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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 March 31, 2003

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.)**

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

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

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

☒ 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 71,671,441 as of March 31, 2003.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

Incyte Corporation

Condensed Consolidated Balance Sheets
(in thousands)
(unaudited)

	March 31, 2003	December 31, 2002*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,637	$ 22,928
Marketable securities—available-for-sale	365,547	406,090
Accounts receivable, net (1)	8,024	8,485
Prepaid expenses and other current assets (2)	17,698	21,268
Total current assets	401,906	458,771
Property and equipment, net	33,789	31,787
Long-term investments (3)	33,749	35,515
Intangible and other assets, net (4)	27,434	26,066
Total assets	$ 496,878	$ 552,139
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,466	$ 9,073
Accrued compensation	9,338	14,319
Interest payable	1,561	3,903
Accrued and other current liabilities (5)	6,216	7,140
Deferred revenue	13,048	11,662
Accrued restructuring charges	19,793	31,596
Accrued acquisition costs	3,517	—
Total current liabilities	60,939	77,693
Convertible subordinated notes	171,930	172,036
Total liabilities	232,869	249,729
Stockholders' equity:		
Common stock	72	67
Additional paid-in capital	725,563	708,163
Deferred stock-based compensation	(2,749)	(3,250)
Accumulated other comprehensive income	1,931	2,454
Accumulated deficit	(460,808)	(405,024)
Total stockholders' equity	264,009	302,410
Total liabilities and stockholders' equity	$ 496,878	$ 552,139

* The condensed consolidated balance sheet at December 31, 2002 has been derived from the audited financial statements at that date.

(1) Includes receivables from companies considered related parties under SFAS 57 of $0.3 million and $0.6 million at March 31, 2003 and December 31, 2002, respectively.

(2) Includes loan receivable from Maxia Pharmaceuticals, Inc. (see Note 11), a company considered a related party under SFAS 57, of $0 million and $1.5 million at March 31, 2003 and December 31, 2002, respectively, and prepaid expenses to companies considered related parties under SFAS 57 of $1.9 million and $2.1 million at March 31, 2003 and December 31, 2002, respectively.

(3) Includes investments in companies considered related parties under SFAS 57 of $26.1 million and $26.1 million at March 31, 2003 and December 31, 2002, respectively.

(4) Includes loans to executive officers of $0.7 million and $0.8 million at March 31, 2003 and December 31, 2002 respectively.

(5) Includes accruals of payments to companies considered related parties under SFAS 57 of $1.5 million and $1.5 million at March 31, 2003 and December 31, 2002, respectively.

See accompanying notes

Incyte Corporation
Condensed Consolidated Statements of Operations
(in thousands, except per share amounts)
(unaudited)

	Three Months Ended March 31,	
	2003	2002
Revenues (1)	$ 12,509	$ 29,014
Costs and expenses:		
Research and development (2)	30,186	33,743
Selling, general and administrative (3)	7,377	14,168
Purchased in-process research and development	28,116	—
Other expenses	1,103	—
Total costs and expenses	66,782	47,911
Loss from operations	(54,273)	(18,897)
Interest and other income, net (4)	1,233	8,157
Interest expense	(2,439)	(2,538)
Gain/(loss) on certain derivative financial instruments	(45)	140
Loss before income taxes	(55,524)	(13,138)
Provision for income taxes	260	303
Net loss	$(55,784)	$(13,441)
Basic and diluted net loss per share	$ (0.81)	$ (0.20)
Shares used in computing basic and diluted net loss per share	68,986	66,864

(1) Includes revenues from transactions with companies considered related parties under SFAS 57 of $0.2 million and $0.7 million for the three months ended March 31, 2003 and 2002, respectively.
(2) Includes expenses from transactions with companies considered related parties under SFAS 57 of $0.1 million and $2.8 million for the three months ended March 31, 2003 and 2002, respectively.
(3) Includes compensation expense related to loans to executive officers of $0.1 million and $0 million for the three months ended March 31, 2003 and 2002, respectively.
(4) Includes gains on investments in companies considered related parties under SFAS 57 of $0 million and $0.8 million for the three months ended March 31, 2003 and 2002, respectively.

See accompanying notes

Incyte Corporation
Condensed Consolidated Statements Of Comprehensive Loss
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2003	2002
Net loss	$(55,784)	$(13,441)
Other comprehensive loss:		
Unrealized losses on marketable securities	(490)	(9,559)
Foreign currency translation adjustments	(33)	(179)
Other comprehensive loss	(523)	(9,738)
Comprehensive loss	$(56,307)	$(23,179)

See accompanying notes

Incyte Corporation
Condensed Consolidated Statements of Cash Flows
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2003	2002
Cash flows from operating activities:		
Net loss	$ (55,784)	$ (13,441)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,457	5,369
Purchased in-process research and development	28,116	—
Non-cash other expenses	393	—
Stock compensation	501	1,461
Compensation expense on executive loans	98	—
(Gain)/loss on derivative financial instruments	45	(140)
Impairment of long-term investments	1,900	—
Realized gain on long-term investments, net	(22)	(981)
Equity received in exchange for goods or services provided	—	(2,688)
Changes in certain assets and liabilities:		
Accounts receivable	652	26,347
Prepaid expenses and other assets	(1,184)	(2,138)
Accounts payable	(2,415)	(862)
Accrued and other current liabilities	(20,893)	(15,433)
Deferred revenue	1,386	(3,514)
Net cash used in operating activities	(42,750)	(6,020)
Cash flows from investing activities:		
Long-term investments	—	(5,000)
Proceeds from the sale of long-term investments	—	704
Acquisition of Maxia Pharmaceuticals, Inc.	(3,532)	—
Capital expenditures	(5,584)	(1,995)
Purchases of marketable securities	(134,408)	(120,222)
Sales and maturities of marketable securities	174,113	186,724
Loans to executive officers	—	(1,150)
Net cash provided by investing activities	30,589	59,061
Cash flows from financing activities:		
Proceeds from issuance of common stock under stock plans	8	2,871
Repurchase of common stock	(105)	—
Other	—	55
Net cash provided by (used in) financing activities	(97)	2,926
Effect of exchange rate on cash and cash equivalents	(33)	(179)
Net (decrease) increase in cash and cash equivalents	(12,291)	55,788
Cash and cash equivalents at beginning of period	22,928	43,368
Cash and cash equivalents at end of period	$ 10,637	$ 99,156

See accompanying notes

INCYTE CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
March 31, 2003
(Unaudited)

1. Organization and business

Incyte Corporation ("Incyte", "we", "us" or "our"), formerly Incyte Genomics, Inc., was incorporated in Delaware in April 1991. In March 2003, we changed our name to Incyte Corporation. Incyte is a drug discovery company that develops proprietary genomic information and applies its expertise in medicinal chemistry and molecular, cellular and in vivo biology to the discovery of novel small molecule and protein therapeutics. We believe we have created the largest commercial portfolio of issued United States patents covering human, full-length genes and the proteins they encode, and license this intellectual property, as well as market our genomic and proteomic information, to many of the world's leading pharmaceutical and biotechnology companies and academic research centers. Incyte has also assembled an experienced and talented drug discovery team that is identifying potential new drug therapies for cancer, inflammatory diseases and other medical conditions.

2. Summary of Significant Accounting Policies

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. The condensed consolidated balance sheet as of March 31, 2003, condensed consolidated statements of operations for the three months ended March 31, 2003 and 2002, condensed consolidated statements of comprehensive loss for the three months ended March 31, 2003 and 2002 and the condensed consolidated statements of cash flows for the three months ended March 31, 2003 and 2002 are unaudited, but include all adjustments (consisting 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, 2002 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 Incyte's Annual Report on Form 10-K for the year ended December 31, 2002.

Certain amounts reported in previous periods have been reclassified to conform to 2003 financial statement presentation.

Stock-Based Compensation

In accordance with the provisions of FASB Statement No. 123, *Accounting for Stock-Based Compensation ("SFAS 123")*, Incyte has 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.

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 For the Three Months Ended March 31,		Employee Stock Purchase Plan For the Three Months Ended March 31,	
	2003	2002	2003	2002
Average risk-free interest rates	3.26%	3.81%	1.40%	2.18%
Average expected life (in years)	3.40	3.56	0.49	0.49
Volatility	82%	87%	108%	76%

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 March 31,	
	2003	2002
	(in thousands, except per share amounts)	
Net loss, as reported	$ (55,784)	$ (13,441)
Add: Stock-based compensation, as reported	501	1,493
Deduct: Total stock-based compensation determined under the fair value based method for all awards	(1,431)	(5,726)
Pro forma net loss, SFAS 123 adjusted	$ (56,714)	$ (17,674)
Net loss per share:		
Basic and diluted net loss per share—as reported	$ (0.81)	$ (0.20)
Basic and diluted net loss per share—SFAS 123 adjusted	$ (0.82)	$ (0.26)

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.

3. Property and equipment

Property and equipment consisted of:

	March 31, 2003	December 31, 2002
	(in thousands)	
Office equipment	$ 4,522	$ 4,968
Laboratory equipment	24,055	24,489
Computer equipment	63,315	70,817
Leasehold improvements	30,012	31,010
	121,904	131,284
Less accumulated depreciation and amortization	(88,115)	(99,497)
	$ 33,789	$ 31,787

4. Intangible Assets

Intangible assets consist of the following (in thousands):

	March 31, 2003			December 31, 2002		
	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net	Gross Carrying Amount	Accumulated Amortization	Other Intangibles, Net
Capitalized patents	$ 16,667	$ (2,002)	$ 14,665	$ 14,465	$ (1,582)	$ 12,883
Capitalized software	8,204	(3,242)	4,962	7,638	(2,797)	4,841
Acquired database technology	2,638	(521)	2,117	2,638	(429)	2,209
Other intangibles	362	(208)	154	362	(171)	191
Total	$ 27,871	$ (5,973)	$ 21,898	$ 25,103	$ (4,979)	$ 20,124

Costs of patents and patent applications are capitalized and amortized on a straight-line basis over their estimated useful lives of approximately 10 years in accordance with the provisions of Accounting Principles Board Opinion No. 17, *Intangible Assets ("APB 17")*. Capitalized software costs, which consist of software development costs incurred in developing certain products once the technological feasibility of the products has been determined, are recorded in accordance with FASB Statement

No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed ("SFAS 86")*, and are amortized on a straight-line basis over the estimated useful life of 3 years. Acquired database technology and other intangible assets recorded in conjunction with the acquisition of Proteome, Inc. are being amortized using the straight-line method over estimated useful lives ranging from 3 to 8 years. Amortization expense related to intangibles was $1.1 million for the three months ended March 31, 2003.

5. Convertible subordinated notes

In February 2000, in a private placement, Incyte issued $200.0 million of convertible subordinated notes, which resulted in net proceeds of approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on February 1 and August 1, and are due February 1, 2007. The notes are subordinated to all senior indebtedness, as defined. The notes can be converted at the option of the holder at an initial conversion price of $67.42 per share, subject to adjustment. 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. No notes were repurchased in the open market during the three-month periods ended March 31, 2003 and 2002.

6. 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 databases of information, use of our intellectual property and sales of our custom products and services. Revenue is deferred for fees received before earned or until no further obligations exist.

Revenues received from agreements in which collaborators paid with equity securities in their company were $0 million and $2.4 million for the three months ended March 31, 2003 and 2002, respectively. Additionally, revenues received from agreements in which we concurrently invested funds in the collaborator's equity securities were $0.2 million and $0.2 million for the three months ended March 31, 2003 and 2002, respectively.

Revenues recognized from transactions in which there was originally a concurrent commitment entered into by us to purchase goods or services for the three months ended March 31, 2003 and 2002 were $1.1 million and $1.0 million, respectively. No new transactions in which there was a concurrent commitment by us to purchase goods or services were entered into during the three months ended March 31, 2003. Of commitments made in prior periods, we expensed $2.8 million and $5.8 million for the three months ended March 31, 2003 and 2002, respectively.

The above transactions were recorded at fair value in accordance with our revenue recognition policy.

7. Loss per share

Options to purchase 10,762,949 and 10,389,077 shares of common stock were outstanding at March 31, 2003 and 2002, respectively, and notes convertible into 2,525,956 and 2,625,333 shares of common stock were outstanding at March 31, 2003 and 2002, respectively, but were not included in the computation of diluted net loss per share, as their effect was antidilutive.

8. Segment reporting

Our operations are treated as one operating segment, in accordance with FASB Statement No. 131 ("SFAS 131"). For the three months ended March 31, 2003, we recorded revenue from customers throughout the United States and in Austria, Belgium, Canada, France, Germany, India, Israel, Japan, the Netherlands, Switzerland, and the United Kingdom. Export revenues for the three months ended March 31, 2003 and 2002 were $3.7 million and $11.8 million, respectively.

9. Related party transactions

Incyte has entered into certain related party transactions as defined by FASB Statement No. 57, *Related Party Disclosures ("SFAS 57")*. In each of these transactions in which a director of Incyte is in some way affiliated with the other party to the transaction, such director has recused himself from voting on the related party transaction. For the three months ended March 31, 2003 and 2002, revenues from companies considered to be related parties as defined by SFAS 57 were $0.2 million and $0.7 million, respectively. At March 31, 2003 and December 31, 2002, accounts receivable from related parties were $0.3 million and $0.6 million, respectively, and loans receivable from related parties were $0.7 million and $2.3 million, respectively. At March 31, 2003 and December 31, 2002, prepaid expenses to related parties were $1.9 million and $2.1 million, respectively.

10. Other Expenses

Costs associated with restructuring activities initiated prior to December 31, 2002 are accounted for 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").* Accordingly, costs associated with such plans are recorded as other expenses in the consolidated statements of operations. Below is a summary of the activity related to other expenses recorded pursuant to EITF 94-3 for the periods in which activity related to our restructuring programs has taken place through the three months ended March 31, 2003.

2002 Restructuring

	Original Charge Recorded in 2002	Accrual Balance as of December 31, 2002	2003 Charges to Operations	2003 Charges Utilized	Accrual Balance as of March 31, 2003
			(in thousands)		
Restructuring expenses:					
Workforce reduction	$ 7,325	$ 4,867	$ —	$(4,867)	$ —
Equipment and other assets	8,662	—	—	—	—
Lease commitments and other restructuring charges	17,924	18,504	504	(1,816)	17,192
Other expenses	$ 33,911	$ 23,371	$ 504	$(6,683)	$ 17,192

During 2002, we recognized other expenses of $33.9 million relating to restructuring programs announced in the fourth quarter of 2002. During the three months ended March 31, 2003, we recognized an additional charge of $0.5 million primarily relating to contract-related settlements and facilities lease expenses in excess of amounts originally estimated. We estimate that it may take us nine to twelve months to sublease the various properties that have been vacated. We utilized $4.9 million of accrued severance charges and $1.8 million of accrued facilities and other restructuring charges during the three months ended March 31, 2003. As of January 11, 2003, all affected employees had been terminated under this restructuring program.

The estimates above 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.

2001 Restructuring and Other Impairments

	Original Charge Recorded in 2001	Accrual Balance as of December 31, 2002	2003 Charges to Operations	2003 Charges Utilized	Accrual Balance as of March 31, 2003
			(in thousands)		
Restructuring expenses:					
Workforce reduction	$ 8,114	$ —	$ —	$ —	$ —
Equipment and other assets	32,629	—	—	—	—
Lease commitments and other restructuring charges	14,859	8,225	599	(6,223)	2,601
Subtotal	55,602	8,225	599	(6,223)	2,601
Impairment of goodwill and other intangible assets	68,666	—	—	—	—
Impairment of other long-lived assets	6,104	—	—	—	—
Other expenses	$ 130,372	$ 8,225	$ 599	$(6,223)	$ 2,601

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 three months ended March 31, 2003, we recognized an additional charge of $0.6 million relating to the restructuring programs from 2001 primarily relating to contract-related settlements and facilities lease expenses in excess of amounts originally estimated. We estimate that it may take us another nine to twelve months to sublease the various properties that have been vacated. We utilized $6.2 million of accrued facilities and other restructuring charges during the three months ended March 31, 2003.

The estimates above 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.

11. Acquisition of Maxia Pharmaceuticals, Inc.

In November 2002, we entered into an agreement to acquire Maxia Pharmaceuticals, Inc. ("Maxia"), a privately-held company based in San Diego, California. On February 18, 2003, the acquisition was completed. Maxia is a drug discovery and development company that specializes 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 transaction was accounted for as an asset purchase pursuant to FASB 141, *Business Combinations*, as Maxia had not commenced its planned principal operations as described in EITF 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*. The purchase price was preliminarily allocated as follows:

		(in thousands)
Net tangible liabilities assumed	$	(722.7)
In-process research and development		28,115.7
Total purchase price	$	27,393.0

The total purchase price of approximately $27.4 million consists of approximately 4,476,092 shares of Incyte common stock with a fair value of $17.5 million, cash of approximately $5.6 million (consisting of $4.1 million cash paid to Maxia stockholders and a $1.5 million note payable from Maxia, issued in August 2002, that was applied to this transaction), direct transaction costs of $1.4 million and additional liabilities assumed by Incyte as part of the acquisition of $2.9 million. The value of the 4,476,092 shares of Incyte common stock was based on a per share price of $3.91. For valuation purposes, this per share price of Incyte common stock was determined as the average closing market price for the five trading days preceding February 18, 2003, the date which the shares became determinable. Estimated direct transaction costs consist of fees for attorneys, accountants and filing costs. Of the total purchase price, up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the second anniversary of the consummation of the merger and up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the third anniversary of the consummation of the merger. We have paid these amounts into a third party escrow account.

The purchase price was allocated to the tangible assets acquired and liabilities assumed on the basis of their respective fair values on the acquisition date and to in-process research and development expense. 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. The charge for the purchase of in-process research and development expense ("IPRD") was determined by an independent valuation expert, utilizing a discounted cash flow analysis. Purchased IPRD are acquired research and development projects which are not currently technologically feasible and which have no alternative future use. Incyte acquired three IPRD projects that are in stages ranging from discovery to preclinical phases; management has determined that each of these projects would require significant further development before they would be available for release to customers. This amount ($28.1 million) was recognized as an expense at the time of the acquisition, and is listed as a separate component of operating expense. The preliminary allocations above are based on management's estimate of the purchase accounting at the date of acquisition and estimates will continue to be refined and the corresponding adjustments will be reflected in in-process research and development expenses. The purchase price allocation is subject to revision as management obtains additional information.

The consolidated financial statements include the operating results of Maxia from February 18, 2003, the date of acquisition. Pro forma results of operations have not been presented because the effects of this acquisition were not material on either an individual or aggregate basis and the acquisition was accounted for as an acquisition of assets.

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 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 could potentially be paid pursuant to the earn out milestones. The milestones 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.

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, 2003 and for the three month periods ended March 31, 2003 and 2002 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 Incyte's Annual Report on Form 10-K for the year ended December 31, 2002.

When used in this discussion, the words "expects," "believes," "anticipates," "estimates," "could," "intends," and similar expressions are intended to identify forward-looking statements. These statements, which include statements as to the impact of certain critical accounting policies on our financial results; expected expenses and expenditure levels; expected revenues and sources of revenues; expected uses of net cash; expected losses, net losses and net loss levels; expected expenditures including expenditures on intellectual property and research and development; the offset of profits from certain products by other expenditures; our plans to manage our information products on a cash flow positive basis; the adequacy of capital resources; the need to raise additional capital; the expected effect of our contractual obligations on our future liquidity and cash flow; our plans to reduce expenditures in 2003 and the expected spending reductions, workforce reductions and office consolidations; our strategic investments, including anticipated expenditures, losses and expenses; the application of United States Patent and Trademark Office utility guidelines to our gene patent applications; costs associated with prosecuting, defending and enforcing patent claims and other intellectual property rights; the size of our intellectual property portfolio and its competitive position; our strategy with regard to protecting our intellectual property; the effect of pharmaceutical and biotechnology company consolidations, including reduced research and development spending and pricing constraints by pharmaceutical and biotechnology customers and the softening of the market for genomic information and the market for our information products; the effect of our pharmaceutical and biotechnology customers' focus on late stage research and clinical products on the pricing of, and the length of contractual commitment for, our information products; the expected growth of, and our ability to manage expansion of, our therapeutic discovery and development operations, including operations in multiple locations; future required expertise relating to clinical trials, manufacturing, sales and marketing and for licenses to technology rights; the commercial availability of drugs resulting from our research; our ability to obtain and maintain product liability insurance; and our plan not to obtain earthquake insurance; 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 and pharmaceutical industries; actual and future consolidations of pharmaceutical and biotechnology companies; continuing trends with respect to reduced pharmaceutical and biotechnology research spending; our ability to manage our information products on a cash flow positive basis; risks relating to the development of new products and their use by our potential collaborators; the impact of technological advances and competition; unanticipated delays in research and development efforts; the result of further research; our ability to consolidate our facilities and to exit and close facilities upon anticipated timelines; our ability to deliver products and services to our customers effectively with reduced headcount and management and key employee diversion; our ability to obtain and retain customers; competition from other entities; early termination of a database collaboration agreement or failure to renew an agreement upon expiration; decreasing database revenues; the cost of accessing, licensing or acquiring technologies developed by other companies; significant delays or costs in obtaining regulatory approvals; failure to obtain regulatory approval; uncertainty as to the scope of coverage, enforceability or commercial protection from patents that issue on gene and other discoveries; our ability to integrate Maxia's operations and programs successfully; 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 on our patent portfolio; developments in and expenses relating to litigation; the results of businesses in which we hold equity; and the matters discussed in "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 a drug discovery company that develops proprietary genomic information and applies its expertise in medicinal chemistry and molecular, cellular and in vivo biology to the discovery of novel small molecule and protein therapeutics. We believe we have created the largest commercial portfolio of issued United States patents covering human, full-length genes and the proteins they encode, and license this intellectual property, as well as market our genomic and proteomic information, to many of the world's leading pharmaceutical and biotechnology companies and academic research centers. We have assembled an experienced and talented drug discovery team that is identifying potential new drug therapies for cancer, inflammatory diseases and other medical conditions.

We were incorporated in Delaware in April 1991 and, until 2001, devoted substantially all of our resources to the development, marketing and sales of genomics technologies and 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 products and services included databases, bioreagents, custom sequencing, gene expression, single nucleotide polymorphism, or SNP, discovery, and other services. Over time, we also increased our investments in growing our intellectual property estate to protect our proprietary information as well as our internal and collaborative efforts to identify and validate drug targets.

During 2001, we increased our focus on our therapeutic discovery and development program, and we exited the following activities: microarray products and related services, genomic screening products and services, public domain clone products and related services, contract sequencing services, transgenic products and services and SNP discovery services.

Our business is now focused on our therapeutic discovery and development programs and our information products. Our current information products include databases, intellectual property licensing, and cDNA clones. The fees and the period of access to our database information are negotiated independently with each customer. In addition to providing access to pharmaceutical and biotechnology customers, we also provide access to our database to third parties who use the database to develop genomic tools, such as microarrays that require genomic content, which they in turn sell to pharmaceutical and biotechnology researchers. Fees payable by pharmaceutical and biotechnology collaborators for our information products also generally consist of non-exclusive or exclusive fees corresponding to patent rights on proprietary genes and proteins. We may also receive future milestone and royalty payments from collaborators from the development and sale of their products derived from our technology and database information.

We expect that the overall market for our information products will continue to be competitive based on softening of the market for genomic information, shrinking research budgets of our current and potential customers and industry consolidation. Revenue trends indicate that subscribers are being more cautious with their spending to focus more of their resources on late stage research and clinical products than in the past, and this has adversely impacted renewals and the pricing of, and the length of the contractual commitment for, our information products. We expect this trend to continue into 2003 and that revenues in 2003 will be lower than those recognized in the prior year.

We intend to manage our information products on a cash flow positive basis. Our ability to earn revenues and successfully manage our information products on a cash flow positive basis depends, in large part, on our ability to attract new customers and retain new and existing customers for our information products in an increasingly competitive market environment. Further, we have only received limited royalty revenues to date, and do not expect to receive significant royalty or other revenues from development and commercialization by our customers using our information products for several years, if at all. Revenues from our customers may be subject to significant fluctuation in both timing and amount and, therefore, our results of operations for any period may not be comparable to the results of operations for any other period.

In conjunction with the 2002 restructuring program, we expect to reduce certain annual expenses by over $80.0 million beginning in 2003, compared with 2002, through a combination of decreased spending, job reductions and office consolidations. The restructuring programs have had little impact on our therapeutic discovery and development programs as we intend to continue to invest in research and development for our therapeutic discovery and development efforts. We expect these expenses to continue to increase in 2003 and that these increases will partially offset our expected expense reductions from the 2002 restructuring program.

We anticipate incurring additional losses for the next several years as we expand our therapeutic 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 therapeutic 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.

Our investment portfolio includes equity and debt investments in publicly-traded and privately-held companies. Many of these companies are still in the start-up or development stage. Our investments in these companies are inherently risky because the technologies or products they have under development are typically in the early stages and may never become successful. The market values of many of these investments can fluctuate significantly. Current market conditions may cause us to write-down the

value of our investments which could result in future charges to our earnings. The determination of investment impairment involves significant management judgment, and actual amounts realized for any specific investment may differ from recorded values. Because the market value of strategic investments that we hold can fluctuate significantly, and such fluctuations are highly variable and not within our control, any gains or losses related to strategic investments have not been included in earnings estimates for 2003.

During 2002 and 2001, we reported charges of $37.3 million and $130.4 million, respectively, relating to restructuring programs and long-lived asset write-downs announced in the fourth quarter of each year. During the three months ended March 31, 2003, we recorded an additional charge of $0.5 million and $0.6 million related to the 2002 and 2001 restructurings, respectively. A discussion of each of these restructuring programs follows:

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. A charge for the 2001 restructuring program and impairment of long-lived assets of $130.4 million was recorded in the fourth quarter of 2001 as a result of the change in focus. This charge was comprised of the following items: $68.7 million—goodwill and intangibles impairment; $55.6 million—restructuring charges (including $32.6 million in equipment and other assets impaired) and $6.1 million—impairment of a long-lived asset. Revenues from exited product lines for the years ended 2002 and 2001 were $3.6 million and $45.3 million, respectively. Additional charges for restructuring expenses of $3.4 million were recorded in 2002 and $0.6 million for the three months ended March 31, 2003 primarily for contract-related settlements, impairment of 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.

On November 12, 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, England 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. For the three months ended March 31, 2003, we recorded an additional charge of $0.5 million relating to contract-related settlements and facilities lease expenses in excess of amounts originally estimated.

In November 2002, we entered into an agreement to acquire Maxia Pharmaceuticals, Inc. (“Maxia”), a privately-held company based in San Diego, California. On February 18, 2003, the acquisition was completed. Maxia is a drug discovery and development company that specializes 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 transaction was accounted for as an asset purchase pursuant to FASB 141, *Business Combinations*, as Maxia has not commenced its planned principal operations as described in EITF 98-3, *Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business*. The purchase price was preliminarily allocated as follows:

		(in thousands)
Net tangible liabilities assumed	$	(722.7)
In-process research and development		28,115.7
Total purchase price	$	27,393.0

The total purchase price of approximately $27.4 million consists of approximately 4,476,092 shares of Incyte common stock with a fair value of $17.5 million, cash of approximately $5.6 million (consisting of $4.1 million cash paid to Maxia stockholders and a $1.5 million note payable from Maxia, issued in August 2002, that was applied to this transaction), direct transaction costs of $1.4 million and additional liabilities assumed by Incyte as part of the acquisition of $2.9 million. The value of the 4,476,092 shares of Incyte common stock was based on a per share price of $3.91. For valuation purposes, this per share price of Incyte common stock was determined as the average closing market price for the five trading days preceding February 18, 2003, the date which the shares became determinable. Estimated direct transaction costs consist of fees for attorneys, accountants and filing costs. Of the total purchase price, up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the second anniversary of the consummation of the merger and up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the third anniversary of the consummation of the merger. We have paid these amounts into a third party escrow account.

The purchase price was allocated to the tangible assets acquired and liabilities assumed on the basis of their respective fair values on the acquisition date and to in-process research and development expense. 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. The charge for the purchase of in-process research and development expense ("IPRD") was determined by an independent valuation expert, utilizing a discounted cash flow analysis. Purchased IPRD are acquired research and development projects which are not currently technologically feasible and which have no alternative future use. Incyte acquired three IPRD projects that are in stages ranging from discovery to preclinical phases; management has determined that each of these projects would require significant further development before they would be available for release to customers. This amount ($28.1 million) was recognized as an expense at the time of the acquisition, and is listed as a separate component of operating expense. The preliminary allocations above are based on management's estimate of the purchase accounting at the date of acquisition and estimates will continue to be refined and the corresponding adjustments will be reflected in in-process research and development expense. The purchase price allocation is subject to revision as management obtains additional information.

The condensed consolidated financial statements include the operating results of Maxia from February 18, 2003, the date of acquisition. Pro forma results of operations have not been presented because the effects of this acquisition were not material on either an individual or aggregate basis and the acquisition was accounted for as an acquisition of assets.

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 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 could potentially be paid pursuant to the earn out milestones. The milestones 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.

Critical Accounting Policies and Estimates

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

- Revenue recognition
- Valuation of long-lived assets
- Accounting for long-term investments
- Restructuring charges

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, use of our intellectual property and sales of our custom products and services. Revenues are deferred for fees received before earned or until no further obligations exist.

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. Revenues from custom products, such as clones and datasets, are recognized upon completion and delivery.

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 the individual element by us to other customers. If such evidence of fair value for each element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist or until all elements of the arrangement are delivered. In accordance with Staff Accounting Bulletin No. 101, ("SAB 101"), 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, acquisition-related intangibles and goodwill, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important that could trigger 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 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. We monitor our investment portfolio for impairment on a periodic basis. Our investment portfolio includes equity and debt investments in publicly-traded and privately-held companies. Many of these companies are still in the start-up or development stage. Our investments in these companies are inherently risky because the technologies or products they have under development are typically in the early stages and may never become successful. Investments in publicly-traded companies are classified as available-for-sale and are adjusted to their fair value each period based on their traded market price with any adjustments being recorded in other comprehensive income. Investments in privately-held companies are carried at cost. We record an investment impairment charge when we believe that the investment has experienced a decline in value that is other than temporary. The determination of whether an impairment is other than temporary consists of a review of qualitative and quantitative factors by members of senior management. Generally, declines that persist for six months or more are considered other than temporary. We use the best information available in these assessments, however, the information available may be limited. These determinations involve significant management judgment, and actual amounts realized for any specific investment may differ from the recorded values. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional impairment charges.

Restructuring Charges. 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").* Any future restructuring activities initiated after December 31, 2002 will be recorded in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146").* The restructuring charges are comprised primarily of costs to exit facilities, reduce our workforce, write-off fixed assets, and costs of outside services incurred in the restructuring. The workforce reduction charge was determined based on the estimated severance and fringe benefit charge for identified employees. In calculating the cost to exit the facilities, we estimated 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 required 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 performed an assessment of the affected facilities and considered the current market conditions for each site. Estimates were also used in our calculation of the estimated realizable value on equipment that is being held for sale. These estimates were 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.

Results of Operations

We recorded a net loss and diluted net loss per share of $55.8 million and $0.81, respectively, for the three months ended March 31, 2003, as compared to $13.4 million and $0.20, respectively, in the same period a year ago.

Revenues. Revenues for the three months ended March 31, 2003 decreased to $12.5 million compared to $29.0 million for the corresponding period in 2002.

Revenues were derived primarily from information products. Information products include database subscriptions, licensing of our intellectual property and partner programs and represented 100% and 93% of total net revenues for the three months ended March 31, 2003 and 2002, respectively. The decrease in revenues from 2002 reflects a softening in the market for genomic

information, a reduction in research spending by pharmaceutical and biotechnology companies due in part to consolidations within these industries, their efforts to reduce spending and the accompanying impact on renewals and the price of our information products. Our database subscription and licensing revenue have been adversely impacted as subscribers are being more cautious with their spending than in the past. Revenues for the three months ended March 31, 2003 and 2002 included $0 million and $2.0 million, respectively, of revenue associated with the exited custom genomics product lines that was announced in the fourth quarter of 2001.

Revenues received from agreements in which collaborators paid with equity securities in their company were $0 million and $2.4 million for the three months ended March 31, 2003 and 2002, respectively. Additionally, revenues received from agreements in which we concurrently invested funds in the collaborator's stock were $0.2 million and $0.2 million for the three months ended March 31, 2003 and 2002, respectively.

Revenues recognized from transactions in which there was originally a concurrent commitment entered into by us to purchase goods or services for the three months ended March 31, 2003 and 2002 were $1.1 million and $1.0, respectively. No transactions in which there was a concurrent commitment by us to purchase goods or services were entered into during the three months ended March 31, 2003. Of commitments made in prior periods, we expensed $2.8 million and $5.8 million for the three months ended March 31, 2003 and 2002, respectively.

The above transactions were recorded at fair value in accordance with our revenue recognition policy.

Operating Expenses. Total costs and expenses for the three months ended March 31, 2003 increased to $66.8 million compared to $47.9 million for the corresponding period in 2002. In conjunction with the 2002 restructuring, we expect to reduce certain annual expenses by over $80.0 million in 2003, compared with 2002, through a combination of decreased spending, job reductions and office consolidations. The restructuring programs have had little impact on our therapeutic discovery and development programs as we intend to continue to invest in research and development for our therapeutic discovery and development efforts. We expect these expenses to continue to increase in 2003, and that such increases will partially offset our expected expense reductions from the 2002 restructuring program.

Research and development expenses. Research and development expenses for the three months ended March 31, 2003 decreased to $30.2 million compared to $33.7 million for the corresponding period in 2002. The decrease in research and development expenses was primarily the result of expenses eliminated from the restructuring programs, partially offset by increased therapeutic discovery and development expenses.

Selling, general and administrative expenses. Selling, general and administrative expenses for the three months ended March 31, 2003 decreased to $7.4 million compared to $14.2 million for the corresponding period in 2002. The decrease was primarily the result of expenses eliminated from the restructuring programs and decreased legal expenses, partially offset by general and administrative expenses incurred to support our therapeutic discovery and development efforts. Legal expenses related to our patent infringement lawsuits were approximately $0.3 million and $1.4 million in the three months ended March 31, 2003 and 2002, respectively. The decrease resulted primarily from the settlement of our patent infringement lawsuit with Affymetrix in December 2002. Regardless of the outcome, our ongoing patent infringement litigation is expected to result in future costs to us, which could be substantial.

Purchased in-process research and development expense. Purchased in-process research and development expense for the three months ended March 31, 2003 of $28.1 million resulted from the acquisition of Maxia.

Other Expenses. Other expenses for the three months ended March 31, 2003 of $1.1 million represent charges recorded in connection with restructuring costs. These expenses consist of $0.5 million related to the restructuring announced in the fourth quarter of 2002 and $0.6 million related to the increase in the 2001 restructuring charges and were related to contract-related settlements and facilities lease expenses in excess of amounts originally estimated.

Interest and other income, net. Interest and other income, net for the three months ended March 31, 2003, decreased to $1.2 million from $8.2 million for the corresponding period in 2002. This decrease was primarily due to a decrease in cash invested, lower interest rates, a $1.9 million long-term investment impairment charge in 2003, and interest and premium earned on the conversion of a note held in another company in 2002.

Interest expense. Interest expense for the three months ended March 31, 2003 decreased slightly to $2.4 million from $2.5 million for the corresponding period in 2002. The decrease was primarily from the timing impact of the early retirement of $6.7 million face value of our convertible subordinated notes in 2002.

Gain/(Loss) on Certain Derivative Financial Instruments. Loss on derivative financial instruments for the three months ended March 31, 2003 of $45,000 and gain on derivative financial instruments for the three months ended March 31, 2002 of $0.1 million represents the change in 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 2003 and 2002, we had a minimal effective annual income tax rate. The income taxes for 2003 and 2002 are primarily attributable to foreign withholding taxes.

Liquidity and Capital Resources

As of March 31, 2003, we had $376.2 million in cash, cash equivalents and marketable securities, compared to $429.0 million as of December 31, 2002. We have classified all of our marketable securities as short-term, as we may choose not to hold our marketable securities until maturity in order to take advantage of favorable market conditions. 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 by operating activities was $42.8 million for the three months ended March 31, 2003, as compared to $6.0 million for the three months ended March 31, 2002. The increase was primarily due to the increase in net loss in 2003, adjusted for non-cash items such as purchased in-process research and development charge and impairment of long-term investments, as well as the decrease in accrued and other liabilities and a decrease in cash provided from accounts receivable.

Our investing activities, other than purchases, sales and maturities of marketable securities, have consisted predominantly of capital expenditures and net purchases of long-term investments. Capital expenditures for the three months ended March 31, 2003 were $5.6 million as compared to $2.0 million in the same period in 2002, primarily due to increased spending on our therapeutic discovery and development efforts. Long-term investments in companies having operations or technology in areas within our strategic focus were $0 million and $5.0 million for the three months ended March 31, 2003 and 2002, respectively. In addition, during the three months ended March 31, 2003, we expended $3.5 million related to the acquisition of Maxia. 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 maturity/sales and purchases of marketable securities.

Net cash used by financing activities was $0.1 million for the three months ended March 31, 2003 as compared to net cash provided of $2.9 million for the three months ended March 31, 2002. Cash used by financing activities in 2003 was primarily due to amounts paid to repurchase shares of our common stock, offset by proceeds received from the issuance of common stock under our stock option and employee stock purchase plans. In October 2002, we announced that our board of directors authorized the expenditure of up to $30.0 million to repurchase shares of our common stock in open market and privately negotiated transactions. Through March 31, 2003, we had repurchased and retired 1,165,000 shares of common stock for an aggregate purchase price of $5.8 million. For the three months ended March 31, 2003, we repurchased 30,000 shares of common stock for an aggregate purchase price of $0.1 million. Net cash provided by financing activities in 2002 was primarily due to proceeds received from the issuance of common stock under our stock option and employee stock purchase plans.

The following summarizes our contractual obligations at March 31, 2003 and the effect those obligations are expected to have on our liquidity and cash flow in future periods, with the time periods in the headings to the columns based upon time elapsed from December 31, 2002 (in millions):

	Total	Less Than 1 Year	Years 1–3	Years 4–5	Over 5 Years
Contractual Obligations:					
Convertible subordinated debt	$ 170.3	$ —	$ —	$ 170.3	$ —
Interest on convertible subordinated debt	37.5	4.7	18.7	14.1	—
Non-cancelable operating lease obligations:					
Related to current operations	44.9	7.4	12.4	10.2	14.9
Related to vacated space	30.1	4.3	8.2	7.0	10.6
Total contractual obligations	$ 282.8	$ 16.4	$ 39.3	$ 201.6	$ 25.5

We have purchase commitments of $10.0 million at March 31, 2003, the timing of which is dependent upon provision by the vendor of products and services. Additionally, we have committed to purchase equity in certain companies when certain events occur. The total amount committed at March 31, 2003 was $5.0 million. These commitments are considered contingent commitments as a future event must occur to cause the commitment to be enforceable.

We expect to use net cash in 2003 as we invest in our therapeutic discovery and development programs, including continued expansion of our laboratory facilities; continue to invest in our intellectual property portfolio; continue to seek access to technologies through investments, research and development and new alliances, license agreements and/or acquisitions; make payments related to our restructuring programs; make strategic investments; and continue to make improvements in existing facilities.

We believe that our existing resources will be adequate to satisfy our capital needs for at least the next twelve months. Our cash requirements depend on numerous factors, including our ability to attract and retain collaborators for our databases and other products and services; expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary technologies and businesses; expenditures in connection with our expansion of therapeutic 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 therapeutic discovery and development programs; and costs associated with the integration of new operations assumed through mergers and acquisitions. Changes in our research and development or business plans or other changes affecting our operating expenses may result in changes in the timing and amount of expenditures of our capital resources.

In February 2003, we completed our acquisition of Maxia Pharmaceuticals, Inc. We paid or will pay to former Maxia stockholders up to approximately 4,476,092 shares of our common stock and $4.1 million in cash. Of the total consideration, up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the second anniversary of the consummation of the merger and up to 437,636 shares of our common stock and $500,000 in cash are payable to former Maxia stockholders on the third anniversary of the consummation of the merger. We have paid these amounts into a third party escrow account. In addition, our $1.5 million note payable from Maxia, issued in August 2002, was applied to the purchase price of this transaction, we incurred direct transaction costs of $1.4 million and, as part of the acquisition, we assumed additional liabilities of Maxia of $2.9 million. Included in the tangible assets we acquired from Maxia was cash of $0.5 million.

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 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 could potentially be paid pursuant to the earn out milestones. The milestones 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.

FACTORS THAT MAY AFFECT RESULTS

RISKS RELATING TO OUR FINANCIAL RESULTS

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

We had net losses from inception in 1991 through 1996 and in 1999 through the three months ended March 31, 2003. Because of those losses, we had an accumulated deficit of $460.8 million as of March 31, 2003. We intend to continue to spend significant amounts on new product and technology development, including the expansion of our research and development efforts for therapeutic discovery and development, the determination of the sequence of genes and the filing of patent applications regarding those gene sequences, the determination of gene functions, and our research and development alliances. As a result, we expect to incur losses in 2003. We expect to report net losses in future periods as well.

We expect that any cash flows from our information products, including our database products and our intellectual property licensing, will be more than offset by expenditures for our therapeutic discovery and development efforts. We anticipate that these efforts will increase as we focus on the studies that are required before we can sell, or license to a third party, a drug product. The development of therapeutic products will require significant expenses for research, development, testing and regulatory approvals. Unless we generate significant revenues to pay these costs, we will not return to profitability. We cannot be certain whether or when we will again become profitable because of the significant uncertainties relating to our ability to generate commercially successful drug products that will generate significant revenues.

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

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

- changes in the demand for our products;
- the timing of intellectual property licenses that we may grant;
- the introduction of competitive databases or services, including databases of publicly available, or public domain, genetic information;
- the nature, pricing, length of commitments for and timing of products and services provided to our collaborators;
- our ability to compete effectively in our therapeutic discovery and development efforts against competitors that have greater financial or other resources or drug candidates that are in further stages of development;
- 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;
- our ability to attract and retain key personnel;
- 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;
- regulatory actions and changes related to the development of drugs;
- changes in intellectual property laws that affect our rights in genetic information that we license;
- payments of milestones, license fees or research payments under the terms of our external alliances and collaborations and our ability to monitor and enforce such payments; and
- expenses related to, and the results of, litigation and other proceedings relating to intellectual property rights, including the lawsuits filed by Invitrogen and counterclaims filed by us.

We anticipate significant fixed expenses, due in part to our expansion of our therapeutic discovery and development programs, and our continuing investment in product development and extensive support for our database collaborators. We may be unable to adjust our expenditures if revenues in a particular period fail to meet our expectations, which would harm our operating results for that period. Forecasting operating and integration expenses for acquired businesses may be particularly difficult, especially where the acquired business focuses on technologies that do not have an established market. We believe that

period-to-period comparisons of our financial results will not necessarily be meaningful. You should not rely on these comparisons as an indication of our future performance. If our operating results in any future period fall below the expectations of securities analysts and investors, our stock price will likely fall, possibly by a significant amount. In addition, if market or other economic conditions impact the stock market generally, or impact other companies in our industry, our stock price may also decline, possibly significantly.

If our strategic investments incur losses or charges, our earnings may decline or our losses may increase.

We make strategic 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 charges related to the impairment in the value of the securities underlying our investment;
- require us to record acquisition-related charges, such as in-process research and development;
- require us to record charges related to post-acquisition impairment in the value of the acquired assets, such as goodwill or intangibles; and
- require us to invest greater amounts than anticipated or to devote substantial management time to the management of research and development or other relationships.

The market values of many of these investments can fluctuate significantly. We evaluate our long-term equity investments for impairment of their values 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 also fluctuate significantly. Current market conditions may cause us to write-down the value of our private company investments. Many private companies are encountering difficulties in raising capital in the current market, and even if they are successful, subsequent rounds of financing are often at lower valuations than previous rounds. Impairment could result in future charges to our earnings. Our strategic investments may cause our earnings to decline or our losses to increase.

Our debt investments are impacted by the financial viability of the underlying companies.

We have a diversified portfolio of investments. The ability for our debt investments to be repaid upon maturity or to have a viable resale market is dependent, in part, on the financial success of the underlying company. Should the underlying company suffer significant financial difficulty, the debt instrument could either be downgraded or, in the worst case, our investment could be worthless. This would result in our losing the cash value of the investment and incurring a charge to our statement of operations.

Our database revenues could decline due to sequences becoming publicly available.

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

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

Our ability to obtain new customers for information products, to enter into license agreements for our intellectual property or to obtain renewals or additions to existing database product subscriptions, depends upon prospective subscribers' perceptions that our products and services can help accelerate their drug discovery efforts. Our database and licensing sales cycle is typically lengthy because we need to educate our potential subscribers and sell the benefits of our products to a variety of constituencies within potential subscriber companies. In addition, each agreement involves the negotiation of unique terms, and we may expend substantial funds and management effort with no assurance that a new, renewed or expanded agreement will result. These expenditures, without increased revenues, will negatively impact our profitability. Consolidations of pharmaceutical companies involved in drug discovery and development as well as expenditure reductions and an increased focus by our current or potential subscribers on later stage development programs and clinical compounds have affected the timing, progress and relative success of our sales and renewal efforts. We expect that any future consolidations and reductions in research budgets will have similar effects. In addition, current or prospective subscribers may perceive us to be in competition with them given our therapeutic discovery and development efforts, which may adversely impact new sales or renewals.

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 March 31, 2003, we had:

- total consolidated debt of $171.9 million,
- stockholders' equity of $264.0 million, and
- a deficiency of earnings available to cover fixed charges of $55.5 million for the three months ended March 31, 2003.

A variety of uncertainties and contingencies will affect our future performance, many of which are beyond our control. We may not generate sufficient cash flow in the future to enable us to meet our anticipated fixed charges, including our debt service requirements with respect to our convertible subordinated notes due 2007 that we sold in February 2000. At March 31, 2003, $170.3 million face value of those notes were outstanding. The following table shows, as of March 31, 2003, the aggregate amount of our interest payments due in each of the next five calendar years listed:

Year	Aggregate Interest
2003 (remaining)	$ 4,683,250
2004	9,366,500
2005	9,366,500
2006	9,366,500
2007	4,683,250

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

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

The capital markets may not permit us to raise additional capital at the time that we require it.

We believe that we have sufficient capital to satisfy our capital needs for at least the next twelve months. However, our future funding requirements will depend on many factors and we anticipate that, at some future point, we will need to raise additional capital to fund our business plan and research and development efforts on a going-forward basis. If we require additional capital at a time when investment in biotechnology companies such as ours, or in the marketplace generally, is limited due to the then prevailing market or other conditions, we may not be able to raise such funds at the time that we desire or any time thereafter.

Additional factors which 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 studies 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;
- 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.

RISKS RELATING TO OUR BUSINESS AND INDUSTRY

Our workforce reduction announced in November 2002 may have an adverse impact on our ability to deliver our information products on time, and we may fail to meet the expectations of our customers, which could in turn negatively impact our operating results.

In November 2002, we announced a reduction of approximately 37% of our workforce, including significant personnel reductions in our information product operations, in order to reduce expenses. Many factors, such as the reallocation of responsibilities among remaining personnel, the planned consolidation of our facilities and employee morale issues, may adversely impact our ability to deliver our products in accordance with our current plans or customer expectations, cause delays in the delivery of our products, or lead us to change our information product plans, which in turn may have a negative impact on our revenues and customer relationships. In addition, the implementation of the expense reduction program may itself result in customer concerns regarding our future performance and our ability to meet their expectations for our products, the diversion of efforts of our executive management team and other key employees, and higher than anticipated costs, any of which may negatively impact our operating results. Further, our management has announced that if our information products activities are not cash flow positive in 2003, further expense reductions may be necessary which, in turn, may also have a negative impact on our operating results.

Difficulties we may encounter managing the growth of our therapeutic discovery and development efforts may divert resources and limit our ability to successfully expand our business.

Our anticipated growth in the future of our therapeutic discovery and development programs, and our establishment of those operations places a strain on our infrastructure. As those operations expand, we expect that we will need to manage multiple locations and additional relationships with various collaborative partners, suppliers and other third parties. To manage our growth effectively, we must continue to improve our operational controls, reporting systems and procedures. We may not be able to successfully implement improvements to our systems and procedures in an efficient or timely manner. In addition, we are currently exploring permanent locations on the East Coast of the United States for our therapeutic discovery and development operations. If we are unable to locate facilities on a timely basis, if at all, the growth of our therapeutic discovery and development operations may be adversely impacted.

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

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

- Applera Corporation,
- Gene Logic Inc.,
- pharmaceutical and biotechnology companies, and
- universities and other research institutions.

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

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

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. If pharmaceutical companies and researchers are able to manage their own genomic data, or find software solutions for managing genomic data that they find preferable to those provided by us and our collaborators, they may not subscribe to our databases.

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

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

The biotechnology and pharmaceutical industries are intensely competitive and subject to rapid and significant technological change. Our therapeutic discovery and development efforts may target diseases and conditions that are already subject to existing therapies or that are subject to the drug discovery efforts of other entities. These competitors may develop products more rapidly or successfully than we or our collaborators are able to do. Our competitors might develop drugs that are more effective or less costly than any that are being developed by us or that would render our products obsolete and noncompetitive. In addition, our competitors may succeed in obtaining regulatory approvals for drug candidates more rapidly. Also, our competitors may obtain patent protection or other intellectual property rights that would limit our ability to develop competitive products. Any drugs resulting from our research and development efforts, or from our joint efforts with any future collaborators, might not be able to compete successfully with competitors' existing and future products or obtain regulatory approval in the United States or elsewhere.

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

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

Our future success also will depend in part on the continued service of our executive management team, key scientific, bioinformatics and management personnel and our ability to identify, hire, train and retain additional personnel for our therapeutic drug discovery and development programs. We experience intense competition for qualified personnel. If we are unable to continue to attract, train and retain these personnel, we may be unable to expand our business in accordance with our business requirements.

We rely on a small number of suppliers of certain products we need for our business and strategic collaborations with software providers for our information products, and if we are unable to obtain sufficient supplies, or maintain such strategic relationships, we will be unable to compete effectively.

Currently, we use gene sequencing machines supplied by Molecular Dynamics, a subsidiary of Amersham Pharmacia Biotech, Ltd., and chemicals used in the sequencing process, called reagents, supplied by Roche Bioscience and Amersham Pharmacia Biotech, Ltd. in our gene sequencing operations. If we are not able to obtain an adequate supply of reagents or other materials at commercially reasonable rates, our ability to identify genes or genetic variations would be slower and more expensive.

In addition, we rely primarily on a strategic collaboration with one software provider to provide important functionality for our products. If this collaborator suffers business difficulties, or provides functionality that does not satisfy our customers' needs, or that our customers can find less expensively elsewhere, we may spend time and money to replace the functionality, we may not be able to deliver on customer commitments, and we may be otherwise adversely affected or our customer relationships and revenues may suffer.

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

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

Security risks in electronic commerce, unfavorable Internet regulations, or business difficulties suffered by our collaborators may deter future use of our products, which could result in a loss of revenues.

We offer several products through our website on the Internet and may offer additional products in the future. Our ability to provide secure transmissions of confidential information over the Internet may limit online use of our products and services by

our database collaborators as we may be limited by our inability to provide secure transmissions of confidential information over the Internet. Advances in computer capabilities and new discoveries in the field of cryptography may compromise the security measures we use to protect our website, access to our databases, and transmissions to and from our website. If our security measures are breached, our proprietary information or confidential information about our collaborators could be misappropriated. Also, a security breach could result in interruptions in our operations. The security measures we adopt may not be sufficient to prevent breaches, and we may be required to incur significant costs to protect against security breaches or to alleviate problems caused by breaches. Further, if the security of our website, or the website of another company, is breached, our collaborators may no longer use the Internet when the transmission of confidential information is involved. For example, 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 would affect our business and operations. Individual states could also enact laws regulating the use of the Internet. If enacted, these federal and state laws, rules and regulations could require us to change our online business and operations, which could limit our growth and our development of our online products.

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

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

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

These factors are not within our control.

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

We are in the early stage of building our therapeutic 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 therapeutic candidates;
- develop products internally;
- complete laboratory testing and human studies;
- obtain and maintain necessary intellectual property rights to our products;
- obtain and maintain necessary regulatory approvals related to the efficiency and safety of our products;
- enter into arrangements with third parties to provide services or 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.

We have limited corporate 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, or at all. In addition, if we, in the future, elect to manufacture our products in our own manufacturing facilities, those facilities will require substantial additional capital resources, and we will need to attract and retain qualified personnel to build or lease or operate any such facilities.

The success of our therapeutic discovery and development efforts may depend on our ability to find collaborators or other service providers to leverage our capabilities, and if we are unable to establish future collaborations or if these future collaborations are unsuccessful, our research and development efforts could be negatively affected.

Our strategy may depend in part upon the formation and sustainability of multiple collaborative arrangements and license agreements with third parties in the future. 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. In order for any future collaboration efforts to be successful, we must first identify potential collaborators whose capabilities complement and integrate well with ours. Our collaborators may prove difficult to work with or less skilled than we originally expected.

It is likely that we will not be able to control the amount and timing of resources that our future corporate collaborators devote to our programs or potential products. We do not know whether our future collaborators, if any, might pursue alternative technologies or develop alternative products either on their own or in collaboration with others, including our competitors, as a means for developing treatments for the diseases targeted by collaborative arrangements with us. Conflicts also might arise with future collaborative partners concerning proprietary rights to particular compounds.

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

At the present time, we have only begun to identify potential therapeutic compounds and have yet to put them into clinical testing. Of the compounds we identify as potential therapeutic candidates, at most, only a few are statistically likely to lead to successful therapeutic development efforts. We expect drugs that result from our research will not be commercially available for a number of years, if at all. Commercialization of any product candidates that we identify and develop depends on successful completion of preclinical studies and clinical trials. Preclinical testing and clinical development are long, expensive and uncertain processes, and we do not know whether we, or any of our future collaborators, will be permitted to undertake clinical trials of any potential products. It may take us or any of our future collaborators several years to complete any such testing, and failure can occur at any stage of testing. Interim results of trial do not necessarily predict final results, and acceptable results in early trials may not be repeated in later trials. Data obtained from tests are susceptible to varying interpretation, which may delay, limit or prevent regulatory approval. Regulatory authorities may refuse or delay approval as a result of many other factors, including changes in regulatory policy during the period of product development. 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. Moreover, if and when our products reach clinical trials, we, or our future collaborators, may decide to discontinue development of any or all of these products at any time for commercial, scientific or other reasons. 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, as well as the potential risk that our products may not be accepted by the marketplace.

Completion of clinical trials may take many years. The length of time required varies substantially according to the type, complexity, novelty and intended use of the product candidate. Our rate of commencement and completion of clinical trials may be delayed by many factors, including:

- our inability to 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.

An important element of our business strategy will be to enter into collaborative arrangements with third parties under which we license our therapeutic product candidates to those third parties for development and commercialization. We face significant competition in seeking appropriate collaborators. Also, these arrangements are complex to negotiate and time-consuming to document. We may not be successful in our attempts to establish these arrangements. The terms of any such arrangements that we establish may not be favorable to us. Further, any such arrangements may be unsuccessful.

We may encounter difficulties in integrating companies we acquire, and our operations and financial results could be harmed.

As part of our business strategy we acquire assets, technologies, compounds and businesses. Our past acquisitions, including our recent 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 management's time and attention;
- we may be unable to integrate or complete the development and application of acquired technology, or compounds;
- 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 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 existing sites, we may experience more difficulty integrating and managing the acquired businesses' operations.

If product liability lawsuits are successfully brought against us, we could face substantial liabilities and may be required to limit commercialization of our products.

The testing and marketing of medical products entails an inherent risk of product liability. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities or be required to limit commercialization of our products. Although we intend to obtain product liability insurance, this insurance may be prohibitively expensive, or 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 future collaborators. We, or our future collaborators, might not be able to obtain insurance at a reasonable cost, if at all.

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

We conduct our database and a significant portion of our other activities at our facilities in Palo Alto, California and San Diego, California, which are in seismically active areas. Although we maintain business interruption insurance, we do not have and do not 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.

RISKS RELATING TO CUSTOMERS AND COLLABORATORS

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

Our revenues are dependent on our ability to attract new customers and to retain existing customers. If we are unable to enter into additional agreements, or if our current database customers choose not to renew their agreements upon expiration or choose to renew their agreements at lower prices or for shorter durations, we may not generate additional revenues or maintain our current revenues. Our database revenues are also affected by the extent to which existing customers expand their agreements to include our new database products and the extent to which existing customers reduce the number of products for which they subscribe, the impact of which will vary based upon our pricing of those products, as well as the pricing of new information

product offerings. If the market for genomic information continues to soften, we may be required to lower prices further or restructure our product offerings to continue to meet customer demands which, in turn, may adversely impact our revenues. Some of our database agreements require us to meet performance obligations, some or all of which we may not be successful in attaining. A database customer 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. In addition, it is likely that database revenues will decrease if we are successful in entering into co-development arrangements with some of our current database subscribers to develop new therapeutic products.

Licensing 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 database customers and to some of our other customers our know-how and patent rights associated with the genetic 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. Therefore, milestone or royalty payments from these collaborations may not contribute to revenues for several years, if at all.

If conflicts arise between our future collaborators or advisors and us, they may act in their self-interest, which may be adverse to our interests or to the interests of our stockholders.

If conflicts arise between us and our future corporate collaborators or future scientific advisors, the other party may act in its self-interest and not in the interest of our stockholders. It is likely that many of our future collaborators will be conducting multiple product development efforts within each disease area that is the subject of the collaboration with us. Our future corporate collaborators may develop, either alone or with others, products in related fields that are competitive with the products or potential products that are the subject of these collaborations. Competing products, either developed by our future collaborators or to which our future collaborators have rights, may result in their withdrawal of support for our product candidates.

If we fail to enter into future in-licensing or collaborative arrangements or if these arrangements are unsuccessful, our business and operations would be negatively impacted.

We do not know if we will be able to establish collaborative arrangements, or whether any such future in-licensing or collaborative arrangements will ultimately be successful. For example, there have been, and may continue to be, a significant number of recent business combinations among large pharmaceutical companies that have resulted, and may continue to result, in a reduced number of potential future corporate collaborators. This consolidation may limit our ability to find partners who will work with us in developing and commercializing drugs. If business combinations involving our existing corporate collaborators were to occur, the effect could be to diminish, terminate or cause delays in one or more of our corporate collaborations or agreements. If we are unable to enter into collaborative arrangements or if those arrangements are unsuccessful, our research and development efforts could be negatively impacted and we may need to seek additional capital resources during times when those resources may not be available or are available on less favorable terms.

RISKS RELATING TO INTELLECTUAL PROPERTY

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

We are currently involved in patent litigation.

In October 2001, Invitrogen Corporation filed an action against us in federal court, alleging infringement of three patents that relate to the use of reverse transcriptase with no RNase H activity in preparing complimentary DNA from RNA. The complaint seeks unspecified money damages and injunctive relief. In November 2001, we filed our answers 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.

In November 2001, we filed a complaint against Invitrogen in federal court alleging infringement of 13 of our patents relating to genes, RNA amplification and gene expression, and methods of fabricating microarrays of biological samples. The complaint seeks a permanent injunction enjoining Invitrogen from further infringement of the patents at issue, damages for Invitrogen’s conduct, as well as our fees, costs, and interest. We are further seeking triple damages from the infringement claim based on Invitrogen’s willful infringement of our patents. In April 2002, Invitrogen filed answers to our patent infringement claims.

We believe we have meritorious defenses and intend to defend the suit brought by Invitrogen vigorously. However, our defenses may be unsuccessful. At this time, we cannot reasonably estimate the possible range of any loss or damages resulting from these suits and counterclaims due to uncertainty regarding the ultimate outcome. In addition, regardless of the outcome, we expect that the Invitrogen litigation will result in future costs to us, which could be substantial. Further, there can be no assurance that any license that may be required as a result of this litigation will be available on commercially acceptable terms, if at all.

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

The technology that we use to develop our products, and the technology that we incorporate in our products, may be subject to claims that they infringe the patents or proprietary rights of others. The risk of this occurring will tend to increase as the genomics, biotechnology and software industries expand, more patents are issued and other companies attempt to discover genes and SNPs and engage in other genomic-related businesses. The success of our therapeutic discovery and development efforts will also depend, in part, on our ability to operate without infringing or misappropriating the proprietary rights of others.

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. Except for Invitrogen, no third party has a current filed 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 or our future collaborators to seek licenses to other parties' patents or proprietary rights. We or our future collaborators may also be restricted or prevented from manufacturing or selling our products and services. 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 protect our proprietary information, which may result in its unauthorized use and a loss of revenue.

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

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

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

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

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

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

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

If the effective term of our patents is decreased due to changes in the 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 U.S. patent laws were amended in 1995 to change the term of patent protection from 17 years from patent issuance to 20 years from the earliest effective filing date of the application. Because the average time from filing to issuance of biotechnology applications is at least one year and may be more than three years depending on the subject matter, a 20-year patent term from the filing date may result in substantially shorter patent protection. Also, we may need to refile some of our applications claiming large numbers of genes 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 believe we have the largest commercial portfolio of issued U.S. patents covering human full-length genes, the proteins they encode and the antibodies directed against them. If legislation currently proposed by the United States Patent and Trademark Office is adopted, fees associated with filing and prosecuting patent applications would increase significantly. If such fees are significantly increased, we would incur higher expenses and our intellectual property strategy could be adversely affected.

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

Biotechnology patent law outside the U.S. is even more uncertain than in the U.S. 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. 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.

REGULATORY RISKS

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

Before commencing clinical trials in humans, we, or our future collaborators, will need to submit and receive approval from the FDA of an Investigational New Drug application, or IND. The regulatory process also requires preclinical testing. Data obtained from preclinical and clinical activities are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval. In addition, delays or rejections may be encountered based upon changes in regulatory policy for product approval during the period of product development and regulatory agency review. Any failure to obtain regulatory approval could delay or prevent us from commercializing products.

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, or our future collaborators, hope to develop. Significant research and development efforts will be necessary before any products can be commercialized. Satisfaction of regulatory requirements typically takes many years, is dependent upon the type, complexity and novelty of the product and requires the expenditure of substantial resources.

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 efficacious. We cannot ensure that any compound developed by us, alone or with others, will prove to be safe and efficacious in clinical trials and will meet all of the applicable regulatory requirements needed to receive marketing approval.

Outside the United States, our ability, or that of our future collaborative partners, 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 FDA approval described above and may also include additional risks.

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.

Our research and development processes involve the controlled use of hazardous and radioactive materials and biological waste. Our operations produce hazardous waste products. We cannot eliminate the risk of accidental contamination or discharge and any resultant injury from these materials. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of these materials and waste products. We may be sued for any injury or contamination that results from our use or the use by third parties of these materials, and our liability may exceed our insurance coverage and our total assets. Compliance with environmental laws and regulations may be expensive, and current or future environmental regulations may impair our research, development and production efforts.

Future changes to environmental, health and safety laws could cause us to incur additional expense or restrict our operations. In addition, our future collaborators may use hazardous materials in connection with our collaborative efforts. To our knowledge, their work is performed in accordance with applicable biosafety regulations. In the event of a lawsuit or investigation, however, we could be held responsible for any injury caused to persons or property by exposure to, or release of, these hazardous materials used by these parties. 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.

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 instruments. As of March 31, 2003, investments in marketable securities were $365.5 million. Due to the nature of these investments, if market interest rates were to increase immediately and uniformly by 10% from levels as of March 31, 2003, the decline in the fair value of the portfolio would not be material.

We are exposed to equity price risks on the marketable portion of equity securities included in our portfolio of investments and long-term investments, entered into to further our business and strategic objectives. These investments are in small capitalization stocks in the pharmaceutical/ biotechnology industry sector, and are primarily in companies with which we have research and development, licensing or other collaborative agreements. We typically do not attempt to reduce or eliminate our market exposure on these securities. As of March 31, 2003, long-term investments were $33.7 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 March 31, 2003, 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-14(c) 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. 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 a date within 90 days prior to the filing date of 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 controls.*** There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II: OTHER INFORMATION

Item 2. Changes in Securities and Use of Proceeds

(c) On February 18, 2003, we issued approximately 2,625,820 shares of our common stock to the stockholders of Maxia Pharmaceuticals, Inc., a privately-held company based in San Diego, California, in exchange for all of the outstanding capital stock of Maxia. An additional 975,000 shares of our common stock were issued to certain debt holders of Maxia. Up to an additional 437,636 shares of our common stock will be issued on each of the second and third anniversaries of the consummation of the merger. Common stock worth $11.2 million (based on the future value of our common stock) may be issued to the former Maxia stockholders if certain milestones are met. In any event, no more than 13,531,138 shares of our common stock will be issued to the former Maxia stockholders in the aggregate pursuant to the merger agreement. We issued these shares in reliance on the exemption set forth in Section 3(a)(10) of the Securities Act of 1933. Pursuant to Section 25142 of the California Corporations Code, a fairness hearing, which met the requirements of Section 3(a)(10), was held in connection with the issuance of the shares of our common stock in exchange for the equity and debt of Maxia. The California Department of Corporations issued a permit for the issuance of these securities on February 3, 2003. These sales were made without general solicitation or advertising.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

Exhibit Number	Description of Document
10.4#	1993 Directors' Stock Option Plan of Incyte Corporation, as amended and restated.

# Indicates management contract or compensatory plan or arrangement.

(b) Reports on Form 8-K

We filed the following reports on Form 8-K during the fiscal quarter ended March 31, 2003:

(i) Current Report on Form 8-K dated February 18, 2003, reporting under Item 5 that we completed the acquisition of Maxia Pharmaceuticals, Inc.

(ii) Current Report on Form 8-K dated May 5, 2003, furnishing under Item 12 our financial results for our first quarter ended March 31, 2003.

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

Date: May 14, 2003

By: /s/ PAUL A. FRIEDMAN

Paul A. Friedman
Chief Executive Officer
(Principal Executive Officer)

INCYTE CORPORATION

Date: May 14, 2003

By: /s/ JOHN M. VUKO

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

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 quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

By: /s/ PAUL A. FRIEDMAN

Paul A. Friedman
Chief Executive Officer

CERTIFICATION

I, John M. Vuko, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Incyte Corporation;

2. Based on my knowledge, this quarterly 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 quarterly report;

3. Based on my knowledge, the financial statements, and other financial information in this quarterly 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 quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures 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 quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

By: /s/ JOHN M. VUKO

John M. Vuko
Chief Financial Officer

COMPLIANCE WITH CERTIFICATION REQUIREMENTS

The certification by such officers of this report on Form 10-Q, as required by Section 906 of the Sarbanes-Oxley Act of 2002, has been submitted to the SEC as additional correspondence accompanying this report.

INCYTE CORPORATION

EXHIBIT INDEX

Exhibit Number	Description of Document
10.4#	1993 Directors' Stock Option Plan of Incyte Corporation, as amended and restated

# Indicates management contract or compensatory plan or arrangement.

Exhibit 10.4

AMENDED AND RESTATED
1993 DIRECTORS' STOCK OPTION PLAN OF
INCYTE CORPORATION
(As Amended March 15, 2003)

SECTION 1. INTRODUCTION.

The Plan was adopted on July 28, 1993, amended and restated as of August 3, 1993, amended as of March 22, 1995, amended and restated as of March 18, 1998, amended and restated as of March 30, 2001, amended as of May 1, 2001, amended as of December 20, 2001, amended as of February 27, 2002, amended as of February 25, 2003 and amended as of March 15, 2003. The purpose of the Plan is to offer the Company's Nonemployee Directors an opportunity to acquire a proprietary interest in the success of the Company, or to increase such interest, by purchasing Shares of the Company's Stock. The Plan seeks to achieve this purpose by providing for the grant of nonstatutory options to purchase Stock.

The Plan is intended to comply in all respects with Rule 16b-3 (or its successor) under the Exchange Act and shall be construed accordingly.

SECTION 2. DEFINITIONS.

(a) "*Board of Directors*" shall mean the Board of Directors of the Company, as constituted from time to time.

(b) "*Change in Control*" shall mean the occurrence of either of the following events:

(i) A change in the composition of the Board of Directors, as a result of which fewer than one-half of the incumbent directors are directors who either:

(A) Had been directors of the Company 24 months prior to such change; or

(B) Were elected, or nominated for election, to the Board of Directors with the affirmative votes of at least a majority of the directors who had been directors of the Company 24 months prior to such change and who were still in office at the time of the election or nomination; or

(ii) Any "person" (as such term is used in sections 13(d) and 14(d) of the Exchange Act) by the acquisition or aggregation of securities is or becomes the beneficial owner, directly or indirectly, of securities of the Company representing 50% or more of the combined voting power of the Company's then outstanding securities ordinarily (and apart from rights accruing under special circumstances) having the right to vote at elections of directors (the "Base Capital Stock"); except that any change in the relative beneficial ownership of the Company's securities by any person resulting solely from a reduction in the aggregate number of outstanding shares of Base Capital Stock, and any decrease thereafter in such person's ownership of securities, shall be

disregarded until such person increases in any manner, directly or indirectly, such person's beneficial ownership of any securities of the Company.

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

(d) "*Company*" shall mean Incyte Corporation (formerly Incyte Genomics, Inc.), a Delaware corporation.

(e) "*Employee*" shall mean an employee (within the meaning of section 3401(c) of the Code and the regulations thereunder) of the Company or of a Subsidiary of the Company.

(f) "*Exchange Act*" shall mean the Securities Exchange Act of 1934, as amended.

(g) "*Exercise Price*" shall mean the amount for which one Share may be purchased upon exercise of an Option, as specified in the applicable Stock Option Agreement.

(h) "*Fair Market Value*" shall mean the market price of Stock, determined by the Board of Directors as follows:

(i) If Stock was traded over-the-counter on the date in question but was not traded on The Nasdaq Stock Market, then the Fair Market Value shall be equal to the mean between the last reported representative bid and asked prices quoted for such date by the principal automated inter-dealer quotation system on which Stock is quoted or, if the Stock is not quoted on any such system, by the "Pink Sheets" published by the National Quotation Bureau, Inc.;

(ii) If Stock was traded over-the-counter on the date in question and was traded on The Nasdaq Stock Market, then the Fair Market Value shall be equal to the last-transaction price quoted for such date by The Nasdaq Stock Market;

(iii) If Stock was traded on a stock exchange on the date in question, then the Fair Market Value shall be equal to the closing price reported for such date by the applicable composite-transactions report; and

(iv) If none of the foregoing provisions is applicable, then the Fair Market Value shall be determined by the Board of Directors in good faith on such basis as it deems appropriate.

In all cases, the determination of Fair Market Value by the Board of Directors shall be conclusive and binding on all persons.

(i) "*Nonemployee Director*" shall mean a member of the Board of Directors who (i) is not an Employee, (ii) does not own five percent or more of the Stock, (iii) does not represent an owner of five percent or more of the Stock and (iv) does not join the Board of Directors pursuant to, or as a result of, a contractual arrangement between the Company and a third party.

(j) "*Nonstatutory Option*" shall mean a stock option not described in sections 422(b) or 423(b) of the Code.

(k) "*Option*" shall mean a Nonstatutory Option granted under the Plan and entitling the holder to purchase Shares.

(l) "*Optionee*" shall mean an individual who holds an Option.

(m) "*Plan*" shall mean this 1993 Directors' Stock Option Plan of Incyte Corporation (formerly Incyte Genomics, Inc.), as it may be amended from time to time.

(n) "*Reverse Split*" shall mean the one-for-two reverse split of the Stock authorized by the Board of Directors prior to the initial adoption of the Plan.

(o) "*Service*" shall mean service as a member of the Board of Directors, whether or not as a Nonemployee Director.

(p) "*Share*" shall mean one share of Stock, as adjusted in accordance with Section 6 (if applicable). All references to numbers of Shares in Section 3 hereof give effect to the Reverse Split and the 100% stock dividends paid in November 1997 and August 2000.

(q) "*Stock*" shall mean the Common Stock ($.001 par value) of the Company.

(r) "*Stock Option Agreement*" shall mean the agreement between the Company and an Optionee that contains the terms, conditions and restrictions pertaining to his or her Option.

(s) "*Subsidiary*" shall mean any corporation, if the Company and/or one or more other Subsidiaries own not less than 50 percent of the total combined voting power of all classes of outstanding stock of such corporation. A corporation that attains the status of a Subsidiary on a date after the adoption of the Plan shall be considered a Subsidiary commencing as of such date.

(t) "*Total and Permanent Disability*" shall mean that the Optionee is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than one year.

SECTION 3. STOCK SUBJECT TO PLAN.

(a) Basic Limitation. Shares offered under the Plan shall be authorized but unissued Shares or treasury Shares. The aggregate number of Shares which may be issued under the Plan shall not exceed 1,100,000 Shares, subject to adjustment pursuant to Section 6. The number of Shares that are subject to Options at any time shall not exceed the number of Shares that then remain available for issuance under the Plan. The Company, during the term of the Plan, shall at all times reserve and keep available sufficient Shares to satisfy the requirements of the Plan.

(b) Additional Shares. In the event that any outstanding Option for any reason expires or is canceled or otherwise terminated, the Shares allocable to the unexercised portion of such Option shall again be available for the purposes of the Plan.

SECTION 4. TERMS AND CONDITIONS OF OPTIONS.

(a) Stock Option Agreement. Each grant of an Option under the Plan shall be evidenced by a Stock Option Agreement between the Optionee and the Company. Such Option shall be subject to all applicable terms and conditions of the Plan and may be subject to any other terms and conditions that are not inconsistent with the Plan and that the Board of Directors deems appropriate for inclusion in a Stock Option Agreement.

(b) Initial Grants. Each new Nonemployee Director who first joins the Board of Directors after March 30, 2001 shall receive an Option covering 30,000 Shares within one business day after his or her initial election to the Board of Directors. The number of Shares included in an Option shall be subject to adjustment under Section 6.

(c) Annual Grants. On the first business day following the conclusion of each regular annual meeting of the Company's stockholders, each Nonemployee Director who will continue serving as a member of the Board of Directors thereafter shall receive an Option covering 7,500 Shares, subject to adjustment under Section 6. Each Nonemployee Director who is not initially elected at a regular annual meeting of the Company's stockholders shall receive an Option to purchase a pro rata portion of 7,500 Shares within ten business days of such Director's election based on the number of full months remaining from date of election until the next regular annual meeting of the Company's stockholders divided by twelve. Any fractional shares resulting from such calculation shall be rounded up to the nearest whole number.

(d) Exercise Price. The Exercise Price under each Option shall be equal to 100 percent of the Fair Market Value of the Stock subject to such Option on the date when such Option is granted. The entire Exercise Price of Shares issued under the Plan shall be payable in cash when such Shares are purchased, except as follows:

(i) Payment may be made all or in part with Shares that have already been owned by the Optionee or the Optionee's representative for more than six months and that are surrendered to the Company in good form for transfer. Such Shares shall be valued at their Fair Market Value on the date when the new Shares are purchased under the Plan.

(ii) Payment may be made all or in part by the delivery (on a form prescribed by the Company) of an irrevocable direction to a securities broker approved by the Company to sell Shares and to deliver all or part of the sales proceeds to the Company in payment of all or part of the Exercise Price and any withholding taxes.

(iii) Payment may be made all or in part by the delivery (on a form prescribed by the Company) of an irrevocable direction to pledge Shares to a securities broker or lender approved by the Company, as security for a loan, and to deliver all or part of the

loan proceeds to the Company in payment of all or part of the Exercise Price and any withholding taxes.

(e) Vesting. Each Option granted under Subsection (b) above shall become exercisable (i) as to one-fourth (1/4) of the total number of shares covered by such Option on the first anniversary of the date of grant and (ii) as to one-forty-eighth (1/48) of the total number of shares covered by such Option on each of a series of thirty-six (36) monthly installments thereafter. Except as set forth in the next succeeding sentence and in the last sentence of this Subsection (e), each Option granted under Subsection (c) above shall become exercisable in full on the first anniversary of the date of grant. Except as set forth in the last sentence of this Subsection (e), each Option granted under Subsection (c) to Nonemployee Directors who were not initially elected at a regular annual meeting of the Company's stockholders shall become exercisable in full at the next regular annual meeting of the Company's stockholders following the date of grant. Notwithstanding the foregoing, each Option granted under Subsection (c) above that is outstanding shall become exercisable in full in the event that a Change in Control occurs with respect to the Company.

(f) Term of Options. Subject to Subsections (g) and (h) below, each Option shall expire on the 10th anniversary of the date when such Option was granted.

(g) Termination of Service (Except by Death). If an Optionee's Service terminates for any reason other than death, then his or her Options shall expire on the earliest of the following occasions:

(i) The expiration date determined pursuant to Subsection (f) above;

(ii) The date 24 months after the termination of the Optionee's Service, if the termination occurs because of his or her Total and Permanent Disability; or

(iii) The date six months after the termination of the Optionee's Service for any reason other than Total and Permanent Disability.

The Optionee may exercise all or part of his or her Options at any time before the expiration of such Options under the preceding sentence, but only to the extent that such Options had become exercisable before his or her Service terminated. The balance of such Options shall lapse when the Optionee's Service terminates. In the event that the Optionee dies after the termination of his or her Service but before the expiration of his or her Options, all or part of such Options may be exercised at any time prior to their expiration by the executors or administrators of the Optionee's estate or by any person who has acquired such Options directly from him or her by bequest, inheritance or beneficiary designation under the Plan, but only to the extent that such Options had become exercisable before his or her Service terminated.

(h) Death of Optionee. If an Optionee dies while he or she is in Service, then his or her Options shall expire on the earlier of the following dates:

(i) The expiration date determined pursuant to Subsection (f) above; or

(ii) The date 24 months after his or her death.

All or part of the Optionee's Options may be exercised at any time before the expiration of such Options under the preceding sentence by the executors or administrators of his or her estate or by any person who has acquired such Options directly from him or her by bequest, inheritance or beneficiary designation under the Plan.

(i) Nontransferability. No Option shall be transferable by the Optionee other than by will, by written beneficiary designation or by the laws of descent and distribution. An Option may be exercised during the lifetime of the Optionee only by the Optionee or by the Optionee's guardian or legal representative. No Option or interest therein may be transferred, assigned, pledged or hypothecated by the Optionee during his or her lifetime, whether by operation of law or otherwise, or be made subject to execution, attachment or similar process.

(j) Stockholder Approval. Subsection (e) above notwithstanding, no Option shall be exercisable under any circumstances unless and until the Company's stockholders have approved the Plan.

SECTION 5. MISCELLANEOUS PROVISIONS.

(a) No Rights as a Stockholder. An Optionee, or a transferee of an Optionee, shall have no rights as a stockholder with respect to any Shares covered by his or her Option until he or she becomes entitled, pursuant to the terms of such Option, to receive such Shares. No adjustment shall be made, except as provided in Section 6.

(b) Modification, Extension and Assumption of Options. Within the limitations of the Plan, the Board of Directors may modify, extend or assume outstanding Options or may accept the cancellation of outstanding Options (whether granted by the Company or another issuer) in return for the grant of new Options for the same or a different number of Shares and at the same or a different Exercise Price. The foregoing notwithstanding, no modification of an Option shall, without the consent of the Optionee, impair such Optionee's rights or increase his or her obligations under such Option.

(c) Restrictions on Issuance of Shares. Shares shall not be issued under the Plan unless the issuance and delivery of such Shares comply with (or are exempt from) all applicable requirements of law, including (without limitation) the Securities Act of 1933, as amended, the rules and regulations promulgated thereunder, state securities laws and regulations, and the regulations of any stock exchange on which the Company's securities may then be listed. The Company may impose restrictions upon the sale, pledge or other transfer of such Shares (including the placement of appropriate legends on stock certificates) if, in the judgment of the Company and its counsel, such restrictions are necessary or desirable in order to achieve compliance with the provisions of the Securities Act of 1933, as amended, the securities laws of any state or any other law.

(d) Withholding Taxes. The Company's obligation to deliver Stock upon the exercise of an Option shall be subject to any applicable tax withholding requirements.

(e) No Retention Rights. No provision of the Plan, nor any Option granted under the Plan, shall be construed as giving any person the right to be elected as, or to be nominated for election as, a Nonemployee Director or to remain a Nonemployee Director.

SECTION 6. ADJUSTMENT OF SHARES.

(a) General. In the event of a subdivision of the outstanding Stock, a declaration of a dividend payable in Shares, a declaration of a dividend payable in a form other than Shares in an amount that has a material effect on the value of Shares, a combination or consolidation of the outstanding Stock into a lesser number of Shares, a recapitalization, a spin-off, a reclassification or a similar occurrence, the Board of Directors shall make appropriate adjustments in one or more of (i) the number of Options available for future grants under Section 3, (ii) the number of Shares to be covered by each new Option under Section 4, (iii) the number of Shares covered by each outstanding Option or (iv) the Exercise Price under each outstanding Option.

(b) Reorganizations. In the event that the Company is a party to a merger or other reorganization, outstanding Options shall be subject to the agreement of merger or reorganization. Such agreement shall provide (i) for the assumption of outstanding Options by the surviving corporation or its parent, (ii) for their continuation by the Company, if the Company is a surviving corporation, (iii) for payment of a cash settlement equal to the difference between the amount to be paid for one Share pursuant to such agreement and the Exercise Price or (iv) for the acceleration of their exercisability followed by the cancellation of Options not exercised, in all cases without the Optionees' consent. Any cancellation shall not occur until after such acceleration is effective and Optionees have been notified of such acceleration.

(c) Reservation of Rights. Except as provided in this Section 6, an Optionee shall have no rights by reason of (i) any subdivision or consolidation of shares of stock of any class, (ii) the payment of any dividend or (iii) any other increase or decrease in the number of shares of stock of any class. Any issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall not affect, and no adjustment by reason thereof shall be made with respect to, the number or Exercise Price of Shares subject to an Option. The grant of an Option pursuant to the Plan shall not affect in any way the right or power of the Company to make adjustments, reclassifications, reorganizations or changes of its capital or business structure, to merge or consolidate or to dissolve, liquidate, sell or transfer all or any part of its business or assets.

SECTION 7. DURATION AND AMENDMENTS.

(a) Term of the Plan. The Plan shall become effective on the date of its adoption by the Board of Directors, subject to approval of the Company's stockholders. The Plan shall remain in effect until it is terminated under Subsection (b) below.

(b) Right to Amend or Terminate the Plan. The Board of Directors may amend, suspend or terminate the Plan at any time and for any reason, except that the provisions of the Plan relating to the amount, price and timing of Option grants shall not be amended more than

once in any six-month period. Any amendment of the Plan shall be subject to the approval of the Company's stockholders to the extent required by applicable laws, regulations, rules, listing standards or other requirements, including (without limitation) Rule 16b-3 under the Exchange Act. Stockholder approval shall not be required for any other amendment of the Plan.

(c) Effect of Amendment or Termination. No Shares shall be issued or sold under the Plan after the termination thereof, except upon exercise of an Option granted prior to such termination. The termination of the Plan, or any amendment thereof, shall not affect any Option previously granted under the Plan.

SECTION 8. EXECUTION.

To record the amendment of the Plan as of March 15, 2003, the Company has caused its authorized officer to execute the same.

INCYTE CORPORATION

By /S/ LEE BENDEKGEY

Title Executive Vice President