UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2006

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: 001-15823

VIRAGEN, INC.

(Exact name of registrant as specified in its charter)

Delaware	**59-2101668**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

865 SW 78th Avenue, Suite 100, Plantation, Florida 33324

(Address of principal executive offices) (Zip Code)

(954) 233-8746

(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 x No¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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

As of February 9, 2007, there were 121,407,448 shares of the registrant s common stock outstanding, par value $0.01.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

VIRAGEN, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended December 31, 2006	Three Months Ended December 31, 2005	Six Months Ended December 31, 2006	Six Months Ended December 31, 2005
Product sales	$ 114,595	$ 116,973	$ 188,162	$ 202,159
Costs and expenses				
Cost of sales	627,035	570,062	1,186,464	1,026,891
Inventory write-down, net	1,516,495	103,662	1,516,495	194,284
Research and development	890,184	1,069,283	1,812,253	2,078,813
Selling, general and administrative	1,628,839	1,638,645	3,100,996	3,380,202
Amortization of intangible assets	42,681	37,932	84,421	77,395
Interest expense	1,106,992	1,425,180	1,836,976	3,284,842
Other income, net	(87,740)	(95,971)	(291,774)	(149,041)
Loss before income taxes and minority interest	(5,609,891)	(4,631,820)	(9,057,669)	(9,691,227)
Income tax benefit	(10,957)	(10,957)	(21,914)	(21,914)
Minority interest	593,281		973,068	
Net loss	(6,192,215)	(4,620,863)	(10,008,823)	(9,669,313)
Deduct required dividends on convertible preferred stock, Series A	538	538	1,075	1,075
Deduct required dividends on convertible preferred stock, Series J	586,366		901,838	
Net loss attributable to common stockholders	$ (6,779,119)	$ (4,621,401)	$ (10,911,736)	$ (9,670,388)
Basic and diluted net loss per share of common stock, after deduction for dividends on preferred stock	$ (0.07)	$ (0.11)	$ (0.15)	$ (0.25)
Weighted average common shares - basic and diluted	94,433,181	40,817,497	70,646,563	39,088,457

See notes to consolidated condensed financial statements which are an integral part of these statements.

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VIRAGEN, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

	December 31, 2006	June 30, 2006
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,343,488	$ 443,115
Accounts receivable	65,368	71,107
Inventories	664,089	1,821,676
Prepaid expenses	624,635	589,131
Other current assets	196,389	597,981
Total current assets	3,893,969	3,523,010
Property, plant and equipment		
Land, building and improvements	5,130,186	4,797,337
Equipment and furniture	4,309,875	4,013,694
	9,440,061	8,811,031
Less accumulated depreciation	(4,611,816)	(3,999,958)
	4,828,245	4,811,073
Goodwill	4,176,265	3,890,415
Developed technology, net	1,574,117	1,548,601
Deposits and other assets	77,288	200,867
	$ 14,549,884	$ 13,973,966
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current liabilities		
Accounts payable	$ 988,001	$ 916,001
Accrued expenses and other liabilities	1,086,420	1,640,903
Current portion of convertible notes and debentures	78,034	453,918
Short term borrowings	112,736	217,321
Current portion of long-term debt	73,216	65,811
Total current liabilities	2,338,407	3,293,954
Convertible notes and debentures, less current portion	9,514,303	11,145,816
Long-term debt, less current portion	654,141	627,265
Deferred income tax liability	390,799	412,712
Royalties payable	107,866	107,866
Commitments and contingencies		
Stockholders equity (deficit)		
Convertible 10% Series A cumulative preferred stock, $1.00 par value. Authorized 375,000 shares; 2,150 shares issued and outstanding at December 31, 2006 and June 30, 2006. Liquidation preference value: $10 per share, aggregating $21,500 at December 31, 2006 and June 30, 2006	2,150	2,150
Convertible Series J 24% cumulative convertible preferred stock, $1.00 par value. No shares authorized at December 31, 2006; 60,000 shares authorized at June 30, 2006; no shares issued and		5,215,000

outstanding at December 31, 2006; 52,150 shares issued and outstanding at June 30, 2006.		
Liquidation preference value: $100 per share, aggregating $5,215,000 at June 30, 2006		
Common stock, $.01 par value. Authorized 250,000,000 shares; 120,285,104 shares issued and outstanding at December 31, 2006; 45,765,687 shares issued and outstanding at June 30, 2006	1,202,851	457,657
Capital in excess of par value	173,726,307	155,989,343
Accumulated deficit	(177,088,339)	(166,176,603)
Accumulated other comprehensive income	3,701,399	2,898,806
Total stockholders equity (deficit)	1,544,368	(1,613,647)
	$ 14,549,884	$ 13,973,966

See notes to consolidated condensed financial statements which are an integral part of these statements.

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VIRAGEN, INC. AND SUBSIDIARIES

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended December 31, 2006	2005
OPERATING ACTIVITIES		
Net loss	$ (10,008,823)	$ (9,669,313)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	362,717	412,341
Amortization of intangible assets	84,421	77,395
Inventory write-down, net	1,516,495	194,284
Net loss on foreign exchange remeasurement	6,079	151,357
Compensation expense on stock options and warrants	8,502	8,967
Amortization of discount on convertible debentures and promissory notes	876,978	2,275,858
Amortization of deferred financing costs	221,265	348,297
Deferred income tax benefit	(21,914)	(21,914)
Minority interest	973,068	
Increase (decrease) relating to operating activities from:		
Accounts receivable	10,867	(31,047)
Inventories	(215,213)	(91,878)
Prepaid expenses	79,092	342,026
Other current assets	53,810	602,883
Accounts payable	(10,753)	(48,080)
Accrued expenses and other liabilities	71,439	20,039
Other	11,115	
Net cash used in operating activities	(5,980,855)	(5,428,785)
INVESTING ACTIVITY		
Additions to property, plant and equipment	(14,310)	(338,303)
Net cash used in investing activity	(14,310)	(338,303)
FINANCING ACTIVITIES		
Proceeds from sale of units, net	16,919,419	
Proceeds from sale of subsidiary preferred stock and common stock, net	2,593,650	
Proceeds from sale of convertible debentures and warrants, net		1,194,895
Redemption of preferred stock, Series J	(5,215,000)	
Redemption of subsidiary preferred stock	(2,885,100)	
Payment of dividends on preferred stock, Series A	(13,438)	
Payment of dividends on preferred stock, Series J	(1,251,600)	
Payment of dividends on subsidiary preferred stock	(692,424)	
Payments on convertible debentures	(1,384,375)	(62,500)
Payments on short term borrowings	(167,524)	(173,592)
Payments on long-term debt	(38,485)	(35,439)
Net cash provided by financing activities	7,865,123	923,364
Effect of exchange rate fluctuations on cash and cash equivalents	30,415	(154,803)
Increase (decrease) in cash and cash equivalents	1,900,373	(4,998,527)
Cash and cash equivalents at beginning of period	443,115	6,885,537

Cash and cash equivalents at end of period	$ 2,343,488	$ 1,887,010

During the six months ended December 31, 2006 and 2005, we had the following non-cash financing activities:

	Six Months Ended December 31,	
	2006	2005
Conversion of convertible notes into common stock	$ 1,500,000	$ 6,070,000
Purchase of insurance with notes payable	62,939	51,554
Purchase of equipment with notes payable	21,988	84,079

See notes to consolidated condensed financial statements which are an integral part of these statements.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE A OVERVIEW AND BASIS OF PRESENTATION

With international operations in the U.S., Scotland and Sweden, we are a bio-pharmaceutical company engaged in the research, development, manufacture and commercialization of therapeutic proteins for the treatment of cancers and viral diseases. Our product and product candidate portfolio includes: *Multiferon*® (multi-subtype, human alpha interferon) uniquely positioned in valuable niche indications, such as high-risk malignant melanoma, other niche cancer indications and selected infectious diseases; VG101 (anti-GD3 antibody), a humanized monoclonal antibody that binds selectively to an antigen over-expressed on Stage IV malignant melanoma tumors; VG102 (anti-CD55 antibody), a highly novel humanized monoclonal antibody that binds selectively to an antigen that is over-expressed on nearly all solid tumors; and VG106, a novel anti-cancer therapeutic. We are also pioneering the development of the OVA System (Avian Transgenics), with the renowned Roslin Institute, the creators of Dolly the Sheep , as a revolutionary manufacturing platform for the large-scale, efficient and economical production of human therapeutic proteins and antibodies, by expressing these products in the egg whites of transgenic hens.

As of December 31, 2006, we owned approximately 77.0% of Viragen International, Inc. Viragen International owns 100% of ViraNative AB, our Swedish subsidiary, and 100% of Viragen (Scotland) Ltd., our Scottish research center.

The accompanying unaudited interim consolidated condensed financial statements include Viragen, Inc., Viragen International, Inc. and all subsidiaries, including those operating outside the United States of America. All significant intercompany balances and transactions have been eliminated. Minority interest, which is shown in our consolidated condensed statement of operations, represents the minority stockholders share of the net loss of Viragen International and dividends on Viragen International s preferred stock. During our fiscal year ended June 30, 2005, stockholders equity of Viragen International decreased to a deficit position. Because the minority stockholders are not required to fund the deficit, we ceased attributing a portion of Viragen International s losses to the minority stockholders at that time. Since then, we have absorbed 100% of Viragen International s losses and will continue to do so until Viragen International has positive stockholders equity.

The accompanying unaudited interim consolidated condensed financial statements for Viragen, Inc. have been prepared in conformity with accounting principles generally accepted in the United States, consistent in all material respects with those applied in our Annual Report on Form 10-K for our fiscal year ended June 30, 2006, filed with the Securities and Exchange Commission. These statements have been prepared in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in financial statements included in our Annual Report on Form 10-K have been condensed or omitted. The accompanying unaudited interim consolidated condensed financial statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations contained in this report and the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for our fiscal year ended June 30, 2006.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. The accounting estimates that require management s most difficult and subjective judgments include: the assessment of recoverability of goodwill and long-lived assets; and the valuation of inventories. Actual results could differ materially from those estimates.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE A OVERVIEW AND BASIS OF PRESENTATION (Continued)

The interim financial information is unaudited, but, in the opinion of management, reflects all adjustments, including normal recurring adjustments, considered necessary for a fair presentation of the results of the interim periods presented. Operating results for the three and six months ended December 31, 2006 are not necessarily indicative of the results that may be expected for our fiscal year ending June 30, 2007.

During the three and six months ended December 31, 2006 we incurred net losses of approximately $6.2 million and $10.0 million, respectively. During our fiscal years ended June 30, 2006, 2005 and 2004, we incurred significant net losses of approximately $18.2 million, $26.2 million and $18.2 million, respectively. As of December 31, 2006, we had an accumulated deficit of approximately $177.1 million and stockholders equity of approximately $1.5 million. Additionally, we had a cash balance of approximately $2.3 million and working capital of approximately $1.6 million at December 31, 2006. We anticipate additional future losses as we commercialize our human alpha interferon product and conduct additional research and development activities and clinical trials to obtain additional regulatory approvals.

We believe we have sufficient cash to support our operations through February 2007. However, we will require substantial additional capital to support our operations subsequent to February 2007. No assurance can be given that additional capital will be available when required or upon terms acceptable to us. Our inability to generate substantial revenue or obtain additional capital through equity or debt financings would have a material adverse effect on our financial condition and our ability to continue operations. Accordingly, we could be forced to significantly curtail or suspend our operations, including laying-off employees, recording asset impairment write-downs and other measures.

These factors, among others, raise substantial doubt about our ability to continue as a going concern. Due to our financial condition, the report of our independent registered public accounting firm on our June 30, 2006 consolidated financial statements includes an explanatory paragraph indicating that these conditions raise substantial doubt about our ability to continue as a going concern. The accompanying consolidated condensed financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result from the outcome of these uncertainties.

We have commenced implementing, and will continue to implement, various measures to address our financial condition, including:

- Continuing to seek debt and equity financing, as well as distribution partners for *Multiferon*® to generate licensing and sales revenues. We are in active dialogue with prospective investors and strategic partners and hope to conclude one or more transactions that will provide us with necessary capital on a timely basis.

- Curtailing operations where feasible to conserve cash through a combination of: staff reductions in the United States, Sweden and Scotland; reducing leased space in the United States, Sweden and Scotland and; deferring certain of our research and development activities until our cash flow improves and we can recommence these activities with appropriate funding.

In the event our capital-raising and revenue-generation efforts are unsuccessful, and unless we obtain payment extensions and voluntary recapitalization of our debt structure, which may involve dilution of existing stockholders, we may, in the interest of stakeholders, elect to seek reorganization of the business under protection of Title 11 of the United States Code. However, before we seek such reorganization, we would contact creditors, including trade creditors and debt holders, to discuss payment extensions, conversion of debt to equity and/or other concessions.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE A OVERVIEW AND BASIS OF PRESENTATION (Continued)

We received a deficiency letter from the AMEX dated March 1, 2006, advising that, based upon its review of our financial statements included in our Quarterly Report on Form 10-Q for the quarter ended December 31, 2005, we did not meet the AMEX s combined minimum stockholders equity and operating losses requirements. Specifically, were are not in compliance with Section 1003(a)(i) of the AMEX Company Guide, because our stockholders equity was less than $2 million and we have sustained losses from continuing operations and/or net losses in two of our three most recent fiscal years. Previously, we received a deficiency letter from the AMEX dated September 20, 2005, advising that, based upon its review of our financial statements included in our Annual Report on Form 10-K for our fiscal year ended June 30, 2005, we are not in compliance with AMEX s continued listing standards. Specifically, we are not in compliance with Section 1003(a)(ii) of the AMEX Company Guide, because our stockholders equity is less than $4 million and we have sustained losses from continuing operations and/or net losses in three out of our four most recent fiscal years, and Section 1003(a)(iii) of the AMEX Company Guide, because our stockholders equity is less than $6 million and we have sustained losses from continuing operations and/or net losses in our five most recent fiscal years. We submitted a plan to AMEX which outlines our plans to regain compliance with AMEX s continued listing standards. On October 25, 2005, AMEX notified us that it accepted our plan of compliance and granted us an extension of time until March 20, 2007 to regain compliance with AMEX s continued listing standards. We will be subject to periodic review by AMEX during the extension period granted by AMEX. Failure to make progress consistent with the plan we submitted to AMEX or to regain compliance with the continued listing standards by the end of the extension period could result in our shares being delisted from AMEX. We have provided quarterly updates to AMEX regarding our progress with the plan.

If we are unable to restructure our financial obligations and/or secure additional capital prior to March 20, 2007, we will be unable to achieve compliance with the American Stock Exchange s (AMEX) maintenance criteria prior to the deadline imposed by the AMEX. If we fail to achieve compliance and the AMEX delists our securities, we do not believe we will be able to secure an alternative listing on the New York Stock Exchange or NASDAQ, in the absence of which, holders of approximately $10.7 million of our outstanding convertible debt will have the right to accelerate payment of amounts due to them.

In the event our securities are delisted from AMEX, we would apply to have our securities listed on the over-the-counter bulletin board; however, certain institutional investors have policies against investments in bulletin board companies and other investors may refrain from purchasing our securities if they are not listed on a national securities exchange. Also, we would lose some of our existing analyst coverage and our efforts to obtain new analyst coverage would be significantly impaired. Further, our ability to sell our equity securities and debt would be significantly limited in numerous states because the exemption we utilize to sell these securities without registration under applicable state securities laws requires that our common stock be listed on AMEX. If we were required to register our equity securities or debt offerings under the securities laws of various states, no assurance will be given as to whether we would be able to obtain the necessary approvals from states securities administrators. To the extent our securities were to be delisted from trading on AMEX, the value of our equity securities and our ability to sell equity securities and debt would be negatively impacted. The occurrence of these events could have a material adverse effect on our ability to repay our outstanding debt and other obligations.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE B STOCK-BASED COMPENSATION

Effective July 1, 2005, we adopted the fair value recognition provisions of SFAS No. 123(R), *Share-Based Payment*, using the modified-prospective-transition method. Under that transition method, stock-based compensation cost recognized subsequent to July 1, 2005 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of July 1, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based compensation granted subsequent to July 1, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The amount of stock-based compensation costs included in our consolidated condensed statements of operations for the three and six months ended December 31, 2006 and 2005 for stock options granted to employees and directors prior to July 1, 2005, which were not fully vested as of July 1, 2005, was immaterial to our results of operations. As of December 31, 2006, there are 50,000 outstanding stock options that have not vested and the amount of unrecognized stock-based compensation for these stock options is approximately $38,000, which will be recognized on a straight-line basis over the next nine quarters.

Our 1995 Stock Option Plan, which was adopted in May 1995 and amended in September 1995, reserved 400,000 shares of Viragen common stock for the grant of stock options to officers, directors, employees and consultants. Stock options granted under the 1995 Stock Option Plan have various vesting dates and all stock options granted have five-year terms from the vesting dates. The 1995 Stock Option Plan expired in May 2005. This expiration did not affect the validity of outstanding stock options previously granted under the plan.

Our 1997 Stock Option Plan, adopted in January 1997, reserved 300,000 shares of Viragen common stock for the grant of stock options to officers, directors, employees and consultants. In April 1998, the 1997 Stock Option Plan was amended increasing the number of shares of common stock reserved under the plan to 400,000 shares. Stock options granted under the 1997 Stock Option Plan have various vesting dates and all stock options granted have five-year terms from the vesting dates. The maximum term of any option granted under the 1997 Stock Option Plan is ten years. At December 31, 2006, there were approximately 163,000 shares available under the 1997 Stock Option Plan. The 1997 Stock Option Plan expired on January 27, 2007. The expiration of the 1997 Stock Option Plan did not affect the validity of any outstanding options previously granted under the plan.

In April 2006, our Board of Directors adopted, subject to approval by our stockholders, the Viragen 2006 Equity Compensation Plan, reserving an aggregate of 4 million shares of our common stock. The Board of Directors also issued options to purchase an aggregate of 843,000 shares to directors, officers and certain employees. The exercise price of each option is $0.57 per share, and each option vests half upon the date of issuance and the remaining half upon the first anniversary of the date of issuance. However, no shares issuable upon exercise of the options could be issued until the 2006 Equity Compensation Plan was approved by our stockholders. Therefore, as of December 31, 2006, a measurement date had not been established under the provisions of SFAS No. 123(R). Accordingly, no stock-based compensation expense has been recognized in our consolidated condensed statements of operations for the three and six months ended December 31, 2006 in connection with this issuance of options.

On January 25, 2007, we held our annual stockholders meeting where stockholders approved the Viragen 2006 Equity Compensation Plan. Therefore, a measurement date has been established under SFAS No. 123(R) and we are able to quantify and begin recognizing the fair value of the options granted in April 2006, under the provisions of SFAS No. 123(R). Due to the number of variables and estimates involved in computing stock-based compensation expense under the provisions of SFAS No. 123(R), the exact amount of stock-based compensation expense associated with the stock options granted in April 2006 will be calculated and disclosed in our quarterly report for the period ending March 31, 2007.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE C INVENTORIES

Inventories consist of raw materials and supplies, work in process, and finished product. Finished product consists of *Multiferon*® (multi-subtype, human alpha interferon) that is available for sale. Costs of raw materials and supplies are determined on a first-in, first-out basis. Costs of work in process and finished product, consisting of raw materials, labor and overhead are recorded at a standard cost (which approximates actual cost). Excess/idle capacity costs represent fixed production costs incurred at our Swedish manufacturing facilities, which were not absorbed as a result of the production of inventory at less than normal operating levels. Excess/idle capacity costs are expensed in the period in which they are incurred and are included in cost of sales.

Our inventories are stated at the lower of cost or market (estimated net realizable value). If the cost of the inventories exceeds their expected market value, provisions are recorded currently for the difference between the cost and the market value. These provisions are determined based on estimates. The valuation of our inventories also requires us to estimate excess inventories and inventories that are not saleable. The determination of excess or non-saleable inventories requires us to estimate the future demand for our product and consider the shelf life of the inventory. If actual demand is less than our estimated demand, we could be required to record inventory write-downs, which would have an adverse impact on our results of operations.

During the three months ended December 31, 2006, we recorded an aggregate write-down of approximately $1.5 million for a portion of our finished product and work in process inventory. The finished product consisted of *Multiferon*® in ampoules. Based on our current sales forecasts and plans to change from ampoules to pre-filled syringes in our major markets, it was determined that a significant portion of our ampoule inventory may not be sold prior to expiration of the shelf-life. The work in process consisted of *Multiferon*® in pre-filled syringes whose shelf-life may expire prior to us being able to sell the inventory based on the current estimated timing of receipt of regulatory approvals and subsequent product sales. Historically, these pre-filled syringes were included in work in process while we sought approval from the Swedish regulatory authorities to deliver *Multiferon*® in pre-filled syringes. Our pre-filled syringe application has been submitted to the Swedish regulatory authorities and is pending approval. A decision is expected during the first half of calendar 2007.

During the three months ended December 31, 2005, we determined that a portion of our work in process inventory would not be converted to finished product prior to expiration. Therefore, we recorded a write-down for this inventory of approximately $104,000. During the three months ended September 30, 2005, a freezer at one of our facilities in Sweden malfunctioned causing the temperature of certain work in process to rise above the approved levels for frozen product. As a result, we were unable to utilize this inventory for commercial purposes and we recorded a net write-down of approximately $91,000, which was net of an insurance recovery of approximately $486,000.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE C INVENTORIES (Continued)

Inventories consisted of the following at December 31, 2006 and June 30, 2006:

	December 31, 2006	June 30, 2006
Finished product	$ 98,588	$ 558,995
Work in process	183,335	899,945
Raw materials and supplies	382,166	362,736
Total inventories	$ 664,089	$ 1,821,676

Certain raw materials used in the manufacture of *Multiferon*®, including human white blood cells, are only available from a limited number of suppliers. We are dependent on our suppliers to allocate a sufficient portion of their capacity to meet our needs.

NOTE D GOODWILL AND OTHER INTANGIBLE ASSETS

On September 28, 2001, Viragen International, Inc., our majority owned subsidiary, acquired all of the outstanding shares of BioNative AB (BioNative), a privately held biotechnology company located in Umeå, Sweden. Subsequent to the acquisition, BioNative was renamed ViraNative. The initial purchase consideration consisted of 2,933,190 shares of Viragen International common stock. In January 2002, ViraNative achieved two milestones defined in the acquisition agreement. As a result, the former shareholders of ViraNative were issued an additional 8,799,570 shares of Viragen International common stock.

The goodwill reported in our consolidated balance sheets as of December 31, 2006 and June 30, 2006 arose from Viragen International s acquisition of ViraNative and the subsequent achievement of the milestones. Subsequent to the initial recording of goodwill, the carrying amount has increased as a result of foreign currency fluctuations between the U.S. dollar and the Swedish Krona. The following table reflects the changes in the carrying amount of goodwill for the six months ended December 31, 2006:

Balance as of June 30, 2006	$ 3,890,415
Foreign exchange adjustment	285,850
Balance as of December 31, 2006	$ 4,176,265

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* goodwill is not amortized but is reviewed for impairment on an annual basis or sooner if indicators of impairment arise. Management has selected April 1st as the date of our annual impairment review. We periodically evaluate the acquired business for potential impairment indicators. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions, and the operational performance of the acquired business. Changes in the estimates used to conduct the impairment review, including revenue projections or market values, could cause our analysis to indicate that our goodwill is impaired in subsequent periods and result in a write-off of a portion or all of our goodwill.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE D GOODWILL AND OTHER INTANGIBLE ASSETS (Continued)

The developed technology intangible asset reported in our consolidated balance sheets as of December 31, 2006 and June 30, 2006 arose from Viragen International s acquisition of ViraNative on September 28, 2001. A detail of our developed technology intangible asset as of December 31, 2006 and June 30, 2006 is as follows:

	December 31, 2006	June 30, 2006
Developed technology	$ 2,500,934	$ 2,329,754
Accumulated amortization	(926,817)	(781,153)
Developed technology, net	$ 1,574,117	$ 1,548,601

The developed technology consists of the production and purification methods developed by ViraNative prior to the acquisition by Viragen International. This technology was complete and ViraNative had been selling the resultant human alpha interferon product prior to the acquisition by Viragen International. The developed technology was recorded at its estimated fair value at the date of acquisition. Subsequent to the initial recording of this intangible asset, the gross carrying amount has increased by approximately $851,000 as a result of foreign currency fluctuations between the U.S. dollar and the Swedish Krona.

The developed technology intangible asset is being amortized over its estimated useful life of approximately 14 years. The 14-year life assigned to this asset was determined using a weighted average of the remaining lives of the patents on the various components of the production and purification processes.

NOTE E CONVERTIBLE NOTES AND DEBENTURES

Details of our convertible notes and debentures outstanding at December 31, 2006 and June 30, 2006 are as follows:

	December 31, 2006	June 30, 2006
Outstanding principal	$ 10,728,125	$ 13,612,500
Less discounts	(1,135,788)	(2,012,766)
	9,592,337	11,599,734
Less current portion, net of discounts	(78,034)	(453,918)
Long term portion	$ 9,514,303	$ 11,145,816

At December 31, 2006, the convertible notes and debentures balance was comprised of convertible notes issued in June 2004, with an outstanding principal amount of $10.55 million and convertible debentures issued in September 2005 with an outstanding principal amount of approximately $178,000. At June 30, 2006, the convertible notes and debentures balance was comprised of convertible notes issued in June 2004, with an outstanding principal amount of $12.05 million and convertible debentures issued in September 2005 with an outstanding principal amount of $1.56 million.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE E CONVERTIBLE NOTES AND DEBENTURES (Continued)

September 2005 Convertible Debentures

On September 15, 2005, we entered into a securities purchase agreement under which we issued our convertible, amortizing debentures in the aggregate principal amount of $2.0 million to four returning institutional investors. Under the terms of the agreement, we received approximately $1.2 million, net of original issue discounts of $570,000, a $200,000 finder s fee and legal expenses. This agreement also provided for the issuance to the purchasers of an aggregate of 952,381 three-year common stock purchase warrants exercisable at a price of $1.25 per share.

The debentures are convertible at a conversion price of $1.05 per share, subject to adjustment, including in the event that Viragen subsequently issues securities at less than the conversion price then in effect (other than an exempt issuance as defined in the debentures). The debentures provide for amortization in 32 equal monthly installments of principal, commencing on January 1, 2006. Monthly amortization payments may be made, at our option, in cash, accompanied by a 10% premium, or in shares of our common stock at a 5% discount to market price (computed by reference to the volume weighted average price of our common stock during the five trading day period immediately preceding the amortization due date). We have the right to require the debenture holders to convert their debentures in the event that the volume weighted average price of our common stock exceeds $2.00 per share for 30 consecutive trading days, the resale of the shares issuable upon conversion of the debentures are covered by an effective registration statement, and certain other conditions are met.

In lieu of interest, the debentures provided for an original issue discount equal to $570,000, the equivalent of 9.5% interest over the three year life of the debentures. For the three and six months ended December 31, 2006, we recognized approximately $246,000 and $312,000, respectively, as interest expense from the amortization of the original issue discount. This included approximately $219,000 that was recognized upon the retirement of a portion of the debentures in November 2006. For the three and six months ended December 31, 2005, we recognized approximately $71,000 and $82,000, respectively, as interest expense from the amortization of the original issue discount.

The warrants issued in connection with these debentures are exercisable during the three year period ending September 15, 2008. Subject to certain conditions, Viragen has the right to call the warrants if the volume weighted average price for Viragen common stock exceeds 250% of the prevailing exercise price of the warrants for 20 consecutive trading days. The relative fair value of these warrants was calculated to be approximately $166,000 using a Black-Scholes valuation model. The relative fair value of these warrants was recorded as a discount on the principal amount of the debentures and is being amortized to interest expense using the effective interest rate method over the life of the debentures. For the three and six months ended December 31, 2006, we recognized approximately $72,000 and $91,000, respectively, as non-cash interest expense from the amortization of the discount that arose from the issuance of the warrants. This included approximately $64,000 that was recognized upon the retirement of a portion of the debentures in November 2006. For the three and six months ended December 31, 2005, we recognized approximately $21,000 and $24,000, respectively, as non-cash interest expense from the amortization of the discount that arose from the issuance of the warrants.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE E CONVERTIBLE NOTES AND DEBENTURES (Continued)

We incurred costs of approximately $290,000 in connection with the issuances of these debentures, which primarily consisted of the finder s fees, registration fees and legal and accounting expenses. These costs will be amortized to interest expense over the life of the debentures using the effective interest rate method. For the three and six months ended December 31, 2006, we recognized approximately $125,000 and $158,000, respectively, as interest expense from the amortization of these debt issuance costs. This included approximately $111,000 that was recognized upon the retirement of a portion of the debentures in November 2006. For the three and six months ended December 31, 2005, we recognized approximately $36,000 and $42,000, respectively, as interest expense from the amortization of these debt issuance costs.

The debentures are subject to acceleration in the event of our default under the debenture agreements, which events of default include, among others:

any default in our payment of the principal amount of the debentures or liquidated damages in respect of the debentures, when due and payable; or

our common stock is not eligible for quotation on or quoted for trading on a trading market and shall not again be eligible for and quoted or listed for trading thereon within five trading days.

If any event of default occurs under the debentures, the full principal amount of the debentures, together with other amounts owing on the debentures, to the date of acceleration, shall become at the debenture holder s election, immediately due and payable in cash. Commencing five days after the occurrence of any event of default that results in the acceleration of the debentures, the interest rate on the debentures shall accrue at the rate of 18% per annum, or such lower maximum amount of interest permitted to be charged under applicable law.

Resale of the shares issuable upon conversion or payment of the debentures and upon exercise of warrants is registered under our Form S-3 registration statement (File No. 333-129319) filed with the Securities and Exchange Commission, which was declared effective on November 9, 2005. If, following the effective date of the registration statement, the registration statement ceases to remain effective for ten consecutive calendar days, but no more than an aggregate of fifteen days during any twelve month period, or if Viragen fails to deliver unlegended shares to the investors as and when required, Viragen is subject to the payment of liquidated damages, payable in cash, based on a percentage of the aggregate purchase price of the then outstanding balance of the convertible debentures.

During the six months ended December 31, 2006, we made cash payments aggregating approximately $237,000 to the September 2005 convertible debenture holders, which represented the monthly installments due on these debentures, including the additional 10% premium for principal payments made in cash. In November 2006, we retired approximately $1.17 million of the outstanding principal balance of these debentures with an aggregate payment of approximately $1.46 million, which included a negotiated 25% premium for early retirement of the obligation.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE E CONVERTIBLE NOTES AND DEBENTURES (Continued)

June 2004 Convertible Notes, as amended

On April 1, 2004, we entered into purchase agreements for the issuance and sale of 7% convertible promissory notes due March 31, 2006, and common stock purchase warrants in the aggregate amount of $20 million. The notes were placed with a group of new and returning institutional investors. The $20 million purchase price for the notes and warrants was placed in escrow pending satisfaction of all conditions precedent to closing, including receipt of stockholder approval for the sale of the notes and warrants, as well as a one for ten reverse split of our common stock. On June 11, 2004, our stockholders voted to approve the sale of the notes and a one for ten reverse split of our common stock. On June 18, 2004, we completed the sale of the notes and warrants. Under the terms of these agreements, we received approximately $18.96 million, net of finder s fees and legal expenses. These agreements also provided for the issuance to the purchasers of an aggregate of 5,357,051 three-year common stock purchase warrants that were exercisable at $1.819 per share. In connection with the April 1, 2004 purchase agreements, we paid a finder s fee of 5%, or $1 million and issued the finder 80,000 three-year common stock purchase warrants initially exercisable at a price of $1.516 per share.

On September 15, 2005, we entered into agreements with each of the eight holders of these notes to:

- extend the maturity date of the notes from March 31, 2006 to August 31, 2008;

- reduce the conversion price from $1.516 to $1.05 per share. This conversion price, with certain exceptions, is subject to reductions if we enter into additional financing transactions for the sale of our common stock below the public trading price and below the conversion price;

- provide for mandatory conversion of the notes if the volume weighted average price for our common stock exceeds $2.00 per share for 30 consecutive trading days;

- amend the adjustment provisions of the notes and the warrants to provide for full ratchet rather than weighted average adjustments in the event that we issue securities in the future (other than an exempt issuance as defined in the notes) for a price of less than the then current conversion price of the notes or 119% of the then current exercise price of the warrants, as the case may be. Full ratchet adjustments reduce the conversion and exercise prices to the lowest price at which we may issue securities in the future. Weighted average adjustments reduce the conversion and exercise prices to a lower price, weighted based upon the average price at which our shares have been sold;

- expand the definition of exempt issuance under the notes and related warrants to exclude from the adjustment provisions of the notes and related warrants, our issuance of shares (a) in a firm commitment public offering by a reputable underwriter, (b) under equity compensation plans approved by a majority of our independent directors or a majority of the non-employee members of a committee of the board, (c) in connection with any future acquisition of the minority interest in Viragen International, Inc. and (d) in connection with strategic transactions not undertaken for the primary purpose of raising capital; and reduce the exercise price of the related warrants to $1.25 per share. As a result of the reduction in the exercise price of the warrants, the holders were entitled to an additional 2.4 million warrants with an exercise price of $1.25 per share.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE E CONVERTIBLE NOTES AND DEBENTURES (Continued)

Interest on the notes remains payable quarterly at an annual rate of 7% on each January 1, April 1, July 1 and October 1. Interest payments are payable in cash or, at our option, in shares of our common stock based upon the average of the closing AMEX bid prices of our common stock during the 20 consecutive trading days preceding the interest payment date, subject to certain conditions. The amount of interest expense on these notes for the three and six months ended December 31, 2006 at 7% interest totaled approximately $185,000 and $385,000, respectively. The quarterly interest due January 1, 2007 of approximately $185,000 was satisfied through the issuance of 1,122,344 shares of our common stock valued at $0.16 per share. The quarterly interest due October 1, 2006 of approximately $200,000 was satisfied through the issuance of 553,380 shares of our common stock valued at $0.36 per share. The quarterly interest due July 1, 2006 of approximately $211,000 was satisfied through the issuance of 532,515 shares of our common stock valued at $0.40 per share.

As a result of the amendments to the notes and our financial condition at that time, the modifications to the notes were accounted for as a troubled debt restructuring under SFAS No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* and EITF 02-04, *Determining Whether a Debtor s Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15*. A modification in a troubled debt restructuring is accounted for prospectively. As a result of the reduced exercise price of the warrants and the issuance of additional warrants on September 15, 2005, we recorded an additional discount of approximately $427,000 on the principal amount of the notes with a corresponding increase to capital in excess of par. This additional discount, together with the unamortized original discount as of the modification date, is being amortized over the new term of the notes using the effective interest rate method.

The relative fair value of the warrants initially issued was calculated to be approximately $3,264,000 using a Black-Scholes valuation model. The relative fair value of these warrants was recorded as a discount on the principal amount of the notes. As discussed above, we recorded an additional discount of approximately $427,000 on the principal amount of the notes due to the reduction of the exercise price of the warrants and the issuance of additional warrants. The aggregate discount is being amortized to interest expense using the effective interest rate method over the life of the notes. For the three and six months ended December 31, 2006, we recognized non-cash interest expense from the amortization of this discount of approximately $71,000 and $237,000, respectively, compared to approximately $440,000 and $1,015,000, for the three and six months ended December 31, 2005, respectively. All common stock purchase warrants issued in connection with this transaction remain unexercised as of December 31, 2006.

As a result of the calculated effective conversion price of the notes, a beneficial conversion amount of approximately $4,372,000 was calculated and recorded as a discount on the principal amount of the notes at the date of issuance. This discount is being amortized to interest expense using the effective interest rate method over the life of the notes. For the three and six months ended December 31, 2006, we recognized non-cash interest expense from the amortization of this discount of approximately $71,000 and $237,000, respectively, compared to approximately $439,000 and $1,154,000, for the three and six months ended December 31, 2005, respectively.

VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE E CONVERTIBLE NOTES AND DEBENTURES (Continued)

In connection with the April 1, 2004 purchase agreements, we incurred costs of approximately $1,161,000. These costs primarily consisted of the finder s fee of 5%, or $1 million, the fair value of 80,000 three-year common stock purchase warrants exercisable at a price of $1.516 per share issued to the finder, and legal and accounting expenses. These costs are being amortized to interest expense over the life of the notes using the effective interest rate method. For the three and six months ended December 31, 2006, we recognized interest expense from the amortization of these debt issuance costs of approximately $19,000 and $63,000, respectively, compared to approximately $116,000 and $306,000, for the three and six months ended December 31, 2005, respectively.

During the six months ended December 31, 2006, $1.5 million of the principal amount of the notes was converted resulting in the issuance of 1,428,571 shares of our common stock.

These notes may be prepaid at 110% of their face amount, plus the issuance to note holders of additional warrants to purchase the number of shares of our common stock into which the notes would otherwise have been convertible, at an exercise price equal to the prevailing conversion price of the notes. If issued on prepayment, the warrants may be exercised for the period that would have been the remaining life of the notes had they not been prepaid. We also have the right to require note holders to convert their notes, subject to certain limitations, if the volume weighted average price of our common stock exceeds $2.00 per share for 30 consecutive trading days.

The notes are subject to acceleration in the event of our default under the notes, which events of default include, among others:

- our failure to pay the principal on the notes when due or any installment of interest on the notes when due, and such failure continues for a period of five business days after the due date;

- our failure to issue shares of our common stock to a note holder upon exercise of the holder s conversion or purchase rights within two trading days after the due date therefore; or

- our common stock is not eligible to trade on the AMEX, New York Stock Exchange or NASDAQ.

If any event of default occurs under the notes, at the option of the note holder, we are required to pay to the holder an amount equal to 130% of the sum of the outstanding principal amount of the notes, plus accrued and unpaid interest on the principal amount to the date of payment, plus accrued and unpaid default interest, if any.

Resale of the shares issuable upon conversion or payment of the notes and related interest and upon exercise of warrants are registered under our Form S-3 registration statement (File No. 333-117338) filed with the Securities and Exchange Commission, which was declared effective on July 28, 2004. If, following the effective date of the registration statement, the registration statement ceases to remain effective or if we fail to deliver unlegended shares to the investors as and when required, we are subject to the payment of liquidated damages, payable in cash, based on a percentage of the aggregate purchase price of the then outstanding balance of the convertible notes.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE F DEBT

Short Term Borrowings

During June 2006, we obtained short term financing of approximately $217,000 for the purchase of certain corporate insurance policies. Outstanding borrowings under this arrangement bear interest at an effective rate of 8.79%. Principal and interest payments of approximately $25,000 are payable in nine equal monthly installments. The outstanding balance on this short term borrowing was approximately $74,000 and $217,000 as of December 31, 2006 and June 30, 2006, respectively.

During August 2006, we obtained short term financing of approximately $63,000 for the purchase of certain corporate insurance policies. Outstanding borrowings under this arrangement bear interest at an effective rate of 9.40%. Principal and interest payments of approximately $7,000 are payable in ten equal monthly installments. The outstanding balance on this short term borrowing was approximately $38,000 as of December 31, 2006.

Long-Term Debt

Our Swedish subsidiary has a 25-year mortgage with a Swedish bank obtained to purchase one of our facilities in Sweden. The outstanding principal balance on this loan, which is payable in Swedish Krona, was approximately $665,000 and $637,000 at December 31, 2006 and June 30, 2006, respectively. This loan carries a floating rate of interest, which was approximately 6.50% at December 31, 2006 and 5.75% at June 30, 2006. We are required to make quarterly payments of principal and interest of approximately $20,000 under this agreement. This loan matures in September 2024 and is secured by the related land and building, including improvements, which had a carrying value of approximately $2.6 million as of December 31, 2006 and June 30, 2006, respectively.

NOTE G SUBSIDIARY REDEEMABLE PREFERRED STOCK

Viragen International established its Series D 24% Cumulative Preferred Stock in August 2006. Each share of Viragen International s Series D cumulative preferred stock, par value $0.01 per share, had a stated value of $100 per share. In August 2006, Viragen International completed a private placement of 3,154 shares of its Series D cumulative preferred stock. Viragen International received net proceeds of approximately $284,000 in connection with this transaction, after payment of a placement agent fee of approximately $25,000 and a non-accountable expense fee of approximately $6,000 paid to the placement agent. In September 2006, Viragen International issued an additional 4,547 shares of its Series D cumulative preferred stock resulting in the receipt of net proceeds of approximately $421,000, after payment of a finder s fee of approximately $34,000. In October 2006, Viragen International issued an additional 3,150 shares of its Series D cumulative preferred stock resulting in the receipt of net proceeds of approximately $291,000, after payment of a finder s fee of approximately $24,000.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE G SUBSIDIARY REDEEMABLE PREFERRED STOCK (Continued)

Viragen International s Series D cumulative preferred stock was redeemable at the option of Viragen International or the holders of the Series D cumulative preferred stock upon the earlier of eighteen months from issuance or upon the closing of any subsequent financing in a single transaction or series of related transactions resulting in the receipt of aggregate gross proceeds equal to or greater than $7 million to Viragen International or us. The holders of the Series D cumulative preferred stock could have required Viragen International to redeem all or a portion of such holders Series D cumulative preferred stock at its stated value, plus any accrued and unpaid dividends, rounded up to August 18 of the year of redemption (i.e., when such redemption occured, dividends would be accrued and payable through the next August 18, despite redemption prior to that date). At the time of any such financing by Viragen International or us, Viragen International had the right to redeem all, but not less than all, of the Series D cumulative preferred stock at its stated value, plus any accrued and unpaid dividends, rounded up to August 18 of the year of redemption (i.e., when such redemption occured, dividends would be accrued and payable through the next August 18, despite redemption prior to that date).

The holders of the Series D cumulative preferred stock were entitled to receive a cumulative dividend of 24% per annum on the stated value, payable in cash at the earlier of (a) annually in arrears commencing August 18, 2007 and annually thereafter or (b) upon redemption following the closing of any subsequent financing by Viragen International or us, with gross proceeds equal to or greater than $7 million. In November 2006, we completed a public offering described in Note I in excess of the $7 million redemption threshold and Viragen International redeemed all outstanding shares of its Series D cumulative preferred stock, including the payment of approximately $260,000 of related dividends.

NOTE H PREFERRED STOCK

We are authorized to issue a total of 1,000,000 shares of preferred stock, par value $1.00 per share. Viragen s board of directors may issue preferred stock by resolutions, without any action of our stockholders. These resolutions may authorize issuance of preferred stock in one or more series. In addition, the board of directors may fix and determine all privileges and rights of the authorized preferred stock series including:

- dividend and liquidation preferences,
- voting rights,
- conversion privileges, and
- redemption terms.

Series A Cumulative Convertible Preferred Stock

Viragen established the 10% Series A cumulative convertible preferred stock in November 1986. We are authorized to issue 375,000 shares of Series A cumulative convertible preferred stock. As of December 31 and June 30, 2006, there were 2,150 shares of Series A cumulative convertible preferred stock outstanding. Each share of series A cumulative convertible preferred stock is immediately convertible, at the option of the holder, into .426 shares of our common stock. Dividends on the Series A cumulative convertible preferred stock are cumulative and have priority over dividends, if any, paid on our common stock or subsequently created series of other stock of Viragen junior to the Series A cumulative convertible preferred stock. These dividends are payable in either cash or shares of our common stock, at our option.

VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE H PREFERRED STOCK (Continued)

The Series A cumulative convertible preferred stock has voting rights only if dividends are in arrears for five annual dividends. In such event, owners of Series A cumulative convertible preferred stock have the right to elect two directors. Voting rights terminate upon payment of the cumulative dividends. We may redeem the Series A cumulative convertible preferred stock at any time after expiration of ten consecutive business days during which the bid or last sale price for our common stock is $60.00 per share or higher. There is no mandatory redemption or sinking fund obligation for the Series A cumulative convertible preferred stock.

Owners of the Series A cumulative convertible preferred stock are entitled to receive $10.00 per share, plus accrued and unpaid dividends, upon our liquidation, dissolution or winding up. During the six months ended December 31, 2006, we paid all accrued and unpaid dividends on the outstanding shares of Series A cumulative convertible preferred stock through September 30, 2006 totaling approximately $13,000. As of December 31, 2006 and June 30, 2006, the aggregate amount of dividends in arrears on the Series A cumulative convertible preferred stock was approximately $600 and $13,000, respectively, or approximately $0.28 and $6.05, respectively, per outstanding share of Series A cumulative convertible preferred stock.

Series J Cumulative Convertible Preferred Stock

At June 30, 2006, there were 52,150 shares of our Series J cumulative convertible preferred stock outstanding. Each share of Series J cumulative convertible preferred stock was immediately convertible, at the option of the holder, into 80 shares of our common stock. Each share of Series J cumulative convertible preferred stock had a stated value equal to $100 and $1.00 par value. The holders of outstanding shares of Series J cumulative convertible preferred stock were entitled to receive preferential dividends in cash out of any funds before any dividend or other distribution was paid or declared and set apart for payment on any shares of any common stock, or other class of stock presently authorized or to be authorized, except for our Series A cumulative convertible preferred stock, at the rate of 24% per annum on the stated value, payable on the earlier of (a) annually in arrears commencing February 28, 2007 and annually thereafter or (b) upon redemption, as discussed below, following the closing of any subsequent financing (whether done in one or more financings of debt or equity) by us with gross proceeds equal to or greater than $5 million.

The Series J cumulative convertible preferred stock provides that upon a subsequent financing, of either debt or equity, resulting in the receipt of gross proceeds to us of $5 million or more, (a) holders of the Series J cumulative convertible preferred stock could require us to redeem, at the holders sole option, all or a portion of their Series J cumulative convertible preferred stock outstanding at such time at the stated value, including any accrued but unpaid dividends, rounded up to February 28, 2007 and to each February 28 thereafter (i.e., if such redemption occurs, dividends will be accrued and payable through the next February 28 despite redemption prior to that date) and (b) we could redeem, at our sole option, the Series J cumulative convertible preferred stock outstanding at such time, in their entirety, at the stated value, including any accrued but unpaid dividend, rounded up to February 28, 2007 and to each February 28 thereafter (i.e., if such redemption occurs, dividends will be accrued and payable through the next February 28 despite redemption prior to that date).

In November 2006, upon completion of our public offering described in Note I, we redeemed all outstanding shares of our Series J cumulative convertible preferred stock, including the payment of approximately $1.25 million of related dividends.

VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE H PREFERRED STOCK (Continued)

At June 30, 2006, the Series J cumulative convertible preferred stock had been recorded as equity rather than a liability, as the right of redemption of the Series J cumulative convertible preferred stock by either the investors or Viragen was contingent upon a subsequent financing for gross proceeds of $5 million or more, which had not occurred as of June 30, 2006, and was within Viragen s control. In addition, it was expected that subsequent financings would be for equity securities as opposed to debt securities.

NOTE I CAPITAL STOCK

As of December 31, 2006 and June 30, 2006, Viragen was authorized to issue 250 million shares of common stock, par value $0.01 per share. On January 25, 2007, our stockholders approved an amendment to our Articles of Incorporation to increase the number of shares of common stock that Viragen is authorized to issue to 500 million.

As of December 31, 2006, there were 120,285,104 shares of our common stock outstanding and 106,682,400 shares of our common stock issuable upon exercise or conversion of the following securities:

Debt and equity offering warrants (exercisable at a weighted average price of $0.46 per share through October 2011)	87,283,685
June 2004 convertible notes or related warrants issuable upon redemption of the notes (convertible/exercisable at $1.05 per share through August 2008)	10,047,622
Underwriter s purchase option to purchase 4,020,000 units at $0.29 per unit through October 2011. Each unit consists of one share of common stock and one warrant to purchase one share of common stock exercisable at $0.39 per share.	8,040,000
Officers, employees, and directors options (exercisable at a weighted average price of $1.54 per share through March 2014)	1,135,533
September 2005 convertible debentures (convertible at $1.05 per share through September 2008)	169,644
Consultant warrants (exercisable at a weighted average price of $3.05 per share through February 2009)	5,000
Series A cumulative convertible preferred stock	916
	106,682,400

In November 2006, we completed an underwritten public offering of 72,004,951 Units at a price to the public of $0.26 per Unit, which included 5,004,951 Units purchased to cover over-allotments. The Units trade on the AMEX under the trading symbol VRA.U , and each Unit consists of one share of Viragen common stock and one warrant to purchase one share of Viragen common stock, exercisable at a price of $0.31 per share exercisable through October 2011. We also issued an option for $100 to the underwriter to purchase 4,020,000 Units at a price of $0.29 per Unit. The warrants underlying the underwriter s Units are exercisable at $0.39 per share, but otherwise have the same terms and conditions as the warrants underlying the Units offered to the public.

This offering raised gross proceeds of approximately $18.7 million, and after fees and expenses, we received approximately $17.0 million. We utilized approximately $11.5 million of the net proceeds for the redemption of all of our outstanding Series J cumulative convertible preferred stock and all of Viragen International s outstanding Series C and D cumulative preferred stock, including the payment of the related accrued and unpaid dividends, and the retirement of a portion of our convertible debentures.

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE I CAPITAL STOCK (Continued)

Separate trading of the common stock and warrants underlying the Units commenced on November 28, 2006. The Warrants trade on the AMEX under the trading symbol VRA.WS

During the six months ended December 31, 2006, we issued an aggregate of 1,428,571 shares of our common stock upon conversion of $1.5 million of our convertible notes at $1.05 per share. Quarterly interest due October 1, 2006 of approximately $200,000 on our convertible notes was satisfied through the issuance of 553,380 shares of our common stock valued at $0.36 per share. Quarterly interest due July 1, 2006 of approximately $211,000 on our convertible notes was satisfied through the issuance of 532,515 shares of our common stock valued at $0.40 per share.

Subsequent to December 31, 2006, we issued an aggregate of 1,122,344 shares of our common stock valued at $0.16 per share as payment of quarterly interest due January 1, 2007 totaling approximately $185,000 on our convertible notes.

NOTE J COMPREHENSIVE LOSS

Comprehensive loss is comprised of our net loss and other comprehensive income (loss). Other comprehensive income (loss) refers to revenue, expenses, gains and losses that under accounting principles generally accepted in the United States are included in comprehensive loss but are excluded from net loss as these amounts are recorded directly as an adjustment to stockholders equity (deficit). Our other comprehensive income (loss) consists of foreign currency translation adjustments. The following table sets forth the computation of comprehensive loss for the periods indicated:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2006	2005	2006	2005
Net loss	$ (6,192,215)	$ (4,620,863)	$ (10,008,823)	$ (9,669,313)
Other comprehensive income (loss):				
Currency translation adjustment	723,535	(314,610)	802,593	(264,536)
Comprehensive loss	$ (5,468,680)	$ (4,935,473)	$ (9,206,230)	$ (9,933,849)

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VIRAGEN, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Continued)

(Unaudited)

NOTE K ROYALTY AGREEMENT

In November 1986, we entered into a royalty agreement with Dialysis Corporation of America (DCA, formerly Medicore, Inc.) with respect to interferon, transfer factor and products using interferon and transfer factor. The agreement was subsequently amended in November 1989 and May 1993. The amended agreement provides for a maximum cap on royalties to be paid to DCA of $2.4 million. It includes a schedule of royalty payments of:

- 5% of the first $7.0 million of sales;
- 4% of the next $10.0 million; and
- 3% of the next $55.0 million.

These royalties are to be paid until the total of $2.4 million is achieved. The amended agreement also states that royalties of approximately $108,000 accrued prior to May 1993 under the agreement are payable to DCA as the final payment. Royalties are paid to DCA based on our sales of human alpha interferon on a quarterly basis. For the three months ended December 31, 2006 and 2005, royalties due under the agreement totaled approximately $6,000 and $6,000, respectively. For the six months ended December 31, 2006 and 2005, royalties due under the agreement totaled approximately $9,000 and $10,000, respectively. To date, we have paid or accrued royalties on approximately $6.4 million in product sales.

NOTE L COMMITMENTS

In connection with the acquisition of ViraNative by Viragen International discussed in Note D, the former shareholders of ViraNative are entitled to additional shares of Viragen International common stock contingent upon the attainment of certain milestones related to regulatory approvals:

- 8,799,570 additional shares when and if a Mutual Recognition Procedures application is filed and receives approval from the requisite national and European Union regulatory authorities for the use, sale and marketing of *Multiferon*® in European Union member countries, one of which must be Germany; and
- 2,933,190 additional shares when and if *Multiferon*® has been approved by the requisite regulatory bodies in the European Union for the treatment of Melanoma or when *Multiferon*® has been approved by the requisite regulatory bodies for sale in the United States of America.

If and as each of these milestones is met, additional shares of Viragen International will be issued.

NOTE M CONTRIBUTION

During our fiscal year ended June 30, 2005, we received a contribution in the amount of $278,000 from a business development agency in Sweden. This contribution was awarded in connection with our capital investment in our renovated facility in Umeå, Sweden, which was completed during our fiscal year ended June 30, 2004. This contribution was recorded as a reduction of the cost of the building improvements. We could be required to repay a portion of this contribution if we do not meet certain conditions under the award, including, but not limited to, keeping the facility in operation. In July 2005, the amount we would have been required to repay decreased to 70% of the contribution. In July

2006, the amount we would have been required to repay decreased to 45% of the contribution. In July 2007 and 2008, the amount we could be required to repay will decrease to 25% and 10%, respectively, of the contribution. At this time, we have no reason to believe we will be required to repay any portion of the contribution.

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