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

FORM 10-Q

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

For the quarterly period ended September 30, 2001

or

[_] TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 0-27488

INCYTE GENOMICS, INC.
(Formerly known as Incyte Pharmaceuticals, Inc.)
(Exact name of registrant as specified in its charter)

Delaware	94-3136539
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3160 Porter Drive
Palo Alto, California 94304
(Address of principal executive offices)

(650) 855-0555
(Registrant's telephone number, including area code)

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

The number of outstanding shares of the registrant's Common Stock, $0.001 par value, was 66,402,217 as of September 30, 2001.

INCYTE GENOMICS, INC.

INDEX

PART I: FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

Incyte Genomics, Inc.
Condensed Consolidated Balance Sheets
(in thousands)
(unaudited)

	September 30, 2001	December 31, 2000*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 45,488	$ 110,155
Marketable securities - available-for-sale	472,058	472,025
Accounts receivable, net	44,117	35,022
Prepaid expenses and other current assets	31,252	30,693
Total current assets	592,915	647,895
Property and equipment, net	80,194	98,948
Long-term investments	52,089	40,003
Goodwill and other intangible assets, net	73,970	82,944
Deposits and other assets	26,472	17,030
Total assets	$ 825,640	$ 886,820
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 8,212	$ 17,497
Accrued compensation	14,764	13,023
Accrued and other current liabilities	20,981	23,036
Deferred revenue	18,888	22,756
Total current liabilities	62,845	76,312
Convertible subordinated notes	179,358	187,814
Total liabilities	242,203	264,126
Stockholders' equity:		
Common stock	66	66
Additional paid-in capital	696,879	689,392
Deferred compensation	(1,955)	(2,773)
Accumulated other comprehensive income	11,382	20,913
Accumulated deficit	(122,935)	(84,904)
Total stockholders' equity	583,437	622,694
Total liabilities and stockholders' equity	$ 825,640	$ 886,820

* The condensed consolidated balance sheet at December 31, 2000 has been derived from the audited financial statements at that date.

See accompanying notes

INCYTE GENOMICS, INC.
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Revenues	$ 57,319	$ 51,982	$ 164,491	$ 138,751
Costs and expenses:				
Research and development	50,662	51,880	161,776	138,621
Selling, general and administrative	17,886	15,848	53,038	45,669
Total costs and expenses	68,548	67,728	214,814	184,290
Loss from operations	(11,229)	(15,746)	(50,323)	(45,539)
Interest income and other income/(expense), net	3,003	11,034	21,640	32,251
Interest expense	(2,547)	(2,886)	(7,692)	(7,794)
Loss on sale of assets	(5,777)	-	(5,777)	-
Gain/(loss) on derivative financial instruments	(1,052)	-	162	-
Loss from joint venture	-	-	-	(1,283)
Loss before income taxes, extraordinary item and accounting change	(17,602)	(7,598)	(41,990)	(22,365)
Provision for income taxes	225	-	705	-
Loss before extraordinary item and accounting change	(17,827)	(7,598)	(42,695)	(22,365)
Extraordinary gain, net of taxes	-	-	2,386	-
Cumulative effect of accounting change, net of taxes	-	-	2,279	-
Net loss	$ (17,827)	$ (7,598)	$ (38,030)	$ (22,365)
Per share data:				
Loss before extraordinary item and accounting change	$ (0.27)	$ (0.12)	$ (0.65)	$ (0.36)
Extraordinary gain, net of taxes	-	-	0.04	-
Cumulative effect of accounting change, net of taxes	-	-	0.03	-
Basic and diluted net loss per share	$ (0.27)	$ (0.12)	$ (0.58)	$ (0.36)
Shares used in computing basic and diluted net loss per share	66,370	64,064	66,064	62,825

See accompanying notes

INCYTE GENOMICS, INC.
Condensed Consolidated Statements Of Comprehensive Income (Loss)
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Net loss	$(17,827)	$ (7,598)	$(38,030)	$(22,365)
Other comprehensive income (loss), net of taxes:				
Unrealized gains (losses) on marketable securities	(4,107)	6,669	(9,566)	30,321
Foreign currency translation adjustments	48	933	35	816
Other comprehensive income (loss)	(4,059)	7,602	(9,531)	31,137
Comprehensive income (loss)	$(21,886)	$ 4	$(47,561)	$ 8,772

See accompanying notes

Incyte Genomics, Inc.
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2001	2000
Cash flows from operating activities:		
Net loss	$ (38,030)	$ (22,365)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	38,847	26,163
Extraordinary item, debt extinguishment	(2,386)	-
Cumulative effect of accounting change	(2,279)	-
Gain on derivative financial instruments, net	(162)	-
Gain on sale of long-term investments	(2,505)	(5,417)
Loss on sale of assets	5,777	-
Impairment of long-term investments	9,015	-
Debt instruments and equity received in exchange for goods or services provided	(8,100)	(6,615)
Losses from joint venture	-	1,283
Changes in certain assets and liabilities:		
Accounts receivable	(9,095)	5,593
Prepaid expenses and other assets	(14,685)	(6,467)
Accounts payable	(9,285)	5,347
Accrued and other current liabilities	(942)	6,956
Deferred revenue	(3,868)	(10,204)
Net cash used in operating activities	(37,698)	(5,726)
Cash flows from investing activities:		
Purchase of long-term investments	(28,019)	(2,475)
Proceeds from the sale of long-term investments	4,337	7,917
Capital expenditures	(11,494)	(49,654)
Purchases of marketable securities	(733,966)	(449,778)
Sales and maturities of marketable securities	739,994	168,553
Other	300	-
Net cash used in investing activities	(28,848)	(325,437)
Cash flows from financing activities:		
Proceeds from exercise of employee stock options	7,487	26,813
Proceeds from issuance of common stock	-	403,351
Proceeds from the issuance of Convertible Subordinated Notes, net	-	196,800
Repurchase of Convertible Subordinated Notes	(5,643)	-
Repayment of receivable from stockholder	-	20
Principal payments on capital lease obligations and note payable	-	(480)
Net cash provided by financing activities	1,844	626,504
Effect of exchange rate on cash and cash equivalents	35	816
Net increase (decrease) in cash and cash equivalents	(64,667)	296,157
Cash and cash equivalents at beginning of period	110,155	32,220
Cash and cash equivalents at end of period	$ 45,488	$ 328,377

See accompanying notes

INCYTE GENOMICS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2001
(Unaudited)

1. Organization and business

Incyte Genomics, Inc. (the "Company") was incorporated in Delaware in April 1991 under the name Incyte Pharmaceuticals, Inc. In June 2000, the Company's stockholders approved an amendment to the Company's Certificate of Incorporation to change the Company's name to Incyte Genomics, Inc. The Company designs, develops, and markets genomic information including database products, microarray-based gene expression services, single nucleotide polymorphisms (SNP) discovery services, genomic reagents and related services. The Company's genomic databases integrate bioinformatics software with proprietary and, when appropriate, publicly available genetic information to create information used by pharmaceutical and biotechnology companies and academic researchers to understand disease and to discover and develop drugs and diagnostic products. The Company is also engaged in its own internal disease pathway and therapeutic drug discovery programs.

On October 25, 2001, the Company announced a restructuring of its operations in order to focus on its database and partnership operations and its internal disease pathway and therapeutic drug discovery programs. As a part of the restructuring, the Company plans to discontinue its microarray-based gene expression products and services, genomic screening products and services, public domain clone products and related services and contract sequencing services. The Company discontinued its transgenics product line and sold certain of its assets in the third quarter of 2001. As a part of these actions, the Company will close its facilities in Fremont, California and St. Louis, Missouri. The Company also proposes to discontinue, by the end of 2001, its internal program on SNP discovery, which has been concentrated in Cambridge, UK.

In addition to the announced closures, the Company will make infrastructure and other personnel reductions at its other locations. The restructuring will result in a reduction of the Company's workforce by approximately 400 employees.

2. Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The condensed consolidated balance sheet as of September 30, 2001, condensed consolidated statements of operations for the three and nine months ended September 30, 2001 and 2000, condensed consolidated statements of comprehensive income (loss) for the three and nine months ended September 30, 2001 and 2000 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2001 and 2000 are unaudited, but include all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The balance sheet at December 31, 2000 has been derived from audited financial statements.

Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Certain amounts reported in the previous year have been reclassified to conform to 2001 financial statement presentation.

Results for any interim period are not necessarily indicative of results for any future interim period or for the entire year. The accompanying financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

3. Property and equipment

Property and equipment consisted of:

	September 30, 2001	December 31, 2000
Office equipment	$ 5,535	$ 5,308
Laboratory equipment	33,404	32,286
Computer equipment	94,997	93,136
Leasehold improvements	45,175	48,924
	179,111	179,654
Less accumulated depreciation and amortization	(98,917)	(80,706)
	$ 80,194	$ 98,948

4. Convertible subordinated notes

In February 2000, in a private placement, the Company issued $200.0 million of convertible subordinated notes, which resulted in net proceeds of approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on February 1 and August 1, and are due February 1, 2007. The notes are subordinated to all senior indebtedness, as defined. The notes can be converted at the option of the holder at an initial conversion price of $67.42 per share, subject to adjustment. The Company may, at its option, redeem the notes at any time before February 7, 2003, but only if the Company's stock price exceeds 150% of the conversion price for 20 trading days in a period of 30 consecutive trading days. On or after February 7, 2003 the Company may, at its option, redeem the notes at specific prices. Holders may require the Company to repurchase the notes upon a change in control, as defined.

In November 2000, the Company repurchased on the open market, and retired, $15.0 million in par value of the convertible subordinated notes. The Company recognized a gain of $3.1 million on the transactions, which was reported as an extraordinary gain in fiscal 2000.

In the first quarter of 2001, the Company repurchased on the open market, and retired, $8.0 million in par value of the convertible subordinated notes. The Company recognized a gain of $2.4 million, net of tax, on the transactions, which was reported as an extraordinary gain in fiscal 2001.

5. Revenue recognition

Revenues are recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable and collectibility is reasonably assured. For database collaboration agreements, revenues are recognized evenly over the term of each agreement. Revenue is deferred for fees received before earned. Revenues from licenses to the Company's intellectual property are recognized when earned under the terms of the related agreements. Revenues from custom orders, such as reagents, are recognized upon completion and delivery. Revenues from custom services are recognized upon completion. Revenue from gene expression microarray services includes: technology access fees, which are recognized ratably over the access term, and usage fees, which are recognized at the completion of key stages in the performance of the service in proportion to costs incurred. Generally, software revenue is allocated between license fees and maintenance fees, in accordance with SOP 97-2, with the license revenue being recognized upon installation, and maintenance fees recognized evenly over the maintenance term.

Revenues recognized from multiple elements contracts are allocated to each element of the arrangement based on the relative fair values of the elements. The determination of fair value of each element is based on objective evidence such as historical sales of the individual element by us to other customers. If adequate evidence of fair value for each element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist or until all elements of the arrangement are delivered. When contracts include non-monetary exchanges, the non-monetary transaction is determined using the fair values of the assets or services involved.

6. Loss per share

The following is a reconciliation of the numerators and denominators of the basic and diluted net loss per share computations for the periods presented below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
Numerator:				
Net loss	$ (17,827)	$ (7,598)	$ (38,030)	$(22,365)
Denominator:				
Denominator for basic net loss Per share - weighted-average shares	66,370	64,064	66,064	62,825
Basic and diluted net loss per share	$ (0.27)	$ (0.12)	$ (0.58)	$ (0.36)

Options to purchase 7,885,393 and 7,696,420 shares of common stock were outstanding at September 30, 2001 and 2000, respectively, and notes convertible into 2,625,333 and 2,966,500 shares of common stock were outstanding at September 30, 2001 and 2000, respectively, but were not included in the computation of diluted net loss per share, as their effect was antidilutive.

7. Loss on Sale of Assets

In September 2001, the Company sold certain assets of its transgenics product line. Loss on the sale of assets of $5.8 million for the three and nine months ended September 30, 2001 resulted from the divestiture of the transgenics product line and the sale of certain of those assets.

8. Business Combinations

In December 2000, the Company completed the acquisition of Proteome, Inc., a privately held proteomics information company based in Beverly, Massachusetts. The Company issued 1,248,522 shares of its common stock and $37.7 million in cash in exchange for all of Proteome's outstanding capital stock. In addition, the Company assumed Proteome's stock options, which if fully vested and exercised, would amount to 216,953 shares of its common stock. The transaction was accounted for as a purchase. The amount of the purchase price in excess of the net tangible assets acquired of $70.8 million, was allocated to goodwill ($50.3 million); database ($16.6 million); tradename ($1.7 million); Proteome's assembled work force ($1.6 million); and developed technology ($0.6 million), each of which is being amortized over 8, 8, 3, 3 and 5 years, respectively.

The Company allocated Proteome's purchase price based on the relative fair value of the net tangible and intangible assets acquired. In performing this allocation, the Company considered, among other factors, the technology research and development projects in process at the date of acquisition. The results of operations of Proteome have been included in the consolidated results of the Company from the date of acquisition on December 28, 2000.

The table below presents the unaudited pro forma results of operations and earnings per share for Proteome and the Company for the three and nine months ended September 30, 2000 assuming that the transaction was completed on January 1, 2000 (in thousands except per share data).

	Three Months Ended	Nine Months Ended
Pro forma revenues	$ 53,123	$ 141,358
Pro forma net loss	$ (11,940)	$ (34,018)
Pro forma basic and diluted net loss per share	$ (0.18)	$ (0.53)
Pro forma shares for basic and diluted net loss per share	65,313	64,074

9. Joint venture

In September 1997, the Company formed a joint venture, diaDexus, LLC ("diaDexus"), with SmithKline Beecham Corporation ("SB"), to utilize genomic and bioinformatic technologies in the discovery and commercialization of molecular diagnostics. The Company held a 50 percent equity interest in diaDexus and accounted for the investment under the equity method. In July 1999, the Company and SB each invested an additional $2.5 million in diaDexus through convertible notes.

On April 4, 2000, diaDexus obtained additional financing through a private equity offering. In connection with the offering, diaDexus converted from an LLC to a corporation and repaid in full the $2.5 million principal amount of, together with accrued interest on, the convertible note held by the Company. Under diaDexus' new capital structure, the Company no longer has the ability to exert significant influence over diaDexus. Accordingly, the Company accounts for its investment in diaDexus under the cost method of accounting from the date of this financing.

diaDexus purchased $0.1 million of contract sequencing, microarray and software services from the Company in the nine months ended September 30, 2001, and $0.7 million and $2.0 million in the three and nine months ended September 30, 2000, respectively. diaDexus did not make similar purchases in the three months ended September 30, 2001.

10. Segment reporting

The Company's operations are treated as one operating segment, in accordance with SFAS 131, the design, development, and marketing of genomic information-based tools, as it only reports profit and loss information on an aggregate basis to chief operating decision makers of the Company. For the three and nine months ended September 30, 2001, the Company recorded revenue from customers throughout the United States and in Asia, Austria, Belgium, Canada, France, Germany, Israel, Netherlands, Switzerland, and the United Kingdom. Export revenue for the three and nine months ended September 30, 2001 were $9.6 million and $31.6 million, respectively and $10.8 million and $32.9 million for the three and nine months ended September 30, 2000, respectively.

11. New pronouncements

In June 1998, the FASB issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities ("SFAS 133"), as amended by SFAS Nos. 137 and 138. The Company adopted SFAS 133 in the first quarter of 2001. SFAS 133 established standards for accounting and reporting derivative instruments and hedging activities. It requires companies to recognize all derivatives as either assets or liabilities on the balance sheet and measure these instruments at fair value. Derivatives that are not designated as hedges must be adjusted to fair value through income. The Company adopted SFAS 133 on January 1, 2001 and recorded a $2.3 million cumulative gain, net of income tax expense, relating to the valuation of warrants held in other companies, which is recorded in the consolidated statements of operations as a cumulative effect of accounting change. The Company also recorded a loss of approximately $0.6 million and $1.1 million during the first and third quarters, respectively, related to the decrease in value of the same instruments subject to SFAS 133, and a gain of $1.8 million related to the

increase in value of the same instruments in the second quarter of 2001.

In July 2001, the FASB issued Statement No. 141, Business Combinations ("SFAS 141") and Statement No. 142, Goodwill and Other Intangible Assets ("SFAS 142"). SFAS 141 prohibits the use of the pooling-of-interest method for business combinations initiated after June 30, 2001 and also applies to all business combinations accounted for by the purchase method that are completed after June 30, 2001. There are also transition provisions that apply to business combinations completed before July 1, 2001 that were accounted for by the purchase method. SFAS 142 requires, among other things, the discontinuance of goodwill amortization and includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, and reclassification of certain intangibles out of previously reported goodwill. The Company is currently evaluating the provisions of SFAS 141 and SFAS 142 and will adopt these statements during the first quarter of fiscal year 2002.

In October 2001, the FASB issued Statement No. 144, Accounting for the Impairment of Long-Lived Assets ("SFAS 144"). The FASB's new rules on asset impairment supersede FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of, and portions of APB Opinion 30, Reporting the Results of Operations. SFAS 144 provides a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. SFAS 144 also requires expected future operating losses from discontinued operations to be displayed in the period in which the losses are incurred, rather than as of the measurement date as presently required. The Company will adopt the provisions of SFAS 144 during the first quarter of fiscal year 2002. The adoption of SFAS 144 is not expected to have a material impact on the Company's consolidated financial statements.

12. Litigation

In January 1998, Affymetrix Inc, ("Affymetrix") filed a lawsuit in the United States District Court for the District of Delaware, which was subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of U.S. patent number 5,444,934 by the Company. The complaint alleges that the Company infringed the `934 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `934 patent and, in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on its allegation of willful infringement by the Company.

In September 1998, Affymetrix filed an additional lawsuit in the United States District Court for the District of Delaware, which was subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging the Company infringed U.S. patent number 5,800,992 and U.S. patent number 5,744,305. The complaint alleges that the Company infringed the `305 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays. It also alleges that the Company infringed the `992 patent by using its GEM microarray technology to conduct gene expression monitoring and other applications using two-color labeling, and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `305 and `992 patents, and in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on the allegation of willful infringement. In January, May and June 2001, the court issued a ruling describing how the claims in the `934, `305 and `992 patents should be interpreted.

Following issuance of the Court's January 2001 claim construction ruling, Incyte filed a motion for partial summary judgment that the Company's cDNA arrays do not infringe any claim of the `934 patent or claims 1 and 3 through 13 of the `305 patent. On May 2, 2001, the court granted summary judgement ruling that the Company's accused cDNA arrays do not infringe any claim of the `934 patent claims or claims 1 and 3 through 13 of the `305 patent.

On September 20 and October 3, 2001, the Court issued orders in Incyte's favor granting summary judgment of invalidity with respect to Incyte's motions for invalidity of claims 1-3 of the `992 patent for indefiniteness and invalidity of claims 4 and 5 of the `992 patent for lack of written description. As a result,

every claim of the `992 patent has now been held invalid.

In April 1999, the Board of Patent Appeals and Interferences of the United States Patent and Trademark Office declared interferences between pending patent applications licensed exclusively to the Company and the Affymetrix `305 and `992 patents. The Board of Patent Appeals and Interferences invokes an interference proceeding when more than one patent applicant claims the same invention. During the proceeding, the Board of Patent Appeals and Interferences evaluates all relevant facts, including those bearing on first to invent, validity, enablement and scope of claims, and then makes a determination as to who, if anyone, is entitled to the patent on the disputed invention. In September 1999, the Board of Patent Appeals and Interferences determined that the Company had not met its prima facie case, and ruled that the patents licensed by the Company from Stanford University were not entitled to priority over corresponding claims in the two Affymetrix patents. The Company is seeking de novo review of the Board's decisions in the United States District Court for the Northern District of California.

In August 2000, the Company filed a lawsuit against Affymetrix in federal court alleging infringement of U.S. patent numbers 5,716,785 and 5,891,636. The patents relate to technologies used in the amplification of RNA and the generation of gene expression information. Affymetrix has filed counterclaims in this lawsuit that allege, among other things, that the Company infringes U.S. patent number 6,040,193 and U.S. patent number 5,871,928. These counterclaims allege that the Company infringes these patents by making, using, offering to sell and/or selling within the United States the inventions claimed in the patents, including, in the case of the `193 patent, methods for forming microarrays and, in the case of the `928 patent, methods for analyzing nucleic acids. The counterclaims also allege that the Company engaged in acts of unfair competition under California statutory and common law. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `193 patent and `928 patent and, in addition, seeks damages, costs and attorneys' fees and interest. Affymetrix further requests triple damages from the infringement claims based on its allegation of willful infringement by the Company.

The Company believes it has meritorious defenses and intends to vigorously defend the suits and counterclaims brought by Affymetrix. However, the Company's defenses may be unsuccessful. At this time, the Company cannot reasonably estimate the possible range of any loss resulting from these suits and counterclaims due to uncertainty regarding the ultimate outcome. Regardless of the outcome, the Affymetrix litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of the Company's management and technical personnel. Further, there can be no assurance that any license that may be required as a result of this litigation or the outcome thereof would be made available on commercially acceptable terms, if at all. This litigation may also affect the Company's ability to make and use microarrays.

On October 17, 2001, Invitrogen Corporation filed an action against the Company in the United States District Court for the District of Delaware, alleging infringement of three patents (U.S. patent number 5,244,797, U.S. patent number 5,668,005, and U.S. patent number 6,063,608) that relate to the use of reverse transcriptase with no RNase H activity in preparing complimentary DNA from RNA. The complaint seeks unspecified money damages and injunctive relief. The Company's response to the complaint is due on November 22, 2001. The Company believes that it has meritorious defenses to the complaint and intends to defend the suit brought by Invitrogen vigorously.

13. Related party transactions

The following are related party transactions as defined by FASB Statement No. 57, Related Party Disclosures:

In March 2001, the Company entered into a LifeSeq Collaboration Agreement, Patent License Agreement, Collaboration and Technology Transfer Agreement and Proteome BioKnowledge Library License Agreement with Genomic Health, Inc. ("Genomic Health"). Randal W. Scott, Chairman of the Board of the Company, is Chairman of the Board, President and Chief Executive Officer of Genomic Health and owns more than 10% of the outstanding capital stock of Genomic Health. Under the agreements, Genomic Health obtained access to the Company's LifeSeq Gold database and BioKnowledge Library and received licenses to certain of the Company's intellectual property. Amounts Genomic Health will pay the Company under these agreements are similar to those paid to the Company under agreements between the Company and unrelated third party customers. The Company received rights to certain intellectual property that Genomic Health may, in the future, develop. At the same time, the Company

entered into an agreement to purchase shares of Series C Preferred Stock of Genomic Health for an aggregate purchase price of $5.0 million which, together with shares of Series A Preferred Stock purchased in November 2000 for an aggregate purchase price of $1.0 million, results in the Company owning approximately 10.9% of the outstanding capital stock of Genomic Health. Under certain circumstances and if Genomic Health so elects, the Company has agreed to purchase in a future offering of Genomic Health's capital stock an aggregate of $5.0 million of the shares being sold in that offering.

In May 2001, the Company entered into a Development and License Agreement with Iconix Pharmaceuticals, Inc. ("Iconix"). Jon S. Saxe, a director of the Company, is Chairman of the Board of Iconix. Under the agreement, Iconix obtained an exclusive license to the Company's LifeExpress Lead database, access to LifeSeq and ZooSeq databases, licenses to certain of the Company's intellectual property and use of the Company's LifeArray expression array technology. Amounts Iconix will pay the Company under these agreements are similar to those paid to the Company under agreements between the Company and unrelated third party customers. The Company will become the exclusive distributor for the database product to be developed by Iconix. At the same time, the Company entered into an agreement to purchase shares of Series E Preferred Stock of Iconix for an aggregate purchase price of $10.0 million. Under certain circumstances, the Company has agreed to purchase in a future offering of Iconix's capital stock up to an aggregate of $5.0 million of the shares being sold in that offering.

In September 2001, the Company entered into a Technology Access for Licensed Reagent Manufacture Agreement with Epoch Biosciences, Inc. ("Epoch"). Frederick B. Craves, a director of the Company, is Chairman of the Board of Epoch. Under the agreements, Epoch obtained access to the Company's LifeSeq Gold and ZooSeq databases and received licenses to certain of the Company's intellectual property. Amounts Epoch will pay the Company under these agreements are similar to those paid to the Company under agreements between the Company and unrelated third party customers. The Company has identified Epoch as the preferred provider of certain probes to Incyte's users of LifeSeq Gold. Additionally, Epoch will supply Incyte with certain probes for internal development purposes.

In September 2001, the Company entered into a Collaboration Agreement, Patent License Agreement and two Unilateral Development and Commercialization Agreements with Medarex, Inc. ("Medarex"). Frederick B. Craves, a director of the Company, is also a director of Medarex. Under the agreements, Medarex obtained access to the Company's LifeSeq Gold database and received licenses to certain of the Company's intellectual property. The agreements were negotiated by the parties at arm's-length. Additionally, under the terms of the agreements, Medarex and Incyte expect to share equally the cost and responsibility of preclinical and clinical development of antibody products. In addition, the two companies plan to jointly commercialize any antibody products resulting from this collaboration.

PART I: FINANCIAL INFORMATION

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations as of September 30, 2001 and for the three and nine month periods ended September 30, 2001 and 2000 should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto set forth in Item 1 of this report and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

When used in this Report, the words "expects," "anticipates," "estimates," "plans," "believes," "intends," and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include statements as to our expected net losses, our expected expenditure levels and rate of growth of expenditures, our expected cash flows, the adequacy of our capital resources, our expected growth in operations, our expected revenues and sources of revenues, the ability to commercialize products developed under collaborations and alliances, our plans to restructure our operations and the expected closures and reductions, the number of job losses to be incurred through our restructuring, and guidance as to the expected non-recurring charge for the fourth quarter of 2001, and the components thereof, our investment in our therapeutic drug discovery and development programs, our ability to complete the sequence of full-length genes in areas of therapeutic interest and obtain patents on these potential drug targets, our ability to integrate companies, operations and their products that we have acquired or will acquire, the scheduling and timing of current and future litigation, our investments in our intellectual property portfolio, our strategic equity investments in other companies, our strategy with regard to protecting our proprietary technology, our investments in, and the success of, our drug target identification and validation efforts, our investment in new products and services, our ability to compete and respond to rapid technological change, our competitive advantage as to the annotation of the human proteome, the effect of government regulation, our compliance with applicable environmental laws and regulations, the adequacy of our current facilities and our ability to locate additional facilities at reasonable rates, our exposure to foreign currency rate fluctuations, products and services under development, and the performance, content and utility of our products and services. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as the extent to which the pharmaceutical and biotechnology industries use genomic information in research and development, risks relating to development of new products and services and their use by our potential customers and collaborators, our ability to develop and commercialize products to improve human health, our ability to work with our collaborators to meet the goals of our collaborations and alliances, our ability to retain and obtain customers, the cost of accessing or acquiring technologies or intellectual property, the effectiveness of our sequencing efforts, the effectiveness of our target validation and drug discovery efforts, impairment of the value of the securities underlying equity investments that we hold, the impact of alternative technological advances and competition, the impact of further changes in our business plan, changes in customer demand for our products, our success in negotiating future licensing transactions, the development of new partnering and collaborative relationships, the impact of competition and technological advances, the number of employees entitled to receive retention benefits, and other costs to be recognized in connection with the restructuring, our ability to implement within the stated timeframe the restructuring and facility closures, uncertainties associated with changes in patent laws and developments in and expenses related to litigation and interference proceedings; and the matters discussed in "Factors that May Affect Results." These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

In the section of this report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations--Factors That May Affect Results," all references to "Incyte," "we," "us," "our" or the "Company" mean Incyte Genomics, Inc. and its subsidiaries.

Incyte, LifeSeq and BioKnowledge are our registered trademarks. LifeExpress and GEM are our trademarks. We also refer to trademarks of other corporations and organizations in this document.

Overview

Incyte Genomics, Inc. ("Incyte" or the "Company") designs, develops and markets genomic information-based products and services. Through the third quarter of 2001, these products and services include database products, microarray-based gene expression services and single nucleotide polymorphism, or SNP, discovery services, genomic reagents, and related services. The Company's genomic databases integrate bioinformatics software with proprietary and, when appropriate, publicly available genetic information to create information-based products and services used by pharmaceutical and biotechnology companies and academic researchers to understand disease and to discover and develop drugs and diagnostic products. The Company is also engaged in its own internal disease pathway and therapeutic drug discovery programs.

In July 2000, the Company's board of directors approved a two-for-one stock split in the form of a stock dividend. Incyte stockholders of record on August 7, 2000 received one additional share for each share of common stock held at the time. The additional shares were distributed to eligible stockholders on August 31, 2000. All share and per share data have been adjusted retroactively to reflect the split.

On October 25, 2001, the Company announced a restructuring of its operations in order to focus on its database and partnership operations and its internal disease pathway and therapeutic drug discovery programs. As a part of the restructuring, the Company plans to discontinue its microarray-based gene expression products and services, genomic screening products and services, public domain clone products and related services and contract sequencing services. The Company discontinued its transgenics product line and sold certain of its assets in the third quarter of 2001. As a part of these actions, the Company will close its facilities in Fremont, California and St. Louis, Missouri. The Company also proposes to discontinue, by the end of 2001, its internal program on SNP discovery, which has been concentrated in Cambridge, UK.

In addition to the announced closures, the Company will make infrastructure and other personnel reductions at its other locations. The restructuring will result in a reduction of the Company's workforce by approximately 400 employees.

In the third quarter of 2001, the Company recorded a charge of $5.8 million associated with the divestiture of its transgenics product line. In connection with its restructuring, the Company also expects that, in the fourth quarter of 2001, it will recognize an additional non-recurring charge that could exceed $80 million. Approximately 25% of the fourth quarter charges are anticipated to be cash related and the remainder of such fourth quarter charges are anticipated primarily to be associated with the write-off of assets.

Revenues recognized by the Company consist primarily of non-exclusive database access fees related to database agreements, gene product and database related license fees, the sales of genomic screening products and services, fees for contract sequencing services, fees for research programs, and fees for microarray-based gene expression services. The Company's database agreements provide for future milestone payments and royalties from the sale of products derived from proprietary information obtained through the databases. There can be no assurance that any database subscriber will ever generate products from information contained within the databases and, thus, that the Company will ever receive additional milestone payments or royalties. The Company's ability to maintain and increase revenues depends on its ability to obtain additional database subscribers, to retain existing subscribers, to maintain adequate price levels, to expand its product and service offerings and to expand its customer base. The loss of revenues from any individual database agreement, if terminated or not renewed, could have an adverse impact on the Company's results of operations, although it is not anticipated to have a material adverse impact on the Company's business or financial condition.

In 2001, the Company has made and intends to continue to make significant investments focused on the further development of its intellectual property portfolio and its internal disease pathway and therapeutic drug discovery programs. Depending on the investment required and the timing of such

investments, expenses or losses related to these investments could adversely affect operating results. In addition to its investments in these areas, the Company is continuing to invest in its identification and characterization of full length genes, proteomics and protein annotation, increasing content in the database products, and bioinformatics in 2001. As a result, the Company expects to report a net loss at least through 2001. If the costs of these new and existing programs are greater than anticipated, or if these programs take longer to complete, or if losses are incurred from strategic investments, the Company may incur losses in future periods as well.

In December 2000, the Company completed the acquisition of Proteome, Inc., a privately held proteomics database company. The Company issued 1,248,522 shares of its common stock and $37.7 million in cash in exchange for all of Proteome's outstanding capital stock. In addition, the Company assumed Proteome's stock options, which if fully vested and exercised, would amount to 216,953 shares of its common stock. The fair value of the stock options assumed were allocated between additional purchase price and deferred compensation in accordance with guidance provided by the Financial Accounting Standards Board's Interpretation No. 44. The transaction was accounted for as a purchase. The amount of the purchase price in excess of net tangible assets acquired of approximately $70.8 million was allocated to goodwill ($50.3 million), database ($16.6 million), developed technology ($0.6 million), tradename ($1.7 million), and assembled workforce ($1.6 million), which are being amortized over 8, 8, 5, 3 and 3 years, respectively. The Company evaluates its intangible assets for impairment on a quarterly basis.

The Company has made and intends to continue to make strategic equity investments in, and acquisitions of, technologies and businesses that are complementary to the businesses of the Company. As a result, the Company may record losses or expenses related to the Company's proportionate ownership interest in such long-term equity investments, record charges for the acquisition of in-process technologies, or record charges for the recognition of the impairment in the value of the securities underlying such investments.

The Company has incurred and may continue to incur substantial expenses in its defense of the lawsuits filed in January and September 1998 by Affymetrix, Inc. ("Affymetrix") alleging patent infringement by the Company and in the lawsuits filed by the Company against Affymetrix in August 2000.

In its lawsuits against the Company, Affymetrix seeks a permanent injunction enjoining the Company from further infringement of certain Affymetrix patents. In addition, Affymetrix seeks damages, costs, attorneys' fees and interest. Affymetrix further requests that any such damages be tripled on its allegation of willful infringement by the Company.

In August 2000, the Company filed a patent infringement suit against Affymetrix in the United States Court for the Northern District of California. The suit alleges infringement of U.S. Patent Numbers 5,716,785 and 5,891,636. These patents cover key technologies used in the amplification of RNA and the creation of gene expression data.

With respect to the lawsuits filed by the Company, Affymetrix has filed counterclaims against the Company. See Note 11 of Notes to Consolidated Financial Statements.

The Company believes it has meritorious defenses and intends to defend these suits and counterclaims vigorously. However, there can be no assurance that the Company will be successful in the defense of these suits. At this time, the Company cannot reasonably estimate the possible range of any loss related to these suits and counterclaims due to uncertainty regarding the ultimate outcome. Regardless of the outcome, this litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of management and technical personnel. Any future litigation could result in similar expenses and diversion of efforts. Further, there can be no assurance that any license that may be required as a result of these suits and counterclaims or the outcome thereof would be made available on commercially acceptable terms, if at all.

Results of Operations

Net loss and diluted net loss per share were $17.8 million and $38.0 million and $0.27 and $0.58 per share for the three and nine months ended September 30, 2001, respectively, as compared to $7.6 million and $22.4 million and $0.12 and $0.36 per share in the corresponding periods in 2000. Loss before extraordinary item and cumulative effect of accounting change for the three and nine months ended September 30, 2001 was $17.8 million and $42.7 million, or $0.27 and $0.65 per diluted share, respectively. Basic and diluted net loss per share for the three and nine months ended September 30, 2001 was impacted by the issuance of 1,248,522 shares of common stock in the Proteome acquisition. Diluted net loss per share for the three and nine months ended September 30, 2001 and 2000 was impacted by a private equity offering of 4,000,000 shares of common stock in February 2000.

Revenues for the three and nine months ended September 30, 2001 increased to $57.3 million and $164.5 million, respectively, compared to $52.0 million and $138.8 million for the corresponding periods in 2000. Revenues resulted primarily from database access fees, license and royalty fees, microarray-based gene expression services, genomic screening products and services, and fees for contract sequencing. The increase in revenues was primarily attributable to the focus of our sales, marketing and business development efforts to expand our customer base and leverage our intellectual property portfolio.

Total costs and expenses for the three and nine months ended September 30, 2001 increased to $68.5 million and $214.8 million, respectively, compared to $67.7 million and $184.3 million for the corresponding periods in 2000. The Company anticipates continuing to invest in its intellectual property portfolio and its internal disease pathway and therapeutic drug discovery programs.

Research and development expenses for the three months ended September 30, 2001 decreased to $50.7 million from $51.9 million for the corresponding period in 2000, and for the nine months ended September 30, 2001 increased to $161.8 million from $138.6 million for the corresponding period in 2000. The decrease for the three months ended September 30, 2001 as compared to the corresponding period in 2000 was primarily due to decreased expenses related to internet marketing, software development efforts, and patent legal expenses, partially offset by increased licensing royalties and goodwill amortization related to the Proteome acquisition. The increase in research and development expenses for the nine months ended September 30, 2001 resulted primarily from an increase in bioinformatics efforts, software development efforts, licensing royalties, goodwill amortization related to the Proteome acquisition, and an increase in internal disease pathway and therapeutic drug discovery programs. The Company is committed to continuing pursuit of the development of its intellectual property portfolio and its internal disease pathway and therapeutic drug discovery programs.

Selling, general and administrative expenses for the three and nine months ended September 30, 2001 increased to $17.9 million and $53.0 million, respectively, compared to $15.8 million and $45.7 million for the corresponding periods in 2000. The increase in selling, general and administrative expenses resulted primarily from higher litigation expenses, and the growth in the Company's sales and marketing function. The Company's selling, general and administrative expenses were also impacted by legal expenses related to the Company's patent infringement lawsuits with Affymetrix and GeneLogic of approximately $4.1 million and $10.7 million in the three and nine months ended September 30, 2001, respectively, and $2.2 million and $5.6 million in the corresponding periods in 2000. The litigation-related expenses, in any given quarter, may result in significant fluctuations impacting the overall selling, general and administrative expenses.

Interest and other income, net for the three and nine months ended September 30, 2001 decreased to $3.0 million and $21.6 million, respectively, from $11.0 million and $32.3 million for the corresponding periods in 2000. The decrease for the three months ended September 30, 2001 resulted from a lower average level of interest bearing investments combined with a $5.3 million impairment charge. For the nine months ended September 30, 2001, the decrease resulted from a $9.0 million impairment charge on strategic investments taken in 2001 and a $5.4 million gain in 2000 compared to a $2.5 million gain in 2001 from investment activity, partially offset by a higher average level of interest bearing investments. The activity on discrete

investments within the portfolio, in any given quarter, may result in gains or losses on sales or impairment charges.

Interest expense for the three and nine months ended September 30, 2001 decreased to $2.5 million and $7.7 million, respectively, from $2.9 million and $7.8 million for the corresponding periods in 2000. The decrease was due to a reduction of the interest expense associated with the Company's convertible subordinated notes issued in February 2000, due to repurchases on the open market in the fourth quarter of 2000 and first quarter of 2001 leaving the face value of the notes outstanding at September 30, 2001 at $177.0 million compared to $200.0 million at September 30, 2000.

Loss on the sale of assets of $5.8 million for the three and nine months ended September 30, 2001 resulted from the divestiture of the transgenics product line and the sale of certain of those assets. There were no sales of assets in the three or nine month periods ended September 30, 2000.

Loss on derivative financial instruments for the three months ended September 30, 2001 of $1.1 million and gain on derivative financial instruments for the nine months ended September 30, 2001 of $0.2 million represents the change in fair value of certain long-term investments, specifically warrants held in other companies, in accordance with SFAS 133.

Loss from joint venture represents the Company's share of diaDexus' losses from operations. The Company incurred no losses from joint venture for the three and nine months ended September 30, 2001 and the three months ended September 30, 2000. The Company incurred $1.3 million in losses from joint venture for the nine months ended September 30, 2000. Beginning on April 4, 2000, the Company accounted for its investment in diaDexus under the cost method of accounting as it no longer had significant influence over diaDexus and therefore did not reflect any portion of diaDexus' results of operations in the Company's statement of operations in the three and nine months ended September 30, 2001.

Provision for income taxes for the three and nine months ended September 30, 2001 of $0.2 million and $0.7 million, respectively, primarily relate to foreign withholding taxes. The Company had no such taxes in the corresponding periods in 2000.

Extraordinary gain, net of taxes, for the nine months ended September 30, 2001 resulted from the Company's repurchase of $8.0 million face value of its 5.5% convertible subordinated notes on the open market in the first quarter of 2001. The repurchases resulted in a gain of $2.4 million, net of taxes.

The cumulative effect of an accounting change for the nine months ended September 30, 2001 resulted from the adoption of SFAS 133 in the first quarter of 2001. The Company recorded the fair value of its warrants in certain long-term strategic investments at January 1, 2001, resulting in a gain of $2.3 million.

Liquidity and Capital Resources

As of September 30, 2001, the Company had $517.5 million in cash, cash equivalents and marketable securities, compared to $582.2 million as of December 31, 2000. The Company has classified all of its marketable securities as short-term, as the Company may choose not to hold its marketable securities until maturity in order to take advantage of favorable market conditions. Available cash is invested in accordance with the Company's investment policy's primary objectives of liquidity, safety of principal and diversity of investments.

Net cash used in operating activities was $37.7 million and $5.7 million for the nine months ended September 30, 2001 and 2000, respectively. The increase was primarily due to the increase in net loss, accounts receivable and prepaid expenses and other assets and decrease in accounts payable as compared to 2000. These changes were partially offset by the increase in depreciation and amortization as compared to 2000. Net cash generated by operating activities may fluctuate significantly from quarter to quarter due to the timing of large prepayments by database collaborators.

In February 2000, in a private placement, the Company issued $200.0 million of convertible

subordinated notes, which resulted in net proceeds of approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on February 1 and August 1, and are due February 1, 2007. The notes are subordinated to senior indebtedness, as defined. The notes can be converted at the option of the holder at an initial conversion price of $67.42 per share, subject to adjustment. The Company may redeem the notes at any time before February 7, 2003, only if the Company's stock exceeds 150% of the conversion price for 20 trading days in a period of 30 consecutive trading days. On or after February 7, 2003 the Company may redeem the notes at specific prices. Holders may require the Company to repurchase the notes upon a change in control, as defined. As of September 30, 2001, the Company had repurchased $23.0 million face value of the notes on the open market.

In February 2000, in a private placement, the Company issued 4,000,000 shares of its common stock at a price of $105.50 per share, resulting in net proceeds of $403.4 million.

The Company's investing activities, other than purchases, sales and maturities of marketable securities, have consisted predominantly of capital expenditures and net purchases of long-term investments. Capital expenditures for the nine months ended September 30, 2001 were $11.5 million as compared to $49.7 million in the same period in 2000, primarily due to the timing of capital purchases. Purchases of long-term investments in companies with which the Company has research and development agreements were $28.0 million for the nine months ended September 30, 2001. In the future, net cash used by investing activities may fluctuate significantly from period to period due to the timing of strategic equity investments, capital expenditures and maturity/sales and purchases of marketable securities.

Net cash provided by financing activities was $1.8 million for the nine months ended September 30, 2001 as compared to $626.5 million for the nine months ended September 31, 2000. The Company repurchased $8.0 million face value of its 5.5% convertible subordinated notes on the open market for $5.6 million in 2001 offset by proceeds from the exercise of employee stock options of $7.5 million. The 2000 activity included the issuance of common stock in a private equity offering resulting in net proceeds of $403.4 million, the net proceeds from the issuance of 5.5% Convertible Subordinated Notes of $196.8 million, and the proceeds from the exercise of employee stock options of $26.8 million.

On October 25, 2001, the Company announced a restructuring of its operations in order to focus on its database and partnership operations and its internal disease pathway and therapeutic drug discovery programs. As a part of the restructuring, the Company plans to discontinue its microarray-based gene expression products and services, genomic screening products and services, public domain clone products and related services and contract sequencing services. The Company discontinued its transgenics product line and sold certain of its assets in the third quarter of 2001. As a part of these actions, the Company will close its facilities in Fremont, California and St. Louis, Missouri. The Company also proposes to discontinue, by the end of 2001, its internal program on SNP discovery, which has been concentrated in Cambridge, UK.

In addition to the announced closures, the Company will make infrastructure and other personnel reductions at its other locations. The restructuring will result in a reduction of the Company's workforce by approximately 400 employees.

In the third quarter of 2001, the Company recorded a charge of $5.8 million associated with the divestiture of its transgenics product line. In connection with its restructuring, the Company also expects that in the fourth quarter of 2001 it will recognize an additional non-recurring charge that could exceed $80 million. Approximately 25% of the fourth quarter charges are anticipated to be cash related and the remainder is anticipated primarily to be associated with the write-off of assets.

The Company expects to use net cash in 2001 as it: invests in its internal disease pathway and therapeutic drug discovery programs, intellectual property portfolio, sequencing, and bioinformatics; invests in data processing-related computer hardware to support its existing and new database products and to enable the on-line delivery of those products; continues to seek access to technologies through investments, research and development alliances, license agreements and/or acquisitions; and makes strategic investments.

Based upon its current plans, the Company believes that its existing resources will be adequate to satisfy its capital needs for at least the next twelve months. The Company's cash requirements depend on numerous factors, including the ability of the Company to attract and retain collaborators for its databases and other products and services; expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary technologies and businesses; expenditures in connection with its

internal disease pathway and therapeutic drug discovery programs; competing technological and market developments; and the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights. Changes in the Company's research and development plans or other changes affecting the Company's operating expenses may result in changes in the timing and amount of expenditures of the Company's capital resources.

Euro Conversion

A single currency called the euro was introduced in Europe on January 1, 1999. Eleven of the fifteen member countries of the European Union agreed to adopt the euro as their common legal currency on that date. Fixed conversion rates between these participating countries' existing currencies (the "legacy currencies") and the euro were established as of that date. The legacy currencies are scheduled to remain legal tender as denominations of the euro until at least January 1, 2002, but not later than July 1, 2002. During this transition period, parties may settle transactions using either the euro or a participating country's legal currency. The Company will evaluate the impact of the euro conversion on its computer and financial systems, business processes, market risk, and price competition. The Company does not expect this conversion to have a material impact on its results of operations, financial position or cash flows.

FACTORS THAT MAY AFFECT RESULTS

We recently announced a restructuring of our operations that includes discontinuing certain of our product lines and a reduction in force, which could negatively impact our operating results

In October 2001, we announced plans to restructure our operations in order to focus on our database and partnership operations and our internal disease pathway and therapeutic drug discovery programs. As a part of the restructuring, we plan to discontinue our microarray-based gene expression products and services, genomic screening products and services, public domain clone products and related services and contract sequencing services. As a result, we plan to close our facilities in Fremont, California and St. Louis, Missouri. By the end of 2001, we also propose to discontinue our internal program on single nucleotide polymorphism discovery, which is concentrated in Cambridge, UK. In the third quarter of 2001, we discontinued our transgenics product line. We believe the restructuring of our operations to focus on our database and partnership operations and our internal disease pathway and therapeutic discovery programs will result in the reduction of our workforce by approximately 400 employees. In connection with the implementation of these actions, we currently expect that we will record an additional non-recurring charge that could exceed $80 million in the fourth quarter of 2001. We anticipate that approximately 25% of the fourth quarter costs will be cash related and that the remainder will primarily be associated with the write-off of assets. Some of our customers that purchase continuing and discontinued products could become dissatisfied as a result of our restructuring, and our future revenues could suffer as a result. In addition, our restructuring plans may result in diversion of the efforts of our sales force, higher than anticipated costs associated with our restructuring plans, and diversion of the efforts of our executive management team and other key employees, any of which may negatively impact our operating results.

We have had only limited periods of profitability, we expect to incur losses in the future and we may not return to profitability

We had net losses from inception in 1991 through 1996 and again incurred net losses in 1999 through the nine months ended September 30, 2001. Because of those losses, we had an accumulated deficit of $122.9 million as of September 30, 2001. We intend to continue to spend significant amounts on new products including therapeutic drug discovery and development programs. The amounts we intend to spend on new product and technology development include spending for our efforts to determine the sequence of genes, or genomic sequencing, determine gene functions, develop database and software products and expand research and development alliances. As a result, we expect to incur losses in 2001. We may report net losses in future periods as well. We will not return to profitability unless we increase our revenues, reduce our expenses or a combination thereof.

To generate significant revenues, we must obtain additional database collaborators and retain existing collaborators

As of September 30, 2001, we had over 30 database agreements. If we are unable to enter into additional agreements, or if our current database collaborators choose not to renew their agreements upon expiration, we may not generate additional revenues or maintain our current revenues. Our database

revenues are also affected by the extent to which existing collaborators expand their agreements with us to include additional database products and the extent to which existing collaborators reduce the number of products or services for which they subscribe, the impact of which will vary based upon our pricing of those products and services. Some of our database agreements require us to meet performance obligations, some or all of which we may not be successful in attaining. A database collaborator can terminate its agreement before the end of its scheduled term if we breach the agreement and fail to cure the breach within a specified period.

Our longer-term strategy for profitability includes milestone payments and royalties from the sale of products developed under licenses to our gene-related intellectual property, but these licenses may not contribute to revenues for several years, and may never result in revenues

Part of our strategy is to license to database collaborators and to some of our other customers our know-how and patent rights associated with the genetic information in our proprietary database, for use in the discovery and development of potential pharmaceutical, diagnostic or other products. Any potential product that is the subject of such a license will require several years of further development, clinical testing and regulatory approval before commercialization. Therefore, milestone or royalty payments from these collaborations may not contribute to revenues for several years, if at all.

Our operating results are difficult to predict, which may cause our stock price to decline and result in losses to investors

Our operating results are difficult to predict and may fluctuate significantly from period to period, which may cause our stock price to decline and result in losses to investors. Some of the factors that could cause our operating results to fluctuate include:

- changes in the demand for our products and services, including our database business;
- the introduction of competitive databases or services, including databases of publicly available, or public domain, genetic information;
- the nature, pricing and timing of products provided to our collaborators;
- acquisition, licensing and other costs related to the expansion of our operations, including operating losses of acquired businesses;
- losses and expenses related to our investments in joint ventures and businesses;
- regulatory developments or changes in public perceptions relating to the use of genetic information and the diagnosis and treatment of disease based on genetic information;
- changes in intellectual property laws that affect our rights in genetic information that we sell;
- payments of milestones, license fees or research payments under the terms of our increasing number of external alliances; and
- expenses related to, and the results of, litigation and other proceedings relating to intellectual property rights, including the lawsuits filed by Affymetrix and counterclaims filed by Affymetrix.

We have significant fixed expenses, due in part to our need to continue to invest in product development and extensive support for our database collaborators. We may be unable to adjust our expenditures if revenues in a particular period fail to meet our expectations, which would harm our operating results for that period. Forecasting operating and integration expenses for acquired businesses may be particularly difficult, especially where the acquired business focuses on technologies that do not have an established market. We believe that period-to-period comparisons of our financial results will not necessarily be meaningful. You should not rely on these comparisons as an indication of our future performance. If our operating results in any future period fall below the expectations of securities analysts

and investors, our stock price will likely fall, possibly by a significant amount.

Our industry is intensely competitive, and if we do not compete effectively, our revenues may decline

We compete in markets that are new, intensely competitive, rapidly changing, and fragmented. Many of our current and potential competitors have greater financial, human and other resources than we do. If we cannot respond quickly to changing customer requirements, secure intellectual property positions, or adapt quickly and obtain access to new and emerging technologies, our revenues may decline. Our competitors include:

- Celera Genomics Group of Applera Corporation,
- CuraGen Corporation,
- Gene Logic Inc.,
- Human Genome Sciences, Inc.,
- Invitrogen Corporation,
- Millennium Pharmaceuticals, Inc.,
- major pharmaceutical companies, and
- universities and other research institutions, including those receiving funding from the federally funded Human Genome Project.

The human genome contains a finite number of genes. Our competitors may seek to identify, sequence and determine the biological function of numerous genes in order to obtain a proprietary position with respect to new genes.

In addition, we face competition from companies who are developing and may seek to develop new technologies for discovering the functions of genes, gene expression information, discovery of variations among genes and related technologies. Also, if we are unable to obtain the technology we currently use or new advanced technology on acceptable terms, but other companies are, we will be unable to compete.

Extensive research efforts resulting in rapid technological progress characterize the genomics industry. To remain competitive, we must continue to enhance our databases, improve our software, and invest in new technologies. New developments will probably continue, and discoveries by others may render our services and potential products noncompetitive.

Our new investments in validating drug targets will lead to increased expenses and may not result in commercial products or services

We have recently decided to further invest in validating drug targets associated with diseases that may be linked to several or many genes working in combination. The process of discovering drugs based upon genomics is new and evolving rapidly, and we have limited experience in discovering or developing drugs. These efforts will result in increased expenses and may not result in commercial products or services. There is limited scientific understanding generally relating to the role of genes in diseases, and few, if any, products based on gene discoveries have been developed and commercialized. Accordingly, even if we are successful in identifying genes, biological pathways or drug candidates associated with specific diseases, we or our collaborators may not be able to develop or commercialize products to improve human health. Rapid technological development by us or others may result in compounds, products or processes becoming obsolete before we recover our development expenses.

Our revenues could decline due to patent positions becoming publicly available, or due to our competitors publicly disclosing their discoveries

Our competitors may discover and establish patent positions with respect to the genes in our databases. Our competitors and other entities who engage in discovering the location of genes within a DNA strand may make the results of their sequencing efforts publicly available. Currently, academic institutions and other laboratories participating in the Human Genome Project make their gene sequence information available through a number of publicly available databases, including the GenBank database. Also, in 2001, Celera Genomics Group made available to the public basic human sequence data. The public availability of these discoveries or resulting patent positions covering substantial portions of the human genome could reduce the potential value of our databases to our collaborators. It could also impair our ability to realize royalties or other revenue from any commercialized products based on this genetic information.

We are involved in patent litigation, which if not resolved favorably could require us to pay damages and to stop making and using microarray products

We are currently involved in patent litigation. If we lose this litigation we could be prevented from producing and using our microarray products, including uses of those products for purposes of providing gene expression database products. We could also be required to pay damages. In January 1998, Affymetrix filed a lawsuit in federal court alleging that we infringe U.S. patent number 5,445,934. The complaint alleges that we infringed the `934 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining us from further infringement of the `934 patent and, in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on its allegation of willful infringement by us.

In September 1998, Affymetrix filed an additional lawsuit in federal court, alleging we infringed U.S. patent number 5,800,992 and U.S. patent number 5,744,305. The complaint alleges that we infringed the `305 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays. It also alleges that we infringed the `992 patent by using GEM(TM) microarray technology to conduct gene expression monitoring and other applications using two-color labeling, and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining us from further infringement of the `305 and `992 patents, and in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on the allegation of willful infringement. In January, May and June 2001, the Court issued claims construction rulings describing how the claims in the `934, `305 and `992 patents should be interpreted.

Following issuance of the Court's claims construction ruling, we filed a motion for partial summary judgement that our cDNA arrays do not infringe any claim of the `934 patent or claims 1 and 3 through 13 of the `305 patent. On May 2, 2001, the Court granted summary judgement ruling that our accused cDNA arrays do not infringe any claim of the `934 patent claims or claims 1 and 3 through 13 of the `305 patent. On September 20 and October 3, 2001, the Court issued two orders in our favor for partial summary judgment of invalidity, the combined effect of which was to hold every claim of the `992 patent invalid.

In April 1999, the Board of Patent Appeals and Interferences of the United States Patent and Trademark Office declared interferences between pending patent applications licensed exclusively to us and the Affymetrix `305 and `992 patents. The Board of Patent Appeals and Interferences invokes an interference proceeding when more than one patent applicant claims the same invention. During the proceeding, the Board of Patent Appeals and Interferences evaluates all relevant facts, including those bearing on first to invent, validity, enablement and scope of claims, and then makes a determination as to who, if anyone, is entitled to the patent on the disputed invention. In September 1999, the Board of Patent Appeals and Interferences determined that we had not met our prima facie case, and ruled that the patents licensed by us from Stanford University were not entitled to priority over corresponding claims in the two Affymetrix patents. We are seeking de novo review of the Board's decisions in the United States District Court for the Northern District of California.

In August 2000, we filed a lawsuit against Affymetrix in federal court alleging infringement of U.S. patent numbers 5,716,785 and 5,891,636. The patents relate to technologies used in the amplification of RNA and the generation of gene expression information. Affymetrix has filed counterclaims in this lawsuit that allege, among other things, that we infringe U.S. patent number 6,040,193 and U.S. patent number 5,871,928. These counterclaims allege that we infringe these patents by making, using, offering to sell and/or selling within the United States the inventions claimed in the patents, including, in the case of the `193 patent, methods for forming microarrays and, in the case of the `928 patent, methods for analyzing nucleic acids. The counterclaims also allege that we engaged in acts of unfair competition under California statutory and common law. Affymetrix seeks a permanent injunction enjoining us from further infringement of the `193 patent and `928 patent and, in addition, seeks damages, costs and attorneys' fees and interest. Affymetrix further requests triple damages from the infringement claims based on its allegation of willful infringement by us.

We believe we have meritorious defenses and intend to defend the suits and counterclaims brought by Affymetrix vigorously. However, our defenses may be unsuccessful. At this time, we cannot reasonably estimate the possible range of any loss resulting from these suits and counterclaims due to uncertainty regarding the ultimate outcome. Regardless of the outcome, the Affymetrix litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of our management and technical personnel. Further, there can be no assurance that any license that may be required as a result of this litigation or the outcome thereof would be made available on commercially acceptable terms, if at all. This litigation may also affect our ability to make and use microarrays.

On October 17, 2001, Invitrogen Corporation filed an action against us in the United States District Court for the District of Delaware, alleging infringement of three patents that relate to the use of reverse transcriptase with no RNase H activity in preparing complimentary DNA from RNA. The complaint seeks unspecified money damages and injunctive relief. Our response to the complaint is due on November 22, 2001. We believe that we have meritorious defenses to the complaint and intend to defend the suit brought by Invitrogen vigorously. However, our defenses may be unsuccessful, and we may incur significant costs in defending this litigation, as well as face diversion of our management and technical personnel. At this time we cannot reasonably estimate the possible costs associated with, or ultimate outcome of, this suit.

If we are subject to additional litigation and infringement claims, they could be costly and disrupt our business

The technology that we use to develop our products, and the technology that we incorporate in our products, may be subject to claims that they infringe the patents or proprietary rights of others. The risk of this occurring will tend to increase as the genomics, biotechnology and software industries expand, more patents are issued and other companies attempt to discover genes and SNPs and engage in other genomic-related businesses.

As is typical in the genomics, biotechnology and software industries, we have received, and we will probably receive in the future, notices from third parties alleging patent infringement. We believe that we are not infringing the patent rights of any third parties. Except for Affymetrix and Invitrogen, no third party has filed a patent lawsuit against us.

We may, however, be involved in future lawsuits alleging patent infringement or other intellectual property rights violations. In addition, litigation may be necessary to:

- assert claims of infringement;
- enforce our patents;
- protect our trade secrets or know-how; or
- determine the enforceability, scope and validity of the proprietary rights of others.

We may be unsuccessful in defending or pursuing these lawsuits. Regardless of the outcome, litigation can be very costly and can divert management's efforts. An adverse determination may subject us

to significant liabilities or require us to seek licenses to other parties' patents or proprietary rights. We may also be restricted or prevented from manufacturing or selling our products and services. Further, we may not be able to obtain any necessary licenses on acceptable terms, if at all.

We may be unable to protect our proprietary information, which may result in its unauthorized use and a loss of revenue

Our business and competitive position depend upon our ability to protect our proprietary database information and software technology. Despite our efforts to protect this information and technology, unauthorized parties may attempt to obtain and use information that we regard as proprietary. Although our database subscription agreements require our subscribers to control access to our databases, policing unauthorized use of our databases and software may be difficult.

We pursue a policy of having our employees, consultants and advisors execute proprietary information and invention agreements when they begin working for us. However, these agreements may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure.

Our means of protecting our proprietary rights may not be adequate, and our competitors may:

- independently develop substantially equivalent proprietary information and techniques;
- otherwise gain access to our proprietary information; or
- design around patents issued to us or our other intellectual property.

If the inventions described in our patent applications on full-length or partial genes are found to be unpatentable, our issued patents are not enforced or our patent applications conflict with patent applications filed by others, our revenues may decline

One of our strategies is to file patent applications on what we believe to be novel full-length and partial genes and SNPs obtained through our efforts to discover the order, or sequence, and functions, of genes. We have filed U.S. patent applications in which we claimed partial sequences of some genes. We have also applied for patents in the U.S. and other countries claiming full-length gene sequences. We hold a number of issued U.S. patents on full-length genes and one issued U.S. patent claiming multiple partial gene sequences. While the United States Patent and Trademark Office has issued patents covering full-length genes, partial gene sequences and SNPs, the Patent and Trademark Office may choose to interpret new guidelines for the issuance of patents in a more restrictive manner in the future, which could impact the issuance of our pending patent applications. We also do not know whether or how courts may enforce our issued patents, if that becomes necessary. If a court finds these types of inventions to be unpatentable, or interprets them narrowly, the value of our patent portfolio and possibly our revenues could be diminished.

We believe that some of our patent applications claim genes and partial sequences of genes that may also be claimed in patent applications filed by others. In some or all of these applications, a determination of priority of inventorship may need to be decided in an interference before the United States Patent and Trademark Office, before a patent is issued. If a full-length or partial length sequence for which we seek a patent is issued to one of our competitors, we may be unable to include that full-length or partial length sequence on a microarray or in a library of bioreagents. This could result in a loss of revenues.

If the effective term of our patents is decreased due to changes in the U.S. patent laws or if we need to refile some of our patent applications, the value of our patent portfolio and the revenues we derive from it may be decreased

The value of our patents depends in part on their duration. A shorter period of patent protection could lessen the value of our rights under any patents that we obtain and may decrease the revenues we derive from our patents. The U.S. patent laws were amended in 1995 to change the term of patent protection from 17 years from patent issuance to 20 years from the earliest effective filing date of the application.

Because the average time from filing to issuance of biotechnology applications is at least one year and may be more than three years depending on the subject matter, a 20-year patent term from the filing date may result in substantially shorter patent protection. Also, we may need to refile some of our applications claiming large numbers of gene sequences and, in these situations, the patent term will be measured from the date of the earliest priority application. This would shorten our period of patent exclusivity and may decrease the revenues that we might obtain from the patents.

International patent protection is particularly uncertain, and if we are involved in opposition proceedings in foreign countries, we may have to expend substantial sums and management resources

Biotechnology patent law outside the United States is even more uncertain than in the United States and is currently undergoing review and revision in many countries. Further, the laws of some foreign countries may not protect our intellectual property rights to the same extent as U.S. laws. We may participate in opposition proceedings to determine the validity of our foreign patents or our competitors foreign patents, which could result in substantial costs and diversion of our efforts.

If our strategic investments result in losses, our earnings may decline

We make strategic investments in joint ventures or businesses that complement our business. These investments may:

- often be made in securities lacking a public trading market or subject to trading restrictions, either of which increases our risk and reduces the liquidity of our investment;
- require us to record losses and expenses related to our ownership interest, such as the losses we reported in 1997, 1998, 1999 and the first quarter of 2000 related to our investment in diaDexus, LLC;
- require us to record charges related to the acquisition of in-process technologies or for the impairment in the value of the securities underlying our investment; and
- require us to invest greater amounts than anticipated or to devote substantial management time to the management of research and development relationships and joint ventures.

The market values of many of these investments fluctuate significantly. We evaluate our long-term equity investments for impairment of their values on a quarterly basis. Impairment could result in future charges to our earnings. These losses and expenses may exceed the amounts that we anticipated.

Because our sales cycle is lengthy, we may spend a lot of time and money trying to obtain new or renewed subscriptions to our products and services but may be unsuccessful, which could hurt our profitability

Our ability to obtain new subscribers for our databases, software tools and other services or to obtain renewals or additions to existing subscriptions depends upon prospective subscribers' perceptions that our products and services can help accelerate drug discovery efforts. Our database sales cycle is typically lengthy because we need to educate our potential subscribers and sell the benefits of our tools and services to a variety of constituencies within potential subscriber companies. In addition, each database subscription involves the negotiation of unique terms. We may expend substantial funds and management effort with no assurance that a new, renewed or expanded subscription or services agreement will result. These expenditures, without increased revenues, will negatively impact our profitability. Actual and proposed consolidations of pharmaceutical companies have affected the timing and progress of our sales efforts. We expect that future proposed consolidations will have similar effects.

If we encounter problems in meeting customers' software needs, our revenues could decline and we could lose our customers' goodwill

Our databases require software support and will need to incorporate features determined by

database collaborators. If we experience delays or difficulties in implementing our database software or collaborator-requested features, we may be unable to service our collaborators, which could result in a loss of revenues and customer goodwill.

We have encountered difficulties integrating companies we acquired, and if in the future we cannot smoothly integrate businesses we acquire, our operations and financial results could be harmed

In December 2000, we acquired Proteome, Inc. As part of our business strategy, we may acquire other assets, technologies and businesses. Our past acquisitions have involved and our future acquisitions may involve risks such as the following:

- we may be exposed to unknown liabilities of acquired companies;
- our acquisition and integration costs may be higher than we anticipated and may cause our quarterly and annual operating results to fluctuate;
- we may experience difficulty and expense in assimilating the operations and personnel of the acquired businesses, disrupting our business and diverting management's time and attention;
- we may be unable to integrate or complete the development and application of acquired technology;
- we may experience difficulties in establishing and maintaining uniform standards, controls, procedures and policies;
- our relationships with key customers of acquired businesses may be impaired, due to changes in management and ownership of the acquired businesses;
- we may be unable to retain key employees of the acquired businesses;
- we may incur impairment expenses if an acquisition results in significant goodwill or other intangible assets; and
- our stockholders may be diluted if we pay for the acquisition with equity securities.

In addition, if we acquire additional businesses that are not located near our Palo Alto, California headquarters, we may experience more difficulty integrating and managing the acquired businesses' operations.

We depend on key employees in a competitive market for skilled personnel, and the loss of the services of any of our key employees would affect our ability to achieve our objectives

We are highly dependent on the principal members of our management, operations and scientific staff. Our product development, operations and marketing efforts would be delayed or curtailed if we lose the services of any of these people.

Our future success also will depend in part on the continued service of our executive management team, key scientific, software, bioinformatics and management personnel and our ability to identify, hire, train and retain additional personnel, including customer service, marketing and sales staff. We experience intense competition for qualified personnel. If we are unable to continue to attract, train and retain these personnel, we may be unable to expand our business.

We rely on a small number of suppliers of products we need for our business, and if we are unable to obtain sufficient supplies, we will be unable to compete effectively

Currently, we use gene sequencing machines supplied by Molecular Dynamics, a subsidiary of Amersham Pharmacia Biotech, Ltd., and chemicals used in the sequencing process, called reagents,

supplied by Sigma-Aldrich, Inc. in our gene sequencing operations. If we are not able to obtain additional machines or an adequate supply of reagents or other materials at commercially reasonable rates, our ability to identify genes or genetic variations would be slower and more expensive.

If the information we obtain from third-party data sources is corrupt or violates the law, our revenues and operating results could decline

We rely on and include in our databases scientific and other data supplied by others, including publicly available information from sources such as the Human Genome Project. This data could contain errors or other defects, which could corrupt our databases. In addition, we cannot guarantee that our data sources acquired this information in compliance with legal requirements. If this data caused database corruption or violated legal requirements, we would be unable to sell subscriptions to our databases. These lost sales would harm our revenue and operating results.

Security risks in electronic commerce or unfavorable Internet regulations may deter future use of our products and services, which could result in a loss of revenues

We offer several products through our website on the Internet and may offer additional products in the future. Our ability to provide secure transmissions of confidential information over the Internet may limit online use of our products and services by our database collaborators as we may be limited by our inability to provide secure transmissions of confidential information over the Internet. Advances in computer capabilities and new discoveries in the field of cryptography may compromise the security measures we use to protect our website, access to our databases, and transmissions to and from our website. If our security measures are breached, our proprietary information or confidential information about our collaborators could be misappropriated. Also, a security breach could result in interruptions in our operations. The security measures we adopt may not be sufficient to prevent breaches, and we may be required to incur significant costs to protect against security breaches or to alleviate problems caused by breaches. Further, if the security of our website, or the website of another company, is breached, our collaborators may no longer use the Internet when the transmission of confidential information is involved. For example, attacks by computer hackers on major e-commerce websites and other Internet service providers have heightened concerns regarding the security and reliability of the Internet.

Because of the growth in electronic commerce, the United States Congress has held hearings on whether to further regulate providers of services and transactions in the electronic commerce market. The federal government could enact laws, rules and regulations that would affect our business and operations. Individual states could also enact laws regulating the use of the Internet. If enacted, these federal and state laws, rules and regulations could require us to change our online business and operations, which could limit our growth and our development of our online products.

Our customers may not consider the Internet as an acceptable method for accessing our products and services

We have expended a significant amount of time and money to make our products available through the Internet. In 2000, we introduced our on-line product LifeSeq Gene-by-Gene and made LifeSeq Gold and LifeExpress available on-line. If only a few of our customers choose to use the Internet as a method for accessing our products and services, we may have to incur a charge against earnings to write-off Internet related assets.

Because our activities involve the use of hazardous materials, we may be subject to costly environmental liability that could exceed our resources

Our research and development involves the controlled use of hazardous and radioactive materials and biological waste. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of these materials and waste products. Although we believe that our safety procedures for handling and disposing of these materials comply with legally prescribed standards, the risk of accidental contamination or injury from these materials cannot be completely eliminated. In the event of an accident, we could be held liable for damages, and this liability could exceed

our resources.

We believe that we are in compliance in all material respects with applicable environmental laws and regulations and currently do not expect to make material additional capital expenditures for environmental control facilities in the near term. However, we may have to incur significant costs to comply with current or future environmental laws and regulations.

Because our revenues are derived primarily from the pharmaceutical and biotechnology industries, our revenues may fluctuate substantially due to reductions and delays in research and development expenditures

We expect that our revenues in the foreseeable future will be derived primarily from products and services provided to the pharmaceutical and biotechnology industries as well as to the academic community. Accordingly, our success will depend in large part upon the success of the companies within these industries and their demand for our products and services. Our operating results may fluctuate substantially due to reductions and delays in research and development expenditures by companies in these industries or by the academic community. These reductions and delays may result from factors such as:

- changes in economic conditions;
- consolidation in the pharmaceutical and biotechnology industries;
- changes in the regulatory environment, including governmental pricing controls, affecting health care and health care providers;
- pricing pressures;
- market-driven pressures on companies to consolidate and reduce costs;
- development of internal genomics programs by current and potential pharmaceutical, biotechnology and academic customers; and
- other factors affecting research and development spending.

In addition, increasing mergers and consolidation in the pharmaceutical and biotechnology industries will reduce the number of current and potential customers for us, which may also adversely affect our future revenues.

These factors are not within our control.

If a natural disaster occurs, we may have to cease or limit our business operations

We conduct our database, sequencing and a significant portion of our other activities at our facilities in Palo Alto, California, which is in a seismically active area. Although we maintain business interruption insurance, we do not have or plan to obtain earthquake insurance. A major catastrophe, such as an earthquake or other natural disaster, could result in a prolonged interruption of our business.

We may experience power blackouts and higher electricity prices as a result of California's current energy crisis, which could disrupt our operations and increase our expenses

California is in the midst of an energy crisis that could disrupt our operations and increase our expenses. We rely on the major Northern California public utility, Pacific Gas & Electric Company, or PG&E, to supply electric power to our facilities in Northern California. Due to problems associated with the de-regulation of the power industry in California and shortages in wholesale electricity supplies, customers of PG&E have been faced with increased electricity prices, power shortages and, in some cases, rolling blackouts. If blackouts interrupt our power supply, we may be temporarily unable to continue operations at our facilities. Any such interruption in our ability to continue operations at our facilities could delay our

ability to develop or provide our products and services, which could damage our reputation and result in lost revenue, either of which could substantially harm our business and results of operations.

We have a large amount of debt and our debt service obligations may prevent us from taking actions that we would otherwise consider to be in our best interests

As of September 30, 2001, we had:

- total consolidated debt of approximately $179.4 million,
- stockholders' equity of approximately $583.4 million, and
- a deficiency of earnings available to cover fixed charges of $37.3 million for the nine months ended September 30, 2001.

A variety of uncertainties and contingencies will affect our future performance, many of which are beyond our control. We may not generate sufficient cash flow in the future to enable us to meet our anticipated fixed charges, including our debt service requirements with respect to our convertible subordinated notes due 2007 that we sold in February 2000. At September 30, 2001, notes with a face value of $177 million were outstanding. The following table shows, as of September 30, 2001, the aggregate amount of our interest payments due in each of the five calendar years listed:

Year	Aggregate Interest
2001	$9,808,300
2002	9,735,000
2003	9,735,000
2004	9,735,000
2005	9,735,000

Our substantial leverage could have significant negative consequences for our future operations, including:

- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring the dedication of a substantial portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of our expected cash flow available for other purposes, including working capital and capital expenditures;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete; or
- placing us at a possible competitive disadvantage compared to less leveraged competitors and competitors that have better access to capital resources.

PART I: FINANCIAL INFORMATION

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to interest rate risk primarily through its investments in short-term marketable securities. The Company's investment policy calls for investment in short term, low risk instruments. As of September 30, 2001, investments in marketable securities were $509.8 million. Due to the nature of these investments, if market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2001, the decline in the fair value of the portfolio would not be material.

The Company is exposed to equity price risks on the marketable portion of equity securities included in its portfolio of investments and long-term investments, entered into to further its business and strategic objectives. These investments are in small capitalization stocks in the pharmaceutical / biotechnology industry sector, and are primarily in companies with which the Company has research and development, licensing or other collaborative agreements. The Company typically does not attempt to reduce or eliminate its market exposure on these securities. As of September 30, 2001, long-term investments were $52.1 million.

The Company is exposed to foreign exchange rate fluctuations as the financial results of its foreign operations are translated into U.S. dollars in consolidation. As exchange rates vary, these results, when translated, may vary from expectations and adversely impact the Company's financial position or results of operations. All of the Company's revenues are denominated in U.S. dollars. The Company does not enter into forward exchange contracts as a hedge against foreign currency exchange risk on transactions denominated in foreign currencies or for speculative or trading purposes. If currency exchange rates were to fluctuate immediately and uniformly by 10% from levels as of September 30, 2001, the impact to the Company's financial position or results of operations would not be material.

PART II: OTHER INFORMATION

Item 1 Legal Proceedings

In January 1998, Affymetrix, Inc. ("Affymetrix") filed a lawsuit in the United States District Court for the District of Delaware, which was subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of U.S. patent number 5,445,934 by the Company. The complaint alleges that the Company infringed the `934 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `934 patent and, in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on its allegation of willful infringement by the Company.

In September 1998, Affymetrix filed an additional lawsuit in the United States District Court for the District of Delaware, which was subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging the Company infringed U.S. patent number 5,800,992 and U.S. patent number 5,744,305. The complaint alleges that the Company infringed the `305 patent by making, using, selling, importing, distributing or offering to sell in the United States high density arrays. It also alleges that the Company infringed the `992 patent by using their GEM microarray technology to conduct gene expression monitoring and other applications using two-color labeling, and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `305 and `992 patents, and, in addition, seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on the allegation of willful infringement. In January, May, and June 2001, the Court issued three claims construction rulings describing how the claims in the `934, `305 and `992 patents should be interpreted.

Following issuance of the Court's January 2001 claim construction ruling, Incyte filed a motion for partial summary judgment that the Company's cDNA arrays do not infringe any claim of the `934 patent or claims 1 and 3 through 13 of the `305 patent. On May 2, 2001, the court granted summary judgment ruling that the Company's accused cDNA arrays do not infringe any claim of the `934 patent claims or claims 1 and 3 through 13 of the `305 patent.

On September 20 and October 3, 2001, the Court issued two orders in Incyte's favor: (i) granting summary judgment of invalidity with respect to Incyte's motions for invalidity of claims 1-3 of the `992 patent; and (ii) for indefiniteness and invalidity of claims 4 and 5 of the `992 patent for lack of written description. As a result, every claim of the `992 patent has now been held invalid.

In April 1999, the Board of Patent Appeals and Interferences of the United States Patent and Trademark Office declared interferences between pending patent applications licensed exclusively to the Company and the Affymetrix `305 and `992 patents. The Board of Patent Appeals and Interferences invokes an interference proceeding when more than one patent applicant claims the same invention. During the proceeding, the Board of Patent Appeals and Interferences evaluates all relevant facts, including those bearing on first to invent, validity, enablement and scope of claims, and then makes a determination as to who, if anyone, is entitled to the patent on the disputed invention. In September 1999, the Board of Patent Appeals and Interferences determined that the Company had not met its prima facie case, and ruled that the patents licensed by the Company from Stanford University were not entitled to priority over corresponding claims in the two Affymetrix patents. The Company is seeking de novo review of the Board's decisions in the United States District Court for the Northern District of California.

In August 2000, the Company filed a lawsuit against Affymetrix in federal court alleging infringement of U.S. patent numbers 5,716,785 and 5,891,636. The patents relate to technologies used in the amplification of RNA and the generation of gene expression information. Affymetrix has filed counterclaims in this lawsuit that allege, among other things, that the Company infringes U.S. patent number 6,040,193 and U.S. patent number 5,871,928. These counterclaims allege that the Company infringes these patents by making, using, offering to sell and/or selling within the United States the inventions claimed in the patents, including, in the case of the `193 patent, methods for forming microarrays and, in the case of the

`928 patent, methods for analyzing nucleic acids. The counterclaims also allege that the Company engaged in acts of unfair competition under California statutory and common law. Affymetrix seeks a permanent injunction enjoining the Company from further infringement of the `193 patent and `928 patent and, in addition, seeks damages, costs and attorneys' fees and interest. Affymetrix further requests triple damages from the infringement claims based on its allegation of willful infringement by the Company.

The Company believes it has meritorious defenses and intends to defend vigorously the suits and counterclaims brought by Affymetrix. However, the Company's defenses may be unsuccessful. At this time, the Company cannot reasonably estimate the possible range of any loss resulting from these suits and counterclaims due to uncertainty regarding the ultimate outcome. Regardless of the outcome, the Affymetrix litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of our management and technical personnel. Further, there can be no assurance that any license that may be required as a result of this litigation or the outcome thereof would be made available on commercially acceptable terms, if at all. This litigation may also affect the Company's ability to make and use microarrays.

On October 17, 2001, Invitrogen Corporation filed an action against the Company in the United States District Court for the District of Delaware, alleging infringement of three patents (U.S. patent number 5,244,797, U.S. patent number 5,668,005, and U.S. patent number 6,063,608) that relate to the use of reverse transcriptase with no RNase H activity in preparing complimentary DNA from RNA. The complaint seeks unspecified money damages and injunctive relief. The Company's response to the complaint is due on November 22, 2001. The Company believes that it has meritorious defenses to the complaint and intends to defend the suit brought by Invitrogen vigorously.

Item 2 Changes in Securities

(a) Not applicable

(b) Not applicable

(c) Not applicable

(d) Not applicable

Item 3 Defaults Upon Senior Securities

None

Item 4 Submission of Matters to a Vote of Security Holders

None

Item 5 Other Information

The 2002 Annual Meeting of Stockholders will be held on June 4, 2002 at such place and time as will be set forth in the Company's proxy statement relating to that meeting. To be considered for inclusion in the Company's proxy statement and form of proxy for its 2002 Annual Meeting of Stockholders, a stockholder proposal must be received at the principal executive offices of the Company not later than January 1, 2002.

A stockholder proposal not included in the Company's proxy statement for the 2002 Annual Meeting will be ineligible for presentation at the meeting unless the stockholder gives timely notice of the proposal in writing to the Secretary of the Company at the principal executive offices of the Company and otherwise complies with the provisions of the Company's Bylaws. To be timely, the Company's Bylaws provide that the Company must have received the stockholder's notice not less than 60 days nor more than 90 days prior to the scheduled date of such meeting. However, if notice or prior public disclosure of the date of the annual meeting is given or made to stockholders less than 70 days prior to the meeting date, the Company must receive the stockholder's notice by the earlier of (i) the close of business on the 10th day after the earlier of the day the Company mailed notice of the annual meeting date or provided such public disclosure of the meeting date and (ii) two days prior to the scheduled date of the annual meeting.

Item 6 Exhibits and Reports on Form 8-K.

a) Exhibits

None

b) Reports on Form 8-K

None

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.

INCYTE GENOMICS, INC.

Date: November 14, 2001 By: /s/ Roy A. Whitfield

Roy A. Whitfield
Chief Executive Officer
(Duly Authorized Signatory)

Date: November 14, 2001 By: /s/ John M. Vuko

John M. Vuko
Chief Financial Officer
(Principal Financial Officer)