TARGETED GENETICS CORP /WA/
Form PRE 14A
March 23, 2009

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

(Rule 14a-101)

Proxy Statement Pursuant to Section 14(a) of the

Securities Exchange Act of 1934

(Amendment No.)

Filed by the Registrant þ Filed by a Party other than the Registrant ¨

Check the appropriate box:

þ Preliminary Proxy Statement

¨ **Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

¨ Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

Targeted Genetics Corporation

(Name of Registrant as Specified in Its Charter)

N/A

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

TARGETED GENETICS CORPORATION

1100 Olive Way, Suite 100

Seattle, Washington 98101

April [ ], 2009

Dear Fellow Shareholder:

You are cordially invited to attend the Targeted Genetics Corporation 2009 Annual Meeting of Shareholders to be held on Thursday, May 14, 2009, at 8:30 a.m. local time at the offices of the Company, 1100 Olive Way, Suite 100, Seattle, Washington.

The matters to be acted upon are described in the accompanying notice of annual meeting and proxy statement. We will also report on our 2008 business results and other matters of interest to our shareholders and there will be time for questions.

YOUR VOTE IS VERY IMPORTANT. Whether or not you plan to attend the Annual Meeting, we urge you to vote so we can ensure the presence of a quorum at the Annual Meeting. Please mark your votes on the enclosed proxy card, sign and date the proxy card and return it promptly in the enclosed postage-prepaid envelope. If you attend the Annual Meeting, you may vote in person if you wish, even if you previously returned your proxy card. If you hold your shares through an account with a broker, bank or other custodian, please follow the instructions you receive from them to vote your shares.

Sincerely,

B.G. Susan Robinson
President and Chief Executive Officer

The information in this preliminary proxy statement is not complete and may be changed. On or about April 8, 2009, we will mail a definitive proxy statement and proxy card to all shareholders entitled to vote at the Annual Meeting.

TARGETED GENETICS CORPORATION

1100 Olive Way, Suite 100

Seattle, Washington 98101

NOTICE OF 2009 ANNUAL MEETING OF SHAREHOLDERS

The 2009 Annual Meeting of Shareholders of Targeted Genetics Corporation will be held on Thursday, May 14, 2009, at 8:30 a.m. local time at our business offices, 1100 Olive Way, Suite 100, Seattle, Washington, for the following purposes, as more fully described in the proxy statement accompanying this notice:

To elect one Class 1 and two Class 3 directors to our Board of Directors, with the Class 1 director to serve for a one-year term expiring at the 2010 annual meeting of shareholders or until her successor is duly elected and qualified, and with each of the Class 3 directors to serve for a three-year term expiring at the 2012 annual meeting of shareholders or until his successor is duly elected and qualified;

To approve an increase in the number of our authorized shares of common stock from 45,000,000 shares to 445,000,000 shares;

To consider and vote on a proposal to amend the Targeted Genetics Corporation Stock Incentive Plan to increase the number of shares of common stock authorized for issuance under the plan from 2,200,000 shares to 4,200,000 shares;

To ratify the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009; and

To transact any other business as may properly come before the Annual Meeting and any adjournments or postponements thereof.

Our Board of Directors has fixed the close of business on March 13, 2009 as the record date for the Annual Meeting. Only holders of record of our common stock on the record date are entitled to notice of and to vote at the Annual Meeting and any adjournments or postponements thereof.

Your vote is very important. Whether or not you plan to attend the Annual Meeting, to ensure your representation and the presence of a quorum, you should complete, sign, date and return the enclosed proxy card as promptly as possible in the enclosed postage-prepaid envelope.

The approximate date of mailing the proxy statement and the accompanying proxy card is April [   ], 2009.

By order of the Board of Directors,

David J. Poston
Vice President, Chief Financial Officer and Secretary

Seattle, Washington

April [ ], 2009

TARGETED GENETICS CORPORATION

1100 Olive Way, Suite 100

Seattle, Washington 98101

PROXY STATEMENT

FOR

2009 ANNUAL MEETING OF SHAREHOLDERS

This proxy statement is being furnished to holders of shares of common stock of Targeted Genetics Corporation, a Washington corporation, in connection with the solicitation of proxies by our Board of Directors for use at our 2009 Annual Meeting of Shareholders, and at any adjournments or postponements thereof. We will hold the Annual Meeting on Thursday, May 14, 2009 at 8:30 a.m. local time at our business offices, 1100 Olive Way, Suite 100, Seattle, Washington. This proxy statement and the accompanying proxy card, together with our 2008 Annual Report to Shareholders, are first being mailed to shareholders entitled to vote at the Annual Meeting on or about April [ ], 2009.

GENERAL INFORMATION

What is the purpose of the Annual Meeting?

There are four proposals to be considered and voted on at the Annual Meeting:

election of one Class 1 and two Class 3 directors to our Board of Directors, with the Class 1 director to serve for a one-year term expiring at the 2010 annual meeting of shareholders or until her successor is duly elected and qualified, and with each of the Class 3 directors to serve a three-year term expiring at the 2012 annual meeting of shareholders or until his successor is duly elected and qualified;

approval of an amendment to our Restated Articles of Incorporation (our Articles) to increase the number of authorized shares of common stock of the Company from 45,000,000 shares to 445,000,000 shares;

approval of an amendment to our Stock Incentive Plan to increase in the number of shares of common stock authorized for issuance under the plan from 2,200,000 shares to 4,200,000 shares; and ratification of the selection of Ernst & Young LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2009.

We will also consider any other business as may properly come before the Annual Meeting and any adjournments or postponements thereof.

Who is entitled to vote at the Annual Meeting?

We have one class of voting securities outstanding, which is designated as common stock, and each share of common stock is entitled to one vote. You may vote all shares of our common stock that you owned at the close of business on March 13, 2009, the record date. As of the record date, 20,447,198 shares of our common stock were outstanding and entitled to vote at the Annual Meeting.

What constitutes a quorum?

The presence, in person or by proxy, of the holders of a majority of the shares of our common stock entitled to vote at the Annual Meeting constitutes a quorum for the transaction of business.

What are the voting requirements to elect the directors and to approve the other proposals?

Proposal 1: The one Class 1 director and the two Class 3 directors who receive the greatest number of affirmative votes cast at the Annual Meeting, in person or by proxy, will be elected to the Board of Directors. You are not entitled to cumulate votes in electing directors.

Proposal 2: The affirmative vote of the holders of shares representing a majority of our outstanding shares of common stock is required to approve the proposed amendment to our Articles to increase the number of authorized shares of common stock.

Proposal 3: The affirmative vote of the holders of shares representing a majority of the votes cast at the Annual Meeting is required to approve the proposed increase in the number of shares of common stock authorized for issuance under the our Stock Incentive Plan.

Proposal 4: The affirmative vote of the holders of shares representing a majority of the votes cast at the Annual Meeting, in person or by proxy, is required to ratify the selection of Ernst & Young LLP as our independent registered public accounting firm.

Our shareholders have no dissenters rights with respect to these proposals.

What is the effect of not voting?

The effect of not voting depends on the proposal and how the shares you own are held. If you are the holder of record of your shares and you do not attend the Annual Meeting or return a valid proxy, your shares will not be represented at the Annual Meeting and will not count toward the establishment of a quorum. If there is a quorum, failure to vote your shares will not affect the outcome of Proposal 1 (election of directors), which outcome is determined by a plurality of the votes cast, or Proposal 3 (approval of increasing the authorized shares under our Stock Incentive Plan) or Proposal 4 (ratification of our independent registered public accounting firm), which outcomes are determined by a majority of the votes cast. However, failure to vote your shares will have the effect of a vote against Proposal 2 (approval of amending our Articles to increase our authorized common stock), because the approval of Proposal 2 requires the affirmative vote of the holders of shares representing a majority of our outstanding common stock.

If your shares are held in street name (i.e., through a broker, bank, nominee, fiduciary or other custodian), your custodian may represent your shares at the Annual Meeting for the purpose of establishing a quorum. In the absence of voting instructions, your custodian may vote your shares in its discretion on routine matters such as Proposal 1 (election of directors) and Proposal 4 (ratification of our independent registered public accounting firm). However, if you do not give your custodian specific instructions on how to vote, your shares will not be voted on Proposal 2 (approval of amending our Articles to increase our authorized common stock) or Proposal 3 (approval of increasing the authorized shares under our Stock Incentive Plan). This inability of your custodian to vote your shares on Proposals 2 and 3 in the absence of specific instructions from you, which is known as a broker non-vote, will have the effect of a vote against each of Proposals 2 and 3.

How are votes withheld and abstentions treated?

An abstention occurs when you affirmatively instruct a vote to be withheld or when you are present at the meeting but have neither given a valid proxy nor cast a ballot. If you abstain from voting your shares, the shares subject to abstention will be treated as present at the Annual Meeting and will therefore be counted toward establishing the presence of a quorum. Abstentions are not treated as votes cast, however, so abstentions will have no effect on Proposal 1 (election of directors), which outcome is determined by a plurality of the votes cast, or Proposal 3 (approval of increasing the authorized shares under our Stock Incentive Plan) or Proposal 4 (ratification of our independent registered public accounting firm), which outcomes are determined by a majority of the votes cast. With respect to Proposal 2 (approval of amending our Articles to increase our authorized common stock), abstentions will have the same effect as a vote against the proposal.

2

How are the votes counted?

Shares of common stock represented by properly executed proxies that we receive at or before the Annual Meeting that have not been revoked will be voted at the Annual Meeting in accordance with the instructions contained on the proxy card. Proxies and ballots will be received and tabulated by Broadridge Financial Solutions, Inc., our inspector of elections for the Annual Meeting. Shares of common stock represented by properly executed proxies for which no instruction is given will be voted FOR the election of the nominees for director, FOR the amendment of our Articles to increase our authorized common stock, FOR the increase in authorized shares under our Stock Incentive Plan, and FOR ratification of the selection of our independent registered public accounting firm.

There are several ways to ensure that your shares are voted. You may vote by internet or telephone using the instructions on the enclosed proxy card, or you may return your proxy card to us by mail using the postage-paid envelope we have provided. If you return your proxy card by mail, please fully complete, sign, date and return it promptly.

Can I change my vote after I have delivered my proxy?

If you are the registered holder of your shares, you may revoke a proxy at any time before its exercise by voting in person at the Annual Meeting or by delivering written notice of revocation to our chief financial officer at any time prior to the Annual Meeting. If your shares are held in street name, you must contact your broker, bank or other custodian to obtain a proxy to vote your shares if you wish to cast your vote in person at the Annual Meeting or to change your vote. If the Annual Meeting is postponed or adjourned for any reason, at any subsequent reconvening of the Annual Meeting, all proxies will be voted in the same manner as the proxies would have been voted at the original convening of the Annual Meeting (except for any proxies that have at that time effectively been revoked or withdrawn), even if the proxies had been effectively voted on the same or any other matter at a previous meeting.

Who pays the cost of soliciting votes for the Annual Meeting?

We will bear the cost of soliciting proxies from our shareholders. In addition to solicitation by mail, our directors, officers and employees may solicit proxies by telephone, e-mail, in person or otherwise. We will not additionally compensate our directors, officers and employees for this solicitation but will reimburse them for any out-of-pocket expenses that they incur. We will reimburse persons who hold our common stock of record but not beneficially, such as brokerage firms, nominees, fiduciaries and other custodians, for the reasonable expenses they incur in forwarding solicitation materials to, and requesting authority for the exercise of proxies from, the persons for whom they hold the shares.

What is the recommendation of the Board of Directors?

The Board of Directors recommends that you vote FOR the election of the nominees for director, FOR the amending our Articles to increase our authorized common stock, FOR the increase in authorized shares under our Stock Incentive Plan, and FOR ratification of the selection of our independent registered public accounting firm.

PROPOSAL ONE

ELECTION OF DIRECTORS

Our bylaws provide that the Board of Directors of Targeted Genetics, or the Board, shall be composed of not less than one nor more than nine directors. We currently have six directors, each of whom is placed into one of three classes such that, to the extent possible, there are an equal number of directors in each class. Directors generally hold office for a three-year term or until a successor is duly elected and qualified. If, however, a director resigns from the Board before his or her term expires, and if the board elects or appoints a director to fill the vacancy, such director must be elected by the shareholders at the next meeting of shareholders at which directors are elected to complete the balance of that term.

At the Annual Meeting, one Class 1 director and two Class 3 directors are to be elected. Unless they receive contrary instructions, the persons named as proxies on the enclosed proxy card intend to cast votes represented by properly executed proxy cards for the election of the nominees named in this proxy statement. If a nominee should become unavailable for any reason, the persons named as proxies intend to cast votes for election of a substitute nominee designated by the Board. The Board has no reason to believe that any of the nominees named will be unable to serve if elected. If a quorum is present, the nominee receiving the highest number of votes cast at the Annual Meeting, in person or by proxy, for Class 1 director will be elected to serve as a Class 1 director, and the two nominees receiving the highest number of votes cast at the Annual Meeting, in person or by proxy, for Class 3 director will be elected to serve as Class 3 directors.

Director Jack L. Bowman (a Class 1 director) resigned from the Board effective May 15, 2008, and H. Stewart Parker (a Class 3 director) resigned from the Board effective November 14, 2008. On November 14, 2008, the Board appointed B.G. Susan Robinson to fill the Class 1 vacancy on the Board.

B.G. Susan Robinson has been nominated for election to the Board as a Class 1 director, and Nelson L. Levy and Michael S. Perry have been nominated for re-election to the Board as Class 3 directors. If Dr. Levy and Dr. Perry are re-elected, and Ms. Robinson is elected, the following persons will constitute our Board following the Annual Meeting:

Name	Age	Class	Director Since	Term Expires
B.G. Susan Robinson	47	1	2008	2010
Jeremy L. Curnock Cook (chairman)	59	1	1995	2010
Joseph M. Davie	69	2	2000	2011
Roger L. Hawley	56	2	2005	2011
Nelson L. Levy	67	3	1999	2012
Michael S. Perry	49	3	2005	2012

Biographical Information

Nominees

B.G. Susan Robinson has served as President and CEO and a director of Targeted Genetics since November 2008. Ms. Robinson served as our Vice President, Business Development from December 2001 to November 2008, and as our Senior Director, Business Development from March 2000 to December 2001. Prior to joining Targeted Genetics, Ms. Robinson served as Director, Business Development at Genzyme Molecular Oncology, a tracking stock of Genzyme Corporation. Prior to Genzyme, and over a nine-year period, Ms. Robinson held increasingly responsible positions in corporate development and corporate communications for two biotechnology companies. Ms. Robinson also serves as an officer and director of each of our wholly-owned subsidiaries, Genovo, Inc. and TGCF Manufacturing Corporation. Ms. Robinson holds a B.S. in Biology from Yale University.

Nelson L. Levy has served as a director of Targeted Genetics since May 1999. Since 1993, Dr. Levy has served as chairman of the board and chief executive officer of CoreTechs Corporation, a privately held company that focuses on the development and marketing of early-stage technologies. Dr. Levy served as president of Fujisawa Pharmaceutical Company, the North American subsidiary of Japan s third-largest pharmaceutical company, from 1992 to 1993, as chief executive officer of CoreTechs Corporation from 1984 to 1992 and as vice president for pharmaceutical Research at Abbott Laboratories from 1981 to 1984. Dr. Levy served as a tenured professor of microbiology and immunology at Duke University from 1970 to 1981. Dr. Levy currently serves as a director of several privately held companies and is on the scientific advisory boards of several public and privately held biotechnology and pharmaceutical companies. Dr. Levy holds a B.A. from Yale University, an M.D. from Columbia University College of Physicians and Surgeons and a Ph.D. from Duke University.

Michael S. Perry has served as a director of Targeted Genetics since November 2005. Dr. Perry is currently chief development officer at VIA Pharmaceuticals, Inc., a publicly held drug development company, and is also a venture partner with Bay City Capital, a venture capital firm. Dr. Perry served as chairman and chief executive officer of Extropy Pharmaceuticals, Inc., a privately held pediatric specialty pharmaceutical company, from 2003 to 2005. From 2002 to 2003, Dr. Perry served as president and chief executive officer of Pharsight Corporation, a publicly held software and consulting services firm. From 2000 to 2002, Dr. Perry served as global head of research and development for Baxter BioScience. From 1994 to 2000, Dr. Perry was president and chief executive officer of both SyStemix Inc. and Genetic Therapy Inc., two wholly owned subsidiaries of Novartis Corp. Prior to 1994, Dr. Perry held various management positions with Syntex Corporation, Schering-Plough Corporation and BioResearch Laboratories, Inc. Dr. Perry holds a Doctor of Veterinary Medicine, a Ph.D. in Biomedical Science-CardioPulmonary Pharmacology and a B.S. in Physics from the University of Guelph.

Continuing Directors

Jeremy L. Curnock Cook has served as a director of Targeted Genetics since July 1995 and as chairman of the Board since February 1998. Since August 2000, Mr. Cook has served as Chairman of International Bioscience Managers Limited. From August 2000 to August 2008, he served as executive chairman of Bioscience Managers Limited, a corporate and investment advisory firm. From 1987 to 2000, Mr. Cook was a director of Rothschild Asset Management Limited, a corporate and investment advisory company, and was responsible for the Rothschild Bioscience Unit. Mr. Cook founded the International Biochemicals Group in 1975, which was sold to Royal Dutch Shell in 1985, where he served as managing director until 1987. Mr. Cook currently serves as chairman of the board of directors of Eacom Timber Corporation, a publicly held timber trading company. He is also a director of Osteologix, Inc., a publicly held pharmaceutical company, and several publicly held and privately held companies outside the United States. Mr. Cook holds a M.A. in Natural Sciences from Trinity College, Dublin.

Joseph M. Davie has served as a director of Targeted Genetics since October 2000. Dr. Davie was employed by Biogen, Inc., a biopharmaceutical company, from 1993 until his retirement in 2000, most recently serving as senior vice president, research. From 1987 to 1993, Dr. Davie held several positions at G.D. Searle & Co., including president of research and development and senior vice president of science and technology. Dr. Davie was professor and head of the Department of Microbiology and Immunology at Washington University School of Medicine from 1975 to 1987. He currently serves as a director of Curis, Inc. and CV Therapeutics, Inc., both publicly held biopharmaceutical companies, and several privately held companies. Dr. Davie holds an A.B., M.A. and Ph.D. in bacteriology from Indiana University and a M.D. from Washington University School of Medicine.

Roger L. Hawley has served as a director of Targeted Genetics since August 2005. Since February 2006, Mr. Hawley has served as chief executive officer of Zogenix, Inc., a privately held specialty pharmaceutical company. From July 2003 until January 2006, Mr. Hawley served as executive vice president, commercial and technical operations of InterMune, Inc, a publicly held biopharmaceutical company. From October 2002 to June 2003, Mr. Hawley served as chief commercial officer at Prometheus Laboratories, Inc., a specialty pharmaceutical company. From 2001 to 2002, Mr. Hawley served as vice president/general manager of sales and marketing at Elan Pharmaceuticals, Inc., a publicly held biopharmaceutical company. From 1987 to 2001, Mr. Hawley held various management positions in corporate finance, sales, and marketing at GlaxoSmithKline, Inc. Prior to joining GlaxoSmithKline, Mr. Hawley spent 12 years in financial management with Marathon Oil Company. Since April 2007, Mr. Hawley has also served as a director of Cypress Bioscience, Inc., a publicly held biotechnology company. Mr. Hawley holds a B.S. in accounting from Eastern Illinois University.

Director Independence

The Board has determined that each of the following directors is an independent director as defined in the rules of the Nasdaq Capital Market, or NASDAQ: Mr. Cook, Dr. Davie, Mr. Hawley, Dr. Levy and Dr. Perry and, when he was serving on the Board, Mr. Bowman. Ms. Robinson is not independent because she is employed as our president and chief executive officer, and Ms. Parker was not independent when she was serving on the Board because she was employed as our president and chief executive officer.

The Board has also determined that each member of the three committees of the Board meets the independence requirements applicable to those committees, as prescribed by NASDAQ and the Securities and Exchange Commission, or SEC. In addition, the Board of Directors has determined that each member of the Audit Committee, Messrs. Cook and Hawley and Dr. Levy, meets the financial literacy requirements applicable to audit committees under NASDAQ rules and is an audit committee financial expert, as that term is defined by the SEC.

Board Committees

The Board maintains three standing committees: the Audit Committee, the Compensation Committee and the Nominating and Corporate Governance Committee. Each year, committee and committee chair assignments are made at the Board of Directors meeting immediately following the annual meeting of shareholders. The composition of each committee is as follows:

Audit	Compensation	Nominating and Corporate Governance
Roger L. Hawley*	Michael S. Perry*	Joseph M. Davie*
Jeremy L. Curnock Cook	Joseph M. Davie	Jeremy L. Curnock Cook
Nelson L. Levy	Roger L. Hawley	

* Chairman

Audit Committee. The Audit Committee operates under an amended and restated written charter adopted by the Board on September 22, 2008. A copy of this charter is also available on our web site at *http://www.targetedgenetics.com*. The Audit Committee has general responsibility for monitoring our finance, accounting, audit, review and attest activities and internal controls. In addition, the Audit Committee selects and engages our independent registered public accounting firm and ensures that such firm understands that it shall be ultimately accountable to and report to the Audit Committee. The Audit Committee has the sole authority to retain, evaluate, terminate and replace the independent registered public accounting firm. The report of the Audit Committee is set forth in the section entitled Audit Committee Report on page of this proxy statement.

Compensation Committee. The Compensation Committee operates under an amended and restated written charter adopted by the Board on May 17, 2007. A copy of this charter is available on our web site at *www.targetedgenetics.com*. The Compensation Committee establishes salaries, incentive compensation, option and stock grants and other forms of compensation for our executive officers and makes recommendations regarding the compensation for non-officer employees, non-employee directors and consultants. The Compensation Committee also supervises the administration of our various incentive compensation and benefit plans, including our stock plans, and recommends the establishment of policies relating to our incentive compensation and benefit plans.

Nominating and Corporate Governance Committee. The Nominating Committee operates under a written charter adopted by the Board on March 4, 2004. A copy of this charter is available on our web site at *www.targetedgenetics.com*. The Nominating Committee helps to ensure that the Board is appropriately constituted to meet its fiduciary obligations to the company and our shareholders, monitors and safeguards the independence of the Board and provides a leadership role in shaping our corporate governance.

Board and Committee Meetings

During fiscal year 2008, the Board held a total of fifteen meetings; the Audit Committee held a total of four meetings; the Compensation Committee held a total of three meetings and took additional action by unanimous written consent on two occasions; and the Nominating Committee held two meetings. During fiscal year 2008, each director attended at least 75% of the aggregate of all of the meetings of the Board and all of the meetings of the Board committees on which he or she served.

It is the practice of the Board for the non-management directors to meet without management present at each of the regularly scheduled meetings of the Board. If the Board convenes a special meeting, the non-management directors meet in executive session if circumstances warrant.

Director Nomination Process

In accordance with its charter, the Nominating and Corporate Governance Committee, or Nominating Committee, is responsible for developing criteria for identifying and evaluating nominees for the Board. The charter of the Nominating Committee describes the process by which candidates for possible inclusion in our recommended slate of director nominees are selected.

The Nominating Committee has two primary methods for identifying candidates beyond those proposed by our shareholders. On a periodic basis, the Nominating Committee may solicit ideas for possible candidates from a number of sources, including members of the Board, senior-level management, individuals personally known to the members of the Board, and research, including publications, databases and Internet searches. In addition, the Nominating Committee may from time to time use its authority under its charter to retain a search firm to identify candidates. At a minimum, a nominee must have significant management or leadership experience that is relevant to our business, as well as the highest standards of ethical conduct.

In accordance with our bylaws and applicable law, recommendations for nominations for the election of directors for consideration by the Nominating Committee may be made by any shareholder of record entitled to vote for the election of directors at shareholder meetings held for such purpose. The requirements a shareholder must follow for recommending persons for consideration by the Nominating Committee for election as directors are set forth in our bylaws and the section of this proxy statement entitled *Shareholder Proposals for the 2010 Annual Meeting*.

Subject to the superior rights, if any, of the holders of any class or series of stock that we may issue in the future having a preference over our common stock, if a shareholder complies with the procedures for recommending persons for consideration by the Nominating Committee for election as directors, the Nominating Committee will conduct the appropriate and necessary inquiries into the backgrounds, qualifications and skills of the shareholder-recommended candidates and, in the exercise of the Nominating Committee s independent judgment and in accordance with the policies and procedures adopted in its charter, will determine whether to recommend the shareholder-recommended candidates to the Board for inclusion in the list of candidates for election as director at the next shareholders meeting at which directors will be elected.

The Nominating Committee will consider all candidates identified through the processes described above and will evaluate each of them, including incumbents, based on the same criteria. If, based on the Nominating Committee s initial evaluation, a candidate continues to be of interest, the Nominating Committee will generally conduct interviews and arrange for appropriate background and reference checks.

Shareholder Communications with Board of Directors

Interested shareholders can send communications to our Board of Directors, a committee of our Board of Directors and individual directors by writing to them care of: Corporate Secretary, Targeted Genetics Corporation, 1100 Olive Way, Suite 100, Seattle, Washington 98101. The outside of the envelope should prominently indicate for whom the correspondence is intended. The Corporate Secretary will forward such communication to our Board of Directors, the appropriate committee of our Board of Directors or individual directors, as the case may be, unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Corporate Secretary has the authority to discard the communication or take appropriate legal action regarding the communication.

Director Attendance at Annual Meeting of Shareholders

It is our policy that our directors attend the annual meeting of shareholders. At the time of our 2008 annual meeting of shareholders, the Board was comprised of seven directors, all of whom attended the annual meeting.

Director Compensation

The following table sets forth the compensation provided in 2008 to each of our directors who were neither employees nor officers of Targeted Genetics. Directors who are our employees do not receive any fees for their services as directors.

DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)	Stock Awards(1) ($)	Option Awards(1)(2) ($)	Total
Jack L. Bowman(3)	$ 15,750	$	$	$ 15,750
Jeremy L. Curnock Cook(4)	55,000	24,943		79,943
Joseph M. Davie(5)	46,000	16,628		62,628
Roger L. Hawley(6)	44,750	16,628		61,378
Nelson L. Levy(7)	41,000	16,628		57,628
Michael S. Perry(8)	37,333	16,628		53,961

(1) Reflects the dollar amount we are required under SEC rules to recognize for financial statement reporting purposes for 2008, in accordance with the provisions of Statement of Financial Accounting Standards, *Share-Based Payment,* or SFAS No. 123R. Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures. SFAS No. 123R requires us to estimate forfeiture when awards are granted and reduce estimated compensation expense accordingly, and in our audited consolidated financial statements, compensation expense is adjusted for estimated forfeitures. Except as otherwise specified with respect to actual forfeitures in 2008, the amounts shown in this table assume that none of the awards will be forfeited. See Note 10 of the consolidated financial statements contained in our annual report for the fiscal year ended December 31, 2008 regarding the assumptions underlying the valuation of equity awards. The amounts shown reflect our accounting expense for these awards, and do not correspond to the actual value that will be recognized by the executive officer. As of the date of this proxy statement, all options reflected in this table have an exercise price that is greater than the price of our common stock.

(2) In 2008, we granted stock awards, consisting of restricted stock units, or RSUs, to directors rather than stock options. This column reflects the current year expense for stock options granted in prior years.

(3) Mr. Bowman resigned from the Board effective May 15, 2008. Upon his resignation, Mr. Bowman forfeited 10,000 RSUs. At December 31, 2008, Mr. Bowman held outstanding options to purchase 13,500 shares of our common stock.

(4) At December 31, 2008, Mr. Cook held outstanding options to purchase 15,000 shares of our common stock and outstanding stock awards, consisting of restricted stock units, or RSUs, for 15,000 shares of our common stock.

(5) At December 31, 2008, Dr. Davie held outstanding options to purchase 13,500 shares of our common stock and outstanding stock awards, consisting of RSUs, for 10,000 shares of our common stock.

(6) At December 31, 2008, Mr. Hawley held outstanding options to purchase 8,000 shares of our common stock and outstanding stock awards, consisting of RSUs, for 10,000 shares of our common stock.

(7) At December 31, 2008, Dr. Levy held outstanding options to purchase 13,500 shares of our common stock and outstanding stock awards, consisting of RSUs, for 10,000 shares of our common stock.

(8) At December 31, 2008, Dr. Perry held outstanding options to purchase 8,000 shares of our common stock and outstanding stock awards, consisting of RSUs, for 10,000 shares of our common stock.

See the section entitled *Management Executive Compensation Summary Compensation Table* for disclosure related to Ms. Parker and Ms. Robinson, each of whom served as both a director and an executive officer in 2008.

Cash Compensation for Non-Employee Directors. Non-employee directors are compensated for their service on the Board and on any committee of the Board, as well as their attendance at Board and committee meetings. We also reimburse our directors for reasonable travel expenses incurred for attending meetings. For each fiscal year, non-employee directors receive the following cash compensation:

	Annual Retainer	**Attendance Fees (per meeting)**
Board of Directors	$15,000 ($20,000 for the chairman)	$1,500 ($2,000 for the chairman)
Audit Committee	$4,000 ($5,000 for the chairman)	$1,000 ($1,500 for the chairman)
Compensation Committee	$3,000 ($4,000 for the chairman)	$1,000 ($1,500 for the chairman)
All other Board committees	$1,000 ($4,000 for the chairman)	$1,000 ($1,500 for the chairman)

Until November 2008, non-employee directors received the same compensation for telephonic and in-person meetings. As of November 2008, until the Board determines otherwise, non-employee directors are not compensated for attendance at telephonic meetings of the Board or Board committees.

Stock Awards for Non-Employee Directors. Under our stock compensation program for non-employee directors, new directors receive an initial grant of RSUs for 30,000 shares of common stock, which vest in three substantially equal installments on each of the first through third annual anniversaries of the date of grant. In the event of a change of control, all unvested RSUs under these initial grants will accelerate. Additionally, on an annual basis, we grant each director RSUs for 10,000 shares of common stock (15,000 shares for the chairman of the Board), which vest on the first anniversary of the date of grant. In the event of a change of control, all unvested RSUs under these annual grants will accelerate. These grants are generally approved at the annual Board of Directors meeting that immediately follows the annual meeting of shareholders.

The Board of Directors recommends a vote FOR the election of Dr. Levy, Dr. Perry and Ms. Robinson.

9

PROPOSAL TWO

AMENDMENT TO THE RESTATED ARTICLES OF INCORPORATION

TO INCREASE THE NUMBER OF AUTHORIZED SHARES OF COMMON STOCK

Our Board of Directors has approved, and recommends that our shareholders approve, an amendment to our Restated Articles of Incorporation in substantially the form attached to this proxy statement as *Annex A*. The current number of authorized shares of common stock of the Company is 45,000,000 shares. This proposed amendment would increase the number of authorized shares of our common stock to 445,000,000 shares.

Approval of this amendment requires the affirmative vote of the holders of shares representing a majority of our outstanding shares of common stock. If approved by our shareholders, the amendment will become effective upon its filing with the Secretary of State of Washington.

As of March 13, 2009, the record date, 20,447,198 shares of our common stock were outstanding. As of that date, we had reserved an aggregate of 2,547,944 shares of our common stock for (a) future issuance upon the exercise of options or vesting of RSUs outstanding under our stock plans, and (b) the exercise of options or vesting of RSUs that may be granted in the future under our stock plans. In addition, we had reserved 7,913,861 shares issuable upon the exercise of outstanding warrants. As of the record date, the number of authorized shares of our common stock was 45,000,000 shares, with 15,154,265 shares available for future issuance. As a result of the increase in authorized shares of our common stock to be effected by this proposed amendment, the number of authorized shares of our common stock would be 445,000,000 shares.

We propose to increase the number of authorized shares of our common stock by 400,000,000 to enable us to consider potential future issuances of stock that may be desirable or necessary to accommodate our business plan. We may use the additional shares to fund our continuing operations by raising additional capital through issuances of common stock or securities convertible into common stock. We may also issue additional shares of common stock in connection with the acquisition of complementary businesses or technologies, or in connection with providing grants of stock-based compensation (such as stock options or RSUs) to our employees or for other general corporate purposes. Except for: (a) options and RSUs outstanding under our stock plans, (b) warrants issued in 1999 to Alkermes, Inc. in connection with a technology license agreement, (c) warrants issued in connection with our January 2007 private placement, and (d) warrants issued in connection with our June 2007 private placement, which collectively total 8,978,907 issuable shares as of the record date, we currently do not have any definitive and present plans, commitments or understandings that would require the issuance of additional shares of common stock.

Once authorized, the additional shares of common stock may be issued upon the approval of our Board of Directors but without further approval of our shareholders, unless shareholder approval is required under any applicable law or rule of any securities market on which our securities are traded. The additional shares of common stock would have rights identical to those of our currently outstanding common stock. The proposed increase in the number of shares of authorized common stock, and any future issuance of the additional shares, will not affect the rights of our current holders of common stock, except for effects that are incidental to the increase, such as dilution that would result from any future issuance of additional authorized shares of common stock. The holders of our common stock are not entitled to preemptive rights with respect to the issuance of additional shares of common stock or securities convertible into or exercisable for common stock.

The increase in the number of authorized shares of common stock and the subsequent issuance of all or a portion of those shares could have the effect of delaying or preventing a change of control without further action by our shareholders. Subject to applicable law and stock exchange requirements, we could issue shares of authorized and unissued common stock in one or more transactions that would make a change of control more difficult and therefore less likely. Any issuance of additional shares could have the effect of diluting the stock ownership and voting rights of an entity seeking to obtain control of Targeted Genetics.

Approval of the amendment to our Articles to increase the number authorized shares of common stock requires the affirmative vote of a majority of our outstanding shares of common stock. Abstentions and broker non-votes will have the same effect as votes against this proposal.

Our Board of Directors believes that approval of this amendment to our Articles is in the best interest of our shareholders and is necessary to provide us with the flexibility to pursue additional capital financing opportunities and licensing and other strategic transactions, to provide grants of stock-based compensation to our employees and to meet our general corporate needs. If this amendment is not approved, we will have insufficient shares of common stock authorized to complete these types of transactions in the future and to carry out our business plan.

The Board of Directors recommends that you vote FOR Proposal Two.

PROPOSAL THREE

AMENDMENT OF THE TARGETED GENETICS STOCK INCENTIVE PLAN

The Board has approved, subject to shareholder approval, an amendment to the Targeted Genetics Corporation Stock Incentive Plan (the Plan), that increases the number of shares of common stock authorized for issuance under the Plan by 2,000,000 shares, from 2,200,000 to 4,200,000 shares. The Plan was last amended and restated by the Board on March 26, 2007 and subsequently approved by our shareholders on May 17, 2007.

The Board believes that long-term incentive compensation programs align the interests of management, employees and our shareholders to create long-term shareholder value. The Board believes that plans such as the Plan increase our ability to achieve this objective, especially, in the case of the Plan, by giving us maximum flexibility to fashion future equity-based compensation by using stock appreciation rights, stock grants and stock units in addition to stock options. The Board believes that the increase in the number of shares issuable under the Plan is necessary to provide sufficient stock options, stock appreciation rights, stock grants and/or stock units to attract and retain the services of experienced and knowledgeable employees in our competitive biotechnology industry, and to preserve certain corporate income tax deductions that may become available to us.

The amendment to the Plan will be effective upon an affirmative vote of the holders of shares representing a majority of the votes cast at the Annual Meeting. If the amendment to the Plan to increase the shares available for issuance is not approved, then the Board will be limited in the amount of stock-based compensation it is able to provide. As of the record date, we had only 419,630 shares remaining available for grant under the Plan.

Description of the Plan

The following is a summary of the principal features of the Plan. The summary is not a complete description of the provisions in the Plan, however, and is qualified in its entirety by reference to the full text of the Plan. A copy of the Plan, as proposed to be approved, is attached to this proxy statement as *Annex B*.

Purpose

The Plan is intended to promote our success by providing a vehicle under which a variety of equity-based incentive awards can be granted to our employees, consultants and directors.

General

The Plan provides for the granting of stock options, stock appreciation rights, or SARs, stock grants and stock units (including RSUs), collectively referred to as Awards, to employees, consultants and directors who provide services to the Company, collectively referred to as participants. As of March 13, 2009, approximately 51 employees, directors and consultants are eligible to participate in the Plan.

If the amendment to the Plan is approved by our shareholders, the number of shares of our common stock authorized for Awards under the Plan will be 4,200,000 shares, which represents an increase of 2,000,000 shares. For purposes of determining the number of shares available for grant under the Plan, the number of shares issuable pursuant to all Awards (including SARs) granted under the Plan are subtracted from the number of shares authorized for issuance under the Plan. As of the record date, March 13, 2009, the number of shares available for grant under the Plan was 419,630 shares.

Administration of the Plan

The Plan can be administered by our Board or Compensation Committee or a combination of the two. In general, the members of the Compensation Committee must qualify as non-employee directors under Rule 16b-3 under the Securities Exchange Act of 1934, or the Exchange Act, for purposes of qualifying Awards as exempt from liability under Section 16(b) of Exchange Act, and as outside directors under Section 162(m) of the Internal Revenue Code, or the Code, for purposes of qualifying Awards as performance-based compensation under Section 162(m) of the Code. However, the Board may appoint one or more separate committees of the Board who need not qualify as non-employee directors or outside directors to administer the Plan with respect to Key Service Providers not covered by Section 16 of the Exchange Act or Section 162(m) of the Code. Unless our Board provides otherwise, the Compensation Committee will administer the Plan.

Subject to the terms of the Plan, the Compensation Committee has the sole discretion to determine the participants who may be granted Awards, the size and types of such Awards and the terms and conditions of such Awards. The Plan provides that, during any fiscal year, no person (other than non-employee directors) may be granted Awards covering more than 150,000 shares. However, during the fiscal year of a person s initial year of service with us (other than non-employee directors), the maximum number of shares that may be granted to such person pursuant to Awards is 500,000 shares. The Plan also provides that no non-employee director may be granted Awards covering more than 50,000 shares during any fiscal year; however, shares received pursuant to stock grants in lieu of the non-employee director s annual retainer fee(s) will not count against the 50,000 share annual limit.

Eligibility to Receive Awards

Our participants are eligible to be selected to receive one or more Awards. Only employees, directors and consultants are eligible for designation by the Compensation Committee, in its sole discretion, to receive Awards. The actual number of individuals who will receive Awards under the Plan cannot be determined because eligibility for participation in, and the granting of Awards under, the Plan is in the discretion of the Compensation Committee.

Stock Options

The Compensation Committee may grant nonstatutory stock options or incentive stock options, or ISOs (which are entitled to favorable tax treatment), or a combination of the two. ISOs may be granted only to employees of Targeted Genetics or employees of our subsidiaries. The number of shares covered by each stock option will be determined by the Compensation Committee. The Plan provides that ISOs can be granted up to the maximum number of shares reserved for issuance.

The price of shares of our common stock subject to each stock option is set by the Compensation Committee but cannot be less than 100% of the fair market value on the date of grant of the stock option. In addition, the exercise price of an ISO must be at least 110% of fair market value on the grant date if the employee owns stock possessing more than 10% of the total combined voting power of all classes of our stock or the stock of any of our subsidiaries.

The exercise price of each stock option must be paid in full at the time of exercise. The Compensation Committee also may permit payment through the tender of shares of our common stock that are already owned by the participant, or by any other means that the Compensation Committee determines to be consistent with the Plan s purpose and applicable laws. Any taxes required to be withheld must be paid by the participant at the time of exercise.

Options become exercisable at the times and on the terms established by the Compensation Committee in the applicable stock option agreement. If the stock option agreement does not specify when the shares subject to the stock option will vest and become exercisable, the Plan provides that shares will vest quarterly over four years. Options expire at the times established by the Compensation Committee, which generally will not be more than ten years after the date of grant (subject to the key service provider s continuous service).

Stock Appreciation Rights

The Compensation Committee determines the terms and conditions of each SAR. SARs may be granted in conjunction with a stock option, or may be granted on an independent basis. Subject to the limits described above, the number of shares covered by each SAR will be determined by the Compensation Committee. Upon exercise of a SAR, the participant will receive payment from us in an amount determined by multiplying: (i) the difference between the fair market value of a share on the date of exercise over the exercise price (fair market value of a share on the grant date), times (ii) the number of shares with respect to which the SAR is exercised. SARs may be paid in cash or shares of our common stock, as determined by the Compensation Committee. SARs are exercisable at the times and on the terms established by the Compensation Committee. The Plan provides that if the applicable SAR agreement does not specify when the shares subject to the SAR become exercisable, then the shares will vest over four years, with 25% of the shares vesting after one year of service and the remaining 75% vesting on a pro rata basis over the next 36 months.

Stock Grants and Stock Units

Stock grant awards are shares of our common stock that may or may not be subject to vesting, in accordance with the terms and conditions established by the Compensation Committee. Stock unit awards are bookkeeping entries that represent shares of our common stock that may or may not vest, in accordance with the terms and conditions established by the Compensation Committee. The Plan provides that if the applicable stock grant agreement or stock unit agreement does not specify when the shares will vest, then the shares subject to the award will vest in four equal annual installments. The holder of a stock grant awarded under the Plan has the same voting, dividend and other rights as the Company s other shareholders. Holders of stock units do not have voting rights until their stock units vest and stock is actually issued to the holder.

In determining whether a stock grant or stock unit award should be made and/or the vesting schedule for such award, the Compensation Committee may impose whatever conditions to vesting that it determines to be appropriate. For example, the Compensation Committee may determine to award a stock grant or stock units only if performance goals established by the Compensation Committee are satisfied.

Performance Goals

The Compensation Committee, in its discretion, may apply performance goals to a participant with respect to an Award. At the Compensation Committee s discretion, one or more of the following performance goals may apply: (i) operating income; (ii) earnings before interest, taxes, depreciation and amortization or EBITDA; (iii) earnings; (iv) cash flow; (v) market share; (vi) sales or revenue; (vii) expenses; (viii) cost of goods sold; (ix) profit/loss or profit margin; (x) working capital; (xi) return on equity or assets; (xii) earnings per share; (xiii) economic value added; (xiv) stock price; (xv) price/earnings ratio; (xvi) debt or debt-to-equity; (xvii) accounts receivable; (xviii) writeoffs; (xix) cash; (xx) assets; (xxi) liquidity; (xxii) operations; (xxiii) intellectual property (e.g., patents); (xxiv) product development; (xxv) regulatory activity, including clinical trial activity; (xxvi) manufacturing, production or inventory; (xxvii) mergers and acquisitions or divestitures; (xxviii) business development activities; (xxix) financings; (xxx) cash burn; and/or (xxxi) cash horizon. The Compensation Committee also may use other performance goals, in its discretion.

Nontransferability of Awards

In general, Awards granted under the Plan may not be sold, transferred, pledged, assigned or otherwise alienated or hypothecated, other than by will or by the applicable laws of descent and distribution, and during the life of a participant, any Awards may be exercised only by the recipient. Notwithstanding the above, the Compensation Committee (or the Board, in the case of Awards granted to non-employee directors) may, in its discretion, permit Awards to be transferred to an individual or entity other than Targeted Genetics subject to such restrictions as the Compensation Committee or the Board may impose.

Dividend Equivalents

Recipients of Awards may, if so determined by the Compensation Committee (or by the Board in case of Awards to non-employee directors), be entitled to receive cash or stock dividends, or cash payments in amounts equivalent to cash or stock dividends declared with respect to shares of our common stock. The Compensation Committee or the Board may also provide that such cash or stock dividends shall be deemed to have been reinvested in additional shares of common stock or otherwise reinvested.

Corporate Transactions

In the event of certain corporate transactions, and subject to the applicable Award agreement, all outstanding Awards will be subject to the applicable agreement of merger or reorganization, which may provide for the assumption, substitution or continuation of outstanding awards, exchange for other property, accelerated vesting, or cancellation without consideration. Awards that are not assumed, substituted or continued will terminate upon consummation of the corporate transaction.

Awards Under the Plan

Awards under the Plan will be made at the discretion of the Compensation Committee. The Compensation Committee has not made any decisions on the amount and type of Awards that are to be made in future years under the Plan.

Amendment and Termination of the Plan

Our Board generally may amend or terminate the Plan at any time and for any reason; provided, however, that any such amendment shall be subject to the approval of the shareholders to the extent required by applicable law or regulation. Unless sooner terminated by our Board, the Plan will terminate on May 17, 2017.

Number of Awards Granted

The Awards that any participant may receive under the Plan in the future, and the number of shares covered by any such Award, is in the discretion of the Compensation Committee or the Board, and therefore cannot be determined in advance. The following table sets forth (i) the dollar value of the RSUs and stock awards awarded under the Plan during 2008, and (ii) the aggregate number of shares of RSUs and stock awards awarded under the Plan during 2008. No stock options were granted during 2008.

NEW PLAN BENEFITS

Targeted Genetics Corporation Stock Incentive Plan

Name of Individual or Group	Dollar Value ($)[(1)]	Units of Restricted Stock Awarded (#)
B.G. Susan Robinson President, Chief Executive Officer and Director	$ 7,700	35,000
H. Stewart Parker, Former President, Chief Executive Officer and Director[(2)]	44,000	200,000
David G. Poston Vice President, Finance, Chief Financial Officer, Treasurer and Secretary	7,700	35,000
Barrie J. Carter, Former Executive Vice President and Chief Scientific Officer[(3)]	7,700	35,000
All current executive officers, as a group (2 persons)	15,400	70,000
All current directors who are not executive officers, as a group (5 persons)	12,100	55,000
All employees who are not executive officers, as a group (84 persons)	68,640	312,000

(1) The dollar values set forth in this table reflects the value of RSUs granted to each named person for 2008, based on the closing price of $0.22 for our common stock on December 31, 2008.

(2) Ms. Parker resigned from the Company in November 2008.

(3) Dr. Carter resigned from the Company in November 2008.

Tax Aspects

A recipient of a stock option or SAR will not have taxable income upon the grant of the stock option or SAR. For stock options (other than ISOs) and SARs, the participant will recognize ordinary income upon exercise in an amount equal to the appreciation value, which is the excess of the fair market value of the shares over the exercise price, on the date of exercise. In the United States, any gain or loss recognized upon any later disposition of the shares generally will be capital gain or loss.

Purchase of shares upon exercise of an ISO will not result in any taxable ordinary income to the participant, but may result in alternative minimum tax liability. Gain or loss recognized by the participant on a later sale or other disposition will either be long-term capital gain or loss or ordinary income, depending upon whether the participant holds the shares transferred upon the exercise of the ISO for a specified period. Any ordinary income recognized will be in the amount, if any, by which the lesser of the fair market value of such shares on the date of exercise or the amount realized from the sale exceeds the exercise price.

Unless the participant elects to be taxed at the time of receipt of a stock grant award that is subject to vesting, the participant will not have taxable income upon receipt, but upon vesting. The participant will recognize ordinary income equal to the fair market value of the shares at the time of vesting (minus any amount paid for the stock grant). A participant who is granted stock units will not have taxable income upon receipt of the Award of stock units; instead the participant will be taxed upon settlement

15

of the Award. The participant will recognize ordinary income equal to the fair market value of the shares or the amount of cash received by the participant.

In addition, Section 409A of the Code imposes certain restrictions on deferred compensation arrangements. Awards that are treated as deferred compensation under Section 409A of the Code are intended to meet the requirements of this section of the Code or the exceptions to treatment as deferred compensation subject to this section of the Code.

At the discretion of the Compensation Committee, the Plan allows a participant to satisfy tax withholding requirements under U.S. federal and state tax laws or applicable foreign tax laws in connection with the exercise or receipt of an Award by electing to have shares of common stock withheld, or by delivering to us already-owned shares, having a value no greater than the minimum amount required to be withheld.

We will be entitled to a tax deduction in connection with an Award under the Plan only in an amount equal to the ordinary income realized by the participant and at the time the participant recognizes such income. In addition, Section 162(m) of the Code contains special rules regarding the federal income tax deductibility of compensation paid to our chief executive officer and to each of certain of our other executive officers. The general rule is that annual compensation paid to any of these specified executives will be deductible only to the extent that it does not exceed $1,000,000. However, we can preserve the deductibility of certain compensation in excess of $1,000,000 if we comply with conditions imposed by Section 162(m) so that such compensation can be classified as performance-based compensation under Section 162(m) of the Code, including, but not limited to, the establishment of a maximum number of shares with respect to which Awards may be granted to any one key service provider during one fiscal year. The Plan has been designed to permit the Compensation Committee to grant Awards that satisfy the requirements of Section 162(m), thereby permitting us to continue to receive a federal income tax deduction in connection with such Awards.

THE FOREGOING IS ONLY A SUMMARY OF THE EFFECT OF FEDERAL INCOME TAXATION ON PARTICIPANTS AND TARGETED GENETICS WITH RESPECT TO THE GRANT AND EXERCISE OF AWARDS UNDER THE PLAN. IT DOES NOT PURPORT TO BE COMPLETE, AND DOES NOT DISCUSS THE TAX CONSEQUENCES OF A PARTICIPANT S DEATH OR THE PROVISIONS OF THE INCOME TAX LAWS OF ANY MUNICIPALITY, STATE OR FOREIGN COUNTRY IN WHICH THE PARTICIPANT MAY RESIDE.

Securities Authorized for Issuance under the Equity Compensation Plan

The following table provides information regarding securities issuable under our equity compensation plans as of December 31, 2008.

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted-average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)**
Equity compensation plans approved by security holders[1]	1,391,126	$ 15.54	328,180
Equity compensation plans not approved by security holders			
Total	1,391,126	15.54	328,180

(1) Represents shares issuable with respect to options and RSUs issued and issuable under our Stock Incentive Plan, our 1992 Restated Stock Option Plan, and the 2000 Genovo Inc. Roll-Over Stock Option Plan. Does not include warrants covering an aggregate of 7,913,861 shares, with a weighted average exercise price of $3.95, issued to investors in 2007 in connection with private equity financings.

The Board of Directors recommends that you vote FOR Proposal Three.

PROPOSAL FOUR

RATIFICATION OF THE SELECTION OF

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected Ernst & Young LLP to serve as our independent registered public accounting firm for the fiscal year ending December 31, 2009. We are asking our shareholders to ratify this selection. If our shareholders fail to ratify the selection of Ernst & Young, the Audit Committee and our Board of Directors will consider whether to retain Ernst & Young and may retain that firm or another firm without resubmitting the matter to our shareholders. Even if the selection of Ernst & Young is ratified, the Audit Committee, at its discretion, may direct the appointment of a different firm at any time during the year if the Audit Committee determines that a change would be in the best interest of Targeted Genetics or our shareholders.

The affirmative vote of the holders of shares representing a majority of the votes cast at the Annual Meeting, in person or by proxy, is required to ratify the selection of Ernst & Young as our independent registered public accounting firm.

Ernst & Young has served as our independent accounting firm since 1989, when Targeted Genetics was formed as a department within Immunex Corporation. Representatives of Ernst & Young are expected to attend the Annual Meeting, be available to respond to appropriate questions from shareholders and have the opportunity to make a statement if they desire to do so.

Our management is responsible for our internal controls and the financial reporting process. Our independent registered public accounting firm, Ernst & Young, is responsible for performing an independent audit of our consolidated financial statements in accordance with auditing standards generally accepted in the United States and issuing a report on its audit.

Fees

The fees billed by Ernst & Young for the indicated services performed during the fiscal years ended December 31, 2007 and December 31, 2008 were as follows:

	Fiscal 2008	Fiscal 2007
Audit fees	$ 381,000	$ 384,000
Audit-related fees		
Tax fees		20,000
Total fees	$ 381,000	$ 404,000

Services rendered by Ernst & Young in connection with the fees presented above were as follows:

Audit fees: Consists of fees related to professional services rendered in connection with the audit of our annual consolidated financial statements, the reviews of the consolidated financial statements included in each of our quarterly reports on Form 10-Q and accounting consultations that relate to the audited consolidated financial statements and are necessary to comply with generally accepted auditing standards.

Audit-related fees: Consists of fees related to assurance and related services that are reasonably related to the performance of the audit or review of the consolidated financial statements and are not reported as audit fees.

Tax fees: Consists of fees billed for professional services related to federal and state tax return preparation.

All fees incurred in 2008 and 2007 and billed by outside auditors were pre-approved by the Audit Committee.

Our Audit Committee has determined that Ernst & Young s rendering of the non-audit services is compatible with maintaining auditor independence. The Audit Committee has adopted a policy for the pre-approval of services provided by our independent registered public accounting firm. Under the policy, pre-approval is generally provided for particular services or categories of services, including planned services, project-based services and routine consultations projects. Each category is subject to a specific budget or quarterly dollar amount. In addition, the Audit Committee may also pre-approve particular services on a case-by-case basis. For each proposed service, our independent registered public accounting firm is required to provide detailed back-up documentation at the time of approval. The Audit Committee has delegated certain pre-approval authority to its Chairman. The Chairman must report any decisions to the Audit Committee at its next scheduled meeting.

The Board of Directors recommends that you vote FOR Proposal Four.

AUDIT COMMITTEE REPORT

In 2008, the Audit Committee met and held discussions with management and the independent registered public accounting firm. In addition, the members of the Audit Committee individually reviewed the company s consolidated financial statements before they were filed with the SEC in the company s quarterly reports on Form 10-Q and annual report on Form 10-K. Management represented to the Audit Committee that the company s consolidated financial statements were prepared in accordance with generally accepted accounting principles, and the Audit Committee reviewed and discussed the consolidated financial statements with management and the independent registered public accounting firm. The Audit Committee also discussed with the independent registered public accounting firm the matters required to be discussed by Statement on Auditing Standards, or SAS, No. 61, as amended by SAS No. 90, *Communication with Audit Committees*.

Our independent registered public accounting firm also provided to the Audit Committee the written disclosures required by the applicable requirements of the Public Company Accounting Oversight Board, and discussed with the Audit Committee its independence. The Audit Committee considered the compatibility of non-audit services with the firm s independence.

Based on the Audit Committee s discussion with management and the independent registered public accounting firm and its review of the representation of management and the report of the independent registered public accounting firm to the Audit Committee, the Audit Committee recommended that our Board of Directors include the audited consolidated financial statements in our annual report on Form 10-K for the year ended December 31, 2008, to be filed with the SEC. The Audit Committee also evaluated the performance of Ernst & Young LLP and recommended to our Board of Directors that Ernst & Young LLP be selected as our independent registered public accounting firm for the year ending December 31, 2009.

Audit Committee

Roger L. Hawley (Chairman)

Jeremy L. Curnock Cook

Nelson L. Levy

MANAGEMENT

Executive Officers

The following table lists our executive officers, who will serve in the capacities noted until their successors are duly appointed and qualified.

Name	Age	Position
B.G. Susan Robinson	47	President, Chief Executive Officer and Director
David J. Poston	46	Vice President, Finance, Chief Financial Officer, Treasurer and Secretary

B.G. Susan Robinson s biography is contained in the section of this proxy statement entitled *Proposal One Election of Directors Biographical Information*.

David J. Poston has served as our vice president, finance, chief financial officer and treasurer since January 2006 and as secretary since November 2008. From October 2005 until January 2006, Mr. Poston served as our acting chief financial officer and treasurer. Mr. Poston joined Targeted Genetics in 1999 as our director, finance and served as our senior director, finance from 2001 until his appointment as acting chief financial officer. Mr. Poston also served as secretary/treasurer of CellExSys, our majority-owned cell therapy subsidiary, from 2000 to its sale in 2004. Mr. Poston also serves as an officer and director of each of our wholly-owned subsidiaries, Genovo, Inc. and TGCF Manufacturing Corporation. Mr. Poston served as controller of Corixa Corporation from 1997 to 1998. He started his career in public accounting at KPMG in 1985. Mr. Poston holds a B.A. in business administration from the University of Puget Sound, where he graduated as the Norton Clapp Arete Scholar.

Key Employees

The following table lists our key employees, who will serve in the capacities noted until their successors are duly appointed and qualified.

Name	Age	Position
Richard W. Peluso	56	Vice President, Process Sciences and Manufacturing
Pervin Anklesaria	51	Vice President, Product Development

Richard W. Peluso has served as our vice president, process sciences and manufacturing since 2003. From 2001 to 2003, Dr. Peluso served as our senior director, technology development. Dr. Peluso served as director of vector assay development and characterization for Genovo, Inc. from 1999 until its acquisition by Targeted Genetics in 2001. Dr. Peluso holds a B.A. in biology from the University of Maryland and a Ph.D. in virology from The Rockefeller University.

Pervin Anklesaria has served as our vice president, product development since 2002. Dr. Anklesaria joined Targeted Genetics in 1993, previously serving as our vice president of research, director of research and development administration and staff scientist. Before joining Targeted Genetics, Dr. Anklesaria was an assistant professor in the Department of Radiation Oncology at the University Massachusetts Medical Center. Dr. Anklesaria holds a B.S. in microbiology and chemistry, a M.S. in biophysics and a Ph.D. in cell biology from the University of Bombay, India.

EXECUTIVE COMPENSATION

Overview. The Compensation Committee of the Board has overall responsibility for approving and evaluating our executive compensation plans, policies and programs. The Compensation Committee is charged with, among other things:

- reviewing and approving corporate and individual goals and objectives of the executive officers relevant to executive compensation;
- evaluating the performance of the executive officers in light of such goals and objectives and determining compensation for the executive officers; and
- overseeing the administration of our stock or cash-based compensation and incentive programs and approving grants and awards of stock options and other equity securities made to the executive officers.

The Compensation Committee consists of Joseph M. Davie, Roger L. Hawley and Michael S. Perry, all of whom are independent directors under the NASDAQ rules. Mr. Bowman, who was also an independent director, served on the Compensation Committee until his resignation from the Board of Directors effective May 15, 2008, and Mr. Hawley was appointed to the Compensation Committee on that date.

Objectives of Executive Compensation Program. The Compensation Committee uses the various elements of executive compensation for different purposes, with the overall intended objectives of reward, motivation and retention of our executive officers, all with an eye toward achieving long-term shareholder value. The Compensation Committee believes that it is important for us to attract and retain qualified executive officers and, in order to achieve that goal, that their compensation be competitive relative to the compensation paid to similarly situated executives at comparable companies. The executive compensation program is designed to motivate our executive officers, individually and as a management group, to manage in the best interests of the shareholders and to reward them for doing so.

Summary Compensation Table for Fiscal Year 2008. The following table outlines the compensation paid in 2008 and 2007 to each person who served as chief executive officer during 2008 and each of our other most highly paid executive officers for 2008. These persons are referred to as the Named Executive Officers.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(1)	Option Awards ($)(1)	All Other Compensation ($)(2)	Total ($)
B.G. Susan Robinson(3)	2008	$ 257,500	$	$ 42,287	$	$ 2,374	$ 302,161
President and Chief Executive Officer	2007	250,000	50,000	22,862	18,985	2,360	344,207
H. Stewart Parker(4)	2008	374,000		75,772		47,704	497,476
Former President and Chief Executive Officer	2007	440,000	154,000	32,661	29,127	4,396	660,184
Barrie J. Carter, Ph.D.(5)	2008	246,500		42,287		36,377	325,164
Former Executive Vice President and Chief Scientific Officer	2007	290,000	72,500	22,862	22,995	3,901	412,258
David J. Poston	2008	257,500		42,287		2,374	302,161
Vice President, Finance, Chief Financial Officer, Treasurer and Secretary	2007	250,000	50,000	22,862	22,995	2,240	348,097

(1) This amount reflects the dollar amount we are required under SEC rules to recognize for financial statement reporting purposes for 2007 and 2008 in accordance with SFAS No. 123R. Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures. SFAS No. 123R requires us to estimate forfeitures when awards are granted and reduce estimated compensation expense accordingly, and in our audited consolidated financial statements, compensation expense is adjusted for estimated forfeitures. Except as otherwise indicated with respect to actual forfeitures in 2008, the amounts shown in this table assume that none of the awards will be forfeited. See Note 10 to our consolidated financial statements for the fiscal year ended December 31, 2008 regarding the assumptions underlying the valuation of equity awards. The amounts shown reflect our accounting expense for these awards, and do not correspond to the actual value that will be recognized by the executive officer. As of the date of this proxy statement, all options reflected in this table have an exercise price that is greater than the price of our common stock.

(2) For each of the named executives, this amount reflects matching contributions to a 401(k) account and excess life insurance premiums. For Dr. Carter, it also includes payment of accrued vacation upon his November 2008 resignation. For Ms. Parker, it also includes payments for subsidized parking and health insurance, accrued vacation and legal fees paid in connection with her November 2008 resignation, and consulting fees paid in 2008 after her resignation.

(3) Ms. Robinson was appointed as president and chief executive officer on November 6, 2008.

(4) Ms. Parker resigned as president and chief executive officer effective November 6, 2008. On November 14, 2008, we and Ms. Parker executed a Separation Agreement and Release, which became effective on November 22, 2008 (the Parker Agreement). Under the terms of the Parker Agreement, among other things, unvested RSUs for 83,334 shares of common stock were accelerated to fully vest upon effectiveness of the Parker Agreement. Ms. Parker was also granted an additional 150,000 shares of common stock under our Stock Incentive Plan, and we agreed to provide continuation of her health insurance coverage for six months. In connection with her resignation, Ms. Parker forfeited unvested stock options for 1,875 shares. The acceleration of her RSUs and the additional grant of stock are reflected in the column titled Stock Awards. The Parker Agreement also provides for Ms. Parker to provide consulting services to us for $5,000 per month for a period of six months.

(5) Dr. Carter resigned as executive vice president and chief scientific officer effective November 6, 2008. On January 12, 2009, we and Dr. Carter executed a Separation Agreement and Release, which became effective on January 20, 2009 (the Carter Agreement). Under the terms of the Carter Agreement, among other things, unvested RSUs for 58,333 shares of common stock were accelerated to fully vest in 2009 upon effectiveness of the Carter Agreement. Mr. Carter was also granted an additional 150,000 shares of common stock under our Stock Incentive Plan, and we paid Dr. Carter $2,453 in lieu of providing continuation of his health insurance coverage for six months. These amounts are not reflected in the table because the grant and the payment occurred in 2009. In connection with his resignation, Mr. Carter forfeited unvested stock options for 1,406 shares. The Carter Agreement and a related consulting agreement also provide for Dr. Carter to provide consulting services to us for $5,000 per month for a period of six months.

Elements of Executive Compensation. The total compensation package provided to our executive officers consists of cash compensation in the form of base salary and annual bonus, and non-cash, long-term incentive compensation in the form of stock options and restricted stock units. In addition, executive officers may participate in our 401(k) plan and other benefit plans generally available to all employees.

The Compensation Committee generally sets cash compensation for all executive officers at regularly scheduled meetings early in the year and generally grants stock options or RSUs to executive officers at regularly scheduled meetings immediately following each annual meeting of shareholders. The Compensation Committee uses the same factors and methodology to determine compensation for each of the executive officers, including the chief executive officer, except as described below with respect to the chief executive officer. The Compensation Committee does not engage a consultant regarding executive compensation matters or delegate authority to approve of any plans, policies or programs, including those relating to executive officer stock compensation matters.

The Compensation Committee does not use any formula and does not have any formal policy with respect to allocating compensation between the various elements of compensation, but rather considers both qualitative and quantitative indicators of individual and corporate performance to determine the composition of executive compensation. In accordance with its charter, the Compensation Committee takes into account each executive officer s performance, the company s overall corporate performance, the compensation paid to similarly situated executives at comparable companies, the compensation paid to the executive officers in past years, including equity compensation, and any other factors it deems appropriate, such as the value of each executive officer s skills and abilities in support of our objectives and his or her contribution to the management team. We do not have a quantitative performance-based plan that sets forth corporate objectives that must be met by executive officers, but the Compensation Committee generally sets qualitative corporate performance objectives and reviews the progress on such objectives when making compensation decisions. Beginning in 2009, as a matter of best practice, the Compensation Committee will review the relationship between the incentive compensation provided to our executive officers and our risk management policies and practices to confirm that our incentive compensation does not encourage unnecessary and excessive risks.

Base Salary. The Compensation Committee uses base salary to compensate the executive officers for services rendered, as well as for motivation and retention purposes. We compete with a variety of companies for executive-level talent. Base salaries are intended to be competitive and are generally set close to the median of base salaries paid by other biotechnology companies of similar size and mission, taking into consideration individual factors such as experience, tenure, qualifications, institutional knowledge and potential business and management team disruption due to turnover.

Base salaries are reviewed annually to determine whether they are consistent with our overall compensation objectives. The Compensation Committee reviews the results of two biotechnology compensation surveys in which we participate, the Radford Global Life Sciences Survey and the Northwest Biotech & Health Technology Salary Survey. The Compensation Committee also reviews the base salary of each executive officer against the individual and aggregate base salaries for executives at companies that are (i) in the same sector of the biotechnology industry, (ii) pursuing development of similar products or in the same stage of development and/or (iii) in the same area geographically. The data in this competitive peer group comparison and the surveys together are referred to as the competitive market study. For 2008, the companies in the competitive peer group were:

Aastrom Biosciences, Inc.	CytRx Corporation	Sangamo Biosciences Inc.
Alnylam Pharmaceuticals Inc.	Dendreon Corp.	Seattle Genetics Inc.
Ariad Pharmaceuticals Inc.	Genvec Inc.	Trubion Pharmaceuticals, Inc.
Avigen Inc.	Introgen Therapeutics Inc.	Vical Inc.
Cell Genesys Inc.	Nastech Pharmaceutical Co. Inc.	
Cell Therapeutics, Inc.	Poniard Pharmaceuticals, Inc.	

In considering increases in base salary, the Compensation Committee reviews individual and corporate performance, as well as our overall financial condition and market and industry conditions.

For 2008, the Compensation Committee considered the competitive market study and, with regard to compensation for executive officers other than Ms. Parker, the recommendations of the chief executive officer. The Compensation Committee determined that increases in base salary for executives other than Ms. Parker and Dr. Carter were appropriate, primarily because those executives had achieved substantially all of the 2007 corporate objectives set for them and their salaries were generally below market.

In the fourth quarter of 2008, in light of our financial condition and overall economic conditions, our management determined that a reduction in executive base salary would be in the best interests of the company and our shareholders. The Compensation Committee concurred with management s determination and, effective January 1, 2009, we reduced the salaries of our most senior employees, including Ms. Robinson and Mr. Poston, by 10% over 2008 levels. Accordingly, the salaries for our most senior executives, including Ms. Robinson and Mr. Poston, will remain at 10% below their 2008 levels until our cash horizon is extended or such other time as the Compensation Committee may determine.

Bonuses. The Compensation Committee may award annual bonuses as a reward for achievement of individual and corporate short-term goals that are established by the Compensation Committee under the annual bonus program for the applicable year. Any award of an annual bonus is made in view of the executive s performance against those individual and corporate goals and in furtherance of our compensation objectives. When an annual bonus is deemed appropriate, the amount is determined by the Compensation Committee, which determination may include another review of the competitive market study and then-current market conditions, and with regard to compensation for executive officers other than the chief executive officer, after considering the recommendations of the chief executive officer. The Compensation Committee may also award discretionary bonuses for significant achievements not enumerated in the annual bonus program, such as capital raising.

For 2008, the Compensation Committee set target bonuses under the annual bonus program at 35% of salary for the chief executive officer, 25% of base salary for the chief scientific officer, 20% of base salary for the chief financial officer and 20% of base salary for non-executive officer vice presidents. Because our executive team did not achieve the performance goals established by the Compensation Committee under the 2008 annual bonus program, they did not receive annual bonuses for 2008. The Compensation Committee did not award any discretionary bonuses for 2008.

The Compensation Committee is currently considering whether to establish a discretionary bonus program for our executive officers for 2009, which discretionary bonuses may include retention and success bonuses for executives remaining with the company and/or extending our cash horizon through capital raising or monetization of assets. The amount of any such bonuses would reflect our then-current cash position.

Long-Term Incentive Programs. The Compensation Committee grants stock-based compensation to executive officers on an annual basis as a way to provide a long-term incentive opportunity that is linked to an increase in shareholder value. The Compensation Committee determines the amount of the stock-based compensation grant in view of individual and corporate performance and in furtherance of our overall compensation objectives. In determining the number of shares to be covered by a grant, the Compensation Committee takes into consideration the vested and unvested RSU and stock option holdings of the executive officer and, for executive officers other than the chief executive officer, the recommendations of the chief executive officer.

Generally, on an annual basis, the Compensation Committee grants stock-based compensation to all employees, including executive officers, at its regularly scheduled meeting following the annual meeting of shareholders. The timing of stock compensation grants is not coordinated with the release of material non-public information and is typically in the middle of the second fiscal quarter. RSUs and stock options are granted under our Stock Incentive Plan. RSUs have a term of ten years and generally vest over a three-year period, in three substantially equal installments on the first three anniversaries of the date of the grant. Stock options are granted with an exercise price equal to the market value of our common stock on the date of the grant and with a term of ten years. Stock options generally become exercisable over a four-year period, in sixteen equal installments beginning three months after the date of the grant. To encourage employee retention, all stock options are granted as incentive stock options to the maximum extent possible under the Internal Revenue Code.

In May 2008, the Board approved RSU grants to our executive officers. Ms. Parker received an RSU grant for 50,000 shares. Each of Dr. Carter, Mr. Poston and Ms. Robinson (then serving as vice president, business development) received an RSU grant for 35,000 shares. The vesting of the RSU grants to Ms. Parker and Mr. Carter were accelerated upon the effectiveness of their respective separation agreements, as described more fully above in the footnotes to the Summary Compensation Table. The grants to Mr. Poston and Ms. Robinson will vest in three substantially equal installments on each of May 15, 2009, May 15, 2010 and May 15, 2011, so long as the executive continues to provide services to the Company.

Perquisites. Our executive officers do not receive any material incremental benefits that are not otherwise available to all of our employees. Our health and other insurance plans are the same for all employees.

Tax and Accounting Considerations. The Compensation Committee considers tax and accounting consequences when making decisions regarding our executive compensation programs. Section 162(m) of the Internal Revenue Code limits deduction of compensation paid to executive officers to $1,000,000 in any fiscal year unless the compensation is performance-based. Cash compensation under our bonus plan does not exceed $1,000,000 in any fiscal year. Our stock option grants and RSU grants comply with Section 162(m). Under SFAS No. 123R, grants of equity compensation result in a stock-compensation charge to our earnings equal to the fair value of the instrument being issued that is recorded over the vesting period of the equity grant.

Equity Ownership by Executives. We do not have a formal stock ownership requirement for our executive officers but we encourage stock ownership on a voluntary basis.

Outstanding Equity Awards at 2008 Fiscal Year-End. The following table sets forth certain information regarding the value of all unexercised options previously awarded to the Named Executive Officers as of December 31, 2008.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

	Option Awards				Stock Awards	
	Number of Securities Underlying Unexercised Options					
Name	Exercisable (#)	Unexercisable (#)	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (#)
H. Stewart Parker	1,081(1)		22.50	1/21/09		
	12,226(1)		22.50	1/21/09		
	3,111(2)		85.60	1/20/10		
	756(2)		85.60	1/20/10		
	2,190(3)		66.60	1/23/11		
	13,809(3)		66.60	1/23/11		
	2,112(4)		25.70	1/22/12		
	10,887(4)		25.70	1/22/12		
	10,000(5)		4.30	3/20/13		
	20,000(6)		13.10	5/20/14		
	8,125(7)		9.10	5/26/15		
	38,000(8)		3.80	6/12/16		
Barrie J. Carter	2,891(1)		22.50	1/21/09		
	3,849(1)		22.50	1/21/09		
	720(2)		85.60	1/20/10		
	1,440(2)		85.60	1/20/10		
	2,041(3)		66.60	1/23/11		
	4,259(3)		66.60	1/23/11		
	1,563(4)		25.70	1/22/12		
	3,437(4)		25.70	1/22/12		
	7,000(5)		4.30	3/20/13		
	15,000(6)		13.10	5/20/14		
	6,093(7)		9.10	5/26/15		
	30,000(8)		3.80	6/12/16		
					23,333(15)	$ 5,133(15)
					35,000(16)	$ 7,700(16)
David J. Poston	2,800(1)		22.50	1/21/09		
	750(2)		85.60	1/20/10		
	2,000(3)		66.60	1/23/11		
	500(9)		59.50	5/8/11		
	2,500(4)		25.70	1/22/12		
	700(4)		25.70	1/22/12		
	1,000(10)		7.60	8/7/12		
	9,100(6)		13.10	5/20/14		
	2,362(7)	338(7)	9.10	5/26/15		
	30,000(8)		3.80	6/12/16		
					23,333(15)	$ 5,133(15)
					35,000(16)	$ 7,700(16)

Name	Option Awards

In addition to the Oasis lawsuit, from time to time, we have been and may become involved in legal proceedings arising in the ordinary course of our business. Although the results of litigation and claims cannot be predicted with certainty, we are not presently involved in any other legal proceeding in which the outcome, if determined adversely to us, would be expected to have a material adverse effect on our business, operating results, or financial condition. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

ITEM 1A. RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information in this Quarterly Report on Form 10-Q before making an investment decision. Our business, prospects, financial condition, or operating results could be harmed by any of these risks, as well as other risks not currently known to us or that we currently consider immaterial. The trading price of our common stock could decline due to any of these risks, and, as a result, you may lose all or part of your investment.

Risks Related to Our Business

We have experienced losses and negative cash flow since our inception, and we may not be able to achieve or sustain profitability or positive cash flow in the future.

We experienced net losses of $17.4 million for 2008, $19.2 million for 2009, $25.8 million for 2010, and $17.4 million for the nine months ended September 30, 2011, respectively, and have an accumulated deficit of $94.3 million as of September 30, 2011. We have not generally achieved positive cash flow from our operations or reported net income, and we do not expect to be profitable for the foreseeable future. We expect to continue making significant expenditures to develop and expand our business, including for advertising, customer acquisition, technology infrastructure, storage capacity, product development, and international expansion, in an effort to increase and service our customer base. In 2011, we have incurred, and expect to continue to incur, increased expenses associated with the relocation of one of our data centers to a new facility, and with relocating our customer service operations from India to the U.S., which will adversely affect our operating results for 2011. We also expect that our quarterly results may fluctuate due to a variety of factors described elsewhere in this Quarterly Report on Form 10-Q, including the timing and amount of our advertising expenditures, which are seasonal, as well as the timing and amount of expenditures related to the development of technologies and solutions and to defend intellectual property infringement and other claims. In addition, as a public company, we incur significant legal,

Table of Contents

accounting and other expenses, including increased costs for director and officer liability insurance that we did not incur as a private company. We may also incur increased losses and negative cash flow in the future for a number of reasons, and we may encounter unforeseen expenses, difficulties, complications, delays, and other unknown events. For these reasons, we expect to continue to record net losses for the next several years and we may not be able to achieve or maintain positive cash flow from operations or profitability.

Any significant disruption in our service or loss or misuse of our customers data could damage our reputation and harm our business and operating results.

Our brand, reputation, and ability to attract, retain, and serve our customers are dependent upon the reliable performance of our service and our customers ability to readily access their stored files. Our customers rely on our online backup service to store digital copies of their valuable data files, including financial records, business information, photos, and other personally meaningful content. Our data centers are vulnerable to damage or interruption from human error, intentional bad acts, computer viruses or hackers, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures, and similar events, any of which could limit our customers ability to access their files and could prevent us from being able to continuously back up our customers files. Prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. A breach of our network security and systems could also cause the loss or public disclosure of, or access by third parties to, our customers stored files. Any event that significantly disrupts our service or exposes our customers stored files to misuse could damage our reputation and harm our business and operating results, including reducing our revenue, causing us to issue credits to customers, subjecting us to potential liability, harming our renewal rates, or increasing our cost of acquiring new customers.

The market for online backup solutions is competitive, and if we do not compete effectively, our operating results could be harmed.

We compete with both online backup providers and providers of traditional hardware-based backup systems. The market for online backup solutions is competitive and rapidly changing. We directly compete with Prosoftnet, CrashPlan, Mozy (a division of VMWare), Symantec s Norton Online Backup, McAfee Online Backup, SOS Online Backup, and others. Certain of our features, including our remote access service, also compete with current or potential services offered by Apple, Google, Microsoft, Amazon, and others. Certain of our planned features, including the ability to share data with third parties, also compete with current or potential services offered by DropBox, Mozy, SugarSync, and others. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. Many of our actual and potential competitors benefit from competitive advantages over us, such as greater name recognition, longer operating histories, more varied services, larger marketing budgets, established marketing relationships, access to larger customer bases, major distribution agreements with computer manufacturers, internet service providers and resellers, and greater financial, technical, and other resources. Some of our competitors may make acquisitions or enter into strategic relationships to offer a more comprehensive service than we do. These combinations may make it more difficult for us to compete effectively. We expect these trends to continue as competitors attempt to strengthen or maintain their market positions.

Demand for our online backup solutions is sensitive to price. Many factors, including our advertising, customer acquisition and technology costs, and our current and future competitors pricing and marketing strategies, can significantly affect our pricing strategies. Certain of our competitors offer, or may in the future offer, lower-priced or free products or services that compete with our solutions. Similarly, certain competitors may use internet-

32

Table of Contents

based marketing strategies that enable them to acquire customers at a lower cost than us. There can be no assurance that we will not be forced to engage in price-cutting initiatives, or to increase our advertising and other expenses to attract and retain customers in response to competitive pressures, either of which could have a material adverse effect on our revenue and operating results.

Our limited operating history makes it difficult to evaluate our current business and future prospects.

We have been in existence since 2005, and our revenue has grown rapidly from $8.2 million in 2008 to $38.6 million in 2010, representing a compound annual growth rate of 117.0% over that period. We do not expect that this growth rate will continue in future periods and you should not rely on the revenue growth of any prior quarterly or annual periods as an indication of our future performance. In addition, because we recognize revenue from customers over the terms of their subscriptions, a large portion of our revenue for each quarter reflects deferred revenue from subscriptions entered into during previous quarters, and downturns or upturns in subscription sales or renewals may not be reflected in our operating results until later periods. We may not achieve sufficient revenue to achieve or maintain positive cash flow from operations or profitability, and our limited operating history may make it difficult for you to evaluate our current business and our future prospects. We have encountered and will continue to encounter risks and difficulties frequently experienced by growing companies in rapidly changing industries, including increasing expenses as we continue to grow our business. If we do not manage these risks successfully, our business will be harmed. If our future growth fails to meet investor or analyst expectations, it could have a negative effect on our stock price. If our growth rate were to decline significantly or become negative, it could adversely affect our financial condition and operating results.

A decline in demand for our solutions or for online backup solutions in general could cause our revenue to decline.

We derive, and expect to continue to derive, substantially all of our revenue from the sale of our online backup solutions, a relatively new and rapidly changing market. As a result, widespread acceptance and use of online backup solutions is critical to our future growth and success. If the market for online backup solutions fails to grow or grows more slowly than we currently anticipate, demand for our solutions could be negatively affected.

Changes in customer preferences for online backup solutions may have a disproportionately greater impact on us than if we offered multiple products and services. The market for online backup solutions is subject to rapidly changing customer demand and trends in preferences. Some of the potential factors that could affect interest in and demand for online backup solutions include:

- awareness of our brand and the online backup solutions category generally;
- the appeal and reliability of our solutions;
- the price, performance, features, and availability of products and services that compete with ours;
- public concern regarding privacy and data security;
- our ability to maintain high levels of customer satisfaction; and
- the rate of growth in online solutions generally.

In addition, substantially all of our revenue is currently derived from customers in the U.S. Consequently, a decrease of interest in and demand for online backup solutions in the U.S. could have a disproportionately greater impact on us than if our geographic mix of revenue was less concentrated.

Table of Contents

If we are unable to attract new customers to our solutions on a cost-effective basis, our revenue and operating results would be adversely affected.

We generate substantially all of our revenue from the sale of subscriptions to our solutions. In order to grow, we must continue to attract a large number of customers on a cost-effective basis, many of whom have not previously used online backup solutions. We use and periodically adjust a diverse mix of advertising and marketing programs to promote our solutions. Significant increases in the pricing of one or more of our advertising channels would increase our advertising costs or cause us to choose less expensive and perhaps less effective channels. As we add to or change the mix of our advertising and marketing strategies, we may need to expand into channels with significantly higher costs than our current programs, which could adversely affect our operating results. Currently, we rely significantly on advertising endorsements by certain radio personalities. The loss of one or more of these endorsement arrangements or our inability to obtain additional effective endorsements could adversely affect our advertising and customer acquisition efforts and our operating results. We may incur advertising and marketing expenses significantly in advance of the time we anticipate recognizing any revenue generated by such expenses, and we may only at a later date, or never, experience an increase in revenue or brand awareness as a result of such expenditures. We have made in the past, and may make in the future, significant investments to test new advertising, and there can be no assurance that any such investments will lead to the cost-effective acquisition of additional customers. If we are unable to maintain effective advertising programs, our ability to attract new customers could be adversely affected, our advertising and marketing expenses could increase substantially, and our operating results may suffer.

A portion of our potential customers locate our website through search engines, such as Google, Bing, and Yahoo!. Our ability to maintain the number of visitors directed to our website is not entirely within our control. If search engine companies modify their search algorithms in a manner that reduces the prominence of our listing, or if our competitors search engine optimization efforts are more successful than ours, fewer potential customers may click through to our website. In addition, the cost of purchased listings has increased in the past and may increase in the future. A decrease in website traffic or an increase in search costs could adversely affect our customer acquisition efforts and our operating results.

A significant portion of our customers first try our online backup solutions through free trials. We seek to convert these free trial users to paying customers of our solutions. If our rate of conversion suffers for any reason, our revenue may decline and our business may suffer.

If we are unable to retain our existing customers, our revenue and operating results would be adversely affected.

If our efforts to satisfy our existing customers are not successful, we may not be able to retain them, and as a result, our revenue and ability to grow would be adversely affected. We may not be able to accurately predict future trends in customer renewals. Customers choose not to renew their subscriptions for many reasons, including if customer service issues are not satisfactorily resolved, a desire to reduce discretionary spending, or a perception that they do not use the service sufficiently, the service is a poor value, or that competitive services provide a better value or experience. If our customer retention rate decreases, we may need to increase the rate at which we add new customers in order to maintain and grow our revenue, which may require us to incur significantly higher advertising and marketing expenses than we currently anticipate, or our revenue may decline. A significant decrease in our customer retention rate would therefore have an adverse effect on our business, financial condition, and operating results.

Table of Contents

If we are unable to develop additional solutions for mobile devices, or if users of these devices do not widely adopt our solutions, our business could be adversely affected.

The number of people who access the internet through devices other than personal computers, including mobile telephones, personal digital assistants, smartphones, and handheld tablets or computers, has increased dramatically in the past few years and is projected to continue to increase. We have recently introduced our initial mobile applications for the iPad and iPhone, BlackBerry, and Android smartphones to access files stored on our systems. However, these initial applications have not achieved widespread adoption. In addition, people are increasingly using their mobile devices to create and store data and other content that is important to them. We have not launched any version of our service that will back up data stored on these devices. If one or more of our competitors were to launch such a service, or if we were to be unsuccessful in an attempt to launch such a service, our competitive position could be materially harmed. As new devices and new platforms are continually being released, it is difficult to predict the problems we may encounter in developing versions of our solutions for use on these mobile devices, and we may need to devote significant resources to the creation, support, and maintenance of such services, which could adversely affect our operating results.

If we are unable to expand our base of SMB customers, our business could be adversely affected.

We recently introduced the first version of our backup solution targeted toward SMBs, which are generally companies that are too small to have a dedicated in-house IT staff. We are committing substantial resources to the expansion and increased marketing of our SMB offerings. If we are unable to market and sell our solutions to SMBs with competitive pricing and in a cost-effective manner, our ability to grow our revenue and achieve profitability will be harmed. We expect it will be more difficult and expensive to attract and retain SMB customers than consumers, because SMBs:

- may have different or much more complex needs than those of individual consumers, such as archiving, version control, enhanced security requirements and other forms of encryption and authentication, which our solutions may not adequately address;

- frequently cease operations due to the sale or failure of their business; and

- are difficult to reach without using more expensive, targeted sales campaigns.

In addition, SMBs frequently have limited budgets and are more likely to be significantly affected by economic downturns than larger, more established companies. As a result, they may choose to spend funds on items other than our solutions, particularly during difficult economic times. If we are unsuccessful in meeting the needs of potential SMB customers, it could adversely affect our future growth and operating results.

If we are unable to improve market recognition of and loyalty to our brand, or if our reputation were to be harmed, we could lose customers or fail to increase the number of our customers, which could harm our revenue, operating results, and financial condition.

Given our consumer and SMB market focus, maintaining and enhancing the Carbonite brand is critical to our success. We believe that the importance of brand recognition and loyalty will increase in light of increasing competition in our markets. We plan to continue investing substantial resources to promote our brand, both domestically and internationally, but there is no guarantee that our brand development strategies will enhance the recognition of our brand. Some of our existing and potential competitors have well-established brands with greater

35

Table of Contents

recognition than we have. If our efforts to promote and maintain our brand are not successful, our operating results and our ability to attract and retain customers may be adversely affected. In addition, even if our brand recognition and loyalty increases, this may not result in increased use of our solutions or higher revenue.

Our offerings, as well as those of our competitors, are regularly reviewed in computer and business publications. Negative reviews, or reviews in which our competitors products and services are rated more highly than our solutions, could negatively affect our brand and reputation. From time-to-time, our customers express dissatisfaction with our solutions, including, among other things, dissatisfaction with our customer support, our billing policies, our handling of personal data, and the way our solutions operate. If we do not handle customer complaints effectively, our brand and reputation may suffer, we may lose our customers confidence, and they may choose not to renew their subscriptions. In addition, many of our customers participate in online blogs about computers and internet services, including our solutions, and our success depends in part on our ability to generate positive customer feedback through such online channels where consumers seek and share information. If actions we take or changes we make to our solutions upset these customers, their blogging could negatively affect our brand and reputation. Complaints or negative publicity about our solutions or billing practices could adversely impact our ability to attract and retain customers and our business, financial condition, and operating results.

The termination of our relationship with any major credit card company would have a severe, negative impact on our ability to collect revenue from customers. Increases in credit card processing fees would increase our operating expenses and adversely affect our operating results.

Substantially all of our customers purchase our solutions online with credit cards, and our business depends upon our ability to offer credit card payment options. The termination of our ability to process payments on any major credit card would significantly impair our ability to operate our business and significantly increase our administrative costs related to customer payment processing. If we fail to maintain our compliance with the data protection and documentation standards adopted by the major credit card issuers and applicable to us, these issuers could terminate their agreements with us, and we could lose our ability to offer our customers a credit card payment option. If these issuers increase their credit card processing fees because we experience excessive chargebacks or refunds or for other reasons, it could adversely affect our business and operating results.

Any significant disruption in service on our websites or in our computer systems could damage our reputation and result in a loss of customers, which would harm our business and operating results.

Our brand, reputation, and ability to attract, retain and serve our customers are dependent upon the reliable performance of our websites, network infrastructure and payment systems, and our customers ability to readily access their stored files. We have experienced interruptions in these systems in the past, including server failures that temporarily slowed down our websites performance and our customers ability to access their stored files, or made our websites and infrastructure inaccessible, and we may experience interruptions in the future. Interruptions in these systems, whether due to system failures, computer viruses, physical or electronic break-ins, or other factors, could affect the security or availability of our websites and infrastructure and prevent us from being able to continuously back up our customers data or our customers from accessing their data. In addition, prolonged delays or unforeseen difficulties in connection with adding storage capacity or upgrading our network architecture when required may cause our service quality to suffer. While we believe that there are alternative suppliers who could meet our needs, we currently depend primarily on one provider of disk storage systems for our data centers. Problems with the reliability or security of our systems could harm our reputation. Damage to our reputation and the cost of remedying these problems could negatively affect our business, financial condition, and operating results.

Table of Contents

Our systems provide redundancy at the disk level, but do not keep separate, redundant copies of backed up customer files. Instead, we rely on the fact that our customers, in effect, back up our system by maintaining the primary instance of their files. We do not intend to create redundant backup sites for our solutions. As such, a total failure of our systems, or the failure of any of our systems, could result in the loss of or a temporary inability to back up our customers data and result in our customers being unable to access their stored files. If one of our data centers fails at the same time that our customers computers fail, we would be unable to provide backed up copies of their data. If this were to occur, our reputation could be compromised and we could be subject to liability to the customers that were affected.

Our data centers are vulnerable to damage or interruption from human error, intentional bad acts, pandemics, earthquakes, hurricanes, floods, fires, war, terrorist attacks, power losses, hardware failures, systems failures, telecommunications failures, and similar events. As all of our data facilities are located in a single metropolitan area, we may be more susceptible to the risk that a single event could significantly harm the operations of these facilities. The occurrence of a natural disaster, power failure or an act of terrorism, vandalism or other misconduct, a decision to close the facilities without adequate notice, or other unanticipated problems could result in lengthy interruptions in our services. The occurrence of any of the foregoing events could damage our systems and hardware or could cause them to fail completely, and our insurance may not cover such events or may be insufficient to compensate us for the potentially significant losses, including the potential harm to the future growth of our business, that may result from interruptions in our service as a result of system failures.

We depend on data centers operated by third parties and any disruption in the operation of these facilities could adversely affect our business.

We host our services and serve all of our customers from our network servers, which are located in data center facilities operated by third parties. While we control and have access to our servers and all of the components of our network that are located in our external data centers, we do not control the operation of these facilities. Our data center leases expire at various times between August 2013 and August 2015, and a separate data center hosting arrangement is cancellable by us upon 120 days notice. The owners of our data center facilities have no obligation to renew their agreements with us on commercially reasonable terms, or at all. If we are unable to renew these agreements on commercially reasonable terms, we may be required to transfer our servers to new data center facilities, and we may incur significant costs and possible service interruption in connection with doing so. We are in the process of relocating one of our data centers to a new facility, including relocation of certain of our existing servers, and we will incur additional costs in connection with this transition. Any operational difficulties or disruptions we experience in connection with this transition could adversely affect our reputation and operating results.

Problems faced by our third-party data center locations, with the telecommunications network providers with whom we or they contract, or with the systems by which our telecommunications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Our third-party data centers operators could decide to close their facilities without adequate notice. In addition, any financial difficulties, such as bankruptcy, faced by our third-party data centers operators or any of the service providers with whom we or they contract may have negative effects on our business, the nature and extent of which are difficult to predict. Additionally, if our data centers are unable to keep up with our growing needs for capacity, this could have an adverse effect on our business. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, or other performance problems with our services could harm our reputation and may damage our customers stored files. Interruptions in our services might reduce our revenue, cause us to issue refunds to customers, subject us to potential liability, or harm our renewal rates.

37

Table of Contents

If the security of our customers confidential information stored in our systems is breached or their stored files are otherwise subjected to unauthorized access, our reputation and business may be harmed, and we may be exposed to liability.

Our customers rely on our online system to store digital copies of their files, including financial records, business information, photos, and other personally meaningful content. We also store credit card information and other personal information about our customers. A breach of our network security and systems or other events that cause the loss or public disclosure of, or access by third parties to, our customers stored files could have serious negative consequences for our business, including possible fines, penalties and damages, reduced demand for our solutions, an unwillingness of customers to provide us with their credit card or payment information, an unwillingness of our customers to use our solutions, harm to our reputation and brand, loss of our ability to accept and process customer credit card orders, and time-consuming and expensive litigation. Third parties may be able to circumvent our security by deploying viruses, worms, and other malicious software programs that are designed to attack or attempt to infiltrate our systems and networks.

Further, outside parties may attempt to fraudulently induce employees to disclose sensitive information in order to gain access to our information or our customers information. The techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently, often are not recognized until launched against a target, and may originate from less regulated or remote areas around the world. As a result, we may be unable to proactively address these techniques or to implement adequate preventative or reactionary measures. In addition, employee error, malfeasance, or other errors in the storage, use, or transmission of personal information could result in a breach of customer or employee privacy.

Many states have enacted laws requiring companies to notify individuals of data security breaches involving their personal data. These mandatory disclosures regarding a security breach often lead to widespread negative publicity, which may cause our customers to lose confidence in the effectiveness of our data security measures. Any security breach, whether successful or not, would harm our reputation and could cause the loss of customers. Similarly, if a well-publicized breach of data security at any other online backup service provider or other major consumer website were to occur, there could be a general public loss of confidence in the use of the internet for online backup services or commercial transactions generally. Any of these events could have material adverse effects on our business, financial condition, and operating results.

We process, store and use personal information and other data, which subjects us to governmental regulation and other legal obligations related to privacy, and our actual or perceived failure to comply with such obligations could harm our business.

We receive, store, and process personal information and other customer data. There are numerous federal, state, local, and foreign laws regarding privacy and the storing, sharing, use, processing, disclosure and protection of personal information and other customer data, the scope of which are changing, subject to differing interpretations, and may be inconsistent among countries or conflict with other rules. We generally seek to comply with industry standards and are subject to the terms of our privacy policies and privacy-related obligations to third parties. We strive to comply with all applicable laws, policies, legal obligations and industry codes of conduct relating to privacy and data protection to the extent possible. However, it is possible that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other rules or our practices. Any failure or perceived failure by us to comply with our privacy policies, our privacy-related obligations to customers or other third parties, or our privacy-related legal obligations, or any compromise of security that results in the unauthorized release or transfer of personally identifiable information or other customer data, may result in governmental enforcement actions, litigation, or public statements against us by consumer advocacy groups

Table of Contents

or others and could cause our customers to lose trust in us, which could have an adverse effect on our reputation and business. Our customers may also accidentally disclose their passwords or store them on a mobile device which is lost or stolen, creating the perception that our systems are not secure against third party access. Additionally, if third parties we work with, such as vendors or developers, violate applicable laws or our policies, such violations may also put our customers information at risk and could in turn have an adverse effect on our business. Any significant change to applicable laws, regulations or industry practices regarding the use or disclosure of our customers data, or regarding the manner in which the express or implied consent of customers for the use and disclosure of such data is obtained, could require us to modify our services and features, possibly in a material manner, and may limit our ability to develop new services and features that make use of the data that our customers voluntarily share with us.

We may not be able to respond to rapid technological changes with new solutions, which could have a material adverse effect on our operating results.

The online backup market is characterized by rapid technological change and frequent new product and service introductions. Our ability to attract new customers and increase revenue from existing customers will depend in large part on our ability to enhance and improve our existing solutions, introduce new features and products and sell into new markets. Customers may require features and capabilities that our current solutions do not have. Our failure to develop solutions that satisfy customer preferences in a timely and cost-effective manner may harm our ability to renew our subscriptions with existing customers and create or increase demand for our solutions, and may adversely impact our operating results.

The introduction of new services by competitors or the development of entirely new technologies to replace existing offerings could make our solutions obsolete or adversely affect our business and operating results. In addition, any new markets or countries into which we attempt to sell our solutions may not be receptive. We may experience difficulties with software development, design, or marketing that could delay or prevent our development, introduction, or implementation of new solutions and enhancements. We have in the past experienced delays in the planned release dates of new features and upgrades, and have discovered defects in new solutions after their introduction. There can be no assurance that new solutions or upgrades will be released according to schedule, or that when released they will not contain defects. Either of these situations could result in adverse publicity, loss of revenue, delay in market acceptance, or claims by customers brought against us, all of which could have a material adverse effect on our reputation, business, operating results, and financial condition. Moreover, upgrades and enhancements to our solutions may require substantial investment and we have no assurance that such investments will be successful. If customers do not widely adopt enhancements to our solutions, we may not be able to realize a return on our investment. If we are unable to develop, license, or acquire enhancements to our existing solutions on a timely and cost-effective basis, or if such enhancements do not achieve market acceptance, our business, operating results, and financial condition may be adversely affected.

Our quarterly operating results have fluctuated in the past and may continue to do so in the future. As a result, we may fail to meet or exceed the expectations of research analysts or investors, which could cause our stock price to decline.

Our quarterly operating results may fluctuate as a result of a variety of factors, many of which are outside of our control. If our quarterly operating results or guidance fall below the expectations of research analysts or investors, the price of our common stock could decline substantially. The following factors, among others, could cause fluctuations in our quarterly operating results or guidance:

Table of Contents

- our ability to attract new customers and retain existing customers;
- our ability to accurately forecast revenue and appropriately plan our expenses;
- our ability to introduce new solutions;
- the actions of our competitors, including pricing changes or the introduction of new products;
- our ability to effectively manage our growth;
- the mix of annual and multi-year subscriptions at any given time;
- seasonal variations or other cyclicality in the demand for our solutions, including the purchasing and budgeting cycles of our SMB customers;
- the timing and cost of advertising and marketing efforts;
- the timing and cost of developing or acquiring technologies, services, or businesses;
- the timing, operating cost, and capital expenditures related to the operation, maintenance, and expansion of our business;

- service outages or security breaches and any related impact on our reputation;
- our ability to successfully manage any future acquisitions of businesses, solutions, or technologies;
- the impact of worldwide economic, industry, and market conditions and those conditions specific to internet usage and online businesses;
- costs associated with defending intellectual property infringement and other claims; and
- changes in government regulation affecting our business.

We believe that our quarterly revenue and operating results may vary significantly in the future and that period-to-period comparisons of our operating results may not be meaningful. You should not rely on the results of one quarter as an indication of future performance.

Seasonal variations in our business may also cause fluctuations in our financial results. For example, we generally spend more on advertising during the first and third quarters of each year to capitalize on lower advertising rates in these periods and increased sales of devices that create or store data during post-holiday and back to school periods and our bookings tend to be higher in these periods. While we believe that these seasonal trends have affected and will continue to affect our quarterly results, our trajectory of rapid growth may have overshadowed these effects to date. We believe that our business may become more seasonal in the future as our growth rate slows, and that such seasonal variations in advertising expenditures and customer purchasing patterns may result in fluctuations in our financial results.

Growth may place significant demands on our management and our infrastructure.

We have experienced substantial growth in our business. This growth has placed and may continue to place significant demands on our management and our operational and financial infrastructure. As our operations grow in size, scope, and complexity, we will need to improve and upgrade our systems and infrastructure to attract, service, and retain an increasing number of customers. The expansion of our systems and infrastructure will require us to commit substantial financial, operational, and technical resources in advance of an increase in the volume of business, with no assurance that the volume of business will increase. Any such additional capital investments will increase our cost base. Continued growth could also strain our ability to maintain reliable service levels for our customers, develop and improve our operational, financial and management controls, enhance our reporting systems and procedures, and recruit, train, and retain highly skilled personnel. If we fail to achieve the necessary level of efficiency in our organization as we grow, our business, operating results, and financial condition could be harmed.

40

Table of Contents

We may expand by acquiring or investing in other companies, which may divert our management s attention, result in additional dilution to our stockholders, and consume resources that are necessary to sustain our business.

We may in the future acquire complementary products, services, technologies, or businesses. For example, in June 2011, we acquired substantially all of the assets of Phanfare, Inc., a privately-held provider of photo sharing services, for $2 million in cash and the assumption of certain liabilities. We also may enter into relationships with other businesses to expand our portfolio of solutions or our ability to provide our solutions in foreign jurisdictions, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing, or investments in other companies. We do not have experience with integrating and managing acquired businesses or assets. Negotiating these transactions can be time-consuming, difficult and expensive, and our ability to complete these transactions may often be subject to conditions or approvals that are beyond our control. Consequently, these transactions, even if undertaken and announced, may not close.

An acquisition, investment, or new business relationship may result in unforeseen operating difficulties and expenditures. In particular, we may encounter difficulties assimilating or integrating the businesses, technologies, products, personnel, or operations of acquired companies, particularly if the key personnel of the acquired company choose not to work for us, the company s software is not easily adapted to be compatible with ours, or we have difficulty retaining the customers of any acquired business due to changes in management or otherwise. Acquisitions may also disrupt our business, divert our resources, and require significant management attention that would otherwise be available for the development of our business. Moreover, the anticipated benefits of any acquisition, investment, or business relationship may not be realized or we may be exposed to unknown liabilities, including litigation against the companies we may acquire. For one or more of those transactions, we may:

- issue additional equity securities that would dilute our stockholders;
- use cash that we may need in the future to operate our business;
- incur debt on terms unfavorable to us or that we are unable to repay or that may place burdensome restrictions on our operations;

- incur large charges or substantial liabilities; or

- become subject to adverse tax consequences, or substantial depreciation, deferred compensation or other acquisition-related accounting charges.

Any of these risks could harm our business and operating results.

The loss of one or more of our key personnel, or our failure to attract, integrate, and retain other highly qualified personnel, could harm our business.

We depend on the continued service and performance of our key personnel, including David Friend, our President and Chief Executive Officer, and Jeffry Flowers, our Chief Architect. We do not have long-term employment agreements with any of our officers or key employees. In addition, many of our key technologies and systems are custom-made for our business by our personnel. The loss of key personnel, including key members of our management team, as well as certain of our key marketing, sales, product development, or technology personnel, could disrupt our operations and have an adverse effect on our ability to grow our business. In addition, several of our key personnel have only recently been employed by us, and we are still in the process of integrating these

Table of Contents

personnel into our operations. Our failure to successfully integrate these key employees into our business could adversely affect our business.

To execute our growth plan, we must attract and retain highly qualified personnel. Competition for these employees is intense, and we may not be successful in attracting and retaining qualified personnel. We have from time to time in the past experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees with appropriate qualifications. New hires require significant training and, in most cases, take significant time before they achieve full productivity. Our recent hires and planned hires may not become as productive as we expect, and we may be unable to hire or retain sufficient numbers of qualified individuals. Many of the companies with which we compete for experienced personnel have greater resources than we have. In addition, in making employment decisions, particularly in the internet and high-technology industries, job candidates often consider the value of the stock options they are to receive in connection with their employment. In addition, employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we fail to attract new personnel, or fail to retain and motivate our current personnel, our business and growth prospects could be severely harmed.

Our corporate culture has contributed to our success, and if we cannot maintain this culture as we grow, we could lose the innovation, creativity, and teamwork fostered by our culture, and our business may be harmed.

We believe that our corporate culture has been a key contributor to our success. If we do not continue to develop our corporate culture as we grow and evolve, including maintaining our culture of transparency with our employees, it could harm our ability to foster the innovation, creativity, and teamwork we believe that we need to support our growth. As our organization grows and we are required to implement more complex organizational structures, we may find it increasingly difficult to maintain the beneficial aspects of our corporate culture, which could negatively impact our future success. In addition, our recently completed initial public offering could create disparities of wealth among our employees, which could adversely impact relations among employees and our corporate culture in general.

Our operating results may be harmed if we are required to collect sales or other related taxes for our subscription services in jurisdictions where we have not historically done so.

We do not believe we are required to collect sales, use, or other similar taxes from our customers. However, one or more states or countries may seek to impose sales, use, or other tax collection obligations on us, including for past sales by us or our resellers and other partners. A successful assertion by a state, country, or other jurisdiction that we should have or should be collecting sales, use, or other taxes on our services could, among other things, result in substantial tax liabilities for past sales, create significant administrative burdens for us, discourage customers from purchasing our services, or otherwise harm our business and operating results.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

As of December 31, 2010, we had federal net operating loss carryforwards, or NOLs, of $72.8 million available to offset future taxable income, which expire in various years through 2031 if not utilized. A lack of future taxable income would adversely affect our ability to utilize these NOLs before they expire. Under the provisions of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, substantial changes in our ownership may limit the amount of pre-change NOLs that can be utilized annually in the future to offset taxable income.

Table of Contents

Section 382 of the Internal Revenue Code, or Section 382, imposes limitations on a company s ability to use NOLs if a company experiences a more-than-50-percent ownership change over a three-year testing period. We believe that, as a result of prior or future issuances of our capital stock, including our initial public offering, it is possible that such a change in our ownership has occurred or will occur. If such a change in our ownership has occurred or occurs, our ability to use our NOLs in any future periods may be substantially limited. For these reasons, we may not be able to utilize a material portion of the NOLs reflected on our balance sheet, even if we achieve profitability. If we are limited in our ability to use our NOLs in future years in which we have taxable income, we will pay more taxes than if we were able to fully utilize our NOLs. This could adversely affect our operating results and the market price of our common stock.

Any expenses or liability resulting from litigation could adversely affect our operating results and financial condition.

From time to time, we may be subject to claims or litigation, including intellectual property litigation as described elsewhere in this Quarterly Report on Form 10-Q. Any such claims or litigation may be time-consuming and costly, divert management resources, require us to change our services, require us to refund subscription fees, or have other adverse effects on our business. Any of the foregoing could have a material adverse effect on our operating results and could require us to pay significant monetary damages. In addition, we receive and must respond on a periodic basis to subpoenas from law enforcement agencies seeking copies of a customer s data stored on our servers in connection with criminal investigations. While we have in place a procedure to respond to such subpoenas, any failure on our part to properly respond to such subpoena requests could expose us to litigation or other proceedings and adversely affect our business, financial condition, and operating results.

Our success depends on our customers continued high-speed access to the internet and the continued reliability of the internet infrastructure.

Our business depends on our customers high-speed access to the internet, as well as the continued maintenance and development of the internet infrastructure. The future delivery of our solutions will depend on third party internet service providers to expand high-speed internet access, to maintain a reliable network with the necessary speed, data capacity and security, and to develop complementary products and services, including high-speed modems, for providing reliable and timely internet access and services. All of these factors are out of our control. To the extent that the internet continues to experience an increased number of users, frequency of use, or bandwidth requirements, the internet may become congested and be unable to support the demands placed on it, and its performance or reliability may decline. Any internet outages or delays could adversely affect our ability to provide services to our customers.

Our business may be significantly impacted by a change in the economy, including any resulting effect on consumer spending.

Our business may be affected by changes in the economy generally, including any resulting effect on consumer spending. Our services are discretionary purchases, and our customers may reduce their discretionary spending on our services during an economic downturn. Although we have not yet experienced a material reduction in subscription renewals, we may experience such a reduction in the future, especially in the event of a prolonged recessionary period. Conversely, media prices may increase in a period of economic growth, which could significantly increase our marketing and advertising expenses. As a result, our business, financial condition, and operating results may be significantly affected by changes in the economy generally.

43

Table of Contents

We face many risks associated with our plans to expand internationally, which could harm our business, financial condition, and operating results.

We anticipate that our efforts to expand internationally will entail the marketing and advertising of our services and brand and the development of localized websites. We do not have substantial experience in selling our solutions in international markets or in conforming to the local cultures, standards, or policies necessary to successfully compete in those markets, and we must invest significant resources in order to do so. We may not succeed in these efforts or achieve our customer acquisition or other goals. For some international markets, customer preferences and buying behaviors may be different, and we may use business or pricing models that are different from our traditional subscription model to provide online backup and related services to customers. Our revenue from new foreign markets may not exceed the costs of establishing, marketing, and maintaining our international offerings, and therefore may not be profitable on a sustained basis, if at all.

In addition, conducting international operations subjects us to new risks that we have not generally faced in the U.S. These risks include:

- localization of our solutions, including translation into foreign languages and adaptation for local practices and regulatory requirements;
- lack of experience in other geographic markets;
- strong local competitors;
- cost and burden of complying with, lack of familiarity with, and unexpected changes in foreign legal and regulatory requirements, including consumer and data privacy laws;
- difficulties in managing and staffing international operations;
- fluctuations in currency exchange rates or restrictions on foreign currency;
- potentially adverse tax consequences, including the complexities of transfer pricing, foreign value added or other tax systems, double taxation and restrictions and/or taxes on the repatriation of earnings;
- dependence on third parties, including channel partners with whom we do not have extensive experience;
- compliance with the Foreign Corrupt Practices Act, economic sanction laws and regulations,

export controls, and other U.S. laws and regulations regarding international business operations;

increased financial accounting and reporting burdens and complexities;

political, social, and economic instability abroad, terrorist attacks, and security concerns in general; and

reduced or varied protection for intellectual property rights in some countries.

Operating in international markets also requires significant management attention and financial resources. The investment and additional resources required to establish operations and manage growth in other countries may not produce desired levels of revenue or profitability.

Our software contains encryption technologies, certain types of which are subject to U.S. and foreign export control regulations and, in some foreign countries, restrictions on importation and/or use. Any failure on our part to comply with encryption or other applicable export control requirements could result in financial penalties or other sanctions under the U.S. export regulations, including restrictions on future export activities, which could harm

Table of Contents

our business and operating results. Regulatory restrictions could impair our access to technologies that we seek for improving our solutions and may also limit or reduce the demand for our solutions outside of the U.S.

We may not be able to maintain control of our business in China.

The government of the People s Republic of China, or PRC, restricts foreign investment in internet and online advertising businesses. Accordingly, we intend to operate our online backup business in China through an affiliated entity in China owned by an individual designated by us. The individual stockholder of the entity will be a PRC citizen. We expect to enter into contractual arrangements with our affiliated entity and its individual stockholder that are intended to protect our technologies and business. While we have not yet established these contractual arrangements, we anticipate that we will loan funds to the designated individual to enable the individual to form the affiliated entity and obtain any necessary licenses, including an Internet Content Provider, or ICP, license. We expect that this loan would be secured by the capital stock of the affiliated entity, and that the designated individual stockholder would grant us the contractual right to exercise his rights as the sole stockholder of the affiliated entity. We cannot assure you, however, that we will be able to enforce these contracts. We will have no equity ownership interest in the affiliated entity and will rely on contractual arrangements with the entity and the designated individual stockholder to control and operate the entity. These contractual arrangements may not be as effective in providing control over the affiliated entity as direct ownership. For example, the entity could fail to take actions required for, or beneficial to, our business or fail to maintain our websites despite its contractual obligations to do so. In addition, we cannot assure you that the individual shareholder of the affiliated entity would always act in our best interests. If the affiliated entity or its individual stockholder fail to perform their obligations under their respective agreements with us, we may need to engage in litigation in China to enforce our rights, which may be time-consuming and costly, divert management resources, or have other adverse effects on our business, and we may not be successful in enforcing our rights. In addition, since the affiliated entity has not yet been formed, it has not begun the process of seeking an ICP license, and we cannot assure you that the affiliated entity will be able to be formed and obtain an ICP license on a timely basis, if at all. Any delay or failure in the affiliated entity obtaining an ICP license could delay or prevent us from operating our online backup business in China, and we would be unable to recover any costs we incur in attempting to establish our business in China.

The laws and regulations governing our business or the enforcement and performance of our proposed contractual arrangements with our affiliated Chinese entity and the designated individual stockholder are relatively new and may be subject to change, and their official interpretation and enforcement may involve substantial uncertainty. New laws and regulations that affect our business may also be applied retroactively. We cannot assure you that the PRC government would agree that the operating arrangements comply with PRC licensing, registration, or other regulatory requirements, with existing policies, or with requirements or policies that may be adopted in the future. For example, in September 2011, the PRC Ministry of Commerce stated that the relevant departments of the PRC government are jointly considering additional regulation of the type of investment structure that we intend to use, which is based on the approach used by other non-PRC companies with respect to their conduct of businesses that require an ICP license. If the PRC government determines that we do not comply with applicable law, it could revoke our business and operating licenses, require us to discontinue or restrict our operations, restrict our right to collect revenue, block our websites, require us to restructure our operations, impose additional conditions or requirements with which we may not be able to comply, impose restrictions on our business operations or on our customers, or take other regulatory or enforcement actions against us that could be harmful to our business. In addition, since the PRC historically has not protected intellectual property to the same extent as the United States, by operating in the PRC we may face an increased risk of infringement of our intellectual property by third parties.

Table of Contents

Risks Related to Intellectual Property

Assertions by a third party that our solutions infringe its intellectual property, whether or not correct, could subject us to costly and time-consuming litigation or expensive licenses. We are currently a defendant in a lawsuit alleging patent infringement.

There is frequent litigation in the software and technology industries based on allegations of infringement or other violations of intellectual property rights. Many companies are devoting significant resources to obtaining patents that could affect many aspects of our business. Third parties may claim that our technologies or solutions infringe or otherwise violate their patents or other intellectual property rights. As we face increasing competition and become increasingly visible as a publicly-traded company, or if we become more successful, the possibility of new third party claims may increase.

We have licensed proprietary technologies from third parties that we use in our technologies and business, and we cannot be certain that the owners rights in their technologies will not be challenged, invalidated, or circumvented. If we are forced to defend ourselves against intellectual property infringement claims, whether they have merit or are determined in our favor, we may face costly litigation, diversion of technical and management personnel, limitations on our ability to use our current websites and technologies, and an inability to market or provide our solutions. As a result of any such claim, we may have to develop or acquire non-infringing technologies pay damages, enter into royalty or licensing agreements, cease providing certain services, adjust our marketing and advertising activities, or take other actions to resolve the claims. These actions, if required, may be costly or unavailable on terms acceptable to us or at all.

Furthermore, we may acquire proprietary technologies from third parties and may incorporate such technologies in our solutions. In addition to the general risks described above associated with intellectual property and other proprietary rights, we are subject to the additional risk that the seller of such technologies may not have appropriately created, maintained, or enforced such rights in such technology.

In August 2010 Oasis Research, LLC, or Oasis Research, filed a lawsuit against us and several of our competitors and other online technology companies in the U.S. District Court for the Eastern District of Texas, alleging that our online backup storage services and other companies products or services infringe certain of

Oasis Research s patents. Oasis Research seeks an award for damages in an unspecified amount. Oasis Research does not currently seek an injunction. We are not able to assess with certainty the outcome of this litigation or the amount or range of potential damages or future payments associated with this litigation at this time. However, any litigation is subject to inherent uncertainties, and there can be no assurance that the expenses associated with defending this lawsuit or its resolution will not have a material adverse impact on our business, operations, financial condition, or cash flows. A trial date has been preliminarily set for late 2012.

Our success depends in large part on our ability to protect and enforce our intellectual property rights. If we are not able to adequately protect our intellectual property and proprietary technologies to prevent use or appropriation by our competitors, the value of our brand and other intangible assets may be diminished, and our business may be adversely affected.

Our future success and competitive position depend in large part on our ability to protect our intellectual property and proprietary technologies. We rely on a combination of trademark, patent, copyright, and trade secret laws, as well as confidentiality procedures and contractual restrictions, to establish and protect our proprietary rights, all of which provide only limited protection and may not now or in the future provide us with a competitive advantage. CARBONITE and the Carbonite logo are our registered trademarks in the U.S. and in certain other

Table of Contents

countries. We have filed trademark applications for additional marks in the U.S. and other countries. We cannot assure you that any future trademark registrations will be issued for pending or future applications or that any registered trademarks will be enforceable or provide adequate protection of our proprietary rights. We have 13 patent applications pending, and are in the process of filing additional patent applications. We cannot assure you that any patents will issue from any such patent applications, that patents that issue from such applications will give us the protection that we seek, or that any such patents will not be challenged, invalidated, or circumvented. Any patents that may issue in the future from our pending or future patent applications may not provide sufficiently broad protection and may not be enforceable in actions against alleged infringers.

There can be no assurance that the steps we take will be adequate to protect our technologies and intellectual property, that our trademark and patent applications will lead to registered trademarks or issued patents, that others will not develop or patent similar or superior technologies, products, or services, or that our trademarks, patents, and other intellectual property will not be challenged, invalidated, or circumvented by others.

Furthermore, effective trademark, patent, copyright, and trade secret protection may not be available in every country in which our services are available or where we have employees or independent contractors. In addition, the legal standards relating to the validity, enforceability, and scope of protection of intellectual property rights in internet-related industries are uncertain and still evolving.

The steps we have taken and will take may not prevent unauthorized use, reverse engineering, or misappropriation of our technologies and we may not be able to detect any of the foregoing. Others may independently develop technologies that are competitive to ours or infringe our intellectual property. Defending and enforcing our intellectual property rights may result in litigation, which can be costly and divert management attention and resources. Any such litigation may not be successful even if such rights have been infringed, and an adverse decision could limit the scope of such rights. If our efforts to protect our technologies and intellectual property are inadequate, the value of our brand and other intangible assets may be diminished and competitors may be able to mimic our solutions and methods of operations. Any of these events could have a material adverse effect on our business, financial condition, and operating results.

Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and proprietary information. Failure to protect our proprietary information could make it easier for third parties to compete with our solutions and harm our business.

We have devoted substantial resources to the development of our proprietary technologies and related processes. In order to protect our proprietary technologies and processes, we rely in part on trade secret laws and confidentiality agreements with our employees, licensees, independent contractors, and other advisors. These agreements may not effectively prevent disclosure of confidential information and may not provide an adequate remedy in the event of unauthorized disclosure of confidential information. In addition, others may independently discover our trade secrets, in which case we would not be able to assert trade secret rights, or develop similar technologies and processes. Further, laws in certain jurisdictions may afford little or no trade secret protection, and any changes in, or unexpected interpretations of, the intellectual property laws in any country in which we operate may compromise our ability to enforce our intellectual property rights. Costly and time-consuming litigation could be necessary to enforce and determine the scope of our proprietary rights, and failure or inability to obtain or maintain trade secret protection or otherwise protect our proprietary rights could adversely affect our business.

47

Table of Contents

Our use of open source software could negatively affect our ability to sell our solutions and subject us to possible litigation.

A portion of the technologies licensed by us to our customers incorporates so-called open source software, and we may incorporate open source software in the future. Such open source software is generally licensed by its authors or other third parties under open source licenses. These licenses may subject us to certain unfavorable conditions, including requirements that we offer our solutions that incorporate the open source software for no cost, that we make publicly available source code for modifications or derivative works we create based upon, incorporating, or using the open source software, and/or that we license such modifications or derivative works under the terms of the particular open source license. Additionally, if a third party software provider has incorporated open source software into software that we license from such provider, we could be required to disclose any of our source code that incorporates or is a modification of such licensed software. If an author or other third party that distributes open source software that we use or license were to allege that we had not complied with the conditions of the applicable license, we could be required to incur significant legal expenses defending against such allegations and could be subject to significant damages, enjoined from the sale of our solutions that contained the open source software, and required to comply with the foregoing conditions. Any of the foregoing could disrupt the distribution and sale of our solutions and harm our business.

We rely on third party software, including server software and licenses from third parties to use patented intellectual property, that is required to develop and provide our solutions.

We rely on software licensed from third parties to develop and offer our solutions, including server software from Microsoft and other patented third-party technologies. In addition, we may need to obtain future licenses from third parties to use intellectual property associated with the development of our solutions, which might not be available to us on acceptable terms, or at all. Any loss of the right to use any software required for the development and maintenance of our solutions could result in delays in the provision of our solutions until equivalent technology is either developed by us, or, if available from others, is identified, obtained, and integrated, which could harm our business. Any errors or defects in third party software could result in errors or a failure of our solutions, which could harm our business.

If we are unable to protect our domain names, our reputation, brand, customer base, and revenue, as well as our business and operating results, could be adversely affected.

We have registered domain names for websites, or URLs, that we use in our business, such as www.carbonite.com. If we are unable to maintain our rights in these domain names, our competitors or other third parties could capitalize on our brand recognition by using these domain names for their own benefit. In addition, although we own the Carbonite domain name under various global top level domains such as .com and .net, as well as under various country-specific domains, we might not be able to, or may choose not to, acquire or maintain other country-specific versions of the Carbonite domain name or other potentially similar URLs. Domain names similar to ours have already been registered in the U.S. and elsewhere, and our competitors or other third parties could capitalize on our brand recognition by using domain names similar to ours. The regulation of domain names in the U.S. and elsewhere is generally conducted by internet regulatory bodies and is subject to change. If we lose the ability to use a domain name in a particular country, we may be forced to either incur significant additional expenses to market our solutions within that country, including the development of a new brand and the creation of new promotional materials, or elect not to sell our solutions in that country. Either result could substantially harm our business and operating results. Regulatory bodies could establish additional top-level domains, appoint additional domain name registrars, or modify the requirements for holding domain names. As a result, we may not be able to acquire or maintain the domain names that utilize the name Carbonite in all of the countries in which we currently conduct or intend to conduct business. Further, the relationship between regulations governing domain names and laws protecting trademarks and similar proprietary rights varies among jurisdictions and is unclear in some

48

Table of Contents

jurisdictions. We may be unable to prevent third parties from acquiring and using domain names that infringe, are similar to, or otherwise decrease the value of, our brand or our trademarks. Protecting and enforcing our rights in our domain names and determining the rights of others may require litigation, which could result in substantial costs, divert management attention, and not be decided favorably to us.

Material defects or errors in our software could harm our reputation, result in significant costs to us, and impair our ability to sell our solutions.

The software applications underlying our solutions are inherently complex and may contain material defects or errors, particularly when first introduced or when new versions or enhancements are released. We have from time to time found defects or errors in our solutions, and new defects or errors in our existing solutions may be detected in the future by us or our customers. The costs incurred in correcting such defects or errors may be substantial and could harm our operating results. In addition, we rely on hardware purchased or leased and software licensed from third parties to offer our solutions. Any defects in, or unavailability of, our or third party software or hardware that cause interruptions to the availability of our solutions could, among other things:

- cause a reduction in revenue or delay in market acceptance of our solutions;
- require us to issue refunds to our customers or expose us to claims for damages;
- cause us to lose existing customers and make it more difficult to attract new customers;
- divert our development resources or require us to make extensive changes to our solutions or software, which would increase our expenses;
- increase our technical support costs; and
- harm our reputation and brand.

Risks Related to Ownership of our Common Stock

Our stock price may be volatile due to fluctuations in our operating results and other factors, each of which could our stock price to decline.

Shares of our common stock were sold in our initial public offering in August 2011 at a price of $10.00 per shares, and our common stock has subsequently traded as high as $21.10. An active, liquid, and orderly market for our common stock may not be developed or sustained, which could depress the trading price of our common stock. The market price for shares of our common stock could be subject to significant fluctuations in response to various factors, some of which are beyond our control. Some of the factors that may cause the market price for shares of our common stock to fluctuate include:

- fluctuations in our quarterly financial results or the quarterly financial results of companies perceived to be similar to us;
- actual or anticipated fluctuations in our key operating metrics, financial condition, and operating results;
- loss of existing customers or inability to attract new customers;
- actual or anticipated changes in our growth rate;
- announcements of technological innovations or new offerings by us or our competitors;
- our announcement of actual results for a fiscal period that are lower than projected or expected or our announcement of revenue or earnings guidance that is lower than expected;

Table of Contents

changes in estimates of our financial results or recommendations by securities analysts;

failure of any of our solutions to achieve or maintain market acceptance;

changes in market valuations of similar companies;

success of competitive products or services;

changes in our capital structure, such as future issuances of securities or the incurrence of debt;

announcements by us or our competitors of significant products or services, contracts, acquisitions, or strategic alliances;

regulatory developments in the U.S. or foreign countries;

actual or threatened litigation involving us or our industry;

additions or departures of key personnel;

general perception of the future of the online backup market or our solutions;

share price and volume fluctuations attributable to inconsistent trading volume levels of our shares;

sales of our shares of common stock by us or our stockholders; and

changes in general economic, industry, and market conditions.

In addition, the stock market in general, and the market for internet-related companies in particular, has experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. Securities class action litigation has often been instituted against companies following periods of volatility in the overall market and in the market price of a company s securities. This litigation, if instituted against us, could result in very substantial costs, divert our management s attention and resources, and harm our business, operating results, and financial condition. In addition, recent fluctuations in the financial and capital markets have resulted in volatility in securities prices.

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired, which could harm our operating results, our ability to operate our business, and investors views of us.

Ensuring that we have adequate internal financial and accounting controls and procedures in place so that we can produce accurate financial statements on a timely basis is a costly and time-consuming effort that needs to be evaluated frequently. As part of our process of documenting and testing our internal control over financial reporting, we may identify areas for further attention and improvement. Implementing any appropriate changes to our internal controls may distract our officers and employees, entail substantial costs to modify our existing processes, and take significant time to complete. These changes may not, however, be effective in maintaining the adequacy of our internal controls, and any failure to maintain that adequacy, or consequent inability to produce accurate financial statements on a timely basis, could increase our operating costs and harm our business. In addition, investors perceptions that our internal controls are inadequate or that we are unable to produce accurate financial statements on a timely basis may harm our stock price and make it more difficult for us to effectively market and sell our solutions to new and existing customers.

Our failure to raise additional capital or generate the cash flows necessary to expand our operations and invest in our business could reduce our ability to compete successfully.

Although we currently anticipate that our available funds, including the net proceeds of our initial public offering and our available bank line of credit, will be sufficient to meet our cash needs for at least the next 12

50

months, we may require additional financing in the future. Our ability to obtain financing will depend, among other things, on our development efforts, business plans, operating performance and condition of the capital markets at the time we seek financing. If we need to raise additional funds, we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the per share value of our common stock could decline. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness and force us to maintain specified liquidity or other ratios. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our solutions;
- continue to expand our development, sales, and marketing organizations;
- acquire complementary technologies, products, or businesses;
- expand our operations in the U.S. or internationally;
- hire, train, and retain employees;

respond to competitive pressures or unanticipated working capital requirements; or

continue our operations.

A significant portion of our total outstanding shares may be sold into the public market in the near future, which could cause the market price of our common stock to drop significantly, even if our business is doing well.

Sales of a substantial number of shares of our common stock in the public market, or the perception that such sales could occur, could adversely affect the market price of our common stock. Approximately 17,900,000 million shares of our common stock may be sold, subject to applicable volume and other limitations under federal securities laws, by stockholders upon expiration, in February 2012, of lock-up agreements entered into with the underwriters of our initial public offering. In addition, the underwriters may, in their sole discretion, release all or some portion of the shares subject to lock-up agreements prior to the expiration of the lock-up period. In August 2011, we filed a Form S-8 under the Securities Act registering 5,177,658 shares of our common stock for issuance under our equity incentive plans. These shares may be sold in the public market upon issuance, subject to the terms of lock-up agreements and other contractual restrictions. If these additional shares are sold, or if it is perceived that they will be sold, in the public market, the market price of our common stock could decline.

We also may issue shares of our common stock or securities convertible into our common stock from time to time in connection with financing, acquisition, investment, or otherwise. Any such issuance could result in substantial dilution to our existing stockholders and cause the market price of our common stock to decline.

Our directors, executive officers, and principal stockholders have substantial control over us and could delay or prevent a change in corporate control.

Our directors, executive officers, and holders of more than 5% of our common stock, together with their affiliates hold a majority of our outstanding shares of common stock and have the ability to control the outcome of matters submitted to our stockholders for approval, including the election of directors and any merger, consolidation, or sale of all or substantially all of our assets. In addition, these stockholders, acting together, may have the ability to control or influence the management and affairs of our company. This concentration of ownership could limit your ability to influence corporate matters and may have the effect of delaying or preventing a change in corporate control.

Table of Contents

If securities or industry analysts do not publish or cease publishing research or reports about us, our business, or our market, or if they change their recommendations regarding our stock adversely, our stock price and trading volume could decline.

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts may publish about us, our business, our market, or our competitors. If any of the analysts who cover us change their recommendation regarding our stock adversely, or provide more favorable relative recommendations about our competitors, our stock price would likely decline. If any analyst who covers us were to cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

Our management will continue to have broad discretion over the use of the proceeds we received in our initial public offering and might not apply the proceeds in ways that increase the value of your investment.

Our management will continue to have broad discretion to use our net proceeds from our initial public offering, and you will be relying on the judgment of our management regarding the application of these proceeds. Our management might not apply these proceeds in ways that increase the value of your investment. We intend to use the net proceeds to us from the initial public offering primarily for general corporate purposes, including working capital, sales and marketing activities, general and administrative matters, and capital expenditures. We may also use a portion of the net proceeds to acquire, invest in, or obtain rights to complementary technologies, solutions, or businesses. Until we use the net proceeds to us from the initial public offering, we plan to invest them, and these investments may not yield a favorable rate of return. If we do not invest or apply the net proceeds from the initial public offering in ways that enhance stockholder value, we may fail to achieve expected financial results, which could cause our stock price to decline.

We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.

We have never declared or paid any cash dividends on our common stock and do not intend to do so for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth and continuing operations. In addition, the provisions of our revolving credit facility prohibit us from paying cash dividends. Therefore, you are not likely to receive any dividends on your shares of common stock for the foreseeable future and the success of an investment in shares of our common stock will depend upon any future appreciation in their value. Our common stock may not appreciate in value or even maintain the price at which our stockholders have purchased their shares.

Anti-takeover provisions contained in our certificate of incorporation and bylaws, as well as provisions of Delaware law, could impair a takeover attempt.

Our certificate of incorporation and bylaws contain provisions that could have the effect of delaying or preventing changes in control or changes in our management without the consent of our board of directors. These provisions include:

- a classified board of directors with three-year staggered terms, which may delay the ability of stockholders to change the membership of a majority of our board of directors;

52

Table of Contents

no cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;

the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of the board of directors or the resignation, death, or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;

the ability of our board of directors to determine to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;

a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;

the requirement that a special meeting of stockholders may be called only by the chairman of the board of directors, the chief executive officer, or the board of directors, which may delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;

- limiting the liability of, and providing indemnification to, our directors and officers;

- controlling the procedures for the conduct and scheduling of stockholder meetings;

- providing the board of directors with the express power to postpone previously scheduled annual meetings of stockholders and to cancel previously scheduled special meetings of stockholders;

- providing that directors may be removed prior to the expiration of their terms by stockholders only for cause; and

- advance notice procedures that stockholders must comply with in order to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders meeting, which may discourage or deter a potential acquiror from conducting a solicitation of proxies to elect the acquiror s own slate of directors or otherwise attempting to obtain control of us.

These provisions, alone or together, could delay hostile takeovers and changes in control of our company or changes in our management.

As a Delaware corporation, we are also subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation Law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock. Any provision of our amended and restated certificate of incorporation or bylaws or Delaware law that has the effect of delaying or deterring a change in control could limit the opportunity for our stockholders to receive a premium for their shares of our common stock, and could also affect the price that some investors are willing to pay for our common stock.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Unregistered Sales of Equity Securities

During the period between July 1, 2011 and August 17, 2011 (the date of the filing of our registration statement on Form S-8, File No. 333-176373), we issued options to purchase 186,750 shares of our common stock at an exercise price of $10.00 per share. During this same period, we issued an aggregate of 66,194 shares of common stock that were not registered under the

Securities Act to our directors, officers, employees, and consultants pursuant to exercise of stock options for cash consideration with aggregate exercise proceeds of $87,907.

53

These issuances were undertaken in reliance upon the exemption from registration requirements of Rule 701 of the Securities Act. The recipients of these shares of commons stock represented their intentions to acquire the shares for investment only and not with a view to or for sale in connection with any distribution, and appropriate legends were affixed to the share book entry records issued in these transactions. All recipients had adequate access, through their relationship with us, to information about us.

On August 10, 2011, our registration statement on Form S-1 (File No. 333-174139) was declared effective for our initial public offering. On August 16, 2011, we closed our initial public offering of 7,187,500 shares of common stock at an offering price of $10.00 per share, of which 6,303,973 shares were sold by us, including 937,500 shares pursuant to the underwriters option to purchase additional shares, and 883,527 shares were sold by selling stockholders. The underwriters of the offering were Merrill Lynch, Pierce, Fenner & Smith Incorporated, J.P. Morgan Securities LLC, William Blair & Company, L.L.C., Canaccord Genuity Inc., Oppenheimer & Co. Inc., and Pacific Crest Securities Inc. Following the sale of the shares in connection with the closing of our initial public offering, the offering terminated.

As a result of the offering, including the underwriters option to purchase additional shares, we received net proceeds of approximately $55.7 million, after deducting total expenses of approximately $7.3 million, consisting of underwriting discounts and commissions of approximately $4.4 million and offering-related expenses of approximately $2.9 million. None of such payments were direct or indirect payments to any of the Company s directors or officers or their associates, to person owning 10% or more of our common stock, or to any of our affiliates.

The net proceeds to us from our initial public offering have been invested in money market accounts.

There has been no material change in the planned use of proceeds from our initial public offering as described in our prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b) under the Securities Act.

ITEM 6. EXHIBITS

Exhibits

3.1	Amended and Restated Certificate of Incorporation of Carbonite, Inc.
3.2(1)	Amended and Restated By-Laws of Carbonite, Inc.

10.1#	Offer Letter with Oussama El-Hilali, dated as of August 11, 2011.
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*	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS+	XBRL Instance Document.
101.SCH+	XBRL Taxonomy Extension Schema Document.
101.CAL+	XBRL Taxonomy Extension Calculation Linkbase

	Document.
101.DEF+	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB+	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE+	XBRL Taxonomy Extension Presentation Linkbase Document.

(1) Filed as Exhibit 3.2 to Amendment No. 2 to Registrant s Registration Statement on Form S-1 filed with the Securities and Exchange Commission on July 13, 2011, and incorporated herein by reference.

54

Table of Contents

\# Indicates a management contract or compensatory plan.

* These certificates are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference in any filing we make under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, irrespective of any general incorporation language in any filings.

\+ In accordance with Rule 406T of Regulation S-T, these XBRL (eXtensible Business Reporting Language) documents are furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, or Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.

Table of Contents

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.

	CARBONITE, INC.	
Dated: November 10, 2011	By:	/s/ David Friend David Friend Chief Executive Officer
Dated: November 10, 2011	By:	/s/ Andrew P. Keenan Andrew P. Keenan Chief Financial Officer

56