
Income tax benefit - exercise of stock options	646,311	2,411,390
Inventories	(400,318)	1,087,327
Prepaid expenses and other current assets	(965,627)	(93,849)
Accounts payable	2,064,946	100,183
Accrued payroll and benefits	3,103,869	236,604
Other accrued expenses	970,692	(512,772)
Other current liabilities	(119,002)	(13,217)
Other	(128,834)	20,931
Net cash provided by operations	<u>19,153,600</u>	<u>13,302,371</u>
Cash provided by (used for) investment transactions:		
Property, plant and equipment	(5,944,071)	(6,259,336)
Proceeds from sale of property, plant, and equipment	55,010	54,203
Acquisition of businesses	<u>(7,201,863)</u>	<u>(4,378,759)</u>
Net cash used for investment transactions	<u>(13,090,924)</u>	<u>(10,583,892)</u>
Cash provided by (used for) financing transactions:		
Line of credit, net	(5,000,000)	5,000,000
Financing costs		(1,725,668)
Exercised value of stock options and warrants	3,685,407	10,210,565
	<u>(1,556,434)</u>	<u>(9,025,767)</u>

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Treasury stock acquisition cost from exercise of stock options and warrants		
Payments on long-term debt	(1,811,228)	(1,867,783)
Notes payable	(109,000)	(50,000)
Preferred stock conversion	(15)	
Net cash provided by (used for) financing transactions	<u>(4,791,270)</u>	<u>2,541,347</u>
Effect of foreign currency translation	<u>294,237</u>	<u>(2,622)</u>
Net increase in cash and cash equivalents	1,565,643	5,257,204
Cash and cash equivalents - beginning of period	<u>8,107,554</u>	<u>5,949,591</u>
Cash and cash equivalents - end of period	<u>\$ 9,673,197</u>	<u>11,206,795</u>

Supplemental disclosures of cash flow information:

Cash paid during the period for:

Interest	<u>\$ 1,630,160</u>	<u>2,847,480</u>
Income taxes	<u>\$ 9,797,172</u>	<u>5,431,339</u>

See accompanying notes to consolidated financial statements.

LabOne, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
September 30, 2003 and 2002

The accompanying consolidated financial statements include the accounts of LabOne, Inc. and its wholly-owned subsidiaries Osborn Group, Inc. ("Osborn"), Intellisys, Inc., Lab One Canada Inc., Systematic Business Services, Inc. ("SBSI"), ExamOne World Wide, Inc. ("ExamOne"), Central Plains Laboratories, L.L.C. ("CPL") and ScanTech Solutions, L.L.C. (ScanTech). All significant intercompany transactions have been eliminated in consolidation.

The financial information furnished herein as of September 30, 2003, and for the periods ended September 30, 2003, and 2002, is unaudited; however, in the opinion of management, it reflects all adjustments, consisting of normal recurring adjustments, which are necessary to fairly state the Company's financial position, the results of its operations and cash flows. The balance sheet information as of December 31, 2002, has been derived from the audited consolidated financial statements as of that date. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States appropriate in the circumstances, and included in the financial statements are certain amounts based on management's estimates and judgments.

The financial information herein is not necessarily representative of a full year's operations because levels of sales, capital additions and other factors fluctuate throughout the year. These same considerations apply to all year-to-year comparisons. Certain information and note disclosures normally included in the Company's annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed, consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

Forward Looking Statements

This Quarterly report on Form 10-Q may contain "forward-looking statements." Forward-looking statements often can be identified by the use of forward-looking terminology, such as "could," "should," "will," "will be," "intended,"

"continue," "believe," "may," "hope," "anticipate," "goal," "forecast," "plan," "estimate" or variations thereof. Forward-looking statements are not guarantees of future performance or results. Forward-looking statements involve known and unknown risks and uncertainties. Many factors could cause actual results to differ materially from those that may be expressed or implied in such forward-looking statements, including, but not limited to, the volume, pricing and mix of services provided by the Company, intense competition, the loss of one or more significant customers, general economic conditions and other factors detailed from time to time in the Company's reports and registration statements filed with the Securities and Exchange Commission ("SEC"), including the Cautionary Statement filed as Exhibit 99 to the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Investors are cautioned not to put undue reliance on any forward-looking statement.

Goodwill and Other Intangible Assets

Total intangible assets as of September 30, 2003, comprised \$97.6 million of goodwill, \$0.9 million for noncompete agreements, \$5.6 million for customer contracts and \$0.2 million for customer lists. Intangible assets as of December 31, 2002, comprised \$96.3 million of goodwill, \$0.9 million for noncompete agreements, \$1.0 million for a customer contract and \$0.1 million for customer lists. Statement of Financial Accounting Standards ("SFAS") 142 requires that goodwill and intangible assets with indefinite useful lives not be amortized, but instead tested for impairment at least annually in accordance with the provisions in the statement. SFAS 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their residual values and reviewed for impairment.

Comprehensive Income

The following table is a reconciliation of the Company's net earnings to comprehensive income for the three month and nine month periods ended September 30:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Net earnings	\$ 5,387,684	3,746,571	\$ 14,983,492	10,481,293
Other comprehensive income:				
Foreign currency translation adjustment	<u>102,975</u>	<u>(88,281)</u>	<u>380,187</u>	<u>8,168</u>
Comprehensive income	<u>\$ 5,490,659</u>	<u>3,658,290</u>	<u>\$15,363,679</u>	<u>10,489,461</u>

Business Segment Information

The Company operates two divisions: risk assessment services and clinical (comprised of healthcare and substance abuse testing). The following table presents selected financial information for each segment:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
Sales:				
Risk assessment services	\$ 57,982,525	51,909,387	\$ 169,074,046	155,396,091
Clinical:				
Healthcare	22,846,993	15,406,814	64,691,628	44,130,352
Substance abuse testing	<u>7,285,532</u>	<u>7,261,260</u>	<u>20,240,336</u>	<u>20,724,191</u>
Total sales	<u>\$ 88,115,050</u>	<u>74,577,461</u>	<u>\$ 254,006,010</u>	<u>220,250,634</u>

Operating earnings:				
Risk assessment services	\$ 11,553,716	10,066,093	\$ 34,743,282	29,547,158
Clinical:				
Healthcare	4,973,209	2,913,142	12,365,940	8,462,473
Substance abuse testing	1,451,309	1,073,055	3,417,942	2,657,532
General corporate expense	(8,666,223)	(6,767,411)	(24,802,678)	(20,760,447)
Total operating earnings	9,312,011	7,284,879	25,724,486	19,906,716
Other expense	(772,632)	(1,018,932)	(1,975,173)	(2,757,223)
Earnings before income taxes	\$ 8,539,379	6,265,947	\$ 23,749,313	17,149,493

Operating earnings of each segment is computed as sales less directly identifiable expenses. In computing operating earnings of the segments, none of the following items have been allocated: general corporate expenses such as administrative, management, and information systems expenses; investment income; or other income (expenses). General corporate assets are principally cash, fixed assets and goodwill not identified with a specific segment.

Stock-Based Compensation

The Company has chosen to adopt the disclosure only provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), as amended by SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FASB Statement No. 123* ("SFAS 148") and continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and related interpretations.

The following table illustrates the effect on net earnings if the fair-value based method had been applied to all outstanding and unvested awards in each period, consistent with the method prescribed by SFAS 123, as amended by SFAS 148:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2003	2002	2003	2002
Net earnings, as reported	\$ 5,387,684	3,746,571	\$ 14,983,492	10,481,293
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards, net of tax	(323,886)	(340,547)	(1,132,185)	(883,784)
Proforma net earnings	\$ 5,063,798	3,406,024	\$ 13,851,307	9,597,509
Basic earnings per share:				
As reported	\$ 0.39	0.26	\$ 1.07	0.73
Proforma	\$ 0.36	0.23	\$ 0.98	0.65
Diluted earnings per share:				
As reported	\$ 0.32	0.23	\$ 0.89	0.65
Proforma	\$ 0.30	0.21	\$ 0.82	0.59
Contingencies				

In the normal course of business, LabOne had certain lawsuits pending at September 30, 2003. Although LabOne cannot predict the outcome of such proceedings or any other claims made against it, management believes that the ultimate resolution of these claims will not have a material adverse impact on the Company's financial position, results of operations and its cash flows.

ITEM 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

RESULTS OF OPERATIONS

SELECTED FINANCIAL DATA

	Three months ended			Nine months ended		
	September 30,			September 30,		
	<u>2003</u>	<u>2002</u>	<u>% Inc.</u>	<u>2003</u>	<u>2002</u>	<u>% Inc.</u>
Sales	\$ 88,115,050	\$ 74,577,461	18%	\$ 254,006,010	\$ 220,250,634	15%
Net earnings	\$ 5,387,684	\$ 3,746,571	44%	\$ 14,983,492	\$ 10,481,293	43%
Basic earnings per common share	\$ 0.39	\$ 0.26		\$ 1.07	\$ 0.73	
Diluted earnings per common share	\$ 0.32	\$ 0.23		\$ 0.89	\$ 0.65	

LabOne provides certified and accredited laboratory testing, investigative services and paramedical examinations for the insurance industry; laboratory testing services for the healthcare industry; and substance abuse testing services for employers.

LabOne's risk assessment division provides underwriting and claims support services to the insurance industry including: teleunderwriting, specimen collection, paramedical examinations, laboratory testing, telephone inspections, motor vehicle reports, claims investigation services and medical records retrieval. The laboratory tests performed by the Company are specifically designed to assist an insurance company in objectively evaluating the mortality and morbidity risks posed by policy applicants. The majority of the testing is performed on specimens of individual life insurance policy applicants, but also includes specimens of individuals applying for individual and group medical and disability policies.

LabOne's clinical division includes laboratory testing services for the healthcare industry as an aid in the diagnosis and treatment of patients. LabOne operates a highly automated and centralized laboratory and other laboratories, which the Company believes have significant economic advantages over other laboratory competitors. LabOne markets its healthcare testing services to managed care companies, insurance companies, self-insured groups, hospitals and physicians.

LabOne's clinical division also includes substance abuse testing services provided to employers and third party administrators. LabOne is certified by the Substance Abuse and Mental Health Services Administration to perform substance abuse testing services for federally regulated employers and currently markets these services throughout the country to both regulated and nonregulated employers. The Company's rapid turnaround times and multiple testing options help clients reduce downtime for affected employees and meet federally mandated drug screening guidelines.

THIRD QUARTER ANALYSIS

Net sales increased 18% in the third quarter 2003 to \$88.1 million from \$74.6 million in the third quarter 2002. The increase of \$13.5 million was due to increases in healthcare laboratory revenue of \$7.4 million and risk assessment services revenue of \$6.1 million. Total revenue from clinical and risk assessment laboratory services was \$51.2 million as compared to \$44.9 million in the third quarter 2002.

During the third quarter, healthcare revenue increased 48% to \$22.8 million as compared to \$15.4 million in the prior year. Total patients tested increased 37% due to growth in LabOne's customer base and the addition of CPL, acquired in December 2002. Average revenue per patient increased 9% as compared to the third quarter 2002. Healthcare revenue attributable to the acquisition of CPL was \$3.1 million for the quarter. SAT revenue increased \$24,000 in 2003 to \$7.3 million.

The risk assessment services division revenue increased \$6.1 million to \$58.0 million primarily due to growth of paramedical (ExamOne) revenue and medical records retrieval revenue. Revenue from ExamOne grew \$3.4 million or 19% to \$21.8 million for the quarter. Medical records retrieval revenue increased \$3.0 million due to the acquisition of ScanTech effective August 2003 and due to organic growth. The total number of insurance applicants tested in the third quarter 2003 decreased 8% compared to the same quarter last year due to a lower number of life insurance policies written and competitive pressures. Average revenue per insurance applicant increased 2% due to an increase in reflex testing.

Cost of sales increased \$8.3 million or 16% in the third quarter 2003 as compared to the prior year, due primarily to increases in outside services (including medical records retrieval fees and paramedical collections), payroll and lab supplies. Medical records retrieval fees increased due to the addition of ScanTech and organic growth in medical records retrieval services. Paramedical services increased primarily due to continued growth of the ExamOne paramedical operations. Payroll increased due to the addition of ScanTech and CPL, increased specimen volume in the healthcare laboratory testing segment, and growth of teleunderwriting and medical records retrieval services. Risk assessment cost of sales, including all of the above mentioned factors, increased to \$41.9 million in 2003 from \$37.6 million in the third quarter 2002. Healthcare cost of sales were \$13.2 million as compared to \$8.8 million in the third quarter 2002. SAT cost of sales expenses decreased to \$5.1 million as compared to \$5.4 million in the third quarter 2002 primarily due to savings on testing reagents, inbound freight and payroll expense.

As a result of the above factors, gross profit for the quarter increased 23% or \$5.2 million from \$22.7 million in 2002 to \$28.0 million in 2003. Risk assessment gross profit increased 12% or \$1.8 million on an increase in revenue of \$5.9 million. Healthcare gross profit increased 47% or \$3.1 million on an increase in revenue of \$7.4 million. SAT gross profit increased 21% or \$0.4 million.

Selling, general and administrative expenses increased \$3.2 million or 21% in the third quarter 2003 as compared to the prior year. This increase is primarily due to increases in payroll expenses, consulting expense, bad debt accruals and insurance expense. Risk assessment overhead expenditures increased to \$4.5 million in 2003 from \$4.2 million in the third quarter 2002. Healthcare overhead expenditures increased to \$4.7 million as compared to \$3.7 million in 2002 due primarily to an increase in payroll and bad debt expense. SAT overhead expenditures remained steady at \$0.8 million for the quarter.

Operating earnings increased from \$7.3 million in the third quarter 2002 to \$9.3 million in 2003. The risk assessment segment operating earnings were \$11.6 million in 2003 as compared to \$10.1 million in the third quarter 2002. The healthcare segment operating earnings were \$5.0 million in 2003 as compared to \$2.9 million in 2002. The SAT segment operating earnings were \$1.4 million in the third quarter 2003 as compared to \$1.1 million in 2002. General corporate operating expenses increased to \$8.7 million from \$6.8 million in the third quarter 2002 primarily due to higher payroll, consulting and insurance expenses.

Non operating expense decreased \$0.2 million primarily due to lower interest expense. The effective income tax rate was 37% in the third quarter 2003 as compared to 40% in 2002. The federal, state and Canadian income tax rates produce a statutory tax rate of approximately 39% of pre-tax income. The Company, pursuant to certain state income tax credits available to it, is able to reduce its effective rate upon usage of these credits. Upon exercise of certain employee non-qualified stock options during 2002, the usage of the state income tax credits became unavailable due to the reduction in state taxable income thereby increasing the reported effective tax rate.

The combined effect of the above factors resulted in net earnings of \$5.4 million in the third quarter 2003 as compared to \$3.7 million in 2002. Convertible preferred dividends in the third quarter 2003 were \$0.8 million and earnings available to common shareholders were \$4.6 million (See "Financial Position, Liquidity and Capital Resources").

Basic earnings per share in the third quarter 2003 were \$0.39, and fully diluted earnings per share were \$0.32. Basic earnings per share in the third quarter 2002 were \$0.26, and fully diluted earnings per share were \$0.23. The basic weighted average number of shares outstanding in the third quarter of 2003 and 2002 were 11,908,231 and 11,623,275, respectively. The fully diluted weighted average number of shares outstanding in 2003 and 2002 were 16,974,911 and 16,467,374, respectively.

YEAR TO DATE ANALYSIS

Net sales increased 15% in the nine month period ended September 30, 2003, to \$254.0 million from \$220.3 million in the same period last year. The increase of \$33.8 million was due to increases in healthcare laboratory revenue of \$20.6 million and risk assessment services revenue of \$13.7 million, partially offset by a decrease in SAT revenue of \$0.5 million. Total revenue in the first nine months of 2003 from clinical and risk assessment laboratory services was \$151.2 million as compared to \$135.5 million in 2002.

Healthcare revenue increased 47% in the first nine months of 2003 to \$64.7 million as compared to \$44.1 million in the prior year. Total patients tested increased 38% due to growth in LabOne's customer base and the addition of CPL. Average revenue per patient increased 7%. Healthcare revenue from the acquisition of CPL was \$9.0 million for the first nine months of 2003. SAT revenue decreased 2% to \$20.2 million in 2003 from \$20.7 million in 2002 due to a 3% decrease in testing volumes, partially offset by a 1% increase in average revenue per specimen.

The risk assessment services division revenue increased \$13.7 million to \$169.1 million primarily due to growth in ExamOne revenue, teleunderwriting revenue and medical records retrieval revenue. ExamOne revenue increased \$8.1 million, medical records retrieval revenue increased \$5.1 million and teleunderwriting revenue increased \$4.1 million in the nine month period. These increases were partially offset by a 6% decrease in insurance laboratory testing revenue. The total number of insurance applicants tested in the first nine months decreased 9% compared to last year due to a lower number of life insurance policies written and competitive pressures. Average revenue per insurance applicant increased 2%.

Cost of sales increased \$20.5 million or 13% in the nine month period as compared to the prior year. This increase was primarily due to growth in the clinical laboratory division and the acquisition of CPL. Additionally, the insurance division experienced increases in medical records retrieval fees, paramedical collections and information services fees, partially offset by lower supply expenses. Medical records retrieval fees increased due to growth in medical records retrieval revenue and the acquisition of ScanTech. Paramedical services increased primarily due to continued growth of the ExamOne paramedical operations. Risk assessment cost of sales, including the above mentioned factors, increased to \$120.8 million in 2003 from \$112.9 million in 2002. Healthcare cost of sales in the nine month period were \$38.1 million as compared to \$24.4 million in 2002. SAT cost of sales expenses decreased to \$14.4 million as compared to \$15.5 million in 2002.

As a result of the above factors, year to date gross profit increased 20% or \$13.2 million from \$67.4 million in 2002 to \$80.7 million in 2003. Risk assessment gross profit increased 13% or \$5.7 million on an increase in revenue of \$13.5 million. Healthcare gross profit increased 35% or \$6.9 million on an increase in revenue of \$20.6 million. SAT gross profit increased 12% or \$0.6 million on a decrease in revenue of \$0.5 million.

Selling, general and administrative expenses increased \$7.4 million or 16% in the first nine months of 2003 as compared to the prior year. The increase is primarily due to increases in payroll expenses, bad debt accruals, consulting expense and insurance expense. Risk assessment overhead expenditures increased to \$13.5 million in 2003 from \$13.0 million in 2002 primarily due to a software write-off included as depreciation expense, and consulting expense, partially offset by lower commission accruals. Healthcare overhead expenditures were \$14.3 million as compared to \$11.3 million in 2002 due to the addition of CPL and an increase in bad debt expense. SAT overhead expenditures decreased to \$2.4 million as compared to \$2.6 million in 2002 primarily due to lower bad debt accruals and payroll expense.

Operating income increased from \$19.9 million in the first nine months of 2002 to \$25.7 million in 2003. The risk assessment segment operating income was \$34.7 million in 2003 as compared to \$29.5 million in 2002. The healthcare segment operating income was \$12.4 million in 2003 as compared to \$8.5 million in 2002. The SAT segment operating income year to date was \$3.4 million in 2003 as compared to \$2.7 million in 2002. Administrative operating expenses increased to \$24.8 million from \$20.8 million in 2002 primarily due to higher payroll, insurance expenses and consulting fees.

Non operating expense decreased \$0.8 million primarily due to decreased interest expense. The effective income tax rate was 37% in the first nine months of 2003 as compared to 39% in 2002.

The combined effect of the above factors resulted in net income of \$15.0 million in 2003 as compared to net income of \$10.5 million in 2002. In the first nine months of 2003, preferred dividends were \$2.3 million and earnings available to common shareholders were \$12.6 million.

Basic earnings per share year to date 2003 were \$1.07 and fully diluted earnings per share were \$0.89. Basic earnings per share were \$0.73 and diluted earnings per share were \$0.65 in 2002. The basic weighted average number of shares outstanding in the first nine months of 2003 and 2002 were 11,757,079 and 11,390,203, respectively. The fully diluted weighted average number of shares outstanding in 2003 and 2002 were 16,796,264 and 16,173,311, respectively.

FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

LabOne's working capital position increased by \$6.8 million to \$47.2 million at September 30, 2003, from \$40.4 million at December 31, 2002. During the first nine months of 2003, net cash provided by operations was \$19.2 million as compared to \$13.3 million in 2002. The increase is due to higher net income, partially offset by changes in current asset and liability accounts.

During the first nine months of 2003, net additions to property, plant and equipment were \$5.9 million primarily due to software and information systems development. Cash used for acquisitions of businesses was \$7.2 million, which was principally recorded as intangibles and operating assets. Net additions to property, plant and equipment in the first nine months of 2002 were \$6.3 million and cash used for acquisitions of paramedical businesses was \$4.4 million.

On August 1, 2003, the Company acquired ScanTech Solutions, L.L.C., from Protective Life Corporation for \$6.0 million and entered into long-term agreements to provide certain Protective Life affiliates with teleunderwriting, paramedical examination, laboratory testing and medical document retrieval services. This transaction was funded with cash from operations.

The Company reduced its line of credit borrowings in the nine month period by \$5.0 million to \$47 million from \$52 million at December 31, 2002. Under the Company's line of credit, which expires in 2005, the total funds available are up to \$100 million. The interest expense on the line of credit is based on the LIBOR rate plus a range of 125 to 225 basis points and, including bank fees, is currently approximately 2.9%. The Company pays a commitment fee on the unused portion of 0.5% annually. Interest on the industrial revenue bonds issued to finance the construction of the Company's facility is based on a taxable seven-day variable rate which, including letter of credit and remarketing fees, is approximately 2.1% as of October 31, 2003.

At September 30, 2003, LabOne had total cash and cash equivalents of \$9.7 million as compared to \$8.1 million at December 31, 2002. The Company expects to fund operations from a combination of cash flows from operations and borrowings under the Company's revolving credit agreement.

CRITICAL ACCOUNTING POLICIES

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

Revenue Recognition

While many operational aspects are subject to complex federal, state and local regulations, the accounting for LabOne's business is generally straightforward. The Company recognizes revenues for its services when those services are provided to the client. Revenues related to clinical healthcare billings include adjustments for revenue disallowances estimated at the time the revenue is booked.

Reserve for Doubtful Accounts

The estimate of reserves for doubtful accounts involves a standardized monthly approach to review the collectibility of receivables based on contractual agreements and the aging of accounts receivable. Contractual agreements, historical collection patterns and payor reimbursement experience are integral in the estimation of reserves for doubtful accounts. In addition, the current state of billing functions is assessed in order to identify any known collection or reimbursement issues in order to assess the impact, if any, on reserve estimates, which involve judgment. Adjustments to the reserve for contractual agreements are reported as a reduction in revenues. Other adjustments to the reserve are recorded as an adjustment to bad debt expense within selling, general and administrative expenses. The collection and reserves processes, along with the monitoring of billing processes, helps to reduce the risk associated with material revisions to reserve estimates resulting from adverse changes in collection and reimbursement experience and billing functions. Based on the amounts reserved for uncollectible accounts in 2002, a 10% increase or decrease in current year reserve for uncollectible accounts would have had an impact of approximately \$0.5 million.

Software Developed for Internal Use

Certain internal and external costs incurred in connection with developing or obtaining software for internal use are capitalized in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. These capitalized costs are included in property and equipment on the consolidated balance sheets and are subject to amortization, over the estimated useful life of the software, beginning when the software project is complete. The Company periodically reviews the lives and values of its capitalized software and makes adjustments if necessary.

Goodwill and Intangible Assets

The Company allocates the purchase price of acquired businesses in accordance with SFAS No. 141, *Business Combinations*. A portion of the purchase price is assigned to each individual asset acquired on the basis of its fair value. Intangible assets are recognized as assets apart from goodwill if they arise from contractual or other legal rights. If intangible assets do not arise from contractual or other legal rights, they are recognized as assets apart from goodwill only if they are capable of being separated from the acquired entity and sold, transferred, licensed, rented, or exchanged. Intangible assets recognized apart from goodwill have a determinable life and are amortized accordingly. The excess of the purchase price over the sum of the amounts assigned to the tangible assets and any separately recognized intangible assets acquired less liabilities assumed is recognized as goodwill.

The Company evaluates the recoverability and measures the potential impairment of goodwill under SFAS 142. Management of and internal reporting for the Company's principal business segments are differentiated as these segments perform distinct business activities. Management believes these business segments represent appropriate reporting units for the evaluation of impairment.

The impairment test is a two-step process that begins with the estimation of the fair value of the reporting units to determine if any impairment exists. The second step measures the amount of the impairment, if any. The estimate of fair value considers publicly available information regarding the market capitalization of the Company, as well as the financial projections and future prospects of business, including growth opportunities and likely operational improvements, and comparable sales prices, if available. To assess potential impairment, the estimate of fair value for the Company is compared to the book value of the consolidated net assets. If the book value of the consolidated net assets is greater than the estimate of fair value, the Company then proceeds to the second step to measure the impairment, if any. The second step compares the implied fair value of goodwill with its carrying value. The implied fair value is determined by allocating the fair value of the reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination and the fair value of the reporting unit was the purchase price paid to acquire the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to its assets and liabilities is the implied fair value of goodwill. If the carrying amount of the reporting unit's goodwill is greater than its implied fair value, an impairment loss will be recognized in the amount of the excess. The Company believes its estimation methods are reasonable and reflective of common valuation practices.

ITEM 3 - Quantitative and Qualitative Disclosures about Market Risk.

An interest rate risk exposure exists due to LabOne's variable interest rates associated with its liability of \$47.0 million borrowing on its line of credit and \$10.8 million in industrial revenue bonds. The interest expense on the line of credit is based on the LIBOR rate plus a range of 125 to 225 basis points and is approximately 2.9% at October 31, 2003. The interest expense incurred on the bonds is based on a taxable seven-day variable rate which, including letter of credit and remarketing fees, is approximately 2.1% as of October 31, 2003. Any future increase in interest rates would result in additional interest expense which could be material. An assumed 10% increase in interest rates (representing approximately 30 basis points) would potentially increase interest expense on these instruments by \$0.2 million annually.

ITEM 4 - Controls and Procedures.

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's reports filed pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures also are designed to ensure that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met.

Management of the Company, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of the Company's disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report. Management of the Company, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of the Company's internal control over financial reporting to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. Based on that evaluation, there has been no such change during the quarter covered by this report.

PART II. OTHER INFORMATION

ITEM 6 - Exhibits and Reports on Form 8-K

(a) Exhibits

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

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

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

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

(b) Reports on Form 8-K

A Form 8-K current report dated August 1, 2003, was filed with the Commission reporting under Item 9. Regulation FD Disclosure, LabOne's agreement to acquire the MetLife Insurance Testing Laboratory located in Elmsford, NY, and the long-term agreement to provide laboratory testing services to MetLife, Inc.

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A Form 8-K current report dated August 6, 2003, was filed with the Commission reporting under Item 9. Regulation FD Disclosure, LabOne's acquisition of ScanTech Solutions, L.L.C., a leading provider of medical document retrieval services, from Protective Life Corporation, and long-term agreements to provide certain Protective Life affiliates with teleunderwriting, paramedical examination, laboratory testing and medical document retrieval services.

A Form 8-K current report dated August 7, 2003, was filed with the Commission reporting under Item 9. Regulation FD Disclosure, the content of the second quarter 2003 financial results conference call to investors.

A Form 8-K current report dated October 8, 2003, was filed with the Commission reporting under Item 9. Regulation FD Disclosure, that the Health Alliance had entered into negotiations with LabOne as its partner for the sale of its medical testing laboratory, Alliance Laboratory Service. The anticipated transaction would also include a long-term commitment by the Health Alliance to obtain medical testing from LabOne.

A Form 8-K current report dated October 10, 2003, was filed with the Commission reporting under Item 9. Regulation FD Disclosure, the completion of the closing process with MetLife to acquire the MetLife Insurance Testing Laboratory located in Elmsford, NY, and initiation of a long-term agreement to provide laboratory testing services to MetLife, Inc. and its affiliated entities.

SIGNATURES

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

LabOne, Inc.

Date: November 13, 2003

By /s/ John W. McCarty
John W. McCarty
Executive V.P. and Chief Financial Officer

" align="justify">

For information regarding ownership of the Company's stock by the Nominating Shareholder and Shareholder Nominees, see Exhibit A.

For information regarding purchases and sales of the Company's securities during the past two years by the Nominating Shareholder and the Shareholder Nominees, see Exhibit B.

Except as set forth in this Proxy Statement, no Shareholder Nominee or the Nominating Shareholder is involved in any material pending legal proceedings with respect to the Company. Except as set forth in this Proxy Statement, there is no other arrangement or understanding between any Shareholder Nominee and any other person pursuant to which he was or is to be selected as a Shareholder Nominee or Director.

The Nominating Shareholder reserves the right to retain one or more financial advisors and proxy solicitors, who may be considered participants in a solicitation under Regulation 14A of the Securities Exchange Act of 1934. The Nominating Shareholder will pay the expenses of any such solicitation.

Except as set forth in this Proxy Statement (including Exhibits A, B and C), (i) during the past 10 years, no participant in this solicitation has been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors); (ii) no participant in this solicitation directly or indirectly beneficially owns any of the Company's securities; (iii) no participant in this solicitation owns any of the Company's securities which are owned of record but not beneficially; (iv) no participant in this solicitation has purchased or sold any of the Company's securities during the past two years; (v) no part of the purchase price or market value of the Company's securities owned by any participant in this solicitation is represented by funds borrowed or otherwise obtained for the purpose of acquiring or holding such securities; (vi) no participant in this solicitation is, or within the past year was, a party to any contract, arrangements or understandings with any person with respect to any of the Company's securities, including, but not limited to, joint ventures, loan or option arrangements, puts or calls, guarantees against loss or guarantees of profit, division of losses or profits, or the giving or withholding of proxies; (vii) no associate of any participant in this solicitation owns beneficially, directly or indirectly, any of the Company's securities; (viii) no participant in this solicitation owns beneficially, directly or indirectly, any securities of any parent or subsidiary of the Company; (ix) no participant in this solicitation or any of his/its associates was a party to any transaction, or series of similar transactions, since the beginning of the Company's last fiscal year, or is a party to any currently proposed transaction, or series of similar transactions, to which the Company or any of its subsidiaries was or is to be a party, in which the amount involved exceeds \$120,000; (x) no participant in this solicitation has, nor do any of their associates have, any arrangement or understanding with any person with respect to any future employment by the Company or its affiliates; (xi) no participant in this solicitation has, nor do any of their associates have, any arrangement or understanding with any person with respect to any future transactions to which the Company or any of its affiliates will or may be a party; (xii) no person, including the participants in this solicitation, who is a party to an arrangement or understanding pursuant to which the Shareholder Nominees are proposed to be elected has a substantial interest, direct or indirect, by security holdings or otherwise in any matter to be acted on at the Annual Meeting; (xiii) no participant in this solicitation is aware of any arrangement (including any pledge, voting trust, or contract for sale) which may at a subsequent date result in a change in control of the Company; (xvi) no participant in this solicitation is aware of any arrangement, or has reason to believe that any arrangement exists, under which 5% or more of any class of the Company's voting securities is held or is to be held subject to any voting agreement, voting trust or other similar agreement; (xv) no participant in this solicitation is aware of any person or group that holds beneficial ownership of more than 5% of the outstanding shares of the Company or has the right to acquire beneficial ownership of more than 5% of such outstanding voting securities, except for persons or groups who may be identified through a review of publicly available information regarding the beneficial ownership of the Company.

IMPORTANT

If your shares are held in "street name," only your bank or broker can vote your shares and only upon receipt of your specific instructions. Please return the proxy provided to you or contact the person responsible for your account and instruct them to vote for the Shareholder Nominees on the proxy card.

If you have any questions, or need further assistance, please contact the Nominating Shareholder's proxy solicitor: Thomas Hemingway, at 300 S. Harbor, Suite 500, Anaheim, CA 92805, Phone: 714-765-0012.

THE NOMINATING SHAREHOLDER HAS OMITTED FROM THIS PROXY STATEMENT CERTAIN DISCLOSURE REQUIRED BY APPLICABLE LAW THAT IS INCLUDED IN THE COMPANY'S PROXY STATEMENT. THIS DISCLOSURE INCLUDES, AMONG OTHER THINGS, SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS, DIRECTORS AND MANAGEMENT, INFORMATION REGARDING SHAREHOLDER PROPOSALS FOR THE ANNUAL MEETING, BIOGRAPHICAL INFORMATION ON THE COMPANY'S DIRECTORS AND EXECUTIVE OFFICERS, INFORMATION CONCERNING EXECUTIVE COMPENSATION AND AN ANALYSIS OF CUMULATIVE TOTAL RETURNS ON AN INVESTMENT IN SHARES DURING THE PAST FIVE YEARS. SHAREHOLDERS SHOULD REFER TO THE COMPANY'S PROXY STATEMENT IN ORDER TO REVIEW THIS DISCLOSURE. THE NOMINATING SHAREHOLDER URGES YOU TO SIGN, DATE AND RETURN THE PROXY CARD IN FAVOR OF THE ELECTION OF THE SHAREHOLDER NOMINEES.

Dated: March 29, 2007

Sincerely,

THE NOMINATING SHAREHOLDER

/s/ Daniel K. Moscaritolo

Daniel K. Moscaritolo

EXHIBIT A

**INFORMATION CONCERNING THE NOMINATING SHAREHOLDER
AND SHAREHOLDER NOMINEES**

The following sets forth the name and the number of shares of Common Stock of the Company beneficially owned as of March 29, 2007, by the Nominating Shareholder and each of the Shareholder Nominees.

Name of Beneficial Owner	Number of Shares Beneficially Owned	Percent of Class
Daniel K. Moscaritolo	2,462,887	14.08
Charles L. Christensen	345,917	1.98
Thomas Hemingway	--	*

*Less than 1%.

EXHIBIT B**PURCHASES AND SALES OVER PAST TWO YEARS BY THE NOMINATING SHAREHOLDER AND SHAREHOLDER NOMINEES**

The following table sets forth for the Nominating Shareholder and each of the Shareholder Nominees their purchases and sales (indicated in parenthesis) of Common Stock (including put options and call options) within the previous two years, the dates of the transactions and the amounts purchased or sold:

Account Name	Trade Date	Quantity
Daniel K. Moscaritolo	04-10-2005	32,782
Daniel K. Moscaritolo	04-15-2005	(17,500)
Daniel K. Moscaritolo	05-10-2005	(15,282)
Daniel K. Moscaritolo	09-10-2005	(105,800)

EXHIBIT C

LETTER of RESIGNATION

Date: Tuesday November 14, 2006

To: Dr. James A. Latty, Chairman of the Board, CEO and President, MEMS USA Inc. Steven S. Newsom, BOD, MEMS USA Inc.

Gentlemen:

I write to inform you of my decision to resign from the Board of Directors of MEMS USA. I understand that you must report my departure within 5 days and I request that this letter, with its attachment, be included as an exhibit to the Form 8-K you file.

As you know, the law firm of Moscarino & Connolly performed an investigation arising from the allegation of Chuck Christensen that Dr. James A. Latty had committed ethics violations. On October 11, 2006, the law firm issued its report, and I attach a copy of the report to this letter. The report concluded that there is reasonable cause to believe that Dr. Latty (1) had a conflict of interest in connection with the Accelon blending skid project; (2) willfully failed to disclose his conflict of interest; (3) actively influenced company policy with respect to Mem's financial dealings with Accelon without disclosing the conflicts of interest. Further, the report concluded that the nature of the conflicts likely interfered with Dr. Latty's ability to fairly and impartially make business decisions on behalf of the company, and that had Dr. Latty disclosed his conflicts of interest, the company might have arrived at different conclusions about its business relationship with Accelon, including different terms and conditions in the contract and different decisions about the company's response to cost overruns.

Upon receipt of the report, I told the Board that the report's conclusions demanded further action by the Board. The response I received was from Board member Steve Newsom, who told me after 3 days of private closed door meetings with Dr. Latty that, "this was old information...that they just wanted to put this all behind them."

Approximately two weeks ago, I again told the Board that Dr. Latty apparently breached his fiduciary duties and that it was serious enough that the information should be provided to investors in an 8K. The Board did not respond. I then told the Board that we could not ignore the findings as they raised matters that needed to be disclosed and corrected, and, at the least, there should be a thorough evaluation of the steps necessary to correct the problems identified. I said that if this was not done there could be liability on the part of the company or the Board. They told me nothing was to be disclosed.

On November 1, 2006, Mr. Newsom proposed a Board resolution under which Dr. Latty would agree to personally obtain ownership of the blending skid from Accelon and then sell the blending skid and all intellectual property related to the design or manufacture or sale or lease of the skid to the company for the amount that the company was paid to build the blending skid and for a settlement agreement that would serve as a general release of all the company's claims against him from the violations identified in the investigative report. I disagreed vehemently and voted "NO", but Mr. Newsom voted "YES" *and allowed Dr Latty to vote "YES"*, which was in my mind clearly a conflict of interest. The resolution passed because Dr. Latty was allowed to vote.

Subsequently, I sent Dr. Latty and Mr. Newsom a very strongly worded response to what I perceived as a clear breach of their fiduciary duty to our shareholders. I also made a proposal that I thought would resolve the conflicts in the best interests of the company. The proposal was rejected out of hand. I understand that since that time a Board meeting was called for on *Sunday* November 12, 2006, without proper notice, without an agenda, and at which the Board

presumably took some type of action adverse to me. I understand this because, since then, I have been locked out of the office and told that an armed security guard was present to prevent my entry into the office. I have been blocked in every sense of the word from performing my duties as chief ethics officer and ombudsman, not to mention my duties as chief technology officer and chief operating officer. However, I have not been notified that I have been terminated nor have I resigned my officer or ombudsman positions. I intend to fulfill those duties unless I am terminated.

However, I can no longer participate as a member of the Board, as I believe it is now operating in complete disregard of its duties to shareholders. I will not participate in any effort that could block shareholders' rights to view the conduct of their company. I also have information I believe could show that Dr. Latty has participated in fabricating documents for purposes of defrauding potential company investors, as well as information that I believe could show that Dr. Latty purposely delayed renewing his MEMS employment contract *which expired on July 1, 2006* so that he could manipulate company stock prices to their lowest point to obtain the lowest, most favorable strike price on his new stock options package. Based upon the way my complaints concerning this conduct have been handled as well as Mr. Newsom's turning a blind eye to the matters raised by the investigative report, I believe it would be futile to move the Board to take action on this information. I thus really have no choice but to resign.

I am submitting a copy of this letter to company counsel Richardson Patel, knowing that I had previously asked that the information concerning Dr. Latty's conduct be disclosed and corrected, or at least that the company conduct a thorough vetting of the proper response to the report. To make matters worse, on or about September 21, 2006 counsel from Richardson Patel apparently had assisted Dr. Latty in an attempt to "buy me out" of the company. Specifically, Mark Abdou of Richardson Patel, apparently on behalf of Dr. Latty, assisted Chuck Rosenblum of Rosenblum Partners, LLC, in preparing a proposed term sheet whereby I would sell 1.6 million of my shares to Rosenblum, requiring that I resign from all Officer and Board positions that I held. I see this apparent representation of Dr. Latty as a conflict of interest with the company and I question the law firm's willingness to fulfill its duties to shareholders as company counsel.

Sincerely,

/s/ D. K. Moscaritolo
Daniel K. Moscaritolo

Cc: Mark Abdou, Richardson Patel (By US Post Office only)

Enclosure

[FRONT OF PROXY CARD]

CONVERGENCE ETHANOL, INC.

**NOMINATING SHAREHOLDER'S PROXY FOR THE ANNUAL MEETING OF SHAREHOLDERS AT
7:30 A.M., MONDAY, APRIL 16, 2007**

The undersigned shareholder of Convergence Ethanol, Inc. (the "COMPANY") hereby appoints Daniel K. Moscaritolo and Charles L. Christensen, or either of them, as proxies, each with full powers of substitution, to vote the shares of the undersigned at the above-stated Annual Meeting and at any adjournment(s) or postponement(s) thereof:

**1. TO APPROVE THE ELECTION OF ANY OR ALL OF THE FOLLOWING NOMINEES FOR
DIRECTOR**

Daniel K. Moscaritolo	<input type="radio"/> FOR	<input type="radio"/> WITHHOLD
Charles L. Christensen	<input type="radio"/> FOR	<input type="radio"/> WITHHOLD
Thomas Hemingway	<input type="radio"/> FOR	<input type="radio"/> WITHHOLD

**THE PROXIES SHALL BE AUTHORIZED TO ACT IN THEIR DISCRETION ON ANY OTHER
BUSINESS THAT MAY PROPERLY COME BEFORE THE MEETING.**

**THIS PROXY HEREBY REVOKES ANY PROXY OR PROXIES HERETOFORE GIVEN BY THE
UNDERSIGNED:**

(Please sign on the reverse side)

[BACK OF PROXY CARD]

(Continued from reverse side)

THIS PROXY IS SOLICITED IN OPPOSITION TO THE BOARD OF DIRECTORS OF CONVERGENCE ETHANOL, INC. BY THE NOMINATING SHAREHOLDER AND FOR THE SHAREHOLDER NOMINEES LISTED BELOW. THIS PROXY IS NOT BEING SOLICITED BY THE BOARD OF DIRECTORS OF CONVERGENCE ETHANOL, INC.

Receipt herewith of the Nominating Shareholder's Proxy Statement, dated March 29, 2007 is hereby acknowledged.

Dated: _____, 2007

(Signature of Shareholder)

(Signature if held jointly)

IMPORTANT: Please date this proxy and sign exactly as your name or names appear(s) on your stock certificate. All joint owners whose names appear should sign. Executors, administrators, trustees, guardians, attorneys and others holding stock in a representative or fiduciary capacity, should sign and also give their title. If a corporation, please sign in corporate name by the president or other authorized officer. If a partnership, please sign in partnership name by an authorized person.

PLEASE SIGN, DATE AND MAIL TODAY.