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

FORM 10-Q

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

For the quarterly period ended September 30, 2004

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 CORPORATION
(Exact name of registrant as specified in its charter)

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

Experimental Station, Route 141 & Henry Clay Road,
Building E336, Wilmington, DE 19880
(Address of principal executive offices)

(302) 498-6700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

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

☒ Yes ☐ No

The number of outstanding shares of the registrant's Common Stock, $0.001 par value, was 73,858,668 as of October 29, 2004.

INCYTE CORPORATION

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PART I: FINANCIAL INFORMATION

Item 1: Financial Statements

INCYTE CORPORATION
Condensed Consolidated Balance Sheets
(in thousands)

	September 30, 2004 (unaudited)	December 31, 2003*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 78,724	$ 29,698
Marketable securities—available-for-sale	333,838	264,109
Accounts receivable, net	2,679	5,733
Prepaid expenses and other current assets	5,602	11,387
Total current assets	420,843	310,927
Property and equipment, net	10,511	27,337
Long-term investments [1]	11,755	16,196
Intangible and other assets, net	27,395	25,085
Total assets	$ 470,504	$ 379,545
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,950	$ 6,450
Accrued compensation	6,458	12,402
Interest payable	2,346	3,816
Accrued and other current liabilities	6,646	4,321
Deferred revenue	4,172	6,401
Accrued restructuring and acquisition costs	38,326	24,036
Total current liabilities	60,898	57,426
Convertible subordinated notes	378,846	167,786
Total liabilities	439,744	225,212
Stockholders' equity:		
Common stock	73	73
Additional paid-in capital	730,934	726,962
Deferred compensation	(281)	(649)
Accumulated other comprehensive loss	(1,188)	(566)
Accumulated deficit	(698,778)	(571,487)
Total stockholders' equity	30,760	154,333
Total liabilities and stockholders' equity	$ 470,504	$ 379,545

* The condensed consolidated balance sheet at December 31, 2003 has been derived from the audited financial statements at that date.

[1] Includes investments in companies considered related parties under SFAS 57 of $11.6 million and $14.7 million at September 30, 2004 and December 31, 2003, respectively.

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Revenues	$ 3,393	$ 13,249	$ 15,198	$ 36,794
Costs and expenses:				
Research and development	18,629	28,619	70,379	88,675
Selling, general and administrative	5,236	8,585	17,041	23,656
Purchased in-process research and development	—	6,250	—	34,366
Other expenses	(132)	(35)	42,538	1,358
Total costs and expenses	23,733	43,419	129,958	148,055
Loss from operations	(20,340)	(30,170)	(114,760)	(111,261)
Interest and other income (expense), net [1]	(571)	(11,259)	1,403	(7,536)
Interest expense	(4,623)	(2,299)	(13,011)	(7,177)
Gain (loss) on repurchase of convertible subordinated notes	(226)	706	(226)	706
Gain (loss) on certain derivative financial instruments, net	(216)	200	(470)	263
Loss before income taxes	(25,976)	(42,822)	(127,064)	(125,005)
Provision for income taxes	—	190	227	691
Net loss	$(25,976)	$(43,012)	$(127,291)	$(125,696)
Basic and diluted net loss per share:	$ (0.35)	$ (0.60)	$ (1.74)	$ (1.77)
Shares used in computing basic and diluted net loss per share	73,323	72,185	72,966	71,022

[1] Includes loss on long-term investments in companies considered related parties under SFAS 57 of $2.5 million and $12.5 million for the three months ended September 30, 2004, and 2003, respectively, and $4.4 million and $12.5 million for the nine months ended September 30, 2004 and 2003, respectively.

See accompanying notes.

INCYTE CORPORATION
Condensed Consolidated Statements of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net loss	$(25,976)	$(43,012)	$(127,291)	$(125,696)
Other comprehensive income (loss):				
Unrealized gain (loss) on marketable securities	2,839	(631)	(686)	(2,484)
Foreign currency translation adjustments	7	(25)	64	(55)
Other comprehensive income (loss)	2,846	(656)	(622)	(2,539)
Comprehensive loss	$(23,130)	$(43,668)	$(127,913)	$(128,235)

See accompanying notes.

INCYTE CORPORATION
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2004	2003
Cash flows from operating activities:		
Net loss	$(127,291)	$(125,696)
Adjustments to reconcile net loss to net cash used in operating activities:		
Non-cash other expenses	25,176	393
Non-cash purchased in-process research and development	—	28,116
Depreciation and amortization	10,985	13,443
Gain (loss) on repurchase of convertible subordinated notes	226	(706)
Compensation expense on executive loans	56	227
Stock compensation	368	1,285
Loss (gain) on derivative financial instruments, net	470	(263)
Realized gain on long-term investments, net	(123)	(1,265)
Impairment of long-term investments	5,247	16,064
Changes in operating assets and liabilities:		
Accounts receivable	3,054	(1,694)
Prepaid expenses and other assets	4,806	(493)
Accounts payable	(3,500)	(2,724)
Accrued and other current liabilities	(4,423)	(22,320)
Deferred revenue	(2,229)	(2,740)
Net cash used in operating activities	(87,178)	(98,373)
Cash flows from investing activities:		
Acquisition of Maxia Pharmaceuticals, net of cash acquired	—	(5,126)
Proceeds from the sale of long-term investments	123	2,647
Capital expenditures	(822)	(8,696)
Proceeds from the sale of equipment	1,491	—
Purchases of marketable securities	(619,173)	(504,846)
Sales and maturities of marketable securities	546,509	607,784
Net cash (used in) provided by investing activities	(71,872)	91,763
Cash flows from financing activities:		
Proceeds from issuance of common stock under stock plans	3,924	1,208
Repurchase of common stock	—	(105)
Repurchase of convertible subordinated notes	(38,412)	(3,059)
Net proceeds from issuance of convertible subordinated notes	242,500	—
Net cash provided by (used in) financing activities	208,012	(1,956)
Effect of exchange rate on cash and cash equivalents	64	(55)
Net increase (decrease) in cash and cash equivalents	49,026	(8,621)
Cash and cash equivalents at beginning of period	29,698	22,928
Cash and cash equivalents at end of period	$ 78,724	$ 14,307

See accompanying notes.

INCYTE CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2004
(Unaudited)

1. Organization and business

Incyte Corporation ("Incyte," "we," "us," or "our") is focused on the discovery and development of novel, small molecule drugs to treat major medical conditions, including infection with human immunodeficiency virus, or HIV, inflammatory disorders, cancer and diabetes. We have assembled a team of scientists with core competencies in the area of medicinal chemistry, and molecular, cellular and in vivo biology.

Previously, Incyte has been considered a leader in the development of proprietary genomic information products, which we marketed to other pharmaceutical and biotechnology companies. Due to the declining market for these products, in April 2004 we discontinued the majority of our information product lines and focused the majority of our resources on an ongoing basis on drug discovery and development.

2. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed 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, 2004, condensed consolidated statements of operations for the three and nine months ended September 30, 2004 and 2003, condensed consolidated statements of comprehensive loss for the three and nine months ended September 30, 2004 and 2003 and the condensed consolidated statements of cash flows for the nine months ended September 30, 2004 and 2003 are unaudited, but include all adjustments, consisting only of normal recurring adjustments, which we consider necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The condensed consolidated balance sheet at December 31, 2003 has been derived from audited financial statements.

Although we believe 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.

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 our Annual Report on Form 10-K for the year ended December 31, 2003.

Reclassifications

Certain amounts reported in prior periods have been reclassified to conform with the current year financial statement presentation.

Stock-based compensation

In accordance with the provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation ("SFAS 123")*, we have elected to continue applying the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees ("APB 25")*, as amended by FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation ("FIN 44")*, in accounting for our stock-based compensation plans. Accordingly, we do not recognize compensation expense for stock options granted to employees and directors when the stock option price at the grant date is equal to or greater than the fair market value of the stock at that date. We also record, and amortize over the related vesting periods, deferred compensation representing the difference between the price per share of stock issued or the exercise price of stock options granted and the fair value of our common stock at the time of issuance or grant.

The fair value of each option and employee purchase right was estimated at the date of grant using a Black-Scholes option-pricing model, assuming no expected dividends and the following weighted average assumptions:

	Employee Stock Options				Employee Stock Purchase Plan			
	For the Three Months Ended		For the Nine Months Ended		For the Three Months Ended		For the Nine Months Ended	
	September 30,				September 30,			
	2004	2003	2004	2003	2004	2003	2004	2003
Average risk-free interest rates	2.74%	2.22%	2.34%	2.78%	1.55%	1.75%	1.54%	1.59%
Average expected life (in years)	2.44	3.41	3.28	3.41	1.43	2.00	1.15	1.31
Volatility	88%	92%	89%	92%	90%	93%	90%	100%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our employee stock options.

For purposes of disclosures pursuant to SFAS 123, as amended by FASB Statement No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure* ("SFAS 148"), the estimated fair value of options is amortized over the options' vesting period. The following illustrates the pro forma effect on net loss and net loss per share as if we had applied the fair value recognition provisions of SFAS 123.

	For the Three Months Ended September 30 ,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
	(in thousands, except per share amounts)			
Net loss, as reported	$(25,976)	$(43,012)	$(127,291)	$(125,696)
Add: Stock-based employee compensation	121	286	416	1,285
Deduct: Total stock-based employee compensation determined under the fair value-based method for all awards	(2,098)	(4,198)	(4,106)	(9,777)
Pro forma net loss	$(27,953)	$(46,924)	$(130,981)	$(134,188)
Net loss per share:				
Basic and diluted net loss per share-as reported	$ (0.35)	$ (0.60)	$ (1.74)	$ (1.77)
Basic and diluted net loss per share-as SFAS 123 adjusted	$ (0.38)	$ (0.65)	$ (1.79)	$ (1.89)

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities ("FIN 46")*. In general, a variable interest entity ("VIE") is a corporation, partnership, trust, or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. We have not entered into any arrangements or made any investments which qualify as a VIE in the period from January 31, 2003 to September 30, 2004. The consolidation requirements apply to entities in which we made investments or with which we made contractual or other arrangements prior to January 31, 2003, beginning with the first fiscal year or interim period ending after March 15, 2004. We have investments in privately held companies that are in the pharmaceutical/biotechnology sector and are in the development or early stage. Some of these investments are considered to be variable interest entities. However, our interests in these VIE's are not significant. We have evaluated our investments in these companies and have determined that upon the adoption of FIN 46, we were not the primary beneficiary of the VIE's and, therefore, they were not required to be consolidated into our financial statements. Accordingly, there was no material impact on our results of operations, financial position or cash flows for the three and nine months ended September 30, 2004 from the adoption of FIN 46.

In November 2003, the Emerging Issues Task Force ("EITF") of the FASB issued EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, ("EITF 03-1"), which provides additional guidance for evaluating whether an investment is other-than-temporarily impaired and requires additional disclosures about unrealized losses on available-for-sale debt and equity securities accounted for under FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit*

Organizations. The guidance in EITF 03-1 for evaluating other-than-temporary impairments is effective for evaluations made in reporting periods beginning after June 15, 2004 and the disclosure requirements are effective in annual financial statements for fiscal years ending after December 15, 2003, for investments accounted for under Statements 115 and 124. For all other investments within the scope of EITF 03-1, the disclosure requirements are effective in annual financial statements for fiscal years ending after June 15, 2004. The additional disclosures for cost method investments are effective for fiscal years ending after June 15, 2004. On September 30, 2004, the FASB issued Staff Position No. EITF Issue 03-1-1, under which the effective date for the measurement and recognition guidance of EITF 03-1 has been delayed pending further consideration of whether application guidance is necessary. We do not expect EITF 03-1 will have an impact on our financial position, results of operations, or cash flows.

On September 30, 2004, the EITF reached a consensus on Issue No. 04-08 "*The Effect of Contingently Convertible Debt on Diluted Earnings per Share*" ("EITF 04-08"), which changes the treatment of contingently convertible debt instruments in the calculation of diluted earnings per share. Contingently convertible debt instruments are financial instruments that include a contingent feature, such as when debt is convertible into common shares of the issuer only after the issuer's common stock price has exceeded a predetermined threshold for a specified time period. EITF 04-08 provides that these debt instruments should be included in the earnings per share computation (if dilutive) regardless of whether the contingent feature has been met. The FASB ratified this consensus in October 2004, and the new rules will be effective for reporting periods ending after December 15, 2004. The adoption of EITF 04-08 will have no impact on our financial position, results of operations, or cash flows.

3. Property and equipment

Property and equipment consisted of the following:

	September 30, 2004	December 31, 2003
	(in thousands)	
Office equipment	$ 661	$ 4,387
Laboratory equipment	11,131	14,792
Computer equipment	9,687	42,514
Leasehold improvements	2,084	30,187
	23,563	91,880
Less accumulated depreciation and amortization	(13,052)	(64,543)
	$ 10,511	$ 27,337

In connection with our 2004 restructuring, during the nine months ended September 30, 2004, we wrote off certain leasehold improvements, and computer, office, and lab equipment located in our Palo Alto facilities with a net book value of $12.8 million. We also received cash proceeds of $1.5 million in connection with the sale of certain computer and lab equipment. See Note 10 for further discussion.

4. Long-term investments

At September 30, 2004, the carrying value of our long-term investments consisted of equity investments in two privately-held companies accounted for under the cost method, one publicly-held company accounted for under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and the fair value of warrants to purchase common stock of one publicly held company accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. At December 31, 2003, the carrying value of our long-term investments consisted of equity investments in six privately-held companies accounted for under the cost method and the fair value of warrants to purchase the common stock of two publicly-held companies.

During the three and nine months ended September 30, 2004, we recorded impairment charges of $2.5 million and $5.2 million, respectively, to reduce the carrying value of our investments in three privately-held investees by $2.5 million, $1.9 million and $0.8 million, respectively, because the investees had less than six months of cash and the likelihood of future debt or equity financing by the investees was remote.

During the three and nine months ended September 30, 2003, we recorded impairment charges of $13.4 million and $16.1 million, respectively, to reduce the carrying value of our investments in four privately-held investees by $12.5 million, $1.9 million, $1.4 million and $0.3 million, respectively. The $12.5 million and $1.4 million charges were because the investees had less than six months of cash and the likelihood of future debt or equity financing by the investees was remote. The $1.9 million charge was due to a reorganization by the investee resulting in a decline in our ownership percentage. The $0.3 million charge was due to the proposed acquisition of the investee by a third party under which existing shareholders of the investee would receive no cash or ownership interest in the acquiring entity.

The activity in our long-term investments, in any given quarter, may result in gains or losses on sales or impairment charges. Amounts realized upon disposition of these investments may be different from their carrying value.

5. Intangible and other assets

Intangible and other assets consist of the following (in thousands):

	September 30, 2004			December 31, 2003		
	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net
Capitalized patents	$22,023	$ (7,038)	$ 14,985	$22,023	$ (3,465)	$ 18,558
Capitalized software	359	(350)	9	359	(305)	54
Acquired database technology	2,638	(1,074)	1,564	2,638	(798)	1,840
Other intangibles	362	(334)	28	362	(317)	45
Total intangible assets	25,382	(8,796)	16,586	25,382	(4,885)	20,497
Debt issuance cost	13,620	(4,646)	8,974	5,804	(3,349)	2,455
Other assets	1,835	—	1,835	2,133	—	2,133
Total intangible and other assets	$40,837	$ (13,442)	$ 27,395	$33,319	$ (8,234)	$ 25,085

Amortization expense related to intangible assets was $1.6 million and $3.9 million respectively, for the three and nine months ended September 30, 2004 and $1.3 million and $3.6 million, respectively, for the corresponding periods in 2003. In connection with our review of the recoverability of our long-lived assets during the second quarter of 2004, we revised the estimated useful life of our capitalized patents from ten to five years based on the increasingly competitive and challenging legal and economic environment for gene and gene-technology related intellectual property. This change in accounting estimate increased our net loss by $0.9 million and $1.9 million and our basic and diluted net loss per share by $0.01 and $0.03 for the three and nine months ended September 30, 2004.

During the nine months ended September 30, 2004, we incurred debt issuance costs of approximately $8.3 million in conjunction with the issuance of $250 million of convertible subordinated debt in February and March 2004. These costs have been capitalized as an other asset and are being amortized on a straight line basis over the life of the convertible subordinated debt. We also have other debt issuance costs related to our convertible subordinated debt issued in February 2000 which are being amortized on a straight line basis over the life of the convertible subordinated debt (see Note 6).

6. Convertible subordinated notes

In February and March 2004, in a private placement, we issued a total of $250.0 million of $3^1/_2$% convertible subordinated notes due 2011 (the “3.5% Notes”), which resulted in net proceeds of approximately $242.5 million. The notes bear interest at the rate of 3.5% per year, payable semi-annually on February 15 and August 15, and are due February 15, 2011. The notes are subordinated to all senior indebtedness and pari passu in right of payment with our 5.5% convertible subordinated notes due 2007. As of September 30, 2004, we had no senior indebtedness, as defined. The notes are convertible into shares of our common stock at an initial conversion price of approximately $11.22 per share, subject to adjustments. Holders may require us to repurchase the notes upon a change in control, as defined. We may redeem the notes beginning February 20, 2007. As of September 30, 2004, $250.0 million of the 3.5% Notes, face value, were still outstanding.

In February 2000, in a private placement, we issued $200.0 million of 5.5% convertible subordinated notes due 2007 (the “5.5% 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. We may, at our option, redeem the notes at any time at specific prices. Holders may require us to repurchase the notes upon a change in control, as defined. During the third quarter of 2004, we repurchased and retired, a total of $38.4 million in face value of the 5.5% Notes in two separate transactions. A net loss of $0.2 million was recognized on the repurchases and is presented as “Gain (loss) on repurchase of convertible subordinated notes” in the accompanying condensed consolidated statement of operations. As of September 30, 2004, $128.1 million of the 5.5% Notes, face value, were still outstanding.

7. Revenues

Revenues recognized from transactions in which there was originally a concurrent commitment entered into by us to purchase goods and services were $0.0 million and $1.5 million, respectively, for the three and nine months ended September 30, 2004 and $0.8 million and $2.7 million, respectively, for the corresponding periods in 2003.

No new transactions under which we expect to generate revenue and in which there was a concurrent commitment by us to purchase goods or services were entered into during the nine months ended September 30, 2004. Of commitments made in prior periods, we expensed $0.0 million and $7.5 million, respectively, for the three and nine months ended September 30, 2004, respectively, and $2.8 million and $8.3 million, respectively, for the corresponding periods in 2003.

For the three and nine months ended September 30, 2004, two and seven customers, respectively, contributed 27% and 36%, respectively, of total revenues. For the three and nine months ended September 30, 2003, one customer contributed 37% and 23% of total revenues, respectively.

Three customers comprised 41% of the accounts receivable balance at September 30 2004. Four customers comprised 50% of the accounts receivable balance at December 31, 2003.

8. Net loss per share

For all periods presented, both basic and diluted net loss per common share are computed by dividing the net loss by the number of weighted average common shares during the period. Stock options and potential common shares issuable upon conversion of our subordinated notes were excluded from the computation of diluted net loss per share, as their share effect was anti-dilutive for all periods presented. The potential common shares that were excluded from the diluted net loss per share computation are as follows:

	September 30,	
	2004	2003
Outstanding stock options	6,746,632	8,695,555
Common shares issuable upon conversion of 3.5% Notes	22,284,625	—
Common shares issuable upon conversion of 5.5% Notes	1,900,043	2,469,667
Total potential common shares excluded from diluted net loss per share computation	30,931,300	11,165,222

9. Segment reporting

Our operations are treated as one operating segment, drug discovery and development, in accordance with FASB Statement No. 131 "*Disclosures about Segments of an Enterprise and Related Information*" ("SFAS 131"). For the nine months ended September 30, 2004, we recorded revenue from customers throughout the United States and in Austria, Belgium, China, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Israel, Korea, Japan, The Netherlands, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. Export revenues for the three and nine months ended September 30, 2004 were $1.7 million and $6.4 million, respectively, and $3.8 million and $10.9 million in the corresponding periods of 2003.

10. Other expenses

Below is a summary of the activity related to other expenses recorded for the periods in which activity related to our restructuring programs has taken place through the nine months ended September 30, 2004.

The estimates below have been made based upon management's best estimate of the amounts and timing of certain events included in the restructuring plan that will occur in the future. It is possible that the actual outcome of certain events may differ from the estimates. Changes will be made to the restructuring accrual at the point that the differences become determinable.

2004 Restructuring

	2004 Charges to Operations	2004 Charges Utilized	Accrual Balance as of September 30, 2004
		(in thousands)	
Restructuring expenses:			
Workforce reduction	$ 6,922	$ (6,763)	$ 159
Lease commitment and related costs	20,232	(1,792)	18,440
Other costs	524	(524)	—
Subtotal	27,678	(9,079)	18,599
Impairment of long-lived assets	11,499	(11,499)	—
Total other expenses	$ 39,177	$ (20,578)	$ 18,599

In February 2004, we announced a restructuring plan to close our information products research facility and headquarters in Palo Alto, California and move our headquarters to our Wilmington, Delaware pharmaceutical research and development facility. The closure of the Palo Alto facility corresponds with terminating further development activities around our Palo Alto-based information products. The restructuring plan consists of the elimination of 183 employees and charges related to the closure of our Palo Alto facilities, previously capitalized tenant improvements and equipment purchases and other items. The lease commitment and related costs relate primarily to the fair value of future lease obligations for two facilities through March 2011. As a result of the long-term nature of these contracts, we will be recording a charge each period through the termination date of the leases related to increases in the fair value of the lease obligations in accordance with the provisions of FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which are estimated to total approximately $3.2 million at September 30, 2004.

2003 Restructuring

	Original Charge Recorded in 2003	Accrual Balance as of December 31, 2003	2004 Charges to Operations	2004 Charges Utilized	Accrual Balance as of September 30, 2004
Restructuring expenses:					
Workforce reduction	$ 4,977	$ 4,592	$ (219)	$(4,373)	$ —
Equipment and other assets	1,879	—	—	—	—
Subtotal	6,856	—	—	—	—
Impairment of other long-lived assets	4,678	—	—	—	—
Other expenses	$ 11,534	$ 4,592	$ (219)	$(4,373)	$ —

As a result of a decision made in the fourth quarter of 2003 to restructure our information products line in connection with the discontinuation of our clone activities and support functions, we recognized other expenses of $11.5 million. The plan included elimination of 75 employees and write-down of certain assets related to our genomic information product line. During the nine months ended September 30, 2004, we reversed $0.2 million of the accrual due to expenses being less than amounts originally estimated. As of January 2, 2004, all affected employees had been terminated under this restructuring program and the plan was completed in the second quarter of 2004.

2002 Restructuring

	Original Charge Recorded in 2002	Accrual Balance as of December 31, 2003	2004 Charges to Operations	2004 Charges Utilized	Accrual Balance as of September 30, 2004
Restructuring expenses:					
Workforce reduction	$ 7,325	$ —	$ —	$ —	$ —
Equipment and other assets	8,662	—	—	—	—
Lease commitments and other restructuring charges	17,924	17,893	1,821	(2,541)	17,173
Other expenses	$ 33,911	$ 17,893	$ 1,821	$(2,541)	$ 17,173

During 2002, we recognized other expenses of $33.9 million related to restructuring programs announced in the fourth quarter of 2002. We currently have one remaining lease related to an exited site that is due to expire in December 2010. During the nine months ended September 30, 2004 we adjusted our estimates of future sublease income related to this lease and recorded additional expense of $1.8 million. While a portion of this facility remains vacant, we expect that all space will be occupied by 2006. We may incur additional costs associated with subleasing and lease termination activities.

2001 Restructuring and Other Impairments

	Original Charge Recorded in 2001	Accrual Balance as of December 31, 2003	2004 Charges to Operations	2004 Charges Utilized	Accrual Balance as of September 30, 2004
Restructuring expenses:					
Workforce reduction	$ 8,114	$ —	$ —	$ —	$ —
Equipment and other assets	32,629	—	—	—	—
Lease commitments and other restructuring charges	14,859	215	41	(256)	—
Subtotal	55,602	215	41	(256)	
Impairment of goodwill and other intangible assets	68,666	—	—	—	—
Impairment of other long-lived assets	6,104	—	—	—	—
Other expenses	$ 130,372	$ 215	$ 41	$ (256)	$ —

During 2001, we recognized other expenses of $130.4 million relating to restructuring programs and long-lived asset write downs announced in the fourth quarter of 2001. During the nine months ended September 30, 2004, we recognized an additional charge of less than $0.1 million related to contract related settlements in excess of amounts originally estimated.

11. Purchased in-process research and development expenses

In February 2003, we completed the acquisition of Maxia Pharmaceuticals, Inc. (“Maxia”), a privately-held drug discovery and development company that specialized in small molecule drugs targeting diabetes and other metabolic disorders, cancer, inflammatory diseases and heart disease. We acquired Maxia to create a more advanced and robust pipeline of discovery projects and product candidates and to further our drug discovery and development efforts.

The total purchase price was approximately $27.4 million, consisting of Incyte common stock and cash. The purchase price was allocated to assets and liabilities acquired and in-process research and development expense, based on management’s estimates of the relative fair values of the acquired assets and liabilities. The purchase price was allocated as follows:

(in thousands)	
Current assets	$ 918
Current liabilities	(1,641)
Net tangible liabilities assumed	(723)
In-process research and development	28,116
Total purchase price	$27,393

Tangible assets acquired and liabilities assumed consist of cash of $0.5 million, prepaid expenses of $0.4 million, accounts payable of $0.8 million and accrued liabilities of $0.8 million. These amounts were allocated based on their fair value which approximated their respective carrying value. As noted above, approximately $28.1 million of the purchase price represented the estimated fair value of purchased in-process research and development projects that at the time of acquisition had not reached technological feasibility and had no alternative future use. Accordingly this amount was immediately charged to operating expense upon the acquisition date and was reflected in the statements of operations as a separate component of operating expense.

The value assigned to purchased in-process research and development was comprised of three compounds which were in stages ranging from discovery to preclinical phases as follows: Type II diabetes valued at $15.6 million; cancer valued at $6.9 million; and metabolic and other disorders valued at $5.6 million. The estimated fair values of these projects were determined by employment of a discounted cash flow model, using discount rates ranging from 20% to 40%. The discount rates used took into account the stage of completion and the risks surrounding the successful development and commercialization of each of the purchased in-process research and development projects that were valued. At the time of acquisition, the Maxia drug development platform was based on three components: chemistry, biology and an integrated drug discovery/development approach. Features of the chemistry component were novel, small, proprietary molecules. The biology component was based on leading scientific expertise in the nuclear receptor and signal transduction areas. The drug discovery platform was believed to provide an accelerated approach to novel drug discovery and development. Management has determined that each of these

projects would require significant further development, including the receipt of marketing approval by the U.S Food and Drug Administration or an equivalent foreign agency, before they would be commercially available. The major risks and uncertainties associated with the timely and successful completion of these projects consist of the ability to confirm the safety and efficacy of the technology acquired and obtaining necessary regulatory approvals. The timing and estimated costs to complete these projects are difficult to predict due to their early stage of development. At September 30, 2004, significant further development of the Maxia compounds remains to be completed.

In accordance with EITF 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination" we recorded a $2.9 million charge related to restructuring costs for Maxia, which consisted of workforce reductions and consolidation of facilities. We currently have one remaining lease related to an exited site in San Diego, California, that is due to expire in November 2008. During the nine months ended September 30, 2004, we adjusted our estimates of future sublease income related to this lease and recorded additional expense of $1.7 million.

Below is a summary of activity related to accrued acquisition costs for the nine months ended September 30, 2004:

	Original Accrual	Accrual Balance as of December 31, 2003	2004 Additions	2004 Accrual Utilized	Accrual Balance as of September 30, 2004
Accrued acquisition costs:					
Workforce reduction	$ 845	$ —	$ —	$ —	$ —
Lease commitments and other restructuring fees	2,016	1,334	1,718	(498)	2,554
Transaction fees	1,450	—	—	—	—
Accrued acquisition costs	$ 4,311	$ 1,334	$ 1,718	$ (498)	$ 2,554

The estimates above have been made based upon management's best estimate of the amounts and timing of certain events that will occur in the future. It is possible that the actual outcome of certain events may differ from the estimates. Changes will be made to this accrual at the point that the differences become determinable.

12. Litigation

In May 2001, we entered into a Development and License Agreement with Iconix Pharmaceuticals, Inc. ("Iconix"). Pursuant to the terms of the Agreement, the parties agreed to collaborate on the development and commercialization of a chemical genomic database (the "Database"), currently called DrugMatrix®. The Database was to be designed by Iconix to contain data, information and annotations related to gene expression, chemicals, pharmacology and toxicology, and related informatics tools and software. On November 10, 2003, Iconix filed a demand for arbitration against us, and on April 16, 2004, Iconix transmitted an amended demand. An arbitration panel has been selected and a hearing will be held in two phases, the first of which was held in October 2004 and the second of which is scheduled for the first quarter of 2005. In the first phase of the hearing, Iconix alleged that we are obligated to make payments to it in the aggregate amount of $28.25 million and that the payments presently due to Iconix, discounted to a present day value, amount to $22.6 million. We believe that Iconix's interpretation of the parties' contract with respect to these payments is erroneous and that these payments are not owed. We expect to receive a decision from the arbitration panel with respect to the first phase of the hearing by the end of 2004. Based on Iconix's amended demand for arbitration, we understand Iconix is also seeking return of a $4.5 million license fee paid to Incyte and recovery of amounts paid to a third-party supplier. The second phase of the hearing will address Iconix's claim for the return of the $4.5 million license fee paid to us and recovery of amounts paid to a third-party supplier, as well as our counterclaims against Iconix. We believe that we have meritorious defenses to Iconix's claims and plan to contest them vigorously. In addition, we are asserting counterclaims related to Iconix's nonperformance of certain of its contractual obligations to us. There can be no assurance as to the ultimate outcome of any such arbitration and at this time, we cannot predict the financial impact to us of the results of the arbitration. We expect that, regardless of the outcome, the Iconix arbitration will result in the diversion of management time and in future legal and other costs to us, which could be substantial.

13. Subsequent Event

On November 1, 2004, we announced the public offering of 9 million shares of our authorized but unissued common stock at $9.75 per share pursuant to an effective shelf registration statement, resulting in net proceeds of $83.3 million after deducting the underwriting discounts and commissions and estimated offering expenses. The offering closed on November 5, 2004. We have granted the underwriter an option, exercisable for 30 days, to purchase up to 1.35 million additional shares of newly issued common stock to cover over-allotments, if any.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and notes to those statements included elsewhere in this Quarterly Report on Form 10-Q as of September 30, 2004 and our audited financial statements for the year-ended December 31, 2003 included in our Annual Report on Form 10-K previously filed with the SEC.

When used in this report, the words "expects," "believes," "intends" "anticipates," "estimates," "plans," and similar expressions are intended to identify forward-looking statements. These are statements that relate to future periods and include statements as to the development, marketing, manufacturing and commercialization of our compounds and our product candidates; the increase in our drug discovery and development efforts and the increased investment to be made to advance such efforts; the expected timing, progress and other information regarding our preclinical testing and clinical trials; conducting clinical trials internally; our collaboration and strategic alliance efforts; the potential treatment and application of our compounds; anticipated benefits and disadvantages of entering into collaboration agreements; regulatory approval; the safety, effectiveness and potential benefits of our product candidates and other compounds under development; potential uses for our product candidates and our other compounds; our ability to manage expansion of our drug discovery and development operations; future required expertise relating to clinical trials, formulation, manufacturing, sales and marketing and for licenses to technology rights; the receipt of or payments to customers resulting from milestones or royalties; the closure of our Palo Alto location, including related charges, the expected cash impact of these charges and related expense reductions; difficulties resulting from the discontinuation of certain of our information product-related activities, including the amendment, termination or transition of customer contracts; the management of multiple locations; our plans for our BioKnowledge® product; our portfolio of gene and gene-technology related intellectual property; the successful prosecution of our patent applications and protection of our patents; expected expenses and expenditure levels; expected revenues, revenue decreases and sources of revenues; expected losses; our critical accounting policies and significant judgments and estimates; our profitability; the adequacy of our capital resources; the need to raise additional capital; the costs associated with resolving a matter currently in arbitration and our ongoing patent infringement litigation; our efforts to license patent rights relating to compounds or technologies; our expected uses of net cash; our expectations regarding competition; our long-term investments, including anticipated expenditures, losses and expenses; valuation allowance for deferred tax assets; costs associated with prosecuting, defending and enforcing patent claims and other intellectual property rights; expected utilization of accruals; our ability to obtain, maintain or increase coverage of product liability and other insurance; adequacy of our product liability insurance and our indebtedness. 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, our ability to discover, develop, formulate, manufacture and commercialize a drug candidate or product; our ability to obtain additional capital when needed; continuing trends with respect to reduced pharmaceutical and biotechnology research spending; risks relating to the development of new products and their use by us and our potential customers; our ability to in-license and out-license a potential drug compound or drug candidate; uncertainties as to actual research and development expenses; the cost of accessing, licensing or acquiring potential drug compounds or drug candidates developed by other companies; the risk of significant delays or costs in obtaining regulatory approvals; the ability to obtain regulatory approval or to conduct clinical trials for our product candidates; our ability to enroll a sufficient number of patients meeting eligibility criteria for our clinical trials; the impact of technological advances and competition; the ability to compete against third parties with greater resources than ours; competition to develop and commercialize similar drug products; the risk of unanticipated delays in research, development, formulation, and manufacturing efforts; our ability to exit and close facilities upon anticipated timelines; uncertainties relating to the transition of our operations to, and the continuing access to and use of, our Delaware headquarters; the actual cash impact of related restructuring charges and reduction of operating expenses; our ability to deliver our information related products to our customers effectively; the outcome of any disputes under an existing customer contract; our ability to obtain patent protection for our discoveries and to continue to be effective in expanding our patent coverage; the impact of changing laws and rising costs on our patent portfolio; developments in and expenses relating to litigation and arbitration; uncertainties relating to milestone and royalty payments due under existing contracts with our database customers and risks relating to their development and sales efforts; our ability to leverage our intellectual property portfolio through licensing arrangements with database customers; and the results of businesses in which we have made investments, and the matters set forth under the caption "Factors That May Affect Results." These forward-looking statements speak only as of the date hereof. We expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our 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," or "our" mean Incyte Corporation and our subsidiaries.

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

Overview

Incyte is focused on the discovery and development of novel, small molecule drugs to treat major medical conditions, including infection with human immunodeficiency virus, or HIV, inflammatory disorders, cancer and diabetes. We are using our expertise in medicinal chemistry, and molecular, cellular and in vivo biology to discover and develop novel drugs. Our most advanced product candidate, Reverset™, is a nucleoside analog reverse transcriptase inhibitor, or NRTI, that is being developed as a once-a-day oral therapy for use in combination with other antiviral drugs for patients with HIV infections. Reverset is currently in Phase IIb clinical trials.

In addition to our Reverset development program, we currently have internally-generated drug discovery programs underway. The most advanced of these programs is focused on developing antagonists to a key receptor involved in inflammation called the CCR2 receptor, and the lead candidate from this program is currently in Phase I clinical trials. We believe that this class of compounds may have application in the treatment of various inflammatory diseases, including rheumatoid arthritis, multiple sclerosis and atherosclerosis. A second internally-generated program is focused on inhibition of sheddase, an enzyme involved in activating members of the epidermal growth factor receptor (EGFR). By inhibiting sheddase we believe it could block signaling mechanisms needed for growth and metastasis of certain breast cancers, and possibly other solid tumors. We have selected a lead candidate for preclinical development and initiated preclinical toxicology testing. If results of preclinical testing are acceptable, we intend to initiate Phase I clinical trials for this compound in the first quarter of 2005. Earlier stage programs have generated other compounds with potential for applications in HIV, diabetes and cancer. We also possess an extensive gene and gene-technology related intellectual property portfolio and a biological research information product line based in Beverly, Massachusetts.

Until 2001, we devoted substantially all of our resources to the development, marketing and sales of genomics technologies and information products to the biotechnology and pharmaceutical industries and research and academic institutions to aid in better and faster prevention, diagnosis and treatment of disease. Our information products and services included databases, bioreagents, and custom sequencing. As part of our 2004 restructuring that we announced in February 2004, we closed our information products research facility and headquarters in Palo Alto, California and moved our headquarters to our Wilmington, Delaware pharmaceutical research and development facilities. The closure of the Palo Alto facility corresponded with terminating further development activities around our Palo Alto-based information products and services related to LifeSeq and ZooSeq. However, we continue to offer pharmaceutical and biotechnology companies and academics our BioKnowledge Library, or BKL, product line, as well as the last release of our LifeSeq and ZooSeq databases. Through our contractual arrangements with our database customers, we have established a number of licensing arrangements involving elements of this portfolio, and we intend to continue to pursue further licensing agreements and other leveraging opportunities for this asset.

As a result of the closure of our Palo Alto operations, we recorded $39.2 million of restructuring and other charges during the nine months ended September 30, 2004, and expect to record additional expenses of up to $0.2 million during the fourth quarter of 2004. These restructuring and other charges include charges related to the closure of our Palo Alto facilities, previously capitalized tenant improvements and equipment purchases, a workforce reduction and other items. The restructuring charges include lease commitment and related costs related primarily to the fair value of future lease obligations for two facilities through March 2011. As a result of the long-term nature of these contracts, we will be recording a charge each period through the termination date of the leases related to increases in the fair value of the lease obligations in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which are estimated to total approximately $3.2 million at September 30, 2004. We expect that the cash usage in 2004 from restructuring related charges will be from $21 to $23 million.

In conjunction with the 2004 restructuring program, we expect to reduce certain annual operating expenses of up to $50 million through a combination of decreased spending, personnel reductions and office consolidations. The restructuring programs will have no impact on our drug discovery and development programs as we intend to continue to invest in research and development related to these efforts. We expect these research and development expenses to continue to increase in 2004 and will partially offset our expected expense reductions from the 2004 restructuring program. We expect our total research and development expense to range from $91 to $95 million in 2004. Of this amount, we expect our drug discovery and development expenses to total approximately $73 million, which does not include any purchased in-process research and development costs. Also included in our overall research and development expenses are $12 million in costs related to our information product line, which primarily includes first and second quarter 2004 activities and up to $10 million in costs related to our gene and gene-technology related intellectual property and BKL product line.

We anticipate incurring additional losses for several years as we expand our drug discovery and development programs. We also expect that losses will fluctuate from quarter to quarter and that such fluctuations may be substantial. We do not expect to generate revenues from our drug discovery and development efforts for several years, if at all. If we are unable to successfully

develop and market pharmaceutical products over the next several years, our business, financial condition and results of operations would be adversely impacted.

Prior Restructurings

A discussion of each of our restructuring programs prior to 2004 is set forth below:

In 2003, as a result of a restructuring decision made in the fourth quarter, we incurred a charge of $11.5 million. The restructuring plan included elimination of approximately 75 employees at our Palo Alto location and write-down of certain assets related to our genomic information product line. The restructuring plan was completed in 2004 and we recorded a credit to restructuring expenses of $0.2 million during the nine month ended September 30, 2004 as a result of actual expenses being less than amounts originally estimated.

In 2002, we announced plans to reduce our expenditures, primarily in research and development, through a combination of spending reductions, workforce reductions and office consolidations. The expense reduction plan included elimination of approximately 37% of our workforce in Palo Alto, California, Beverly, Massachusetts, and Cambridge, United Kingdom and consolidation of our office and research facilities in Palo Alto, California. As a result of these actions, we incurred a charge of $33.9 million during the fourth quarter of 2002. In 2003, we recorded an additional charge of $3.7 million related to this restructuring, primarily relating to facilities lease expenses in excess of amounts originally estimated. During the nine months ended September 30, 2004, we adjusted our estimates of future sublease income related to the facility lease and recorded additional expense of $1.8 million.

During 2001, we exited certain product lines and, as a result of exiting these activities, we closed certain of our facilities in Fremont, California, Palo Alto, California, St. Louis, Missouri and Cambridge, United Kingdom. In addition to the product lines exited, we made infrastructure and other personnel reductions at our locations, resulting in an aggregate workforce reduction of approximately 400 employees. As a result of these actions, we recorded $130.4 million of restructuring charges in the fourth quarter of 2001. Additional charges for restructuring expenses of $3.4 million, $0.7 million and less than $0.1 million were recorded in 2002, 2003 and the nine months ended September 30, 2004, respectively, primarily for contract-related settlements, revised impairment estimates for long-lived assets and facilities lease expenses in excess of estimated amounts, offset by the release of other restructuring accruals in excess of actual expenses.

Pharmasset Collaborative Licensing Agreement

In September 2003, we entered into a collaborative licensing agreement with Pharmasset, Inc. (“Pharmasset”) to develop and commercialize Reverset, an antiretroviral drug that is currently in Phase IIb clinical development for the treatment of HIV. Under the terms of the agreement we paid Pharmasset $6.3 million, which we recorded as a charge to purchased in-process research and development expense that is presented as a separate component of operating expenses. In addition to this one-time payment, we also agreed to pay Pharmasset certain future performance milestone payments and future royalties on net sales, in exchange for exclusive rights in the United States, Europe and certain other markets to develop, manufacture and market the drug. Pharmasset will retain marketing and commercialization rights in certain territories, including South America, Mexico, Africa, the Middle East and China. One of the milestones was met in the second quarter of 2004, resulting in $0.5 million of research and development expense during the nine months ended September 30, 2004.

Maxia Acquisition

In February 2003, we completed the acquisition of Maxia Pharmaceuticals, Inc. (“Maxia”), a privately-held drug discovery and development company that specialized in small molecule drugs targeting diabetes and other metabolic disorders, cancer, inflammatory diseases and heart disease. We acquired Maxia to create a more advanced and robust pipeline of discovery projects and product candidates and to further our drug discovery and development efforts.

The total purchase price was approximately $27.4 million, consisting of Incyte common stock and cash. The purchase price was allocated to assets and liabilities acquired and in-process research and development expense, based on management’s estimates of the relative fair values of the acquired assets and liabilities. The purchase price was allocated as follows:

(in thousands)	
Current assets	$ 918
Current liabilities	(1,641)
Net tangible liabilities assumed	(723)
In-process research and development	28,116
Total purchase price	$27,393

Tangible assets acquired and liabilities assumed consist of cash of $0.5 million, prepaid expenses of $0.4 million, accounts payable of $0.8 million and accrued liabilities of $0.8 million. These amounts were allocated based on their fair value which approximated their respective carrying value. As noted above, approximately $28.1 million of the purchase price represented the estimated fair value of purchased in-process research and development projects that at the time of acquisition had not reached technological feasibility and had no alternative future use. Accordingly this amount was immediately charged to operating expense upon the acquisition date and was reflected in the statements of operations as a separate component of operating expense.

The value assigned to purchased in-process research and development was comprised of three compounds which were in stages ranging from discovery to preclinical phases as follows: Type II diabetes valued at $15.6 million; cancer valued at $6.9 million; and metabolic and other disorders valued at $5.6 million. The estimated fair values of these projects were determined by employment of a discounted cash flow model, using discount rates ranging from 20% to 40%. The discount rates used took into account the stage of completion and the risks surrounding the successful development and commercialization of each of the purchased in-process research and development projects that were valued. At the time of acquisition, the Maxia drug development platform was based on three components: chemistry, biology and an integrated drug discovery/development approach. Features of the chemistry component were novel, small, proprietary molecules. The biology component was based on leading scientific expertise in the nuclear receptor and signal transduction areas. The drug discovery platform was believed to provide an accelerated approach to novel drug discovery and development. Management has determined that each of these projects would require significant further development, including the receipt of marketing approval by the U.S Food and Drug Administration or an equivalent foreign agency, before they would be commercially available. The major risks and uncertainties associated with the timely and successful completion of these projects consist of the ability to confirm the safety and efficacy of the technology acquired and obtaining necessary regulatory approvals. The timing and estimated costs to complete these projects are difficult to predict due to their early stage of development. At September 30, 2004, significant further development of the Maxia compounds remains to be completed.

Critical Accounting Policies and Estimates

The preparation of financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

We believe the following critical accounting policies reflect the more significant estimates and judgments used in the preparation of our consolidated financial statements.

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. We enter into various types of agreements for access to our information databases and use of our intellectual property. Revenues are deferred for fees received before earned or until no further obligations exist. We exercise judgment in determining that collectibility is reasonably assured or that services have been delivered in accordance with the arrangement. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the customer’s payment history and on the creditworthiness of the customer.

Revenues from ongoing database agreements are recognized evenly over the access period. Revenues from licenses to our intellectual property are recognized when earned under the terms of the related agreements. Royalty revenues are recognized upon the sale of products or services to third parties by the licensee or other agreed upon terms. We estimate royalty revenues based on previous period royalties received, based on information provided by the third party licensee. We exercise judgment in determining whether the information provided by licensees is sufficiently reliable for us to base our royalty revenue recognition thereon. Revenues from custom products, such as clones and datasets, were recognized upon completion and delivery.

Certain of our contractual arrangements with customers involve multiple deliverables or elements. Under these arrangements, the multiple elements generally consist only of access to our information databases, use of our intellectual property, and sales of our custom products and services. Revenues recognized from multiple element contracts are allocated to each element of the arrangement based on the fair values of the elements. The determination of fair value of each element is based on objective evidence from historical sales of individual elements by us to other customers. If such evidence of fair value for each undelivered element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value for each undelivered element does exist or until all elements of the arrangement are delivered. When elements are specifically tied to a separate earnings process, revenue is recognized when the specific performance obligation associated with

the element is completed. When revenues for an element are not specifically tied to a separate earnings process, they are recognized ratably over the term of the agreement.

When contracts include non-monetary payments, the value of the non-monetary transaction is determined using the fair value of the products and services involved, as applicable. For non-monetary payments involving the receipt of equity in a public entity, the fair value is based on the traded stock price on the date revenue is earned. For non-monetary payments involving the receipt of equity in a privately-held company, fair value is determined either based on a current or recent arm's length financing by the issuer or upon an independent valuation of the issuer.

Valuation of Long-Lived Assets. We assess the impairment of long-lived assets, which includes property and equipment as well as intangible and other assets, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important that could indicate the need for an impairment review include the following:

- Significant changes in the strategy of our overall business;
- Significant underperformance relative to expected historical or projected future operating results;
- Significant changes in the manner of use of the acquired assets;
- Significant negative industry or economic trends;
- Significant decline in our stock price for a sustained period; and
- Our market capitalization relative to net book value.

When we determine that the carrying value of long-lived assets may not be recoverable based upon the existence of one or more of the above indicators of impairment, in accordance with *FASB Statement No. 144*, *Accounting for the Impairment or Disposal of Long Lived Assets* ("SFAS 144"), we perform an undiscounted cash flow analysis to determine if impairment exists. If impairment exists, we measure the impairment based on the difference between the asset's carrying amount and its fair value.

Accounting for Long-Term Investments. Our long-term investments have historically consisted of investments in both privately and publicly-held companies in which we have owned less than 20% of the outstanding voting stock and have not had the ability to exert significant influence over the investees. Accordingly, our long-term investments in privately-held companies have been accounted for under the cost method and our investments in publicly-held companies have been accounted for in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investments in publicly-held companies are classified as available-for-sale and are adjusted to their fair value each period based on their quoted market price with any adjustments being recorded in accumulated other comprehensive income (loss) as a separate component of stockholders' equity.

We periodically evaluate the carrying value of our ownership interests in privately-held cost method investees by reviewing conditions that might indicate an other-than temporary decline in fair value, including the following:

- Financial performance of the investee;
- Achievement of business plan objectives and milestones including the hiring of key employees, obtaining key business partnerships, and progress related to research and development activities;
- Available cash; and
- Completion of debt and equity financings.

If our review of these factors indicates that an other-than-temporary decline in the fair value of the investee has occurred, we estimate the fair value of the investee. When the carrying value of our investments is materially greater than our pro-rata share of the estimated fair value of the investee, we record an impairment charge to reduce our carrying value. Impairment charges are recorded in the period when the related triggering condition becomes known to management. We use the best information available in performing our periodic evaluations; however, the information available may be limited. These evaluations involve significant management judgment, and the actual amounts realized for a specific investment may differ from the carrying value. For our available-for-sale investments in publicly-held investees, we monitor all unrealized losses to determine whether a decline in fair value below carrying value is other-than-temporary. Generally, when fair value is materially less than carrying value, and the stock price of the investee has declined for six consecutive months, we consider the decline to be other-than-temporary. When we conclude that a decline is other-than-temporary, we adjust the carrying value of our long-term investments in publicly-held investees so that our carrying value per share is equal to the quoted market price per share. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional impairment charges.

Restructuring Charges. The 2004 and 2003 restructuring charges have been recorded in accordance with *FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146").* The restructuring charges resulting from the 2002 and 2001 restructuring programs have been recorded in accordance with EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) ("EITF 94-3")* and Staff Accounting Bulletin No. 100, *Restructuring and Impairment Charges ("SAB 100").* Restructuring costs resulting from the acquisition of Maxia have been recorded in accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination ("EITF 95-3").* The restructuring charges are comprised primarily of costs to exit facilities, reduce our workforce, write-off fixed assets, and pay for outside services incurred in the restructuring. The workforce reduction charge is determined based on the estimated severance and fringe benefit charge for identified employees. In calculating the cost to exit the facilities, we estimate for each location the amount to be paid in lease termination payments, the future lease and operating costs to be paid until the lease is terminated, the amount, if any, of sublease receipts and real estate broker fees. This requires us to estimate the timing and costs of each lease to be terminated, the amount of operating costs, and the timing and rate at which we might be able to sublease the site. To form our estimates for these costs, we perform an assessment of the affected facilities and considered the current market conditions for each site. We also estimate our credit adjusted risk free interest rate in order to discount our projected lease payments in accordance with SFAS 146. Estimates are also used in our calculation of the estimated realizable value on equipment that is being held for sale. These estimates are formed based on recent history of sales of similar equipment and market conditions. Our assumptions on either the lease termination payments, operating costs until terminated, the offsetting sublease receipts and estimated realizable value of fixed assets held for sale may turn out to be incorrect and our actual cost may be materially different from our estimates. Our estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities recorded. At the end of each reporting period, we evaluate the remaining accrued balances to ensure their adequacy, that no excess accruals are retained and the utilization of the provisions are for their intended purposes in accordance with developed exit plans. For certain facilities that we have been unable to sublease due to poor real estate market conditions (such as higher than expected vacancy rates and lower sublease rates), we periodically evaluate current available information and adjust our restructuring reserve as necessary. We also make adjustments related to professional fees due to actual amounts being lower than originally estimated.

Results of Operations

We recorded a net loss of $26.0 million and $127.3 million and basic and diluted net loss per share of $0.35 and $1.74 per share for the three and nine months ended September 30, 2004, respectively, as compared to a net loss of $43.0 million and $125.7 million and basic and diluted net loss per share of $0.60 and $1.77 per share in the corresponding periods in 2003.

Revenues. Our revenues for the three and nine months ended September 30, 2004 declined to $3.4 million and $15.2 million, respectively, from $13.2 million and $36.8 million for the three and nine months ended September 30, 2003. Revenues were derived exclusively from our information products, which include database subscriptions, licensing of our gene and gene-technology related intellectual property, and partner programs. The decrease in revenues for the three and nine months ended September 30, 2004 compared to 2003 corresponded with terminating further development activities around our former Palo Alto-based information products and services related to LifeSeq and ZooSeq. Revenues for these products have been declining in recent years due to consolidation within the pharmaceutical and biotechnology sectors as well as a challenging economic environment that led to reduced demand of research tools and services. These trends, together with the public availability of genomic information, significantly reduced the market for, and revenues from, our former Palo Alto-based information products and services.

Revenues recognized from transactions in which there was originally a concurrent commitment entered into by us to purchase goods and services were $0.0 million and $1.5 million, respectively, for the three and nine months ended September 30, 2004 and $0.8 million and $2.7 million, respectively, for the corresponding periods in 2003. No new transactions in which there was a concurrent commitment by us to purchase goods for services were entered into during the nine months ended September 30, 2004. Of commitments made in prior periods, we expensed $0.0 million and $7.5 million, respectively, for the three and nine months ended September 30, 2004 and $2.8 million and $8.3 million, respectively, for the corresponding periods in 2003.

We expect that revenues generated from information products, including licensing of gene and gene-technology related intellectual property, will continue to decline as we focus on our drug discovery and development programs. We expect that revenues from information products in 2004 will be in the range of $15.0 to $17.0 million.

Operating Expenses. Total costs and expenses for the three and nine months ended September 30, 2004 were $23.7 million and $130.0 million, respectively, compared to $43.4 million and $148.1 million for the corresponding periods in 2003. In conjunction with the 2004 restructuring program, we recorded $0.2 million and $39.2 million, respectively, during the three and nine months ended September 30, 2004 which is included in other expense in the accompanying condensed consolidated statements of operations. We estimate that we will record additional restructuring charges of up to $0.2 million in the fourth quarter of 2004. These restructuring charges include charges related to the closure of our Palo Alto facilities, previously

capitalized tenant improvements and equipment purchases, a workforce reduction and other items. As a result of the 2004 restructuring program, we expect to reduce certain annual operating expenses by up to $50 million through a combination of decreased spending, personnel reductions and facilities closures. The restructuring programs will have no impact on our drug discovery and development programs as we intend to continue to invest in research and development related to these efforts. We expect these research and development expenses to continue to increase in 2004, and such expenses should partially offset our expected expense reductions from the 2004 restructuring program. We expect our total research and development expenses to range from $91 to $95 million in 2004.

During the three and nine months ended September 30, 2004, we also recorded other expense of $(0.3) million and $3.4 million related primarily to adjustments to our estimated sublease income for a facility closed in connection with our 2001 restructuring and a facility closed in connection with our acquisition of Maxia.

Research and development expenses.

	For the three months ended, September 30,		For the nine months ended, September 30,	
	2004	2003	2004	2003
	(in millions)		(in millions)	
Salary and related benefits	$ 5,945	$ 11,873	$ 23,860	$ 38,653
Collaboration and outside services	6,216	6,687	22,630	19,058
Occupancy and all other costs	6,468	10,059	23,889	30,964
Total research and development expenses	$ 18,629	$ 28,619	$ 70,379	$ 88,675

We currently track research and development costs by natural expense line and not costs by project. These costs are exclusive of all charges related to the purchase of in-process research and development projects. The decrease in 2004 from 2003 was primarily the result of expenses eliminated through the restructuring programs, partially offset by increased drug discovery and development expenses.

We expect that research and development expenditures related to drug discovery and development will increase during 2004 and subsequent years due to the continuation and expansion of clinical trials for our small molecule programs, the initiation of trials for other potential indications and additional study expenditures for potential pharmaceutical candidates. Research and development expenses may fluctuate from period to period depending upon the stage of certain projects and the level of pre-clinical testing and clinical trial-related activities.

Our most advanced clinical development programs are our efforts to develop Reverset for the treatment of patients infected with HIV and the development of antagonists to the CCR2 receptor. We completed our initial Phase II trial and began dosing in a Phase IIb human clinical trial for Reverset in the second quarter of 2004. Our lead compound from our CCR2 antagonist program is currently in Phase I clinical trials. A lead compound in our sheddase inhibitor program was nominated for development during the first quarter of 2004 and is currently undergoing preclinical toxicology testing. If results of these trials are acceptable, we intend to initiate Phase I clinical trials for this compound in the first quarter of 2005. Many factors can affect the cost and timing of our trials, including inconclusive results requiring additional clinical trials, slow patient enrollment, adverse side effects among patients, insufficient supplies for our clinical trials and real or perceived lack of effectiveness or safety of our trials. In addition, the development of all of our products will be subject to extensive governmental regulation. These and other risk factors, detailed in “Factors That May Affect Results - Risks Relating to our Business,” make it difficult for us to predict the timing and costs of the further development and approval of our products.

Selling, general and administrative expenses.

	For the three months ended, September 30,		For the nine months ended, September 30,	
	2004	2003	2004	2003
	(in millions)		(in millions)	
Salary and benefits related	$ 1,995	$ 5,592	$ 7,234	$ 15,469
Other contract service and outside costs	3,241	2,993	9,807	8,187
Total selling, general and administrative expenses	$ 5,236	$ 8,585	$ 17,041	$ 23,656

The decrease in 2004 over 2003 was primarily the result of expenses eliminated through the restructuring programs, partially offset by legal expenses related to patent infringement litigation and arbitration, outside services related to transitioning our corporate headquarters functions from Palo Alto to Delaware and increased facility costs related to our Delaware and San Diego sites. Regardless of the outcome, we expect our ongoing patent infringement litigation and pending arbitration to result in future costs to us, which could be substantial.

Purchased in-process research and development expense. Purchased in-process research and development expenses for the three months ended September 30, 2003 of $6.3 million resulted from our collaborative licensing agreement with Pharmasset. Purchased in-process research and development for the nine months ended September 30, 2003 of $34.4 million resulted from the acquisition of Maxia and our collaborative licensing agreement with Pharmasset.

Other expenses. Total other expenses for the three and nine months ended September 30, 2004 were $(0.1) million and $42.5 million, respectively, compared to $0.0 million and $1.4 million, respectively, for the corresponding periods in 2003, and represent charges recorded in connection with previously announced restructuring programs. The increase from 2003 to 2004 is due to the significant costs associated with the shutdown of our Palo Alto operations.

Interest and Other Income (Expense), Net. Interest and other income, net, for the three and nine months ended September 30, 2004 was $(0.6) million and $1.4 million, respectively, compared to $(11.3) million and $(7.5) million, respectively, for the corresponding periods in 2003. The $10.7 million change for the three months ended September 30, 2004 over the comparable period in 2003 is due primarily to a $10.9 million decrease in impairment charges to reduce the carrying value of our investments in certain privately-held investees. The $8.9 million change for the nine-months ended September 30, 2004 over the comparable period in 2003 is due primarily to a $10.9 million decrease in impairment charges to reduce the carrying value of our investments in certain privately-held investees partially offset by lower interest rates in 2004 and realized losses on the sale of marketable securities.

Interest Expense. Interest expense for the three and nine months ended September 30, 2004 was $4.6 million and $13.0 million, respectively, compared to $2.3 million and $7.2 million, respectively, for the corresponding periods in 2003. The increase in 2004 is related to additional interest expense incurred as a result of the issuance of $250 million of convertible debt in February and March of 2004.

Gain/(Loss) on Repurchase of Convertible Subordinated Notes. Loss on repurchase of convertible subordinated notes for the three and nine months ended September 30, 2004 of $(0.2) million was due to our repurchase of $38.4 million face value of our 5.5% convertible notes in the third quarter of 2004. Gain on repurchase of convertible subordinated notes for the three and nine months ended September 30, 2003 of $0.7 million was due to the repurchase of $3.8 million face value of our 5.5% convertible notes on the open market in the third quarter of 2003. In accordance with SFAS 145, all gains and losses on the repurchase of convertible subordinated notes are presented as “Gain/(loss) on repurchase of convertible subordinated notes.”

Gain/(Loss) on Certain Derivative Financial Instruments, Net. The losses on derivative financial instruments of $0.2 million and $0.5 million, respectively, in the three and nine months ended September 30, 2004 and the gain of $0.2 million and $0.3 million in the corresponding periods in 2003 represent the change in the fair value of certain long-term investments, specifically warrants held in other companies, in accordance with FASB Statement No. 133 (“SFAS 133”).

Provision for Income Taxes. Due to our net loss in 2004 and 2003, we had a minimal effective annual income tax rate. The income taxes for 2004 and 2003 are primarily attributable to foreign withholding taxes. There was no foreign tax expense in the three months ended September 30, 2004 due to a change in a tax treaty eliminating certain withholding requirements effective July 1, 2004.

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities (“FIN 46”)*. In general, a variable interest entity (“VIE”) is a corporation, partnership, trust, or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity’s activities or entitled to receive a majority of the entity’s residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. We have not entered into any arrangements or made any investments which qualify as a VIE in the period from January 31, 2003 to September 30, 2004. The consolidation requirements apply to entities in which we made investments or with which we had contractual or other arrangements prior to January 31, 2003 beginning with the first fiscal year or interim period ending after March 15, 2004. We have investments in privately held companies that are in the pharmaceutical/biotechnology sector and are in the development or early stage. Some of these investments are considered to be variable interest entities. However, our interests in these VIE’s are not significant. We have evaluated our investments in these companies and have determined that upon the adoption of FIN 46, we were not the primary beneficiary of the VIE’s and, therefore, they were not required to be consolidated into our financial statements. Accordingly, there was no material impact on our results of operations, financial position or cash flows for the nine months ended September 30, 2004.

In November 2003, the Emerging Issues Task Force ("EITF") of the FASB issued EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, ("EITF 03-1"), which provides additional guidance for evaluating whether an investment is other-than-temporarily impaired and requires additional disclosures about unrealized losses on available-for-sale debt and equity securities accounted for under FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations.* The guidance in EITF 03-1 for evaluating other-than-temporary impairments is effective for evaluations made in reporting periods beginning after June 15, 2004 and the disclosure requirements are effective in annual financial statements for fiscal years ending after December 15, 2003, for investments accounted for under Statements 115 and 124. For all other investments within the scope of EITF 03-1, the disclosure requirements are effective in annual financial statements for fiscal years ending after June 15, 2004. The additional disclosures for cost method investments are effective for fiscal years ending after June 15, 2004. On September 30, 2004, the FASB issued Staff Position No. EITF Issue 03-1-1, under which the effective date for the measurement and recognition guidance of EITF 03-1 has been delayed pending further consideration of whether application guidance is necessary. We do not expect EITF 03-1 will have an impact on our financial position, results of operations, or cash flows.

On September 30, 2004, the EITF reached a consensus on Issue No. 04-08 "*The Effect of Contingently Convertible Debt on Diluted Earnings per Share*" ("EITF 04-08"), which changes the treatment of contingently convertible debt instruments in the calculation of diluted earnings per share. Contingently convertible debt instruments are financial instruments that include a contingent feature, such as when debt is convertible into common shares of the issuer only after the issuer's common stock price has exceeded a predetermined threshold for a specified time period. EITF 04-08 provides that these debt instruments should be included in the earnings per share computation (if dilutive) regardless of whether the contingent feature has been met. The FASB ratified this consensus in October 2004, and the new rules will be effective for reporting periods ending after December 15, 2004. The adoption of EITF 04-08 will have no impact on our financial position, results of operations, or cash flows.

Liquidity and Capital Resources

As of September 30, 2004, we had $412.6 million in cash, cash equivalents and marketable securities, compared to $293.8 million as of December 31, 2003. We have historically financed our operations primarily through the sale of equity securities, the issuance of convertible subordinated notes and cash received from our customers.

In February and March 2004, in a private placement, we issued a total of $250 million of $3^1/_2$% convertible subordinated notes due 2011 (the "3.5% Notes"), which resulted in net proceeds of approximately $242.5 million. The notes bear interest at the rate of 3.5% per year, payable semi-annually on February 15 and August 15, and are due February 15, 2011. The notes are subordinated to all senior indebtedness and pari passu in right of payment with our 5.5% convertible subordinated notes due 2007 (the "5.5% notes"). As of September 30, 2004, we had no senior indebtedness. The 3.5% Notes are convertible into shares of our common stock at an initial conversion price of approximately $11.22 per share. Holders may require us to repurchase the notes upon a change in control, as defined. We may redeem the notes beginning February 20, 2007.

During the third quarter of 2004, we repurchased and retired a total of $38.4 million in face value of the 5.5% Notes in two separate transactions. A net loss of $0.2 million was recognized on the repurchases and is presented as "Gain (loss) on repurchase of convertible subordinated notes" in the accompanying condensed consolidated statement of operations.

On November 1, 2004, we announced the public offering of 9 million shares of our authorized but unissued common stock at $9.75 per share pursuant to an effective shelf registration statement, resulting in net proceeds of $83.3 million after deducting the underwriting discounts and commissions and estimated offering expenses. The offering closed on November 5, 2004. We have granted the underwriter an option, exercisable for 30 days, to purchase up to 1.35 million additional shares of newly issued common stock to cover over-allotments, if any.

We have classified all of our marketable securities as short-term, as we may choose not to hold our marketable securities until maturity. Available cash is invested in accordance with our investment policy's primary objectives of liquidity, safety of principal and diversity of investments.

Net cash used in operating activities was $87.2 million for the nine months ended September 30, 2004 compared to $98.4 million for the nine months ended September 30, 2003. The decrease of $11.2 million was primarily due to a $27.7 million change in cash flow from changes in operating assets and liabilities offset by a $14.9 million decrease in non-cash items and a $1.6 million increase in net loss.

Our investing activities, other than purchases, sales and maturities of marketable securities, have consisted predominantly of capital expenditures. Capital expenditures for the nine months ended September 30, 2004 and 2003, were $0.8 million and $8.7 million, respectively. In the future, net cash used by investing activities may fluctuate significantly from period to period

due to the timing of strategic equity investments, acquisitions, including possible earn-out payments to former Maxia stockholders, capital expenditures and maturities/sales and purchases of marketable securities.

Net cash provided by financing activities was $208.0 million for the nine months ended September 30, 2004 as compared to a use of cash of $2.0 million for the nine months ended September 30 2003. This increase is primarily due to the net proceeds of $242.5 million from the issuance of convertible debt in February and March of 2004 and an increase in proceeds from the issuance of common stock under our stock compensation plans of $2.7 million. These items were offset by our repurchase and retirement of a total of $38.4 million in face value of the 5.5% Notes in two separate transactions.

The following summarizes our future minimum convertible debt payments, future interest payments on convertible debt, and future operating lease payments for the next five fiscal years and thereafter as of September 30, 2004 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in millions):

	Total	Less Than 1 Year	Years 1–3	Years 4–5	Over 5 Years
			(in millions)		
Contractual Obligations:					
Principal on convertible subordinated debt	$378.1	$ —	$128.1	$ —	$250.0
Interest on convertible subordinated debt	74.5	15.8	28.1	17.5	13.1
Non-cancelable operating lease obligations:					
Related to current operations	15.3	4.1	7.7	3.5	—
Related to vacated space	53.4	8.8	17.0	16.3	11.3
Total contractual obligations	$521.3	$ 28.7	$180.9	$37.3	$274.4

The amounts and timing of payments related to vacated facilities may vary based on negotiated timing of lease terminations. Estimates may require further adjustments due to the real estate market conditions, such as higher than expected vacancy rates or lower sub-lease rates. We have entered into sublease agreements for certain of the vacated space with scheduled payments to us of $1.9 million (less than 1 year), $3.9 million (years 1 -3), $2.7 million (years 4-5), and $2.0 million (over 5 years).

The table above excludes certain commitments that are contingent upon future events. The most significant of these contractual commitments that we consider to be contingent obligations are summarized below.

We have a commitment to purchase up to $5.0 million of equity in Genomic Health, Inc. (“Genomic Health”), at the election of Genomic Health, which election may be made by Genomic Health at any time on or after January 1, 2005.

Additional commitments related to Maxia and Pharmasset are also considered contingent commitments as future events must occur to cause these commitments to be enforceable. In February 2003, we completed our acquisition of Maxia. Under the merger agreement, former Maxia stockholders have the right to receive certain earn out amounts of up to a potential aggregate amount of $14.0 million upon the occurrence of certain research and development milestones set forth in the merger agreement. Twenty percent of each earn out payment, if earned, will be paid in cash and the remaining eighty percent will be paid in shares of our common stock such that an aggregate of $2.8 million in cash and $11.2 million in our common stock (based upon the then fair value) could potentially be paid pursuant to the earn out milestones. The milestones are set to occur as Maxia products enter various stages of human clinical trials and may be earned at any time prior to the tenth anniversary of the consummation of the merger. In any event, no more than 13,531,138 shares of our common stock may be issued to former Maxia stockholders in the aggregate pursuant to the merger agreement. None of these milestones has been achieved as of September 30, 2004.

Under the terms of our collaborative licensing agreement with Pharmasset, we agreed to pay Pharmasset certain future performance milestone payments and future royalties on net sales. One of these milestones had been met as of September 30, 2004, resulting in $0.5 million of research and development expense during the nine months ended September 30, 2004.

We have entered into and intend to continue to seek to license additional patent rights relating to compounds or technologies in connection with our drug discovery and development programs. Under these licenses, we may be required to pay milestone payments and royalties on sales of future products.

We have entered into agreements with clinical research organizations to provide certain clinical trial management services. Under the terms of the most significant of these agreements, we agreed to pay up to $6.2 million for certain future performance milestone payments, management fees and pre-approved out of pocket expenses, of which approximately $2.8 million had been paid as of September 30, 2004.

We expect to use net cash in 2004 as we invest in our drug discovery and development programs; make payments related to our restructuring programs; continue to seek access to technologies through investments, research and development and new alliances, license agreements and/or acquisitions; and continue to invest in our intellectual property portfolio.

We believe that our cash, cash equivalents and marketable securities will be adequate to satisfy our capital needs for at least the next twelve months. Our cash requirements depend on numerous factors, including expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary technologies and businesses; expenditures in connection with potential repurchases of our 5.5% subordinated convertible notes due in 2007; expenditures in connection with our expansion of drug discovery and development programs; competing technological and market developments; the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights; capital expenditures required to expand our facilities, including facilities for our expanding drug discovery and development programs; and costs associated with the integration of new operations assumed through mergers and acquisitions; and our ability to license our gene and gene-technology related intellectual property. Changes in our research and development plans or other changes affecting our operating expenses may result in changes in the timing and amount of expenditures of our capital resources. We expect that future revenues generated from information products, including licensing of our gene and gene-technology related intellectual property, will continue to decline as we focus on drug discovery and development programs.

Off Balance Sheet Arrangements

We have no material off-balance sheet arrangements other than those that are discussed above.

FACTORS THAT MAY AFFECT RESULTS

RISKS RELATING TO OUR BUSINESS

We are at the early stage of our drug discovery and development efforts and we may be unsuccessful in our efforts.

We are in the early stage of building our drug discovery and development operations. Our ability to develop and commercialize pharmaceutical products based on proteins, antibodies and other compounds will depend on our ability to:

- hire and retain key scientific employees;
- identify high quality therapeutic targets;
- identify potential drug candidates;
- develop products internally or license drug candidates from others;
- identify and enroll suitable volunteers, either in the United States or abroad, for our clinical trials;
- complete laboratory testing and clinical trials on humans;
- obtain and maintain necessary intellectual property rights to our products;
- obtain and maintain necessary regulatory approvals for our products, both in the United States and abroad;
- enter into arrangements with third parties to provide services or to manufacture our products on our behalf, or develop efficient production facilities meeting all regulatory requirements;
- deploy sales and marketing resources effectively or enter into arrangements with third parties to provide these functions;
- lease facilities at reasonable rates to support our growth; and
- enter into arrangements with third parties to license and commercialize our products.

Of the compounds that we identify as potential drug products or that we in-license from other companies, only a few, at most, are statistically likely to lead to successful drug development programs. Significant research and development efforts will be necessary. We have limited experience with these activities and may not be successful in developing or commercializing drug products. If we choose to outsource some of these activities, we may be unable to enter into outsourcing or licensing agreements on commercially reasonable terms, if at all. In addition, if we elect to manufacture our products in our own manufacturing

facilities, we will require substantial additional capital resources to lease or build and maintain those facilities, including attracting and retaining qualified personnel to lease or build and operate our facilities.

Our efforts to discover and develop potential drug candidates may not lead to the development, commercialization or marketing of drug products.

We are currently engaged in a number of different approaches to discover and develop novel drug candidates. We are internally developing novel small molecule chemokine receptor antagonists to treat inflammation and our scientists have produced a number of lead compounds that are in the final stages of preclinical testing and a lead candidate from this program has entered Phase I clinical trials. Other internal drug discovery programs are focused on sheddase inhibitors to treat cancer and compounds with potential for applications in HIV, diabetes and cancer. Discovery and development of potential drug candidates are expensive and time-consuming, and we do not know if our efforts will lead to discovery of any drug candidates that can be successfully developed and marketed. If our efforts do not lead to the discovery of a suitable drug candidate, we may be unable to grow our clinical pipeline or we may be unable to enter into agreements with collaborators who are willing to develop our drug candidates.

The success of our drug discovery and development efforts may depend on our ability to find suitable collaborators to fully exploit our capabilities. If we are unable to establish collaborations or if these future collaborations are unsuccessful, our research and development efforts may be unsuccessful, which could adversely affect our results of operations and financial condition.

An important element of our business strategy will be to enter into collaborative or license arrangements with third parties under which we license our drug candidates to those third parties for development and commercialization. We expect that while we may initially seek to conduct initial clinical trials on our drug candidates, we will need to seek collaborators for a number of our drug candidates because of the expense, effort and expertise required to continue additional clinical trials and further develop those drug candidates. Because collaboration arrangements are complex to negotiate, we may not be successful in our attempts to establish these arrangements. Also, we may not have drug compounds that are desirable to other parties, or we may be unwilling to license a drug compound because the party interested in it is a competitor. The terms of any such arrangements that we establish may not be favorable to us. Alternatively, potential collaborators may decide against entering into an agreement with us because of our financial, regulatory or intellectual property position or for scientific, commercial or other reasons. If we are not able to establish collaborative agreements, we may not be able to develop and commercialize a drug product, which would adversely affect our business and our revenues.

In order for any of these collaboration efforts to be successful, we must first identify potential collaborators whose capabilities complement and integrate well with ours. We may rely on these arrangements for not only financial resources, but also for expertise or economies of scale that we expect to need in the future relating to clinical trials, manufacturing, sales and marketing, and for licenses to technology rights. However, it is likely that we will not be able to control the amount and timing of resources that our collaborators devote to our programs or potential products. If our collaborators prove difficult to work with, are less skilled than we originally expected or do not devote adequate resources to the program, the relationship will not be successful. If a business combination involving a collaborator and a third party were to occur, the effect could be to diminish, terminate or cause delays in development of a potential product.

We face significant competition for our drug discovery and development efforts, and if we do not compete effectively, our commercial opportunities will be reduced or eliminated.

The biotechnology and pharmaceutical industries are intensely competitive and subject to rapid and significant technological change. Our drug discovery and development efforts may target diseases and conditions that are already subject to existing therapies or that are being developed by our competitors, many of which have substantially greater resources, larger research and development staffs and facilities, more experience in completing preclinical testing and clinical trials in order to obtain regulatory approvals and formulation, marketing and manufacturing capabilities. As a result of these resources, our competitors may develop drug products that render our products obsolete or noncompetitive by developing more effective drugs or by developing their products more efficiently. Our ability to develop competitive products would be limited if our competitors succeeded in obtaining regulatory approvals for drug candidates more rapidly than we were able to or in obtaining patent protection or other intellectual property rights that limited our drug development efforts. Any drugs resulting from our research and development efforts, or from our joint efforts with collaborators, might not be able to compete successfully with our competitors' existing and future products, or obtain regulatory approval in the United States or elsewhere.

Our ability to develop and commercialize Reverset may be adversely affected if a dispute arose with Pharmasset.

We are developing Reverset under a collaborative licensing agreement with Pharmasset entered into in September 2003. If a dispute arose with Pharmasset over the terms of the collaborative license agreement, including the alleged breach of any provision, our development, commercialization and marketing of Reverset may be adversely affected.

If conflicts arise between our collaborators or advisors and us, our collaborators or advisors may act in their self-interest, which may adversely affect our business.

If conflicts arise between us and our collaborators, including Pharmasset, or our scientific advisors, the other party may act in its self-interest and not in the interest of our stockholders. Conflicts may arise with our collaborators if they pursue alternative technologies or develop alternative products either on their own or in collaboration with others as a means for developing treatments for the diseases that we have targeted. Competing products, either developed by these future collaborators or to which these future collaborators have rights, may result in their withdrawal of support for our product candidates.

Additionally, conflicts may arise if there is a dispute about the achievement and payment of a milestone amount or the ownership of intellectual property that is developed during the course of the relationship. Similarly, the parties to a collaboration agreement may disagree as to which party owns newly developed products. Should an agreement be terminated as a result of a dispute and before we have realized the benefits of the collaboration, our reputation could be harmed and we may not obtain revenues that we anticipated receiving.

If we fail to enter into additional in-licensing agreements or if these arrangements are unsuccessful, our business and operations might be adversely affected.

In addition to establishing collaborative arrangements under which third parties license our drug candidates for development and commercialization, we intend to continue to explore opportunities to develop our clinical pipeline by in-licensing drug compounds that fit within our expertise and research and development capabilities. We may be unable to enter into any additional in-licensing agreements because suitable product candidates that are within our expertise may not be available to us on terms that are acceptable to us or because competitors with greater resources seek to in-license the same product candidates. Product candidates that we would like to develop may not be available to us because they are controlled by competitors who are unwilling to license the rights to the drug compound or candidate to us. We may also need to license drug delivery or other technology in order to continue to develop our drug candidate pipeline. If we are unable to enter into additional agreements to license drug candidates, drug delivery technology or other technology or if these arrangements are unsuccessful, our research and development efforts could be adversely affected.

We have limited expertise with and capacity to conduct clinical trials, and our resulting dependence on third parties to conduct clinical trials could result in delays in and additional costs for our drug development efforts.

We have only limited experience with clinical trials, manufacturing and commercialization of drug products. We also have limited internal resources and capacity to perform preclinical studies and clinical trials. As a result, we intend to hire contract research organizations, or CROs, to perform most of our clinical trials for drug candidates that we choose to develop without a collaborator. If the CROs that we hire to perform our clinical trials or our collaborators do not meet deadlines or do not follow proper procedures, our clinical trials may take longer than expected, may be delayed or may be terminated. If we were forced to find a replacement entity to perform any of our clinical trials, we may not be able to find a suitable entity on favorable terms, or at all. Even if we were able to find another company to perform a trial, the delay in the trial may result in significant expenditures. Events such as these may result in delays in our obtaining regulatory approval for our drug candidates or our ability to commercialize our products and could result in increased expenditures that would adversely affect our operating results.

In addition, for some of our drug candidates, we plan to contract with collaborators to advance those candidates through later-stage, more expensive clinical trials, rather than invest our own resources to perform these trials. Depending on the terms of our agreements with these collaborators, we may not have any control over the conduct of these clinical trials, and in any event we would be subject to the risks associated with depending on collaborators to develop these drug candidates.

If we are unable to obtain regulatory approval to develop and market products in the United States and foreign jurisdictions, we will not be permitted to manufacture or commercialize products resulting from our research.

In order to manufacture and commercialize drug products in the United States, our drug candidates will have to obtain regulatory approval from the Food and Drug Administration, or the FDA. Satisfaction of regulatory requirements typically takes many years. To obtain regulatory approval, we must first show that our drug products are safe and effective for target indications through preclinical studies (animal testing) and clinical trials (human testing). Preclinical testing and clinical development are long, expensive and uncertain processes, and we do not know whether the FDA will allow us to undertake clinical trials of any potential drug products in addition to Reverset and our lead compound from our CCR2 antagonist program.

Completion of clinical trials may take several years and failure may occur at any stage of testing. The length of time required varies substantially according to the type, complexity, novelty and intended use of the product candidate. Interim results of a preclinical study or clinical trial do not necessarily predict final results, and acceptable results in early trials may not be repeated in later trials. For example, a drug candidate that is successful at the preclinical level may cause harmful or dangerous

side effects when tested at the clinical level. Our rate of commencement and completion of clinical trials may be delayed by many factors, including:

- our inability to formulate or manufacture sufficient quantities of materials for use in clinical trials;
- variability in the number and types of patients available for each study;
- difficulty in maintaining contact with patients after treatment, resulting in incomplete data;
- unforeseen safety issues or side effects;
- poor or unanticipated effectiveness of products during the clinical trials; or
- government or regulatory delays.

Data obtained from the clinical trials are susceptible to varying interpretation, which may delay, limit or prevent regulatory approval. A number of companies in the pharmaceutical industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after achieving promising results in earlier trials. In addition, regulatory authorities may refuse or delay approval as a result of other factors, such as changes in regulatory policy during the period of product development and regulatory agency review.

Due, in part, to the early stage of our drug candidate research and development process, we cannot predict whether regulatory approval will be obtained for any product we develop. At the present time, we have two drug candidates, Reverset and our lead CCR2 antagonist, in Phase II and Phase I clinical trials, respectively, and other drug candidates are still undergoing preclinical testing. Compounds developed by us, alone or with other parties, may not prove to be safe and effective in clinical trials and may not meet all of the applicable regulatory requirements needed to receive marketing approval. If regulatory approval of a product is granted, this approval will be limited to those disease states and conditions for which the product is demonstrated through clinical trials to be safe and effective. Failure to obtain regulatory approval would delay or prevent us from commercializing products.

Outside the United States, our ability to market a product is contingent upon receiving a marketing authorization from the appropriate regulatory authorities. This foreign regulatory approval process typically includes all of the risks associated with the FDA approval process described above and may also include additional risks.

Our reliance on third parties to manufacture and commercialize any of our drug candidates that receives regulatory approval could result in a short supply of the drugs or withdrawal of the FDA's regulatory approval.

The FDA requires that drug products be manufactured according to its current Good Manufacturing Practices, or cGMP, regulations and a limited number of manufacturers comply with these requirements. If the third party that we choose to manufacture our drug products is not compliant with cGMP, the FDA may not approve our application to manufacture our drug products. We may not be able to arrange for our products to be manufactured by one of these companies on reasonable terms, if at all. Failure to comply with cGMP in the manufacture of our products could result in the FDA withdrawing its regulatory approval of our drug product or other enforcement actions. If either of these events occurred, our revenues would be negatively impacted.

If we receive marketing approval from the FDA for any of our drug candidates, we will rely on a third party to manufacture our products. We may not be able to obtain sufficient quantities of our new drug products if the manufacturer does not have the capacity to manufacture our products according to our schedule. Also, raw materials that may be required to manufacture any products we develop may only be available from a limited number of suppliers. If we have promised delivery of a new product and are unable to meet the delivery requirement due to manufacturing difficulties, our reputation would be impaired or our customers may buy our competitors' products. Additionally, we may have to expend additional sums in order to ensure that manufacturing capacity is available when we need it even if we do not use all of the manufacturing capacity. This expense would adversely affect our operating results. Manufacturers of pharmaceutical products often encounter difficulties in production, especially in scaling up initial production. These problems include difficulties with production costs and yields, quality control and assurance and shortages of qualified personnel, as well as compliance with strictly enforced federal, state and foreign regulations. The third party manufacturer we choose may not perform as agreed or may terminate its agreement with us.

We may incur additional expense in order to market our drug products.

We do not have experience marketing drug products. If the FDA approves one of our drug products to go to market, we would have to employ additional personnel or engage a third party to market our drug products, which would be an additional expense to us.

We might not be able to commercialize our drug candidates successfully, and we may spend significant time and money attempting to do so.

Reverset and our lead CCR2 antagonist are our only two drug candidates in clinical trials. We, or our collaborators, may decide to discontinue development of any or all of our drug candidates at any time for commercial, scientific or other reasons. If a product is developed, but is not marketed, we may have spent significant amounts of time and money on it, which would adversely affect our operating results and financial condition. Even if Reverset, or another drug candidate that we develop, receives regulatory approval, we may decide not to commercialize it if we determine that commercialization of that product would require more money and time than we are willing to invest. For example, drugs that receive approval are subject to post-regulatory surveillance and may have to be withdrawn from the market if previously unknown side effects occur. At this point, the regulatory agencies may require additional clinical trials or testing. Once a drug is marketed, if it causes side effects, the drug product may be recalled or may be subject to reformulation, additional studies, changes in labeling, warnings to the public and negative publicity. As a result, we may not continue to commercialize a product even though it has obtained regulatory approval. Further, we may decide not to continue to commercialize a product if the market does not accept the product because it is too expensive and third parties such as insurance companies or Medicare have not approved it for substantial reimbursement. Actions of governmental authorities and other groups could result in lower prices for certain drugs, including drugs that address HIV infection. In addition, we may decide not to continue to commercialize a product if another product comes on the market that is as effective but has fewer side effects. There is also a risk that competitors and third parties may develop similar or superior products or have proprietary rights that preclude us from ultimately marketing our products.

Our ability to generate revenues will be diminished if we are unable to obtain acceptable prices or an adequate level of reimbursement from third-party payors.

The continuing efforts of government and insurance companies, health maintenance organizations, or HMOs, and other payors of healthcare costs to contain or reduce costs of health care may affect our future revenues and profitability, and the future revenues and profitability of our potential customers, suppliers and collaborative partners and the availability of capital. For example, in certain foreign markets, pricing or profitability of prescription pharmaceuticals is subject to government control. In the United States, given recent federal and state government initiatives directed at lowering the total cost of health care, the U.S. Congress and state legislatures will likely continue to focus on health care reform, the cost of prescription pharmaceuticals and on the reform of the Medicare and Medicaid systems. While we cannot predict whether any such legislative or regulatory proposals will be adopted, the announcement or adoption of these proposals could reduce the price that we or any of our collaborators receive for any products in the future.

Our ability to commercialize our products successfully will depend in part on the extent to which appropriate reimbursement levels for the cost of our products and related treatment are obtained by governmental authorities, private health insurers and other organizations, such as HMOs. Third-party payors are increasingly challenging the prices charged for medical products and services. Also, the trend toward managed health care in the United States and the concurrent growth of organizations such as HMOs, which could control or significantly influence the purchase of health care services and products, as well as legislative proposals to reform health care or reduce government insurance programs, may all result in lower prices for or rejection of our products. The cost containment measures that health care payors and providers are instituting and the effect of any health care reform could materially and adversely affect our ability to generate revenues.

As our drug discovery and development operations are conducted at our headquarters in Wilmington, Delaware, the loss of access to this facility would negatively impact our business.

Our facility in Wilmington, Delaware is our headquarters and is also where we conduct all of our drug discovery operations and research and development activities. Our lease contains provisions that provide for its early termination upon the occurrence of certain events of default or upon a change of control. Further, our headquarters facility is located in a large research and development complex that may be temporarily or permanently shutdown if certain environmental or other hazardous conditions were to occur within the complex. In addition, actions of activists opposed to aspects of pharmaceutical research may disrupt our experiments or our ability to access or use our facilities. The loss of access to or use of our Wilmington, Delaware, facility, either on a temporary or permanent basis, or early termination of our lease would result in an interruption of our business and, consequently, would adversely affect the advancement of our drug discovery and development programs and our overall business.

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 expand our drug discovery and development programs and achieve our objectives.

We are highly dependent on the principal members of our management, operations and scientific staff. We experience intense competition for qualified personnel. Our future success also depends in part on the continued service of our executive management team, key scientific and management personnel and our ability to recruit, train and retain essential scientific personnel for our drug discovery and development programs, including those who will be responsible for overseeing our internal preclinical testing and clinical trials as well as for the establishment of collaborations with other companies. If we lose the

services of any of these people, our research and product development goals, including the identification and establishment of key collaborations, operations and marketing efforts could be delayed or curtailed. We do not maintain "key person" insurance on any of our employees.

We may encounter difficulties in integrating companies we acquire, which may harm our operations and financial results.

As part of our business strategy, we have in the past and may in the future acquire assets, technologies, compounds and businesses. Our past acquisitions, such as the acquisition of Maxia Pharmaceuticals, Inc., 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 our management's time and attention;
- we may be unable to integrate or complete the development and application of acquired technology, compounds or drug candidates;
- we may experience difficulties in establishing and maintaining uniform standards, controls, procedures and policies;
- our relationships with key customers or collaborative partners 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 amortization or impairment expenses if an acquisition results in significant goodwill or other intangible assets; or
- 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 new headquarters, we may experience more difficulty integrating and managing the acquired businesses' operations.

We may encounter difficulties, including higher than anticipated costs and the diversion of management's attention, as a result of the restructuring of our business and the relocation of our headquarters and finance department from California to Delaware.

In April 2004, we had a significant reduction in our workforce and closed our Palo Alto, California research facilities. We may incur higher than anticipated costs associated with closing our California facilities, and this restructuring could result in the diversion of the efforts of our executive management team and other key employees, which could adversely affect our drug discovery and development efforts. As a part of this restructuring, we have discontinued our information products research and development efforts, with the exception of the activities related to, and products developed by, our Proteome subsidiary. We may encounter difficulties associated with the discontinuation of certain of our information product-related activities that could adversely affect our operating results and financial position. These difficulties could include challenges in providing support to our customers, and, in particular, our non-U.S. customers. Some of our database customers could become dissatisfied as a result of our restructuring, and we could incur expenses associated with the amendment, termination or transition of these customer contracts.

As a part of increasing our focus on our drug discovery and development programs, we relocated our headquarters, including our finance and legal staff and information systems, to our facility in Wilmington, Delaware. During this transition process, we expect that we will need to continue to manage multiple locations and our relationships with information products customers, suppliers and other third parties.

RISKS RELATING TO OUR FINANCIAL RESULTS

We expect to incur losses in the future and we may not achieve or maintain profitability in the future.

We had net losses from inception in 1991 through 1996 and in 1999 through 2004. Because of those losses, we had an accumulated deficit of $698.8 million as of September 30, 2004. We will continue to spend significant amounts on our efforts to discover and develop drugs. As a result, we expect to continue to incur losses in 2004 and in future periods as well.

We expect that any revenues from our information products, intellectual property licensing, and contracts, if any, will be more than offset by expenses for our drug discovery and development efforts. We anticipate that these efforts will increase as we focus on the studies, including preclinical tests and clinical trials prior to seeking regulatory approval, that are required before we can sell, or license to a third party, a drug product. The development of drug products will require us to spend significant funds on research, development, testing, obtaining regulatory approvals, manufacturing and marketing. To date, we do not have any drug products that have generated revenues and we anticipate that we will not generate significant revenues from the drug candidates that we license or develop for several years, if ever. We cannot be certain whether or when we will achieve profitability because of the significant uncertainties relating to our ability to generate commercially successful drug products. Even if we were successful in obtaining regulatory approvals for manufacturing and commercializing Reverset, our leading drug candidate, or another drug, we expect that we will continue to incur losses if our drug products do not generate significant revenues. If we achieve profitability we may not be able to sustain or increase profitability.

We will need additional capital in the future. The capital markets may not permit us to raise additional capital at the time that we require it, which could result in limitations on our research and development or commercialization efforts or the loss of certain of our rights in our technologies or drug candidates.

Our future funding requirements will depend on many factors and we anticipate that we will need to raise additional capital to fund our business plan and research and development efforts on a going-forward basis.

Additional factors that may affect our future funding requirements include:

- any changes in the breadth of our research and development programs;
- the results of research and development, preclinical testing and clinical trials conducted by us or our future collaborative partners or licensees, if any;
- the acquisition or licensing of businesses, technologies or compounds, if any;
- our ability to maintain and establish new corporate relationships and research collaborations;
- competing technological and market developments;
- the amount of revenues generated from our business activities, if any;
- the time and costs involved in filing, prosecuting, defending and enforcing patent and intellectual property claims;
- the receipt of contingent licensing or milestone fees from our current or future collaborative and license arrangements, if established; and
- the timing of regulatory approvals, if any.

If we require additional capital at a time when investment in companies such as ours, or in the marketplace generally, is limited due to the then prevailing market or other conditions, we may have to scale back our operations, eliminate one or more of our research or development programs, or attempt to obtain funds by entering into an agreement with a collaborative partner that would result in terms that are not favorable to us or relinquishing our rights in certain of our proprietary technologies or drug candidates. If we are unable to raise funds at the time that we desire or at any time thereafter on acceptable terms, we may not be able to continue to develop our potential drug products. The sale of equity or additional convertible debt securities in the future would be dilutive to our stockholders, and debt financing arrangements may require us to pledge certain assets or enter into covenants that could restrict our operations or our ability to incur further indebtedness.

Because our revenues are derived from information products and licensing activities, our revenues may fluctuate substantially due to reductions and delays in research and development expenditures by pharmaceutical and biotechnology companies.

We expect that our revenues from our information products 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, these revenues 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; and
- other factors affecting research and development spending.

These factors are not within our control and may cause volatility to the price of our common stock.

Future milestone and royalty payments from our gene-related intellectual property may not contribute significantly to revenues for several years, and may never result in revenues.

Part of our strategy is to license to our database customers and to other pharmaceutical and biotechnology companies our know-how and patent rights associated with the information we have generated in the creation of our proprietary databases, 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 trials and regulatory approval before commercialization, all of which is beyond our control, and possibly beyond the control of our licensee. These licensees may not develop the potential product if they do not devote the necessary resources or decide that they do not want to expend the resources to do the clinical trials necessary to obtain the necessary regulatory approvals. Therefore, milestone or royalty payments from these licenses may not contribute to our revenues for several years, if at all. We may decide at any time to discontinue some or all of our gene and gene-technology related patent prosecution or maintenance, which could limit our ability to receive license-based revenues from our gene and gene-technology related patent portfolio.

Our long-term investments may decline in value and our losses may increase.

We have made and may in the future make long-term investments in entities 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;
- require us to record acquisition-related charges, such as in-process research and development;
- require us to record charges related to 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 or other relationships.

The market values of many of these investments can fluctuate significantly. We evaluate our long-term investments for impairment of their value on a quarterly basis. The volatility of the equity markets and the uncertainty of the biotechnology industry may result in fluctuations in the value of our investments in public companies. The value of our investments in private companies can fluctuate significantly. In past periods, market conditions have caused us to write-down the value of our private company investments, sometimes substantially, and market conditions may cause us to write down additional amounts. In addition, we have in the past written down the value of our debt investments in companies experiencing financial difficulties. Impairment could result in future charges to our earnings. Decreases in the value of our strategic investments may cause our losses to increase. As of September 30, 2004, the total aggregate value of our long-term investments was $11.8 million. We incurred charges related to write-downs in the valuation of long-term investments of $5.2 million during the nine months ended September 30, 2004.

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, 2004, we had total consolidated debt of $378.8 million and stockholders' equity of $30.8 million. The indentures pursuant to which our outstanding convertible subordinated notes were issued do not limit the issuance of additional indebtedness. 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 for working capital, capital and research and development expenditures, and general corporate purposes;
- requiring the dedication of a substantial portion of our expected cash flow or our existing cash to service our indebtedness, thereby reducing the amount of our cash 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.

In the past five years, we have had negative cash flow from operations. We likely will not generate sufficient cash flow from our operations in the future to enable us to meet our anticipated fixed charges, including our debt service requirements with respect to our outstanding convertible subordinated notes. As of September 30, 2004, $128.1 million aggregate principal amount of our 5.5% convertible subordinated notes due 2007 were outstanding. In February and March 2004, we issued $250.0 million aggregate principal amount of our 3 1/2% convertible subordinated notes due 2011. Our annual interest payments for the 5.5% notes through 2006, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $7.0 million, and an additional $3.5 million in interest is payable in 2007. Our annual interest payments for the 3 1/2% notes through 2010, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $8.8 million, and an additional $4.4 million in interest is payable in 2011. We intend to fulfill our debt service obligations from our existing cash and marketable securities. If we are unable to generate cash from our operations or raise additional cash through financings sufficient to meet these obligations, we will need to use existing cash or liquidate marketable securities in order to fund these obligations, which may delay or curtail our research, development and commercialization programs.

RISKS RELATING TO INTELLECTUAL PROPERTY AND LEGAL MATTERS

We are involved in patent litigation, which, if not resolved favorably, could require us to pay damages.

In October 2001, Invitrogen Corporation, or Invitrogen, filed an action against us in federal court, alleging infringement of three patents. The complaint seeks unspecified money damages and injunctive relief. In November 2001, we filed our answer to Invitrogen's patent infringement claims, and asserted seven counterclaims against Invitrogen, seeking declaratory relief with respect to the patents at issue, implied license, estoppel, laches and patent misuse. We are also seeking our fees, costs and expenses. Invitrogen filed its answer to our counterclaims in January 2002. In February 2003, we added a counterclaim for unfair business practices. On February 9, 2004, the Court ordered a stay of all proceedings pending disposition of the appeal in a related case of a judgment invalidating the same patents that are asserted in this case.

Our defenses against the suit brought by Invitrogen may be unsuccessful. At this time, we cannot reasonably estimate the possible range of any loss or damages resulting from this suit due to uncertainty regarding the ultimate outcome. If the case goes forward, we expect that the Invitrogen litigation will result in future legal and other costs to us, regardless of the outcome, which could be substantial.

We are involved in contractual arbitration, which could be costly to us.

We are in an arbitration with Iconix Pharmaceuticals, Inc., or Iconix, with respect to payments that Iconix alleges we owe it pursuant to a contract. Iconix initiated the arbitration process under the contract seeking final and binding arbitration. An arbitration panel has been selected and a hearing will be held in two phases, the first of which was held in October 2004 and the second of which is scheduled for the first quarter of 2005. In the first phase of the hearing, Iconix alleged that we are obligated to make payments to it in the aggregate amount of $28.25 million and that the payments presently due to Iconix, discounted to a present day value, amount to $22.6 million. We expect to receive a decision from the arbitration panel with respect to the first phase of the hearing by the end of 2004. Based on Iconix's amended demand for arbitration, we understand Iconix is also seeking return of a $4.5 million license fee paid to us and recovery of amounts paid to a third-party supplier. The second phase of the hearing will address Iconix's claim for the return of the $4.5 million license fee paid to us and recovery of amounts paid to a third-party supplier, as well as our counterclaims against Iconix. There can be no assurance as to the ultimate outcome of the arbitration and, at this time, we cannot predict the financial impact to us of the results of the arbitration. Regardless of the outcome, we could incur substantial costs and diversion of management time as a result of the arbitration.

If we are subject to additional litigation and infringement claims, they could be costly and disrupt our drug discovery and development efforts.

The technology that we use to make and develop our drug products, the technology that we incorporate in our products, and the products we are developing may be subject to claims that they infringe the patents or proprietary rights of others. The success of our drug discovery and development efforts will also depend on our ability to develop new compounds, drugs and technologies without infringing or misappropriating the proprietary rights of others.

From time to time we may receive notices from third parties alleging patent or copyright infringement, claims regarding trade secrets or other contract claims. Receipt of these notices could result in significant costs as a result of the diversion of the attention of management from our drug discovery and development efforts. Except for Invitrogen and Iconix, no third party has a current filed patent lawsuit or arbitration against us. If a successful claim were brought against us, we would have to attempt to license the technology from the claimant or to spend time and money to design around the technology. Any such license of the technology may not be available at reasonable terms, or at all.

We may, however, be involved in future lawsuits or other legal proceedings alleging patent infringement or other intellectual property rights violations. In addition, litigation or other legal proceedings 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 or claims. 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 or our collaborators to seek licenses to other parties' patents or proprietary rights. We or our collaborators may also be restricted or prevented from manufacturing or selling a drug product that we develop. Further, we or our future collaborators may not be able to obtain any necessary licenses on acceptable terms, if at all.

We may be unable to adequately protect or enforce our proprietary information, which may result in its unauthorized use, a loss of revenue under a collaboration agreement or loss of sales to generic versions of our products or otherwise reduce our ability to compete.

Our business and competitive position depend upon our ability to protect our proprietary technology, including any drug products that we create. Despite our efforts to protect this information, unauthorized parties may attempt to obtain and use information that we regard as proprietary. For example, one of our collaborators may disclose proprietary information pertaining to our drug discovery efforts. Any patents issued in connection with our drug discovery efforts may not be broad enough to protect all of the potential uses of the product.

Additionally, when we do not control the prosecution, maintenance and enforcement of certain important intellectual property, such as a drug compound in-licensed to us, the protection of the intellectual property rights may not be in our hands. In the case of Reverset, we do not control the intellectual property rights with respect to the compound and therefore may be unable to protect those rights. If the entity that controls the intellectual property rights related to Reverset does not adequately protect those rights, our rights may be impaired, which may impact our ability to develop, market and commercialize Reverset.

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

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

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. If we fail to maintain trade secret and patent protection, our potential, future revenues may be decreased.

If the effective term of our patents is decreased due to changes in the United States 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 United States 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 genes or other additional subject matter 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.

If patent application filing fees are significantly increased, our expenses related to intellectual property or our intellectual property strategy may be adversely affected.

Our ability to license proprietary genes may be dependent on our ability to obtain patents. We have a large portfolio of issued United States patents covering human full-length genes, the proteins they encode and the antibodies directed against them and a significant number of pending applications. If the United States Patent and Trademark Office and other patent offices where we file our patent applications increase the fees associated with filing and prosecuting patent applications we would incur higher expenses and our intellectual property strategy could be adversely affected.

International patent protection is particularly uncertain and costly, 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 and costly 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 United States laws. For example, certain countries do not grant patent claims that are directed to the treatment of humans. 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 product liability lawsuits are successfully brought against us, we could face substantial liabilities and may be required to limit commercialization of our products and our results of operations could be harmed.

The clinical trials and marketing of medical products that are intended for human use entails an inherent risk of product liability. If any product that we or any of our collaborators develops causes injury or is found to be unsuitable during clinical trials, manufacturing or sale, we may be held liable. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities, including substantial damages to be paid to the victims and legal costs, or we may be required to limit commercialization of our products. Although we currently carry a product liability insurance policy that provides coverage for liabilities arising from our clinical trials, it may not fully cover our potential liabilities. In addition, we may determine that we should increase our coverage upon the addition of new clinical trials, and this insurance may be prohibitively expensive to us or our collaborators and may not fully cover our potential liabilities. Our inability to obtain sufficient product liability insurance at an acceptable cost to protect against potential product liability claims could prevent or inhibit the commercialization of pharmaceutical products we develop, alone or with our collaborators. Additionally, any product liability lawsuit could cause injury to our reputation, recall of products, participants to withdraw from clinical trials, and potential collaborators to seek other partners, any of which could impact our results of operations.

Because our activities involve the use of hazardous materials, we may be subject to claims relating to improper handling, storage or disposal of these materials that could be time consuming and costly.

We are subject to various environmental, health and safety laws and regulations governing, among other things, the use, handling, storage and disposal of regulated substances and the health and safety of our employees. Our research and development processes involve the controlled use of hazardous and radioactive materials and biological waste resulting in the production of hazardous waste products. We cannot completely eliminate the risk of accidental contamination or discharge and any resultant injury from these materials. If any injury or contamination results from our use or by the use by third party collaborators of these materials, we may be sued and our liability may exceed our insurance coverage and our total assets. Further, we may be required to indemnify our collaborators against all damages and other liabilities arising out of our development activities or products produced in connection with these collaborations. Compliance with the applicable environmental and workplace laws and regulations is expensive. Future changes to environmental, health, workplace and safety laws could cause us to incur additional expense or may restrict our operations or impair our research, development and production efforts.

Item 3: Quantitative and Qualitative Disclosures About Market Risk

We are exposed to interest rate risk primarily through our investments in short-term marketable securities. Our investment policy calls for investment in short term, low risk, investment-grade instruments. As of September 30, 2004, cash, cash equivalents and marketable securities were $412.6 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, 2004, the decline in fair value would not be material.

We are exposed to valuation risks related to our portfolio of long-term investments. These investments are primarily in small capitalization stocks of privately-held companies in the pharmaceutical/biotechnology industry sector and are primarily in companies with which we have or had research and development, licensing or other collaborative agreements. As of September 30, 2004, long-term investments were $11.8 million.

We are exposed to foreign exchange rate fluctuations as the financial results of our 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 our financial position or results of operations. All of our revenues are denominated in U.S. dollars. We do 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, 2004, the impact to our financial position or results of operations would not be material.

Item 4: Controls and Procedures

(a) ***Evaluation of disclosure controls and procedures.*** We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and management believes that they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) ***Changes in internal control over financial reporting***. There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II: OTHER INFORMATION

Item 1: Legal Proceedings

In May 2001, we entered into a Development and License Agreement with Iconix Pharmaceuticals, Inc. ("Iconix"). Pursuant to the terms of the Agreement, the parties agreed to collaborate on the development and commercialization of a chemical genomic database (the "Database"), currently called DrugMatrix®. The Database was to be designed by Iconix to contain data, information and annotations related to gene expression, chemicals, pharmacology and toxicology, and related informatics tools and software. On November 10, 2003, Iconix filed a demand for arbitration against us, and on April 16, 2004, Iconix transmitted an amended demand. An arbitration panel has been selected and a hearing will be held in two phases, the first of which was held in October 2004 and the second of which is scheduled for the first quarter of 2005. In the first phase of the hearing, Iconix alleged that we are obligated to make payments to it in the aggregate amount of $28.25 million and that the payments presently due to Iconix, discounted to a present day value, amount to $22.6 million. We believe that Iconix's interpretation of the parties' contract with respect to these payments is erroneous and that these payments are not owed. We expect to receive a decision from the arbitration panel with respect to the first phase of the hearing by the end of 2004. Based on Iconix's amended demand for arbitration, we understand Iconix is also seeking return of a $4.5 million license fee paid to Incyte and recovery of amounts paid to a third-party supplier. The second phase of the hearing will address Iconix's claim for the return of the $4.5 million license fee paid to us and recovery of amounts paid to a third-party supplier, as well as our counterclaims against Iconix. We believe that we have meritorious defenses to Iconix's claims and plan to contest them vigorously. In addition, we are asserting counterclaims related to Iconix's nonperformance of certain of its contractual obligations to us. There can be no assurance as to the ultimate outcome of any such arbitration and at this time, we cannot predict the financial impact to us of the results of the arbitration. We expect that, regardless of the outcome, the Iconix arbitration will result in the diversion of management time and in future legal and other costs to us, which could be substantial.

Item 6: Exhibits and Reports on Form 8-K

a) Exhibits

Exhibit Number	Description of Document
10.15	Incyte Corporation 1997 Employee Stock Purchase Plan, as amended July 28, 2004
31.1	Rule 13a – 14(a) Certification of Chief Executive Officer
31.2	Rule 13a – 14(a) Certification of Chief Financial Officer
32.1*	Statement of the Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350)
32.2*	Statement of the Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350)

* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed "filed" for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

b) Reports on Form 8-K

On August 4, 2004, we filed a Current Report on Form 8-K furnishing under Item 12 our press release relating to our financial results for the quarter ended June 30, 2004.

SIGNATURES

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

INCYTE CORPORATION

Dated: November 5, 2004

By: /s/ PAUL A. FRIEDMAN

PAUL A. FRIEDMAN
Chief Executive Officer
(Principal Executive Officer)

Dated: November 5, 2004

By: /s/ DAVID C. HASTINGS

DAVID C. HASTINGS
Chief Financial Officer
(Principal Financial Officer)

INCYTE CORPORATION

EXHIBIT INDEX

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INCYTE CORPORATION

1997 EMPLOYEE STOCK PURCHASE PLAN
(as amended July 28, 2004)

The following constitute the provisions of the 1997 Employee Stock Purchase Plan of Incyte Corporation, as amended July 28, 2004.

1. Purpose. The purpose of the Plan is to provide employees of the Company and its Designated Subsidiaries with an opportunity to purchase Common Stock of the Company through accumulated payroll deductions. It is the intention of the Company to have the Plan qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended. The provisions of the Plan, accordingly, shall be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

2. Definitions.

(a) "Board" shall mean the Board of Directors of the Company.

(b) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(c) "Common Stock" shall mean the Common Stock, $.001 par value, of Incyte Corporation.

(d) "Company" shall mean Incyte Corporation and any Designated Subsidiary of the Company.

(e) "Compensation" shall mean all cash salary, wages, commissions and bonuses, but shall not include any imputed income or income arising from the exercise or disposition of equity compensation.

(f) "Effective Date" shall mean April 15, 2003.

(g) "Designated Subsidiary" shall mean any Subsidiary which has been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan.

(h) "Employee" shall mean any individual who is an Employee of the Company for tax purposes whose customary employment with the Company is at least twenty (20) hours per week and more than five (5) months in any calendar year. For purposes of the Plan, the employment relationship shall be treated as continuing intact while the individual is on sick leave or other leave of absence approved by the Company. Where the period of leave exceeds 90 days and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship shall be deemed to have terminated on the 91st day of such leave.

(i) "Enrollment Date" shall mean the first day of each Offering Period.

(j) "Exercise Date" shall mean the last Trading Day of each Purchase Period.

(k) "Fair Market Value" shall mean, as of any date, the value of Common Stock determined as follows:

(1) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation The Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system on the date of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or

(2) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the mean of the closing bid and asked prices for the Common Stock on the date of such determination, as reported in *The Wall Street Journal* or such other source as the Board deems reliable; or

(3) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Board.

(l) "Offering Periods" shall mean the periods of approximately twenty-four (24) months during which an option granted pursuant to the Plan may be exercised, commencing on the first Trading Day on or after May 1 and November 1 of each year and terminating on the last Trading Day in the periods ending twenty-four months later. The duration and timing of Offering Periods may be changed pursuant to Section 4 of this Plan.

(m) "Plan" shall mean this Employee Stock Purchase Plan.

(n) "Purchase Price" shall mean an amount equal to 85% of the Fair Market Value of a share of Common Stock on the Enrollment Date or on the Exercise Date, whichever is lower.

(o) "Purchase Period" shall mean the approximately six-month period commencing after one Exercise Date and ending with the next Exercise Date, except that the first Purchase Period of any Offering Period shall commence on the Enrollment Date and end with the next Exercise Date.

(p) "Reserves" shall mean the number of shares of Common Stock covered by each option under the Plan which have not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but not yet placed under option.

(q) "Subsidiary" shall mean a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a Subsidiary.

(r) "Trading Day" shall mean a day on which national stock exchanges and The Nasdaq National Market (or any successor market system) are open for trading.

3. Eligibility.

(a) Any Employee who has been employed by the Company for one month or more on a given Enrollment Date shall be eligible to participate in the Plan.

(b) Any provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) to the extent that, immediately after the grant, such Employee (or any other person whose stock would be attributed to such Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase such stock possessing five percent (5%) or more of the total combined voting power or value of all classes of the capital stock of the Company or of any Subsidiary, or (ii) to the extent that his or her rights to purchase stock under all employee stock purchase plans of the Company and its subsidiaries accrues at a rate which exceeds Twenty-Five Thousand Dollars ($25,000) worth of stock (determined at the fair market value of the shares at the time such option is granted) for each calendar year in which such option is outstanding at any time.

4. Offering Periods. The Plan shall be implemented by consecutive, overlapping Offering Periods with a new Offering Period commencing on the first Trading Day on or after May 1 and November 1 each year, or on such other dates as the Board shall determine, and continuing thereafter until terminated in accordance with Section 19 hereof. The Board or a committee thereof shall have the power to change the duration of Offering Periods (including the commencement dates thereof) and Purchase Periods thereunder with respect to future offerings without stockholder approval if such change is announced at least five (5) days prior to the scheduled beginning of the first Offering Period to be affected thereafter.

5. Participation.

(a) An eligible Employee may become a participant in the Plan by completing a subscription agreement authorizing payroll deductions in the form of Exhibit A to this Plan and filing it with the Company's stock administrator not later than ten (10) business days prior to the applicable Enrollment Date.

(b) Payroll deductions for a participant shall commence on the first payroll following the Enrollment Date and shall end on the last payroll in the Offering Period to which such authorization is applicable, unless sooner terminated by the participant as provided in Section 10 hereof.

6. Payroll Deductions.

(a) At the time a participant files his or her subscription agreement, he or she shall elect to have payroll deductions made on each pay day during the Offering Period in an amount not less than one percent (1%) and not more than ten percent (10%) of the participant's Compensation, with such amount designated in integral multiples of one percent (1%); provided, however, that the aggregate of such payroll deductions during any Offering Period shall not

exceed ten percent (10%) of the participant's aggregate Compensation during such Offering Period.

(b) All payroll deductions made for a participant shall be credited to his or her account under the Plan and shall be withheld in whole percentages only. A participant may not make any additional payments into such account.

(c) A participant may discontinue his or her participation in the Plan as provided in Section 10, or may increase or decrease the rate of his or her payroll deductions as provided in this Section 6(c). A participant may increase the rate of his or her payroll deductions only as of the beginning of a Purchase Period. Such increase shall take effect with the first payroll following the beginning of the new Purchase Period provided the participant has completed and delivered to the Company's stock administrator a new subscription agreement authorizing the increase in the payroll deduction rate at least ten (10) business days prior to the beginning of the new Purchase Period. A participant may decrease the rate of his or her payroll deductions each month. Any decrease shall become effective as of the first payroll of the next calendar month following the date that the participant completes and delivers to the Company's stock administrator a new subscription agreement authorizing the decrease in the payroll deduction rate. However, if the subscription agreement is not received at least five (5) business days prior to such payroll, the decrease shall become effective as of the first payroll of the second succeeding calendar month. The Board may, in its discretion, limit the number of participation rate changes during any Offering Period. Subject to the foregoing, a participant's subscription agreement shall remain in effect for successive Offering Periods unless terminated as provided in Section 10 hereof.

(d) Notwithstanding the foregoing, to the extent necessary to comply with Section 423(b)(8) of the Code and Section 3(b) hereof, a participant's payroll deductions may be decreased to zero percent (0%) at any time during a Purchase Period. Such a decrease shall not be treated as a withdrawal from the Plan subject to Section 10, unless the participant elects to withdraw pursuant to Section 10. Payroll deductions shall recommence at the rate provided in such participant's subscription agreement at the beginning of the first Purchase Period which is scheduled to end in the following calendar year, unless the participant elects to withdraw from the Plan as provided in Section 10 hereof.

(e) At the time the option is exercised, in whole or in part, or at the time some or all of the Common Stock issued under the Plan is disposed of, the participant must make adequate provision for the Company's federal, state, or other tax withholding obligations, if any, which arise upon the exercise of the option or the disposition of the Common Stock. At any time, the Company may, but shall not be obligated to, withhold from the participant's compensation the amount necessary for the Company to meet applicable withholding obligations, including any withholding required to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by the Employee.

7. Grant of Option. On the Enrollment Date of each Offering Period, each eligible Employee participating in such Offering Period shall be granted an option to purchase on each Exercise Date during such Offering Period (at the applicable Purchase Price) up to a number of

shares of Common Stock determined by dividing such Employee's payroll deductions accumulated prior to such Exercise Date and retained in the Participant's account as of the Exercise Date by the applicable Purchase Price; provided that in no event shall an Employee be permitted to purchase during each Purchase Period more than eight thousand (8,000) shares of Common Stock (subject to any adjustment pursuant to Section 18) on the Enrollment Date, and provided further that such purchase shall be subject to the limitations set forth in Sections 3(b) and 13 hereof. Exercise of the option shall occur as provided in Section 8 hereof, unless the participant has withdrawn pursuant to Section 10 hereof. The option shall expire on the last day of the Offering Period.

8. Exercise of Option. Unless a participant withdraws from the Plan as provided in Section 10 hereof, his or her option for the purchase of shares of Common Stock shall be exercised automatically on the Exercise Date, and the maximum number of full shares of Common Stock subject to option shall be purchased for such participant at the applicable Purchase Price with the accumulated payroll deductions in his or her account. No fractional shares shall be purchased; any payroll deductions accumulated in a participant's account which are not sufficient to purchase a full share shall be retained in the participant's account for the subsequent Purchase Period or Offering Period, subject to earlier withdrawal by the participant as provided in Section 10 hereof. Any other monies left over in a participant's account after the Exercise Date shall be returned to the participant. During a participant's lifetime, a participant's option to purchase shares hereunder is exercisable only by him or her.

9. Delivery. As promptly as practicable after each Exercise Date on which a purchase of shares occurs, a share certificate or certificates representing the number of shares of Common Stock so purchased shall be delivered to a brokerage account designated by the Company and kept in such account pursuant to a subscription agreement between each participant and the Company and subject to the conditions described therein which may include a requirement that shares be held and not sold for certain time periods, or the Company shall establish some other means for such participants to receive ownership of the shares.

10. Discontinuation; Withdrawal.

(a) A participant may discontinue his or her participation in the Plan only by withdrawing from the Plan as provided in this Section 10. A participant may withdraw all but not less than all the payroll deductions credited to his or her account and not yet used to exercise his or her option under the Plan by giving written notice to the Company in the form of Exhibit B to this Plan. Such notice must be received by the Company no later than 2:00 p.m. Pacific Standard Time on the second Trading Day preceding the Exercise Date. All of the participant's payroll deductions credited to his or her account shall be paid to such participant promptly after receipt of notice of withdrawal and such participant's option for the Offering Period shall be automatically terminated, and no further payroll deductions for the purchase of shares shall be made for such Offering Period. If a participant withdraws from an Offering Period, payroll deductions shall not resume at the beginning of the succeeding Offering Period unless the participant delivers to the Company a new subscription agreement in accordance with Section 5(a) .

(b) A participant's withdrawal from an Offering Period shall not have any effect upon his or her eligibility to participate in any similar plan which may hereafter be adopted by the Company or in succeeding Offering Periods which commence after the participant withdraws from the Plan, subject to compliance with Section 5(a).

11. Termination of Employment.

Upon a participant's ceasing to be an Employee, for any reason, he or she shall be deemed to have elected to withdraw from the Plan and the payroll deductions credited to such participant's account during the Offering Period but not yet used to exercise the option shall be returned to such participant or, in the case of his or her death, to the person or persons entitled thereto under Section 15 hereof, and such participant's option shall be automatically terminated. The preceding sentence notwithstanding, a participant who receives payment in lieu of notice of termination of employment shall be treated as continuing to be an Employee for the participant's customary number of hours per week of employment during the period in which the participant is subject to such payment in lieu of notice.

12. Interest. No interest shall accrue on the payroll deductions of a participant in the Plan.

13. Stock.

(a) The maximum number of shares of the Company's Common Stock which shall be made available for sale under the Plan shall be three million one hundred thousand (3,100,000) shares, subject to adjustment upon changes in capitalization of the Company as provided in Section 18 hereof. If, on a given Exercise Date, the number of shares with respect to which options are to be exercised exceeds the number of shares then available under the Plan, the Company shall make a pro rata allocation of the shares remaining available for purchase in as uniform a manner as shall be practicable and as it shall determine to be equitable.

(b) The participant shall have no interest or voting right in shares covered by his option until such option has been exercised.

(c) Shares purchased by a participant under the Plan shall be registered in the name of the participant or in the name of the participant and his or her spouse.

14. Administration. The Plan shall be administered by the Board or a committee of members of the Board appointed by the Board. The Board or its committee shall have full and exclusive discretionary authority to construe, interpret and apply the terms of the Plan, to determine eligibility and to adjudicate all disputed claims filed under the Plan. Every finding, decision and determination made by the Board or its committee shall, to the full extent permitted by law, be final and binding upon all parties.

15. Designation of Beneficiary.

(a) A participant may file a written designation of a beneficiary who is to receive any shares and cash, if any, from the participant's account under the Plan in the event of such participant's death subsequent to an Exercise Date on which the option is exercised but

prior to delivery to such participant of such shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to exercise of the option. If a participant is married and the designated beneficiary is not the spouse, spousal consent shall be required for such designation to be effective.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

16. Transferability. Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 15 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds from an Offering Period in accordance with Section 10 hereof.

17. Use of Funds. All payroll deductions received or held by the Company under the Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

18. Adjustments Upon Changes in Capitalization, Dissolution, Liquidation, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the stockholders of the Company, the Reserves, the maximum number of shares each participant may purchase each Purchase Period (pursuant to Section 7), as well as the Purchase Price per share and the number of shares of Common Stock covered by each option under the Plan which has not yet been exercised shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of outstanding shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration". Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an option.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Offering Periods shall terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board.

(c) Merger or Asset Sale. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, limited liability company or other entity, the Plan shall terminate upon the date of the consummation of such transaction unless the plan of merger, consolidation or reorganization provides otherwise, and any Purchase Periods then in progress shall be shortened by setting a new Exercise Date (the "New Exercise Date") and any Offering Periods then in progress shall end on the New Exercise Date. The New Exercise Date shall be before the date of the Company's proposed sale or merger. The Board shall notify each participant in writing, at least ten (10) business days prior to the New Exercise Date, that the Exercise Date for the participant's option has been changed to the New Exercise Date and that the participant's option shall be exercised automatically on the New Exercise Date, unless prior to such date the participant has withdrawn from the Offering Period as provided in Section 10 hereof. The Plan shall in no event be construed to restrict the Company's right to undertake any liquidation, dissolution, merger, consolidation or other reorganization.

19. Amendment or Termination.

(a) The Board of Directors of the Company may at any time and for any reason terminate or amend the Plan. Except as provided in Section 18 hereof, no such termination can affect options previously granted, provided that an Offering Period may be terminated by the Board of Directors on any Exercise Date if the Board determines that the termination of the Plan is in the best interests of the Company and its stockholders. Except as provided in Section 18 hereof, no amendment may make any change in any option theretofore granted which adversely affects the rights of any participant. To the extent necessary to comply with Section 423 of the Code (or any successor rule or provision or any other applicable law, regulation or stock exchange rule), the Company shall obtain stockholder approval in such a manner and to such a degree as required.

(b) Without stockholder consent and without regard to whether any participant rights may be considered to have been "adversely affected," the Board (or its committee) shall be entitled to change the Offering Periods, limit the frequency and/or number of changes in the amount withheld during an Offering Period, establish the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars, permit payroll withholding in excess of the amount designated by a participant in order to adjust for delays or mistakes in the Company's processing of properly completed withholding elections, establish reasonable waiting and adjustment periods and/or accounting and crediting procedures to ensure that amounts applied toward the purchase of Common Stock for each participant properly correspond with amounts withheld from the participant's Compensation, and establish such other limitations or procedures as the Board (or its committee) determines in its sole discretion advisable which are consistent with the Plan.

20. Notices. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in

the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

21. Conditions Upon Issuance of Shares. Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an option, the Company may require the person exercising such option to represent and warrant at the time of any such exercise that the shares are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned applicable provisions of law.

22. Term of Plan. The Plan, as amended and restated, shall become effective upon the Effective Date. It shall continue until February 27, 2007 unless sooner terminated under Section 19 hereof.

23. Automatic Transfer to Low Price Offering Period. To the extent permitted by any applicable laws, regulations, or stock exchange rules, if the Fair Market Value of the Common Stock on any Exercise Date in an Offering Period is lower than the Fair Market Value of the Common Stock on the Enrollment Date of such Offering Period, then all participants in such Offering Period shall be automatically withdrawn from such Offering Period immediately after the exercise of their option on such Exercise Date and automatically re-enrolled in the immediately following Offering Period as of the first day thereof.

24. Execution. To record the amendment and restatement of the Plan by the Board of Directors as of the Effective Date, the Company has caused its authorized officer to execute the same.

INCYTE CORPORATION

By /s/ PATRICIA SCHRECK

Its **Executive Vice President**

EXHIBIT A

INCYTE CORPORATION

1997 EMPLOYEE STOCK PURCHASE PLAN

SUBSCRIPTION AGREEMENT

Enrollment Date: _____

☐ Original Application

☐ Change in Payroll Deduction Rate

☐ Change of Beneficiary(ies)

(1) _____ hereby elects to participate in the Incyte Corporation 1997 Employee Stock Purchase Plan (the "Employee Stock Purchase Plan") and subscribes to purchase shares of the Company's Common Stock in accordance with this Subscription Agreement and the Employee Stock Purchase Plan.

(2) I hereby authorize payroll deductions from each paycheck in the amount of ____% of my Compensation (as defined in the Employee Stock Purchase Plan) on each payday (from 1 to 10%) during the Offering Period in accordance with the Employee Stock Purchase Plan. (Please note that no fractional percentages are permitted.)

(3) I understand that these payroll deductions will be accumulated for the purchase of shares of Common Stock at the applicable Purchase Price determined in accordance with the Employee Stock Purchase Plan. I understand that if I do not withdraw from an Offering Period, any accumulated payroll deductions will be used to automatically exercise my option to purchase shares.

(4) I have received a copy of the complete Employee Stock Purchase Plan. I understand that my participation in the Employee Stock Purchase Plan is in all respects subject to the terms of such Plan. I understand that my ability to exercise the option under this Subscription Agreement is subject to stockholder approval of the Employee Stock Purchase Plan.

(5) Shares purchased for me under the Employee Stock Purchase Plan should be deposited in my brokerage account with _____ [name of broker], or issued in the name(s) of (Employee or Employee and Spouse only):

_____.

(6) I understand that if I dispose of any shares received by me pursuant to the Plan within 2 years after the Enrollment Date (the first day of the Offering Period during which I purchased such shares) or one year after the Exercise Date, I will be treated for federal income tax purposes as having received ordinary income at the time of such disposition in an amount equal to the excess of the fair market value of the shares at the time such shares were purchased by me over the price which I paid for the shares. I hereby agree to

notify the Company in writing within 30 days after the date of any disposition of my shares and I will make adequate provision for Federal, state or other tax withholding obligations, if any, which arise upon the disposition of the Common Stock. The Company may, but will not be obligated to, withhold from any compensation the amount necessary to meet any applicable withholding obligation including any withholding necessary to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by me. If I dispose of such shares at any time after the expiration of the 2-year and 1-year holding periods, I understand that I will be treated for federal income tax purposes as having received income only at the time of such disposition, and that such income will be taxed as ordinary income only to the extent of an amount equal to the lesser of (1) the excess of the fair market value of the shares at the time of such disposition over the purchase price which I paid for the shares; or (2) 15% of the fair market value of the shares on the first day of the Offering Period. The remainder of the gain, if any, recognized on such disposition will be taxed as capital gain.

(7) I hereby agree to be bound by the terms of the Employee Stock Purchase Plan. The effectiveness of this Subscription Agreement is dependent upon my eligibility to participate in the Employee Stock Purchase Plan.

(8) In the event of my death, I hereby designate the following as my beneficiary(ies) to receive all payments and shares due me under the Employee Stock Purchase Plan:

NAME: (Please print) _____
(First) (Middle) (Last)

_____ _____
(Relationship)

_____
(Address)

Employee's Social Security Number: _____

Employee's Address: _____

I UNDERSTAND THAT THIS SUBSCRIPTION AGREEMENT SHALL REMAIN IN EFFECT THROUGHOUT SUCCESSIVE OFFERING PERIODS UNLESS TERMINATED BY ME. I HAVE RECEIVED A COPY OF THE COMPLETE EMPLOYEE STOCK PURCHASE PLAN AND UNDERSTAND THAT MY PARTICIPATION IN SUCH PLAN IS IN ALL RESPECTS SUBJECT TO THE TERMS OF SUCH PLAN.

Dated: _____ _____
Signature of Employee

_____
Spouse's Signature
(If beneficiary other than spouse)

EXHIBIT B

INCYTE CORPORATION

1997 EMPLOYEE STOCK PURCHASE PLAN

NOTICE OF WITHDRAWAL

The undersigned participant in the Offering Period of the Incyte Corporation 1997 Employee Stock Purchase Plan which began on _____, ____ (the "Enrollment Date") hereby notifies the Company that he or she hereby withdraws from the Offering Period. He or she hereby directs the Company to pay to the undersigned as promptly as practicable all the payroll deductions credited to his or her account with respect to the Offering Period. The undersigned understands and agrees that his or her option for such Offering Period will be automatically terminated. The undersigned understands further that no further payroll deductions will be made for the purchase of shares in the current Offering Period and the undersigned shall be eligible to participate in succeeding Offering Periods only by delivering to the Company a new Subscription Agreement. The undersigned has received a copy of the complete Employee Stock Purchase Plan, and understands that his or her participation in the Employee Stock Purchase Plan is in all respects subject to the terms of such Plan.

Name and Address of Participant:

_____

_____

_____

Signature:

_____

Date: _____

APPENDIX A

EMPLOYEES OF INCYTE CORPORATION LTD

Gains on options exercised under the Plan by Employees who are employed by Incyte Corporation Ltd ("Limited") are subject to National Insurance Contributions under United Kingdom Social Security Contributions and Benefits Act 1992, section 4(4)(a) ("Secondary Contributions"). Secondary Contributions are payable by Limited unless Limited and the Employee enter into a joint election in the form attached hereto as Exhibit A to transfer liability for payment of the Secondary Contributions to the Employee (the "Joint Election"). Effective January 1, 2001, any Employee of Limited who wishes to exercise options granted pursuant to the Plan must enter into a Joint Election in accordance with the following provisions:

A.1 Filing Date for Current Participants. Employees of Limited who enrolled in the Plan prior to October 31, 2001 and who have not withdrawn from the Plan must file the Joint Election with the Company's stock administrator not later than ten (10) business days prior to October 31, 2001. Any such Employee who fails to file the Joint Election in a timely manner will be deemed to have withdrawn from the Plan prior to October 31, 2001 and his or her option or options will not be exercised on the Exercise Date falling on October 31, 2001.

A.2 New Participants. An eligible Employee of Limited who wishes to become a participant in the Plan on or after November 1, 2001 must file a Joint Election with the Company's stock administrator at least ten (10) business days prior to the applicable Enrollment Date. An eligible Employee who does not file a Joint Election will not be granted an option under the Plan.

A.3 Amendment of the Joint Election; Approval. The form for the Joint Election, as it may be amended by the Company from time to time, shall be submitted to the Board of Inland Revenue for approval and such approval shall be obtained before the Company and an eligible Employee enter into a particular Joint Election. A Joint Election may be amended in a writing signed by both the Company and the Employee, provided that any such amendment must be approved by the Board of Inland Revenue before it takes effect.

A.4 Effect of Withdrawal from the Plan. If a participant withdraws from the Plan, the Joint Election shall continue to apply in the event that the Employee re-enrolls in the Plan.

Exhibit 31.1

CERTIFICATION

I, Paul A. Friedman, certify that:

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

Date: November 5, 2004

/s/ PAUL A. FRIEDMAN

PAUL A. FRIEDMAN
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, David C. Hastings, certify that:

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

Date: November 5, 2004

/s/ DAVID C. HASTINGS

DAVID C. HASTINGS
Chief Financial Officer

Exhibit 32.1

STATEMENT PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

With reference to the Quarterly Report of Incyte Corporation (the "Company") on Form 10-Q for the quarter ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul A. Friedman, Chief Executive Officer of Incyte, certify, for the purposes of 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of Incyte.

/s/ PAUL A. FRIEDMAN
PAUL A. FRIEDMAN
Chief Executive Officer

November 5, 2004

Exhibit 32.2

STATEMENT PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

With reference to the Quarterly Report of Incyte Corporation (the "Company") on Form 10-Q for the quarter ended September 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David C. Hastings, Chief Financial Officer of Incyte, certify, for the purposes of 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

(1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of Incyte.

/s/ DAVID C. HASTINGS

DAVID C. HASTINGS
Chief Financial Officer

November 5, 2004