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

FORM 10-Q

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

For the quarterly period ended March 31, 2000

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 PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

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

3174 Porter Drive
Palo Alto, California 94304
(Address of principal executive offices)

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

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

The number of outstanding shares of the registrant's Common Stock, $0.001 par value, was 31,801,867 as of March 31, 2000.

INCYTE PHARMACEUTICALS, INC.

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PART I: FINANCIAL INFORMATION
ITEM 1 FINANCIAL STATEMENTS

INCYTE PHARMACEUTICALS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)
(unaudited)

	MARCH 31, 2000	DECEMBER 31, 1999*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 421,334	$ 32,220
Marketable securities - available-for-sale	270,820	34,717
Accounts receivable, net	14,368	26,608
Prepaid expenses and other current assets	22,418	15,956
Total current assets	728,940	109,501
Property and equipment, net	73,562	67,293
Long-term investments	41,272	19,275
Goodwill and other intangible assets, net	13,966	14,564
Deposits and other assets	17,952	11,301
Total assets	$ 875,692	$ 221,934
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,903	$ 6,501
Accrued compensation	6,816	6,731
Accrued and other current liabilities	11,138	11,767
Deferred revenue	38,092	26,459
Total current liabilities	67,949	51,458
Non-current portion of capital lease obligations and note payable	-	194
Convertible subordinated notes	203,423	-
Total liabilities	271,372	51,652
Stockholders' equity:		
Common stock	32	29
Additional paid-in capital	641,873	222,805
Deferred compensation	(514)	(806)
Receivable from stockholders	-	(20)
Accumulated other comprehensive income (loss)	26,275	3,443
Accumulated deficit	(63,346)	(55,169)
Total stockholders' equity	604,320	170,282
Total liabilities and stockholders' equity	$ 875,692	$ 221,934

See accompanying notes

INCYTE PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2000	1999
Revenues	$ 40,754	$37,630
Costs and expenses:		
Research and development	41,334	31,244
Selling, general and administrative	14,821	8,379
Total costs and expenses	56,155	39,623
Loss from operations	(15,401)	(1,993)
Interest and other income, net	10,404	1,597
Interest expense	(1,897)	(138)
Losses from joint venture	(1,283)	(1,376)
Net loss	$ (8,177)	$(1,910)
Basic and diluted net loss per share	$ (0.27)	$ (0.07)
Shares used in computing basic and diluted net loss per share	30,306	27,879

See accompanying notes

INCYTE PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2000	1999
Net loss	$(8,177)	$(1,910)
Other comprehensive income (loss), net of taxes:		
Unrealized gains (losses) on marketable securities.	22,830	(402)
Foreign currency translation adjustments.	2	(150)
Other comprehensive income (loss).	22,832	(552)
Comprehensive income (loss).	$14,655	$(2,462)

See accompanying notes

INCYTE PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	THREE MONTHS ENDED MARCH 31,	
	2000	1999
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (8,177)	$ (1,910)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	8,114	6,029
Losses in joint venture	1,283	1,376
Gain on sale of long-term investment	(5,417)	-
Changes in certain assets and liabilities:		
Accounts receivable	12,240	4,605
Prepaid expenses and other assets	(7,684)	(1,186)
Accounts payable	5,402	(1,751)
Accrued and other current liabilities	(275)	466
Deferred revenue	11,633	24,033
Net cash provided by operating activities	16,119	31,662
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of long-term investments	5,417	-
Capital expenditures	(12,490)	(8,927)
Purchases of marketable securities	(247,851)	(14,990)
Sales and maturities of marketable securities	11,298	25,824
Net cash provided by (used in) investing activities	(243,626)	1,907
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from exercise of employee stock options	20,972	368
Proceeds from issuance of common stock	398,290	-
Proceeds from the issuance of convertible subordinated notes, net	196,800	-
Repayment of receivable from stockholder	20	-
Principal payments on capital lease obligations and note payable	(463)	(289)
Net cash provided by financing activities	615,619	79
Effect of exchange rate on cash and cash equivalents	2	(150)
Net increase in cash and cash equivalents	389,114	33,498
Cash and cash equivalents at beginning of period	32,220	50,048
Cash and cash equivalents at end of period	$ 421,334	$ 83,546

See accompanying notes

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INCYTE PHARMACEUTICALS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2000
(UNAUDITED)

1. ORGANIZATION AND BUSINESS

Incyte Pharmaceuticals, Inc. (the "Company") was incorporated in Delaware in April 1991. The Company designs, develops, and markets genomic information-based tools including database products, genomic data management software tools, microarray-based gene expression services and genomic reagents and related services. The Company's genomic databases integrate bioinformatics software with proprietary and, when appropriate, publicly available genetic information to create information-based tools used by pharmaceutical and biotechnology companies and academic researchers to understand disease and to discover and develop drugs. In the first quarter of 2000, the Company's Board of Directors approved an amendment to the Company's Certificate of Incorporation to change the Company's name to Incyte Genomics, Inc. The amendment will be submitted for stockholder approval at the annual meeting to be held in June 2000.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The consolidated balance sheet as of March 31, 2000, statements of operations for the three months ended March 31, 2000 and 1999, statements of comprehensive net income (loss) for the three months ended March 31, 2000 and 1999 and the statements of cash flows for the three months ended March 31, 2000 and 1999 are unaudited, but include all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of the financial position, operating results and cash flows for the periods presented. The balance sheet at December 31, 1999 has been derived from audited financial statements.

Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote information normally included in financial statements prepared in accordance with generally accepted accounting principles 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 the Company's Annual Report on Form 10-K for the year ended December 31, 1999.

3. PROPERTY AND EQUIPMENT

Property and equipment consisted of:

	MARCH 31, 2000	DECEMBER 31, 1999
Office equipment	$ 5,893	$ 4,630
Laboratory equipment	25,735	25,297
Computer equipment	56,032	52,565
Leasehold improvements	44,412	37,941
	132,072	120,433
Less accumulated depreciation and amortization	(58,510)	(53,140)
	$ 73,562	$ 67,293

4. CONVERTIBLE SUBORDINATED NOTES

In February 2000, in a private placement, the Company issued $200 million of convertible subordinated notes, which resulted in net proceeds of

approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on March 1 and September 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 $134.84 per share, subject to adjustment. The Company may, at its option, redeem the notes at any time before February 7, 2003, but only if the Company's stock exceeds 150% of the conversion price for 20 trading days in a period of 30 consecutive trading days. On or after February 7, 2003 the Company may, at its option, redeem the notes at specific prices. Holders may require the Company to repurchase the notes upon a change in control, as defined.

5. REVENUE RECOGNITION

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

6. LOSS PER SHARE

Basic net loss per share is computed by dividing net loss available to common stockholders (numerator) by the weighted average number of common shares outstanding (denominator) during the period and excludes the dilutive effect of stock options.

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

THREE MONTHS ENDED
MARCH 31,

	2000	1999
Numerator:		
Net loss	$(8,177)	$(1,910)
Denominator:		
Denominator for basic net loss Per share - weighted-average shares.	30,306	27,879
Dilutive potential common shares		
Stock options.	-	-
Convertible subordinated notes	-	-
Denominator for diluted net loss per share	30,306	27,879
Basic net loss per share.	$ (0.27)	$ (0.07)
Diluted net loss per share.	$ (0.27)	$ (0.07)

Options to purchase 4,237,496 and 4,944,707 shares of common stock were outstanding at March 31, 2000 and 1999, respectively, and notes convertible into 1,483,250 shares of common stock were outstanding at March 31, 2000, but were not included in the computation of diluted net loss per share, as their effect was antidilutive.

7. JOINT VENTURE

In September 1997, the Company formed a joint venture, diaDexus, LLC ("diaDexus"), with SmithKline Beecham Corporation ("SB") which will utilize

genomic and bioinformatic technologies in the discovery and commercialization of molecular diagnostics. The Company held a 50 percent equity interest in diaDexus and accounted for the investment under the equity method. In July 1999, the Company and SB each invested an additional $2.5 million in diaDexus through convertible notes that matured in April 2000. The notes had an interest at 5.6%, and were subordinate to all other claims.

On April 6, 2000, diaDexus obtained additional financing through a private equity offering. In conjunction with the offering, diaDexus repaid in full the $2.5 million principal amount of, together with accrued interest on, the convertible note held by the Company. Under diaDexus' new capital structure, the Company 's investment is below 20% and the Company' no longer has the ability to exert significant influence over diaDexus. Accordingly, the Company will account for its investment in diaDexus under the cost method of accounting as of the date of the financing.

diaDexus purchased $0.6 million of contract sequencing and microarray services from the Company in the three months ended March 31, 2000, diaDexus did not make similar purchases in 1999.

8. SEGMENT REPORTING

The Company operates primarily in one reportable segment: the design, development, and marketing of genomic information based tools, and follows the requirements of SFAS 131, Disclosures about Segments of an Enterprise and Related Information. For the three months ended March 31, 2000, the Company recorded revenue from customers throughout the United States and in Canada, Austria, Belgium, France, Germany, Israel, Netherlands, Switzerland, and the United Kingdom. Export revenue for the three months ended March 31, 2000 and 1999 were $11,487,000 and $10,783,000, respectively.

9. NEW PRONOUNCEMENTS

In June 1998, the FASB issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. ("SFAS 133"). SFAS 133 established standards for accounting and reporting derivative instruments and hedging activities. In June 1999, The FASB issued Statement No. 137, Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133 ("SFAS 137"). This statement defers the effective date of SFAS 133 until June 15, 2000. Application of SFAS 133 will have no impact on the consolidated financial position or results of operations as currently reported.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements ("SAB 101"). Among other things, SAB 101 discusses the SEC staff's view on accounting for non-refundable up-front fees. The Company is currently evaluating SAB 101 as to whether it would have any material impact on the Company. Should the Company determine that a change in its accounting policy is necessary, such a change will be made effective in the second quarter of 2000 and would result in a charge to results of operations for the cumulative effect of the change. This amount, if recognized, would be recorded as deferred revenue and recognized as revenue in future periods. Financial statements prior to January 1, 2000 will not be restated.

10. LITIGATION

In January 1998, Affymetrix, Inc. ("Affymetrix") filed a lawsuit in the United States District Court for the District of Delaware, subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of U.S. patent number 5,445,934 (the " '934 Patent") by both Synteni and Incyte. The complaint alleges that the '934 Patent has been infringed by the making, using, selling, importing, distributing or offering to sell in the U.S. high density arrays by Synteni and Incyte and that such infringement was willful. Affymetrix seeks a permanent injunction enjoining Synteni and Incyte from further infringement of the '934 Patent and, in addition, seeks damages, costs and attorney's fees and interest. Affymetrix further requests that any such damages be trebled based on its allegation of willful infringement by Incyte and Synteni.

In September 1998, Affymetrix filed an additional lawsuit in the United States District Court for the District of Delaware, subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of the U.S. patent number 5,800,992 (the " '992 Patent") and U.S. patent number 5,744,305 (the " '305 Patent") by both Synteni and Incyte. The complaint alleges that the '305 Patent has been infringed by the making, using, selling, importing, distributing or offering to sell in the United States high density arrays by Synteni and Incyte, that the '992 Patent has been infringed by the use of Synteni's and Incyte's GEM microarray technology to conduct gene expression monitoring using two-color labeling, and that such infringement was willful. Affymetrix seeks a permanent

injunction enjoining Synteni and Incyte from further infringement of the '305 and '992 Patents and, in addition, Affymetrix had sought a preliminary injunction enjoining Incyte and Synteni from using Synteni's and Incyte's GEM microarray technology to conduct gene expression monitoring using two-color labeling as described in the '992 Patent. Affymetrix's request for a preliminary injunction was denied in May 1999. As a result of the assignment of the case to a new judge, all scheduled trial and pretrial dates have been vacated. The court is expected to set a new schedule in late July 2000.

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

Incyte and Synteni believe they have meritorious defenses and intend to defend the suits vigorously. However, there can be no assurance that Incyte and Synteni will be successful in the defense of these suits. At this time, the Company cannot reasonably estimate the possible range of any loss resulting from these suits due to uncertainty regarding the ultimate outcome. Regardless of the outcome, this litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of management and technical personnel. Further, there can be no assurance that any license that may be required as a result of this suit or the outcome thereof would be made available on commercially acceptable terms, if at all.

11. PRIVATE PLACEMENT OF EQUITY

In February 2000, in a private placement, the Company issued 2,000,000 of its common stock at a price of $211.00 per share, resulting in net proceeds of $398.3 million.

PART I: FINANCIAL INFORMATION
ITEM 2

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations as of March 31, 2000 and for the three month periods ended March 31, 2000 and 1999 should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto set forth in Item 1 of this report and the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's Annual Report on Form 10-K for the year ended December 31, 1999.

When used in this discussion, the words "expects," "anticipates," "estimates," and similar expressions are intended to identify forward-looking statements. These statements, which include statements as to expected net loss, expected expenditure levels, expected cash flows, the adequacy of capital resources, and growth in operations, are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as the extent of utilization of genomic information by the biotechnology, pharmaceutical, and agricultural industries; risks relating to the development of new products and their use by potential collaborators of the Company; the impact of technological advances and competition; the ability of the Company to obtain and retain customers; competition from other entities; early termination of a database collaboration agreement or failure to renew an agreement upon expiration; the ability to successfully integrate the operations of recent business combinations; the cost of accessing or acquiring technologies developed by other companies; uncertainty as to the scope of coverage, enforceability or commercial protection from patents that issue on gene sequences and other genetic information; developments in and expenses relating to litigation and interference proceedings; the results and viability of joint ventures and businesses in which the Company has purchased equity; and the matters discussed in "Factors That May Affect Results." These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

Incyte, LifeSeq and PathoSeq are our registered trademarks. ZooSeq, LifeTools, LifeArray, LifeProt, LifeExpress, GeneAlbum and GEM are our trademarks. We also refer to trademarks of other corporations and organizations in this document.

OVERVIEW

Incyte Pharmaceuticals, Inc. ("Incyte" and, together with its wholly owned subsidiaries, the "Company") designs, develops and markets genomic information-based products and services. These products and services include database products, genomic data management software tools, microarray-based gene expression services, genomic reagents, and related services. The Company's genomic databases integrate bioinformatics software with proprietary and, when appropriate, publicly available genetic information to create information-based products and services used by pharmaceutical and biotechnology companies and academic researchers to understand disease and to discover and develop drugs. In the first quarter of 2000, the Company's Board of Directors approved an amendment to the Company's Certificate of Incorporation to change the Company's name to Incyte Genomics, Inc.The amendment will be submitted for stockholder approval at the annual meeting to be held in June 2000.

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

anticipated to have a material adverse impact on the Company's business or financial conditions.

The Company intends to invest in its sequencing, bioinformatics, expression database development, SNP discovery, and e-commerce programs in 2000 and as a result expects to report a net loss at least through 2000. If the costs of these programs are greater than anticipated, or if these programs take longer to complete, or if losses are incurred from strategic investments, the Company may incur losses in future periods, as well.

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

In September 1997, the Company formed a joint venture, diaDexus, LLC ("diaDexus"), with SmithKline Beecham Corporation ("SB") which will utilize genomic and bioinformatics technologies in the discovery and commercialization of molecular diagnostics. Through March 31, 2000, the Company and SB each held a 50 percent equity interest in diaDexus. The investment was accounted for under the equity method, and the Company recorded its share of diaDexus' earnings and losses in its statement of operations. On April 6, 2000, diaDexus completed a private equity financing. Under the new capital structure, the Company's investment is below 20% and the Company no longer has significant influence over diaDexus. Accordingly, the Company will account for its investment in diaDexus under the cost method of accounting as of the date of the financing.

In January 1998, the Company announced a relationship relating to the joint development of proteomics data and related software with Oxford GlycoSciences plc ("OGS"). As part of this relationship, the Company made a $5.0 million initial equity investment and a follow-on investment in April 1998 of approximately $0.8 million as part of the OGS initial public offering of its ordinary shares. As part of the collaborative agreement, the Company reimbursed OGS $5.0 million in 1999 for services rendered and will reimburse OGS up to $5.0 million in 2000 to offset OGS' expenses for services rendered. The market prices of the securities of the companies in which the Company invests are highly volatile and therefore subject to declines in market value. The Company will continue to evaluate its long-term equity investments for impairment on a quarterly basis.

In an effort to broaden its business, the Company is investing in a number of new areas, including molecular diagnostics, genome sequencing, SNP discovery, proteomics, microarray services and the sale of its products over the internet. Given that many of these address new markets, or involve untested technologies, it is not known if any of them will generate revenues or if the revenues will be sufficient to provide an adequate return on the investment. Depending on the investment required and the timing of such investments, expenses or losses related to these investments could adversely affect operating results.

The Company has incurred and could continue to incur substantial expenses in its defense of the lawsuits filed in January and September 1998 by Affymetrix, Inc. ("Affymetrix") alleging patent infringement by Synteni and Incyte. Affymetrix seeks a preliminary injunction enjoining Incyte and Synteni from using certain microarray technology in a manner alleged to infringe an Affymetrix patent and a permanent injunction enjoining Incyte and Synteni from further infringement of certain Affymetrix patents. In addition, Affymetrix seeks damages, costs, attorneys' fees and interest. Affymetrix further requests that any such damages be trebled on its allegation of willful infringement by Incyte and Synteni. Incyte and Synteni believe they have meritorious defenses and intend to defend these suits vigorously. However, there can be no assurance that Incyte and Synteni will be successful in the defense of these suits. At this time, the Company cannot reasonably estimate the possible range of any loss related to these suits due to uncertainty regarding the ultimate outcome. Regardless of the outcome, this litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of management and technical personnel. Any future litigation could result in similar expenses and diversion of efforts. Further, there can be no assurance that any license that may be required as a result of these suits or the outcome thereof would be made available on commercially acceptable terms, if at all.

RESULTS OF OPERATIONS

Net loss and diluted net loss per share were $8.2 million and $0.27 for the three months ended March 31, 2000, respectively, as compared to $1.9 million and $0.07 in the same period a year ago, respectively. Diluted net loss per share for the three months ended March 31, 2000 was impacted by a private equity offering of 2,000,000 shares of common stock in February 2000.

Revenues for the three months ended March 31, 2000 increased to $40.8 million compared to $37.6 million for the corresponding period in 1999. Revenues resulted primarily from database and related products and, to a much lesser extent, from the Company's custom genomics product line, which includes genomic screening products and services, gene expression services and custom sequencing services. The increase in revenues was primarily attributed to revenues from new products such as expression databases and in silico Single Nucleotide Polymorphism ("isSNP") product as well as increased revenues from custom genomics products.

Total costs and expenses for the three months ended March 31, 2000 increased to $56.2 million compared to $39.6 million for the corresponding period in 1999. Total costs and expenses are expected to increase in the foreseeable future due to the continued investment in the development of new products and services, and in the expansion of the Company's customer base

Research and development expenses for the three months ended March 31, 2000 increased to $41.3 million compared to $31.2 million for the corresponding period in 1999. The increase in research and development expenses resulted primarily from an increase in bioinformatics and software development efforts, gene mapping and SNP discovery efforts, microarray production, and the development of e-commerce products. The Company expects research and development spending to increase as the Company continues to pursue the development of new database products and services, expansion of existing database products, increases in sequencing, bioinformatics, expression database development and SNP discovery operations, development of e-commerce products and services and investments in new technologies.

Selling, general and administrative expenses for the three months ended March 31, 2000 increased to $14.8 million compared to $8.4 million for the corresponding period in 1999. The increase in selling, general and administrative expenses resulted primarily from the growth in the Company's sales and marketing function, including its branding efforts, and increased personnel to support the growing complexity of the Company's operations. The Company's operations were also impacted by legal expenses from the patent infringement lawsuits filed by Affymetrix of approximately $1.4 million and $2.1 million in the three months ended March 31, 2000 and 1999, respectively. The Company expects that selling, general and administrative expenses will increase throughout 2000 due to continued growth in marketing, sales and customer support functions, legal expenses related to the Company's defense of the patent infringement lawsuit filed by Affymetrix and increases in personnel to support the Company's growing complexity.

Interest and other income, net for the three months ended March 31, 2000 increased to $10.4 million from $1.6 million for the corresponding period in 1999. This increase was primarily a result of a $5.4 million gain from the exercise and sale of a warrant in a long-term strategic investment as well as increased interest income due to higher cash balances from the Company's convertible subordinated note and private equity offerings in February 2000.

Interest expense for the three months ended March 31, 2000 increased to $1.9 million from $0.1 million for the corresponding period in 1999. The increase was due to the interest expense associated with the Company's convertible subordinated notes issued in February 2000.

Losses from joint venture were $1.3 million for the three months ended March 31, 2000 compared to $1.4 million for the corresponding period in 1999. The loss represents the Company's share of diaDexus' losses from operations. Beginning on April 6, 2000, the Company will account for its investment in diaDexus under the cost method of accounting and therefore will no longer reflect diaDexus' losses in the Company's statement of operations.

Due to the Company's expected loss in 2000, the Company expects a minimal effective annual income tax rate, which is consistent with the corresponding period a year ago.

LIQUIDITY AND CAPITAL RESOURCES

As of March 31, 2000, the Company had $692.2 million in cash, cash equivalents and marketable securities, compared to $66.9 million as of December 31, 1999. The Company has classified all of its marketable securities as short-term, as the Company may choose not to hold its marketable securities until maturity in order to take advantage of favorable market conditions. Available cash is invested in accordance with the Company's investment policy's primary objectives of liquidity, safety of principal and diversity of investments.

Net cash provided by operating activities was $16.4 million for the three months ended March 31, 2000, as compared to $31.7 million for the three months ended March 31, 1999. The decrease was primarily due to the higher net loss, net of non-cash charges in 2000 as compared to 1999, increase in prepaid expenses in

2000 and the lower increase in deferred revenues in 2000 as compared to 1999. These changes were partially offset by the larger decrease in accounts receivable in 2000 as compared to 1999 and the increase in accounts payable in 2000. Net cash generated by operating activities may in the future fluctuate significantly from quarter to quarter due to the timing of large prepayments by database collaborators.

In February 2000, in a private placement, the Company issued $200 million of convertible subordinated notes, which resulted in net proceeds of approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on March 1 and September 1, and are due February 1, 2007. The notes are subordinated to senior indebtedness, as defined. The notes can be converted at the option of the holder at an initial conversion price of $134.84 per share, subject to adjustment. The Company may redeem the notes at any time before February 7, 2003, only if the Company's stock exceeds 150% of the conversion price for 20 trading days in a period of 30 consecutive trading days. On or after February 7, 2003 the Company may redeem the notes at specific prices. Holders may require the Company to repurchase the notes upon a change in control, as defined.

In February 2000, in a private placement, the Company issued 2,000,000 of its common stock at a price of $211.00 per share, resulting in net proceeds of $398.3 million.

The Company's investing activities, other than purchases, sales and maturities of marketable securities, have consisted of capital expenditures and long-term investments. Capital expenditures for the three months ended March 31, 2000 were $12.5 million as compared to $8.9 million in the same period in 1999, primarily due to the expansion of the Company's facilities. The Company generated net proceeds of $5.4 million on the exercise of a warrant and sale of the underlying common shares in one of its long term strategic investments. Net cash used by investing activities may in the future fluctuate significantly from quarter to quarter due to the timing of investments in and sales of strategic equity investments, capital expenditures and maturity/sales and purchases of marketable securities.

Net cash provided by financing activities was $616.3 million for the three months ended March 31, 2000 as compared to $0.01 million for the three months ended March 31, 1999. The 2000 activity included the issuance of common stock in a private equity offering resulting in net proceeds of $398.3 million, the net proceeds from the issuance of 5.5% Convertible Subordinated Notes of $196.8 million, and the proceeds from the exercise of employee stock options of $21.0 million.

The Company expects its cash requirements to continue to increase in 2000 as it: invests in its sequencing, bioinformatics, expression database development, and SNP discovery programs; invests in data-processing-related computer hardware to support its existing and new database products and to enable the on-line delivery of those products; continues to seek access to technologies through investments, research and development alliances, license agreements and/or acquisitions; makes strategic investments; and continues to make improvements in existing facilities.

Based upon its current plans, the Company believes that its existing resources will be adequate to satisfy its capital needs for at least the next twelve months. The Company's cash requirements depend on numerous factors, including the ability of the Company to attract and retain collaborators for its databases and other products and services; expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary technologies and businesses; competing technological and market developments; the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights; the purchase of additional capital equipment, including capital equipment necessary to ensure the Company's sequencing and microarray operations remain competitive; capital expenditures required to expand the Company's facilities; and costs associated with the integration of new operations assumed through mergers and acquisitions. Changes in the Company's research and development plans or other changes affecting the Company's operating expenses may result in changes in the timing and amount of expenditures of the Company's capital resources.

EURO CONVERSION

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

the euro conversion on its computer and financial systems, business processes, market risk, and price competition. The Company does not expect this conversion to have a material impact on its results of operations, financial position or cash flows.

FACTORS THAT MAY AFFECT RESULTS

The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations.

If any of the following risks actually occur, our business, financial condition and results of operations could be materially and adversely affected.

WE HAVE HAD ONLY LIMITED PERIODS OF PROFITABILITY AND WE EXPECT TO INCUR LOSSES IN THE FUTURE, WHICH MAY PREVENT US FROM RETURNING TO PROFITABILITY

We had net losses from inception in 1991 through 1996, and again incurred net losses in 1999 and 2000. Because of those losses, we had an accumulated deficit of $63.3 million as of March 31, 2000. We intend to continue to make significant investments in sequencing, bioinformatics, expression database development, single nucleotide polymorphism, or SNP, discovery and development of e-commerce products. As a result, we expect to report a net loss for the year ending December 31, 2000. We may report net losses in future periods as well. We expect that our expenditures may continue to increase in 2000 due in part to our continued investment in new product and technology development, including the continuation of our genomic sequencing, bioinformatics, expression database development, SNP-discovery programs, e-commerce initiative, obligations under existing and future research and development alliances, and our increasing investment in marketing, sales and customer service. Our profitability depends on our ability to increase our revenues:

TO GENERATE SIGNIFICANT REVENUES, WE MUST OBTAIN ADDITIONAL DATABASE COLLABORATORS AND RETAIN EXISTING COLLABORATORS. While we had over 20 database agreements as of March 31, 2000, we may be unable to enter into any additional agreements. Also, our database collaborators may choose not to renew their agreements upon expiration. In 1999, one of our LifeSeq Gold database collaborators did not renew its subscription. Our database revenues are also affected by the extent to which existing collaborators expand their agreements with us to include our new database products and to the extent that existing collaborators reduce the number of products or services for which they subscribe. Some of our database agreements require us to meet performance obligations. A database collaborator can terminate its agreement before the end of its scheduled term if we breach the agreement and fail to cure the breach within a specified period.

OUR REVENUES AND PROFITABILITY WILL ALSO DEPEND ON OUR ABILITY TO GENERATE PROFITS FROM EXPRESSION DATABASES AND MICROARRAY SERVICES. We acquired Synteni, Inc. in January 1998 to provide microarray services and to generate information for expression databases. The contribution of our microarray operations to our operating results will depend on whether we can continue to obtain high-volume customers for microarray services and expression databases, whether we can continue to increase our microarray production capacity in a timely manner and with consistent volumes and quality, and the costs associated with increasing our microarray production capacity.

WE DO NOT EXPECT MILESTONE OR ROYALTY PAYMENTS TO SUBSTANTIALLY CONTRIBUTE TO REVENUES FOR SEVERAL YEARS. Part of our strategy is to license to database collaborators our know how and patent rights associated with the gene sequences and related information in 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 testing and regulatory approval before commercialization.

OUR OPERATING RESULTS ARE UNPREDICTABLE AND MAY ADVERSELY IMPACT OUR STOCK PRICE

Our operating results are unpredictable and may fluctuate significantly from period to period due to a variety of factors, including:

- - changes in the demand for our products and services;

- - the introduction of competitive databases or services, including public domain databases;

- - the pricing of access to our databases;

- - the nature, pricing and timing of other products and services provided to our collaborators;

- - changes in the research and development budgets of our collaborators and potential collaborators;

- - depreciation expense from capital expenditures;

- - acquisition, licensing and other costs related to the expansion of our operations, including operating losses of acquired businesses;

- - losses and expenses related to our investments in joint ventures and businesses;

- - payments of milestones, license fees or research payments under the terms of our increasing number of external alliances; and

- - expenses related to, and the results of, litigation and other proceedings relating to intellectual property rights (including the lawsuits filed by Affymetrix, Inc. described below).

In particular, revenues from our database business are unpredictable because:

- - the timing of our database installations is determined by our collaborators;

- - the sales cycle for our database products is lengthy; and

- - the time required to complete custom orders can vary significantly.

We expect our expression databases to represent an increasing amount of our revenues. These revenues may, however, be affected by developments in the Affymetrix litigation, which may cause potential customers to postpone or change their decision to use our microarray services or to purchase our expression databases

We are investing in a number of new areas to try to broaden our business. These areas include sequencing, bioinformatics, gene expression databases, SNP discovery, molecular diagnostics, proteomics, or the large scale, high-throughput analysis of protein expression, and the online delivery of our database and software products. Because many of these address new markets or involve untested technologies, they may not generate any revenues or provide an adequate return on our investment. In these cases, we may have to recognize expenses or losses.

We have significant fixed expenses, due in part to our need to continue to invest in product development and extensive support for our database collaborators. We may be unable to adjust our expenditures if revenues in a particular period fail to meet our expectations, which would adversely affect our operating results for that period. Forecasting operating and integration expenses for acquired businesses may be particularly difficult, especially where the acquired business focuses on technologies that do not have an established market.

We believe that period-to-period comparisons of our financial results will not necessarily be meaningful. You should not rely on these comparisons as an indication of our future performance. If our operating results in any future period fall below the expectations of securities analysts and investors, our stock price will likely fall, possibly by a significant amount.

WE EXPERIENCE INTENSE COMPETITION AND RAPID TECHNOLOGICAL CHANGE AND IF WE DO NOT COMPETE EFFECTIVELY OUR REVENUES MAY DECLINE

GENOMIC BUSINESSES ARE INTENSELY COMPETITIVE. The human genome contains a finite number of genes. Our competitors may seek to identify, sequence and determine the biological function of numerous genes in order to obtain a proprietary position with respect to new genes. A number of companies, other institutions and government-financed entities are engaged in gene sequencing, gene discovery, gene expression analysis, positional cloning, the study of genetic variation, and other genomic service businesses. Many of these companies, institutions and entities have greater financial and human resources than we do.

Some of our competitors have developed databases containing gene sequence, gene expression, genetic variation or other genomic information and are marketing or plan to market their data to pharmaceutical companies. Additional competitors may attempt to establish databases containing this information in the future. We expect that competition in our industry will continue to intensify. Several large pharmaceutical companies have formed a consortium to create a SNPs database and to make all of the information publicly available. The formation of this consortium could delay or reduce the potential revenues related to our SNP-related business.

PATENT POSITIONS OR PUBLIC DISCLOSURES MAY REDUCE THE VALUE OF OUR DATABASES. Competitors may discover and establish patent positions with respect to gene sequences in our databases. Further, certain entities engaged in gene sequencing have made the results of their sequencing efforts publicly available. In April 2000, the Celera Genomics Group of PE Corporation announced that it has completed the sequencing phase of one person's genome and will now begin to assemble the sequenced fragments of the genome into their proper order. Celera has announced that it has filed a provisional patent application on newly discovered partial genes and stated its intention to file full applications on medically important discoveries. The Human Genome Project, which is coordinated by the U.S. Department of Energy and the National Institutes of Health, has announced that a consortium of laboratories associated with the Project predicts that they will produce at least 90% of the human genome sequence in a "working draft form" by the spring of 2000 and that they intend to make the information publicly available. The public availability of gene sequences or resulting patent positions covering substantial portions of the human genome or microbial or plant genomes could reduce the potential value of our databases to our collaborators. It could also impair our ability to realize royalties or other revenue from any commercialized products based on this genetic information.

COMPETITORS MAY DEVELOP SUPERIOR TECHNOLOGY. The gene sequencing machines used in our computer-aided sequencing operations are commercially available and are being used by at least one competitor. In addition, some of our competitors and potential competitors are developing proprietary sequencing technologies that may be more advanced than ours.

In addition, a number of companies are pursuing alternative methods for generating gene expression information, including microarray technologies. These advanced sequencing or gene expression technologies may not be commercially available for us to purchase or license on reasonable terms, if at all. At least one other company currently offers microarray-based services that might be competitive with ours.

Our SNP discovery platform represents a modification of a process that is in the public domain. We are seeking patent protection for these improvements, but have not yet received any patents. Other companies could make similar or superior improvements to this process without infringing our rights, and we may not have access to those improvements. The discovery of SNPs is a competitive area. Other companies may develop or obtain access to different SNP discovery platforms, to which we may not have access, that may make our technology obsolete.

We also face competition from providers of software. A number of companies have announced their intent to develop and market software to assist pharmaceutical companies and academic researchers in managing and analyzing their own genomic data and publicly available data.

WE MUST CONTINUE TO INVEST IN NEW TECHNOLOGIES. The genomics industry is characterized by extensive research efforts, resulting in rapid technological progress. To remain competitive, we must continue to expand our databases, improve our software, and invest in new technologies. New developments are expected to continue, and discoveries by others may render our services and potential products noncompetitive.

WE ARE INVOLVED IN PATENT LITIGATION, WHICH IF NOT RESOLVED FAVORABLY COULD HARM OUR BUSINESS

In January 1998, Affymetrix filed a lawsuit in federal court alleging infringement of U.S. patent number 5,445,934 by both Synteni and Incyte. The complaint alleges that the '934 patent has been infringed by Synteni's and Incyte's making, using, selling, importing, distributing or offering to sell high density arrays in the United States and that this infringement was willful. Affymetrix seeks a permanent injunction enjoining Synteni and Incyte from further infringement of the '934 patent and seeks damages, costs, attorneys' fees and interest. Affymetrix also requests triple damages based on allegedly willful infringement.

In September 1998, Affymetrix filed an additional lawsuit alleging infringement of U.S. patent numbers 5,744,305 and 5,800,992 by Synteni and Incyte. The complaint alleges that the '305 patent has been infringed by Synteni's and Incyte's making, using, selling, importing, distributing or offering to sell high density arrays in the United States. It also alleges that the '992 patent has been infringed by the use of Synteni's and Incyte's GEM microarray technology to conduct gene expression monitoring using two-color labeling and that this infringement was willful. Affymetrix had sought a preliminary injunction enjoining Synteni and Incyte from using GEM microarray technology to conduct this kind of gene expression monitoring, and a permanent injunction enjoining Synteni and Incyte from further infringing the '305 and '992 patents.

The lawsuits were initially filed in the United States District Court for the District of Delaware. In November 1998, the court granted Incyte's motion to transfer the suits to the United States District Court for the Northern District of California. Affymetrix's request for a preliminary injunction was denied in April 1999. As a result of the assignment of the case to a new judge, all scheduled trial and pretrial dates have been vacated. The court is expected to set a new schedule in July 2000.

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

We believe we have meritorious defenses and intend to defend these suits vigorously. However, our defense may be unsuccessful. At this time, we cannot reasonably estimate the possible range of any loss resulting from these suits due to uncertainty about the ultimate outcome. We have spent and expect to continue to spend a significant amount of money and management time on this litigation. Also, if we are required to license any technology as a result of these suits, we do not know whether we will be able to do so on commercially acceptable terms, if at all.

WE SPEND A SUBSTANTIAL AMOUNT OF MONEY ON NEW AND UNCERTAIN BUSINESSES AND DEMAND FOR OUR PRODUCTS AND SERVICES MAY BE INSUFFICIENT TO COVER OUR COSTS, WHICH COULD IMPACT OUR PROFITABILITY

There is little precedent for microarray-based gene expression database or service businesses or the use of SNP-based genetic variation information. We and our potential customers are in the early stages of evaluating the usefulness of the information generated by these businesses, and market demand for this information is uncertain. Our collaborators and potential collaborators may determine that our databases, software tools and microarray-related services are not useful or cost-effective. Due to the nature and price of some of the products and services we offer, only a limited number of companies are potential collaborators for those products and services. If we do not develop these new products and services in time to meet market demand or if there is insufficient demand for these products and services, we may not be able to cover our costs of developing these products and services or earn a sufficient return on our investment.

Additional factors that may affect demand for our products and services include:

- - the extent to which pharmaceutical and biotechnology companies conduct these activities in-house or through industry consortia;

- - the emergence of competitors offering similar services at competitive prices;

- - the extent to which the information in our databases is made public or is covered by others' patents;

- - our ability to establish and enforce proprietary rights to our products;

- - regulatory developments or changes in public perceptions relating to the use of genetic information and the diagnosis and treatment of disease based on genetic information; and

- - technological innovations that are more advanced than the technologies that we have developed or that are available to us.

Many of these factors are beyond our control.

OUR NEW PROGRAMS RELATING TO THE ROLE OF GENETIC VARIATION IN DISEASE AND DRUG RESPONSE MAY NEVER GENERATE SIGNIFICANT REVENUES OR PROFITABLE OPERATIONS

We recently began to focus part of our business on developing information-based products and services to assist pharmaceutical companies in a new and unproven area: the identification and correlation of genetic variation to disease and drug response. We will incur significant costs over the next several years in expanding our research and development in this area. These

activities may never generate significant revenues or profitable operations.

This new aspect of our business will focus on SNPs, one type of genetic variation. The role of SNPs in disease and drug response is not fully understood, and relatively few, if any, therapeutic or diagnostic products based on SNPs have been developed and commercialized. Among other things, demand in this area may be adversely affected by ethical and social concerns about the confidentiality of patient-specific genetic information and about the use of genetic testing for diagnostic purposes.

Except for a few anecdotal examples, we have no precedent that SNPs have any correlation to diseases or a patient's response to a particular drug or class of drug. Identifying statistically significant correlations is time-consuming and could involve the collection and screening of a large number of patient samples. We do not know if the SNPs we have discovered to date are suitable for these correlation studies. Nor do we currently have access to the patient samples needed or technology allowing us to rapidly and cost-effectively identify pre-determined SNPs in large numbers of patients.

Most SNPs may occur too infrequently to warrant their use in analyzing patients' genetic variation. We may have trouble identifying SNPs that both correlate with diseases or drug responses and occur frequently enough to justify their use by pharmaceutical companies.

Our success will also depend upon our ability to develop, use and enhance new and relatively unproven technologies. Our strategy of using high-throughput mutation detection processes and sequencing to identify SNPs and genes rapidly is unproven. Among other things, we will need to continue to improve the throughput of our SNP-discovery technology. We may not be able to achieve these necessary improvements, and other factors may impair our ability to develop our SNP-related products and services in time to be competitively available.

OUR STRATEGIC INVESTMENTS MAY RESULT IN LOSSES AND OTHER ADVERSE EFFECTS

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

- - often be made in securities lacking a public trading market or subject to trading restrictions, either of which increases our risk and reduces the liquidity of our investment;

- - require us to record losses and expenses related to our ownership interest;

- - require us to record charges related to the acquisition of in-process technologies or for the impairment in the value of the securities underlying our investment; and

- - require us to invest greater amounts than anticipated or to devote substantial management time to the management of research and development relationships and joint ventures.

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

OUR SALES CYCLE IS LENGTHY AND THERE IS NO GUARANTEE THAT A SUBSCRIPTION OR SERVICES AGREEMENT WILL RESULT

Our ability to obtain new subscribers for our databases, software tools and microarray and other services depends upon prospective subscribers' perceptions that our products and services can help accelerate drug discovery efforts. Our database sales cycle is typically lengthy because we need to educate our potential subscribers and sell the benefits of our tools and services to a variety of constituencies within potential subscriber companies. In addition, each database subscription and microarray services agreement involves the negotiation of unique terms. We may expend substantial funds and management effort with no assurance that a subscription or services agreement will result. Actual and proposed consolidations of pharmaceutical companies have affected the timing and progress of our sales efforts. We expect that future proposed consolidations will have similar effects.

PATENTS AND OTHER PROPRIETARY RIGHTS PROVIDE UNCERTAIN PROTECTION OF OUR PROPRIETARY INFORMATION AND OUR INABILITY TO PROTECT A PATENT OR OTHER PROPRIETARY RIGHT MAY IMPACT OUR BUSINESS AND OPERATING RESULTS

WE MAY BE UNABLE TO PROTECT OUR PROPRIETARY INFORMATION, WHICH MAY RESULT IN UNAUTHORIZED USE AND A LOSS OF REVENUE. Our business and competitive

position depend upon our ability to protect our proprietary database information and software technology, but our strategy of obtaining and protecting proprietary rights in pharmaceutically-relevant genes and SNPs is untested. Despite our efforts to protect this information and technology, unauthorized parties may attempt to obtain and use information that we regard as proprietary. Although our database subscription agreements require our subscribers to control access to our databases, policing unauthorized use of our databases and software may be difficult.

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

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

- - independently develop substantially equivalent proprietary information and techniques;

- - otherwise gain access to our proprietary information; or

- - design around patents issued to us or our other intellectual property.

OUR PATENT APPLICATIONS MAY CONFLICT WITH OTHERS. Our current policy is to file patent applications on what we believe to be novel full-length and partial gene sequences obtained through our gene sequencing efforts. We have filed U.S. patent applications in which we have claimed certain partial gene sequences. We have also applied for patents in the U.S. and other countries claiming full-length gene sequences associated with cells and tissues involved in our gene sequencing program. We hold a number of issued U.S. patents on full-length genes and one issued U.S. patent claiming multiple partial gene sequences. A number of entities make certain gene sequences publicly available, which may adversely affect our ability to obtain patents on those genes.

We believe that some of our patent applications claim genes that may also be claimed in patent applications filed by others. In some or all of these applications, a determination of priority of inventorship may need to be decided in an interference before the United States Patent and Trademark Office.

ENFORCEMENT OF GENE PATENTS IS UNCERTAIN AND GENE PATENTS MAY BE FOUND UNENFORCEABLE, RESULTING IN A LOSS OF COMPETITIVE BENEFIT. One of our strategies is to obtain proprietary rights in pharmaceutically-relevant genes (including partial gene sequences) and SNPs. While the USPTO has issued patents covering full-length genes, partial gene sequences and SNPs, we do not know whether or how courts may enforce those patents, if that becomes necessary. If a court finds these types of inventions to be unpatentable, or interprets them narrowly, the benefits of our strategy may not materialize.

WE MAY DECIDE TO ABANDON PATENT APPLICATIONS, WHICH COULD DIMINISH THE VALUE OF OUR PATENT PORTFOLIO AND POSSIBLY OUR FUTURE REVENUES. The USPTO has had a substantial backlog of biotechnology patent applications, particularly those claiming gene sequences. In 1996, the USPTO issued guidelines limiting the number of partial gene sequences that can be examined within a single patent application. Many of our patent applications contain more partial sequences than the maximum number allowed under these guidelines. Due to the resources needed to comply with the guidelines, we may decide to abandon patent applications for some of our partial gene sequences.

Because filing large numbers of patent applications and maintaining issued patents can be very costly, we may choose not to pursue every application. If we do not pursue patent protection for all of our full-length and partial gene sequences, the value of our intellectual property portfolio could be diminished. Because of the possible delay in obtaining allowance of some of our patent applications, and the secrecy of patent applications, we do not know if other applications having priority over ours have been filed.

WE MAY NEED TO REFILE SOME OF OUR PATENT APPLICATIONS AND THE PERIOD OF PATENT PROTECTION HAS BEEN SHORTENED, WHICH MAY AFFECT OUR POTENTIAL REVENUES AND PROFITS. The value of our patents depends in part on their duration. The U.S. patent laws were amended in 1995 to change the term of patent protection from 17 years from patent issuance to 20 years from the earliest effective filing date of the application. Because the average time from filing to issuance of biotechnology applications is at least one year and may be more than three years depending on the subject matter, a 20-year patent term from the filing date may result in substantially shorter patent protection, which may adversely affect our rights under any patents that we obtain. We may need to refile applications claiming large numbers of gene sequences and, in these situations, the patent term will be measured from the date of the earliest priority application. This would shorten our period of patent exclusivity.

INTERNATIONAL PATENT PROTECTION IS PARTICULARLY UNCERTAIN, AND OPPOSITION PROCEEDINGS IN FOREIGN COUNTRIES MAY BE COSTLY AND DIVERT MANAGEMENT RESOURCES. Biotechnology patent law outside the United States is even more uncertain than in the United States and is currently undergoing review and revision in many countries. Further, the laws of some foreign countries may not protect our intellectual property rights to the same extent as U.S. laws. We may participate in opposition proceedings to determine the validity of our or our competitors' foreign patents, which could result in substantial costs and diversion of our efforts.

WE MAY BE SUBJECT TO ADDITIONAL LITIGATION AND INFRINGEMENT CLAIMS THAT COULD BE COSTLY AND DISRUPT OUR BUSINESS

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

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

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

- - assert claims of infringement;

- - enforce our patents;

- - protect our trade secrets or know-how; or

- - determine the enforceability, scope and validity of the proprietary rights of others.

We may be unsuccessful in defending or pursuing these lawsuits. Regardless of the outcome, litigation can be very costly and can divert management's efforts. An adverse determination may subject us to significant liabilities or require us to seek licenses to other parties' patents or proprietary rights. We may also be restricted or prevented from manufacturing or selling our products. Further, we may not be able to obtain the necessary licenses on acceptable terms, if at all.

WE MAY ENCOUNTER PROBLEMS IN MEETING CUSTOMERS' SOFTWARE NEEDS, WHICH COULD ADVERSELY IMPACT OUR REVENUES AND THE GOODWILL OF OUR CUSTOMERS

Our databases also require software support and will need to incorporate features determined by database collaborators. If we experience delays or difficulties in implementing our database software or collaborator-requested features, we may be unable to service our collaborators.

PAST ACQUISITIONS HAVE AND ANY FUTURE ACQUISITIONS THAT WE MAY MAKE COULD ADVERSELY AFFECT OUR OPERATIONS OR FINANCIAL RESULTS

As part of our business strategy, we may acquire other assets, technologies and businesses. We acquired Synteni in January 1998 and Hexagen in September 1998.

These and any future acquisitions involve risks such as the following:

- - we may be exposed to unknown liabilities of acquired companies;

- - our acquisition and integration costs may be higher than we anticipated and may cause our quarterly and annual operating results to fluctuate;

- - we may experience difficulty and expense in assimilating the operations and personnel of the acquired businesses, disrupting our business and diverting management's time and attention;

- - we may be unable to integrate or complete the development and application of acquired technology;

- - we may experience difficulties in establishing and maintaining uniform standards, controls, procedures and policies;

- - our relationships with key customers of acquired businesses may be

impaired, due to changes in management and ownership of the acquired businesses;

- - we may be unable to retain key employees of the acquired businesses;

- - we may incur amortization expenses if an acquisition results in significant goodwill or other intangible assets; and

- - our stockholders may be diluted if we pay for the acquisition with equity securities.

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

WE MAY HAVE DIFFICULTY MANAGING OUR GROWTH, WHICH MAY IMPACT OUR ABILITY TO OPTIMIZE OUR RESOURCES

We expect to continue to experience significant growth in the number of our employees and the scope of our operations. This growth has placed, and may continue to place, a significant strain on our management and operations. Our ability to manage this growth will depend upon our ability to attract, hire and retain skilled employees. Our success will also depend on the ability of our officers and key employees to continue to implement and improve our operational and other systems and to hire, train and manage our employees.

In addition, we must continue to invest in customer support resources as the number of database collaborators and their requests for support increase. Our database collaborators typically have worldwide operations and may require support at multiple U.S. and foreign sites. To provide this support, we may need to open offices in addition to our Palo Alto, California headquarters and our offices in Fremont, California, St. Louis, Missouri and Cambridge, England, which could result in additional burdens on our systems and resources.

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 MATERIALLY AFFECT OUR BUSINESS

We are highly dependent on the principal members of our management, operations and scientific staff, including our executive officers. The loss of services of these individuals may have a material adverse effect on our business. We have not entered into any employment agreement with any of these persons and do not maintain a key person life insurance policy on the life of any employee.

Our future success also will depend in part on the continued service of our executive management team, key scientific, software, bioinformatics and management personnel and our ability to identify, hire and retain additional personnel, including customer service, marketing and sales staff. We experience intense competition for qualified personnel. We may not be able to continue to attract and retain personnel necessary for the development of our business.

OUR INABILITY TO OBTAIN NECESSARY EQUIPMENT, SUPPLIES AND DATA FROM THIRD PARTIES MAY ADVERSELY IMPACT OUR RESULTS

WE RELY ON A SMALL NUMBER OF SUPPLIERS OF GENE SEQUENCING MACHINES AND REAGENTS REQUIRED FOR GENE SEQUENCING. Although we are evaluating alternative gene sequencing machines, they may not be available in sufficient quantities or at acceptable costs. In addition, if a third party claims that our use of these machines infringes their patent rights, our use of these machines could become more costly or could be prevented. If we are unable to obtain additional machines or an adequate supply of reagents or other materials at commercially reasonable rates, our ability to identify genes and SNPs would be adversely affected.

WE RELY ON OUTSIDE SOURCES FOR TISSUE SAMPLES FROM WHICH WE ISOLATE GENETIC MATERIAL USED IN OUR OPERATIONS. Our business could be adversely affected if we lose access to some of these sources, or if they charged us higher access fees or imposed tighter restrictions on our use of the information generated from the samples.

WE CANNOT CONTROL THE PERFORMANCE OF COLLABORATORS. We may enter into research and development relationships with corporate and academic collaborators and others. The success of these relationships depends upon third parties' performance of their responsibilities. Our ability to develop these relationships is uncertain, and any established relationships may prove unsuccessful. Our collaborators may also be pursuing alternative technologies or developing alternative products on their own or in collaboration with others, including our competitors.

WE RELY ON THIRD-PARTY DATA SOURCES. We rely on scientific and other data supplied by others, including our academic collaborators and sources of

tissue samples. This data could contain errors or other defects, which could corrupt our databases. In addition, we cannot guarantee that our data sources acquired this information in compliance with legal requirements. If either of these happen and become known, our business prospects could be adversely affected.

SECURITY RISKS IN ELECTRONIC COMMERCE OR UNFAVORABLE INTERNET REGULATIONS MAY DETER FUTURE USE OF OUR PRODUCTS AND SERVICES, WHICH COULD HARM OUR BUSINESS.

We plan to make our products available through our website on the Internet and have recently introduced our first online product, the LifeSeq Gene-by-Gene program. Online use of our products and services by our database collaborators may be limited by our inability to provide secure transmissions of confidential information over the Internet. The security measures we use to protect our website, access to our databases, and transmissions to and from our website may be compromised by advances in computer capabilities and new discoveries in the field of cryptography. If our security measures are breached, our proprietary information or confidential information about our collaborators could be misappropriated. Also, a security breach could result in interruptions in our operations. The security measures we adopt may not be sufficient to prevent breaches and we may incur significant costs to protect against security breaches or to alleviate problems caused by breaches. Further, if the security of our website or the website of another company is breached, our collaborators may no longer use the Internet when the transmission of confidential information is involved. For example, recent attacks by computer hackers on major e-commerce websites and other Internet service providers have heightened concerns regarding the security and reliability of the Internet.

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

OUR ACTIVITIES INVOLVE HAZARDOUS MATERIALS AND MAY SUBJECT US TO COSTLY ENVIRONMENTAL LIABILITY

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

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

OUR REVENUES ARE DERIVED PRIMARILY FROM THE PHARMACEUTICAL AND BIOTECHNOLOGY INDUSTRIES AND MAY FLUCTUATE SUBSTANTIALLY DUE TO REDUCTIONS AND DELAYS IN RESEARCH AND DEVELOPMENT EXPENDITURES

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

- - changes in economic conditions;

- - consolidation in the pharmaceutical industry;

- - changes in the regulatory environment 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.

OUR BUSINESS COULD BE INTERRUPTED BY NATURAL DISASTERS

We conduct our sequencing and a significant portion of our other activities at our facilities in Palo Alto, California, and conduct our microarray-related activities at our facilities in Fremont, California. Both locations are in a seismically active area. Although we maintain business interruption insurance, we do not have or plan to obtain earthquake insurance. A major catastrophe (such as an earthquake or other natural disaster) could result in a prolonged interruption of our business.

SUBSTANTIAL LEVERAGE AND DEBT SERVICE OBLIGATIONS MAY ADVERSELY AFFECT OUR CASH FLOW

We have substantial amounts of outstanding indebtedness, primarily the $200.0 million of convertible subordinated notes issued in February 2000. As a result of this indebtedness, our principal and interest payment obligations have increased substantially. There is the possibility that we may be unable to generate cash sufficient to pay the principal of, interest on and other amounts due in respect of our indebtedness when due.

PART I: FINANCIAL INFORMATION
ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to interest rate risk primarily through its investments in short-term marketable securities and its note payable. The Company's investment policy calls for investment in short term, low risk instruments. As of March 31, 2000, investments in marketable securities was $630.7 million. Due to the nature of these investments and note, if market interest rates were to increase immediately and uniformly by 10% from levels as of December 31, 1999, the decline in the fair value of the portfolio would not be material.

The Company is exposed to equity price risks on the marketable portion of equity securities included in its portfolio of investments and long-term investments, entered into to further its business and strategic objectives. These investments are in small capitalization stocks in the pharmaceutical/biotech industry sector, in companies with which the Company has research and development or licensing agreements. The Company typically does not attempt to reduce or eliminate its market exposure on these securities. As of March 31, 2000, long-term investments, excluding diaDexus, were $37.5 million.

The Company typically does not hedge its foreign currency exposure. Management does not believe that the Company's exposure to foreign currency rate fluctuations is material.

PART II: OTHER INFORMATION

ITEM 1 Legal Proceedings

In January 1998, Affymetrix, Inc. ("Affymetrix") filed a lawsuit in the United States District Court for the District of Delaware, subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of U.S. patent number 5,445,934 (the "'934 Patent") by both Synteni and Incyte. The complaint alleges that the '934 Patent has been infringed by the making, using, selling, importing, distributing or offering to sell in the U.S. high density arrays by Synteni and Incyte and that such infringement was willful. Affymetrix seeks a permanent injunction enjoining Synteni and Incyte from further infringement of the '934 Patent and, in addition, seeks damages, costs and attorney's fees and interest. Affymetrix further requests that any such damages be trebled based on its allegation of willful infringement by Incyte and Synteni.

In September 1998, Affymetrix filed an additional lawsuit in the United States District Court for the District of Delaware, subsequently transferred to the United States District Court for the Northern District of California in November 1998, alleging infringement of the U.S. patent number 5,800,992 (the "'992 Patent") and U.S. patent number 5,744,305 (the "'305 Patent") by both Synteni and Incyte. The complaint alleges that the '305 Patent has been infringed by the making, using, selling, importing, distributing or offering to sell in the United States high density arrays by Synteni and Incyte, that the '992 Patent has been infringed by the use of Synteni's and Incyte's GEM microarray technology to conduct gene expression monitoring using two-color labeling, and that such infringement was willful. Affymetrix seeks a permanent injunction enjoining Synteni and Incyte from further infringement of the '305 and '992 Patents and, in addition, Affymetrix had sought a preliminary injunction enjoining Incyte and Synteni from using Synteni's and Incyte's GEM microarray technology to conduct gene expression monitoring using two-color labeling as described in the '992 Patent. Affymetrix's request for a preliminary injunction was denied in May 1999. As a result of the assignment of the case to a new judge, all scheduled trial and pretrial dates have been vacated. The court is expected to set a new schedule in July 2000.

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

Incyte and Synteni believe they have meritorious defenses and intend to defend the suits vigorously. However, there can be no assurance that Incyte and Synteni will be successful in the defense of these suits. At this time, the Company cannot reasonably estimate the possible range of any loss resulting from these suits due to uncertainty regarding the ultimate outcome. Regardless of the outcome, this litigation has resulted and is expected to continue to result in substantial expenses and diversion of the efforts of management and technical personnel. Further, there can be no assurance that any license that may be required as a result of this suit or the outcome thereof would be made available on commercially acceptable terms, if at all.

ITEM 2 Changes in Securities

(a) Not applicable

(b) Not applicable

(c) On February 4 and February 14, 2000, the Company completed the sale of $150,000,000 and $50,000,000 aggregate principal amount of 5.5% Convertible Subordinated Notes Due 2007 (the "Notes"). The Notes are convertible at the option of the holder into shares of Common Stock, at any time prior to redemption or maturity, at a conversion price of $134.839 per share (equal to a conversion rate of 7.4163 shares per $1,000 principal amount of the Notes and representing in the aggregate 1,483,250 shares), subject to adjustment under certain circumstances.

The Notes were sold by the Company to Deutsche Bank Securities Inc. and Warburg Dillon Read LLC, as initial purchasers (the "Initial Purchasers"), in a private placement in reliance upon Section 4(2) of the Securities Act of 1933, as amended (the "Act") and Regulation D under the Act. The aggregate offering price of the Notes was $200,000,000 and the aggregate discount to the Initial Purchasers was $6,000,000.

The Company has been advised that the Initial Purchasers resold $141,400,000 aggregate principal amount of the Notes to "qualified institutional buyers" in reliance on Rule 144A under the Act and $8,600,000 aggregate principal amount of the Notes in sales outside the United Stated to persons other than U.S. persons in reliance on Regulation S under the Securities Act.

On February 28, 2000 the Company entered into a Stock Purchase Agreement with each of Janus Aspen Series and Janus Investment Fund pursuant to which it issued and sold 305,355 and 1,694,645 shares of Common Stock, respectively, for an aggregate purchase price of $422,000,000. The Company relied on the exemption provided by Section 4(2) of the Act and Regulation D under the Act, because the transaction did not involve a public offering and each of Janus Aspen Series and Janus Investment Fund represented that it was an "accredited investor" as such term in defined by the rules of the SEC promulgated under the Act.

(d) Not applicable

ITEM 3 Defaults Upon Senior Securities

None

ITEM 4 Submission of Matters to a Vote of Security Holders

None

ITEM 5 Other Information

None

ITEM 6 Exhibits and Reports on Form 8-K.

a) Exhibits

See Exhibit Index on Page 32

b) Reports on Form 8-K

The Company filed 5 reports on Form 8-K during the fiscal quarter covered by this report, as follows:

(i) Current Report on Form 8-K, filed on February 1, 2000, reporting under Item 5 the Company's financial information for the quarter and year ended December 31, 1999 and announcement of the Company's proposed private offering of convertible subordinated notes.

(ii) Current Report on Form 8-K, filed on February 17, 2000, reporting under Item 5, the Company's announcement of the issuance of an additional $50 million of convertible subordinated noted.

(iii) Current Report on Form 8-K, filed on February 22, 2000, reporting under Item 5, the Company's updated description of its business and risk factors.

(iv) Current Report on Form 8-K, filed on February 24, 2000, reporting under Item 5, the Company's announcement of the Company's issuance of 2,000,000 of its common stock to selected institutional investors at a price of $211.00 per share.

(v) Current Report on Form 8-K, filed on March 24, 2000, reporting under Item 5, the June 5, 2000 date for the Company's 2000 Annual Meeting of stockholders.

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 PHARMACEUTICALS, INC.

Date: May 12, 2000 By: /s/ Roy A. Whitfield

Roy A. Whitfield
Chief Executive Officer

Date: May 12, 2000 By: /s/ John M. Vuko

John M. Vuko
Chief Financial Officer

INCYTE PHARMACEUTICALS, INC.

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MAR-31-2000
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