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

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2005**

**OR**

**o TRANSITION REPORT 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 of other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |
| **Experimental Station, Route 141 & Henry Clay Road, Building E336, Wilmington, DE 19880** | **(302) 498-6700** |
| (Address of principal executives offices) | (Registrant's telephone number, including area code) |

**Securities registered to Section 12(b) of the Act: None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, par value $.001 per share**

**Series A Participating Preferred Stock Purchase Rights**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Exchange Act. Yes o No x

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

The aggregate market value of Common Stock held by non-affiliates (based on the closing sale price on the Nasdaq National Market on June 30, 2005) was approximately $384.2 million.

As of February 28, 2006 there were 83,644,107 shares of Common Stock, $.001 per share par value, outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Items 10 (as to directors and Section 16(a) Beneficial Ownership Reporting Compliance), 11, 12, 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2006 Annual Meeting of Stockholders to be held on May 23, 2006.

**Table of Contents**

**Item 1.** ***Business***

*This report contains forward-looking statements that involve risks and uncertainties. These statements relate to future periods, future events or our future operating or financial plans or performance. These statements can often be identified by the use of forward-looking terminology such as "expects," "believes," "intends," "anticipates," "estimates," "plans," "may," or "will," or the negative of these terms, and other similar expressions . These forward-looking statements include statements as to the discovery, development, formulation, manufacturing and commercialization of our compounds and our product candidates; the increase in our drug discovery and development efforts; the expected timing, progress, results and other information regarding our preclinical testing, clinical trials and drug development programs; conducting clinical trials internally, with collaborators, or with contract research organizations; our collaboration and strategic alliance efforts; anticipated benefits and disadvantages of entering into collaboration agreements; the regulatory approval process, including determinations to seek FDA approval for, and plans to commercialize, our products in the United States and abroad; the safety, effectiveness and potential benefits and indications of our product candidates and other compounds under development; potential uses for our product candidates and our other compounds; our ability to manage expansion of our drug discovery and development operations; future required expertise relating to clinical trials, manufacturing, sales and marketing; obtaining licenses to products, compounds or technology, or other intellectual property rights; the receipt of or payments to collaborators resulting from milestones or royalties; difficulties resulting from the discontinuation of certain of our information product-related activities, including the amendment, termination or transition of customer contracts; expected expenses and expenditure levels; expected revenues and sources of revenues; expected losses; our profitability; the adequacy of our capital resources; the need to raise additional capital; the costs associated with resolving matters currently in litigation; our expectations regarding competition; our long-term investments, including anticipated expenditures, losses and expenses; costs associated with prosecuting, maintaining, defending and enforcing patent claims and other intellectual property rights; the adequacy of our current facilities; our ability to obtain, maintain or increase coverage of product liability and other insurance; adequacy of our product liability insurance; our indebtedness; and the impact of the adoption of SFAS 123R on our results of operations.*

*These forward-looking statements reflect our current views with respect to future events, are based on assumptions and are subject to risks and uncertainties. These risks and uncertainties could cause actual results to differ materially from those projected and include, but are not limited to, our ability to discover, develop, formulate, manufacture and commercialize a drug candidate or product; the risk of unanticipated delays in research and development efforts; the risk that previous preclinical testing or clinical trial results are not necessarily indicative of future clinical trial results; risks relating to the conduct of our clinical trials; changing regulatory requirements; the risk of adverse safety findings; the risk that results of our clinical trials do not support submission of a marketing approval application for our product candidates; the risk of significant delays or costs in obtaining regulatory approvals; risks relating to our reliance on third party manufacturers, collaborators, and contract research organizations; risks relating to the development of new products and their use by us and our current and potential collaborators; our ability to in-license a potential drug compound or drug candidate; the cost of accessing, licensing or acquiring potential drug compounds or drug candidates developed by other companies; the risk that our product candidates may not obtain regulatory approval; the impact of technological advances and competition; the ability to compete against third parties with greater resources than ours; competition to develop and commercialize similar drug products; uncertainties relating to the continuing access and use of our Delaware headquarters; our ability to obtain patent protection and freedom to operate 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 have made investments; our ability to obtain additional capital when needed; our history of operating losses and the risks set forth under Item 1A., "Risk Factors." Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Except as required by federal securities laws, we undertake no obligation to update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.*



*In this report all references to "Incyte," "we," "us" or "our" mean Incyte Corporation and our subsidiaries, except where it is made clear that the term means only the parent company.*

*Incyte is our registered trademark. We also refer to trademarks of other corporations and organizations in this Annual Report on Form 10-K.*

**Overview**

Incyte Corporation is focused on the discovery and development of novel drugs to treat major medical conditions. Our three core therapeutic areas are human immunodeficiency virus, or HIV, inflammation and cancer. We have assembled a team of scientists with core competencies in the areas of medicinal chemistry, and molecular, cellular and in vivo biology.

Our most advanced product candidate, dexelvucitabine or DFC (formerly known as Reverset™), is a nucleoside analog reverse transcriptase inhibitor, or NRTI, that is being developed as a once-a day oral therapy for use in combination with other antiviral drugs for patients with HIV infections. In 2005, we completed a Phase IIb clinical trial, Study 203, in treatment-experienced HIV patients which demonstrated that DFC provided potent antiviral effects as compared to placebo and was most effective in patients who were not receiving 3TC, FTC or ddI, currently approved NRTIs. In a meeting with the Food & Drug Administration ("FDA") to discuss moving DFC directly into two Phase III trials, the FDA requested that we conduct a second Phase IIb clinical trial prior to initiating Phase III. This second Phase IIb clinical trial was initiated in February 2006.

In addition to our DFC development program, we have several internal drug development programs underway. The most advanced of these programs is focused on developing antagonists to a key chemokine receptor involved in inflammation called CCR2. We believe that CCR2 receptor antagonists may represent a new class of compounds to treat various inflammation-driven diseases, including rheumatoid arthritis, multiple sclerosis, diabetes, and atherosclerosis. In November 2005, we entered into a collaborative research and license agreement with Pfizer Inc. ("Pfizer"), which became effective in

January 2006. Pfizer gained worldwide development and commercialization rights to Incyte's portfolio of CCR2 antagonist compounds, the most advanced of which is currently in Phase IIa clinical trials in rheumatoid arthritis and insulin-resistant obese patients. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and one other undisclosed indication, where Incyte retained worldwide rights, along with certain compounds. Incyte does not have obligations to Pfizer on pre-clinical development candidates it selects for pursuit in these indications. As part of this agreement, Incyte may receive up to $803 million in milestone and other payments, including $40 million that was received as an upfront payment in January 2006 and $10 million that was received through the purchase of a convertible subordinated note in February 2006.

Our next most-advanced program involves novel sheddase inhibitors that we believe may have application in the treatment of breast cancer and other tumor types. Based on results from single and multiple-dose-rising Phase I clinical trials of our sheddase inhibitor lead candidate in healthy volunteers, we have initiated a Phase Ib/IIa dose-ranging clinical trial in cancer patients.

We have also selected an oral CCR5 antagonist compound that is expected to begin Phase I clinical trials in healthy volunteers in the first half of 2006. Our CCR5 compound in preclinical testing has shown potent anti-HIV activity in cell culture as well as excellent pharmacokinetic properties. We expect to complete Phase I clinical trials in healthy volunteers in the second half of 2006.

We have recently identified a novel proprietary compound with the potential to treat Type 2 diabetes. The compound is a selective orally-available small molecule inhibitor of 11-beta hydroxysteroid dehydrogenase type 1 ("11ßHSD1") and is expected to begin Phase I clinical trials in the first half of 2006.

Earlier stage programs have generated other compounds with potential for applications in cancer and inflammation.



In the past, our business focused on the development and sale of genomic and proteomic information products. However, in response to the decreasing commercial potential of this area, we made the decision in February 2004 to discontinue further development of the information products, close our Palo Alto headquarters and focus solely on the discovery and development of novel drugs.

**Product Candidate Pipeline**

***HIV Portfolio***

*DFC* —In September 2003, we signed a collaborative licensing agreement with Pharmasset, Inc. ("Pharmasset") to further develop and commercialize DFC. Under our agreement with Pharmasset, we paid Pharmasset an upfront payment of $6.3 million and are required to pay future performance milestone payments and future royalties on net sales in exchange for exclusive rights in the United States, Europe and certain other markets to develop, manufacture and market DFC. Pharmasset will retain marketing and commercialization rights in certain territories, including South America, Mexico, Africa, the Middle East, Korea and China.

In 1981, acquired immune deficiency syndrome (AIDS) was identified as a disease that severely compromised the human immune system. In 1983, it was reported that the cause of AIDS was determined to be the human immunodeficiency virus, commonly referred to as HIV. For the last 15 years, the advent of potent antiretroviral therapies and the introduction of highly active anti-retroviral therapy have markedly reduced morbidity and mortality for HIV-infected patients in developed countries. Highly active anti-retroviral therapy is composed of multiple anti-HIV drugs and usually includes two NRTIs and one protease inhibitor and or a non-nucleoside reverse transcription inhibitor. Unfortunately, many patients do not achieve optimal results with existing therapies, and approximately 85% of treatment experienced patients develop drug resistance. As a result, there is a clear medical need for new HIV treatments.

We believe DFC has the requisite characteristics to be developed as a new therapy primarily for treatment-experienced HIV patients. We are developing DFC as a once-a-day oral therapy for use in combination with other antiviral drugs for patients with HIV infections. In both preclinical and clinical studies, DFC has been shown to inhibit replication of HIV virus that has become fully or partially resistant to currently marketed NRTIs such as 3TC, FTC, AZT and tenofovir.

Our most recent clinical trial, Study 203, a randomized double blind placebo controlled Phase IIb trial, involved 199 patients in the United States and Europe. In September 2005, we met with representatives from the FDA to discuss the results of Study 203 and our plan to advance DFC into two Phase III pivotal clinical trials. During the meeting, FDA representatives raised a concern that the rationale for moving DFC into Phase III development was based on several subgroup analyses that were unscheduled and post hoc and that the number of evaluable patients in the key subgroups was small. Additionally, the FDA was concerned that the low frequency of hyperlipasemia observed in the absence of ddl might represent a signal of the potential risk for development of pancreatitis in future studies. As a result, the FDA requested that we conduct a second Phase IIb trial prior to progressing into Phase III. This second Phase IIb trial, Study 204, was initiated in February 2006.

Study 204 has been designed to compare DFC directly to 3TC to confirm the results from Study 203 and is expected to involve 250 treatment-experienced patients and over 100 clinical sites in the United States, Europe and South America.

*CCR5 Antagonist Program* —We also have an oral CCR5 antagonist program. CCR5 is a major chemokine receptor that the HIV virus uses to enter CD4 cells, which are critical to the human immune system. Once inside the cell, the HIV virus then teaches the cells how to make more HIV and plays a key role in viral transmission and replication during the early phase of the disease process. We believe CCR5 antagonists may represent a new class of HIV drugs given their potential to bind specifically to CCR5 receptors and, in turn, block the HIV virus before it enters human cells. We expect to complete the Investigational New Drug Application, or IND, and initiate a Phase I clinical trial in healthy volunteers for the lead compound in this program in the first half of 2006.



***Inflammation Portfolio***

*CCR2 Receptor Antagonist Program* —Chemokines are proteins, secreted at sites of injury or inflammation that attract and activate leukocytes, or white blood cells, such as monocytes. CCR2 is a key chemokine receptor found on monocytes that controls their migration into sites of inflammation, where they differentiate into tissue scavenger cells known as macrophages. Although, in their normal role, macrophages scavenge foreign organisms or injured tissues, excessive or inappropriately triggered macrophage activity can cause damage to tissues and provoke a chronic inflammatory response. For example, in rheumatoid arthritis, macrophages secrete chemokines and cytokines, perpetuating the inflammatory response, and also produce proteases that degrade cartilage and contribute to joint destruction. CCR2 receptor antagonists may thus substantially reduce tissue damage and limit the degree of the inflammatory process in rheumatoid arthritis and other inflammation-driven disorders, including multiple sclerosis, diabetes, and atherosclerosis, by blocking the migration and recruitment of macrophages. We have identified a series of orally-available CCR2 receptor antagonist compounds. The most advanced compound from this program, INCB-3284, is in Phase IIa clinical trials in rheumatoid arthritis and insulin-resistant obese patients.

In November 2005, we entered into a collaborative research and license agreement with Pfizer under which Pfizer gained worldwide development and commercialization rights to Incyte's portfolio of CCR2 antagonist compounds, with the exception of two indications.

Incyte received an upfront non refundable payment of $40 million in January 2006 and is eligible to receive additional future development and milestone payments of up to $743 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. Pfizer purchased a $10 million convertible subordinated note in February 2006 and may purchase an additional $10 million note at Incyte's option after Incyte files an IND in a retained Incyte indication. The notes will bear no interest, are due seven years from the date of issuance and will be convertible into Incyte common stock. Under the agreement, Pfizer will also provide research funding to Incyte to support the continued expansion of the CCR2 compound portfolio.

We are pursuing multiple sclerosis as an indication for our retained CCR2 antagonist because the accumulation of inflammatory macrophages in the human central nervous system appears to be a key step in the pathological cascade that characterizes multiple sclerosis and leads to exacerbations of the disease. Based on a growing body of preclinical evidence, we believe selective CCR2 antagonism in this setting has the potential to disrupt the recruitment and accumulation of these inflammatory macrophages and thus interrupt or ameliorate the pathological cascade seen in multiple sclerosis and, in turn, modify the course of this disease, relieve symptoms and improve patient outcomes. We have selected a lead clinical candidate and intend to initiate a Phase I clinical trial in healthy volunteers in the second half of 2006. We have retained a second indication that for competitive reasons we have not disclosed, which also has the potential to benefit from an oral CCR2 antagonist treatment.

*New Program* —We also have a second compound in preclinical development for inflammation that is distinct from our CCR2 antagonists. By year end, we expect to complete studies that may support the submission of an IND for this compound.

***Cancer Portfolio***

*Sheddase Inhibitor Program* —As the fundamental biology of cancer has been explored at the molecular level, new therapeutics are emerging that distinguish themselves from the classic, relatively non-selective, cytotoxic agents. These new therapies are targeted specifically to pathways or proteins that are more critical for the growth of tumor cells than for the growth of normal cells, thereby having the potential to provide a greater therapeutic index, both when used alone and in combination with cytotoxic agents. Currently approved targeted therapeutics of this type, including Gleevec®, have proven to be of value in the treatment of certain important tumor types.



The signaling pathways that utilize the receptors and ligands of the epidermal growth factor receptor (EGFR) family play a key role in the growth and survival of multiple tumor types, including breast, colorectal, and non-small cell lung cancers. There are multiple forms of both the receptors (for example, HER1 and HER2) and the corresponding ligands (such as EGF and TGFalpha). Reduction in the signaling of one of these pathways by antibodies that bind to a specific EGFR-family receptor (HER2), interfering with ligand-induced activation, has shown efficacy in certain breast cancers. An alternative approach to interfere with EGFR signaling is through the administration of a tyrosine kinase inhibitor such as Tarceva.

We have identified a third way to inhibit EGFR signaling pathways, which we believe may be both complementary with the two approaches described above and possibly more broadly effective. EGFR family ligands must be cleaved from larger, cell-attached proteins in order to be released in their soluble active form. EGFR family receptors are also subject to cleavage, which in this case results in a constitutively activated receptor that does not require the presence of the corresponding ligand for signaling. We have identified a protease whose action appears to contribute to the growth and metastasis of breast cancer and possibly other cancers.

Proteases are enzymes that catalyze the splitting of proteins into smaller peptide fractions and amino acids. Inhibition of this protease, referred to as sheddase, could thus interfere with signaling in a considerable range of tumor types which use EGFR family signaling. We have identified novel, potent, and orally available small-molecule inhibitors of sheddase that show efficacy in animal tumor models as single agents. We began Phase I clinical trials with the lead compound from this program in March 2005. Based on the results of our single and multiple dose Phase I clinical trials, we initiated a Phase Ib/IIa dose-ranging clinical trial in refractory cancer patients with solid tumors in October 2005. In this trial we plan to include patients with a variety of solid tumors such as breast, non-small cell lung, prostate, colorectal and head and neck cancers, all of which can be associated with excessive signaling of epidermal growth factor receptors (HER1, HER2, HER3).

*New Program* —We also have a lead preclinical candidate for cancer that addresses a different target. By year end, we expect to complete studies that may support the submission of an IND for this candidate.

***Diabetes Opportunity***

*HSD Program* —We have developed a series of novel proprietary small molecule inhibitors of 11ßHSD1, an enzyme that converts the biologically-inactive steroid cortisone into the potent biologically-active hormone cortisol. 11ßHSD1 inhibitors may have the potential to be developed to treat Type 2 diabetes by controlling both insulin production and insulin resistance. The lead compound in this program is INCB13739.

Unlike insulin, which is produced by beta-cells in the pancreas and maintains normal blood glucose levels, cortisol elevates blood glucose levels by promoting glucose production in the liver and inhibiting the uptake and disposal of glucose in muscle and adipose tissue. In this way, cortisol acts an antagonist of insulin. Recent preclinical findings suggest that 11ßHSD1-mediated production of cortisol may increase the body's resistance to insulin and lead to elevated blood glucose and Type 2 diabetes. Inhibition of cortisol production may prevent the progression of insulin resistance to Type 2 diabetes.

Current treatments for Type 2 diabetes increase the production of insulin or the body's sensitivity to insulin, but few address both components of insulin control, and most produce unwanted side effects. As a result, many patients do not achieve optimal reductions in blood glucose levels and experience life-threatening disease complications. By selectively inhibiting 11ßHSD1 and reducing the level of cortisol available in multiple key tissues, we believe INCB13739 may address both components of the disease—insulin production and insulin resistance—and offer a new approach to treating Type 2 diabetes and other



conditions often associated with this disease, such as dyslipidemia, atherosclerosis, and coronary heart disease. We expect to begin a Phase I clinical trial of INCB13739 in the first half of 2006.

In addition to the programs described above, we have a number of earlier-stage efforts in cancer and inflammation.

**Background on Incyte's Transition into Small-Molecule Drug Discovery and Development**

We were founded in 1991. Before the completion of our transition into a drug discovery and development company, we marketed and sold access to our genomic information databases. However, in recent years, consolidation within the pharmaceutical and biotechnology sectors and a challenging economic environment led to reduced demand for research tools and services. This trend, together with the public availability of genomic information, significantly reduced the market for and revenues from, our information products.

On February 2, 2004, we announced substantial changes in our information products operations, including the closure of our Palo Alto, California facility and the cessation of development of the information products developed at this facility. In January 2005, we sold certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts. We no longer have any activities in the information products area. However, we retain certain existing licenses and licensing activities related to the intellectual property portfolio generated prior to the transition.

**Incyte's Approach To Drug Discovery and Development**

In November 2001, we recruited Paul A. Friedman, M.D., the former president of DuPont Pharmaceuticals Research Laboratories, to serve as our Chief Executive Officer and to lead our drug discovery and development efforts. We then began our transition from information products to our current focus on drug discovery and development. With the recruitment of Dr. Brian Metcalf, formerly head of worldwide medicinal chemistry and platform technologies at SmithKline Beecham, and an experienced team of chemists, pharmacologists, and molecular biologists largely drawn from DuPont Pharmaceuticals, we have assembled a strongly credentialed and experienced drug discovery team, including approximately 141 scientists, approximately equally divided between biologists and chemists. In biology, we have experience in the research areas of inflammation and cancer and our chemists have broad pharmaceutical experience in designing novel small molecule compounds, including compounds in the fields of inflammation, HIV, diabetes and cancer. We have complemented this discovery team with personnel experienced in drug development.

We have established a wide breadth of discovery capabilities in-house, including target validation, high-throughput screening, medicinal chemistry, computational chemistry, and pharmacological assessment, and we intend to continue to augment these capabilities through collaborations with academic and contract laboratory resources with specialized expertise. We have integrated our chemistry and biology teams with development experts in the critical areas of drug metabolism, formulation, and toxicology. We believe that early emphasis on these areas is critical to the optimization of lead clinical candidates with the greatest likelihood of success, and that this emphasis, together with our strength in medicinal chemistry, may allow us to avoid critical pitfalls related to the safety and efficacy of our compounds in later clinical trials.

We are focused on three core therapeutic areas: HIV, inflammation and cancer. This focus allows us to apply resources to our selected programs at a level that we believe is competitive with much larger pharmaceutical companies. This level of resource allocation, particularly in the area of chemistry, was a key to our early success in the identification of a proprietary CCR2 antagonist clinical candidate. While CCR2 is a well-known target, and there is extensive animal model evidence for its role in disease, it is a chemically challenging target and certain companies active in this area have been unsuccessful in



synthesizing a novel small molecule compound that could qualify for pharmaceutical development. In contrast, we were able to identify a clinical candidate within twelve months of initiating screening.

The selection of CCR2 as a target is also indicative of our strategy of focusing on targets in our areas of in-depth biological expertise, particularly inflammation and cancer. We select targets for which there is extensive animal and laboratory evidence of their importance in disease, such that through the application of our medicinal chemistry capabilities we believe that we have the opportunity to generate novel molecules for further development that have the potential to be the best in their therapeutic class. These targets may either be publicly known, such as CCR2, or identified in-house, such as sheddase.

We intend to devote sufficient resources to generate follow-up candidates and multiple chemical series for the programs we pursue. We believe that this strategy may allow us to generate additional opportunities in the event of development failure or, more positively, for the pursuit of multiple indications for compound classes with that potential.

**Commercial Strategy**

As discussed above, our internal programs are focused on the discovery and development of new therapies to address major medical needs in inflammatory disease, HIV, oncology, and diabetes. For some of these programs, such as those in HIV, oncology, and multiple sclerosis, which tend to be managed by a concentrated, well-defined group of physicians, we may elect to develop our products through to commercialization. For others, such as those that address major primary care markets, we intend to seek strategic alliances with major pharmaceutical companies, such as the collaboration with Pfizer for our CCR2 program. We also plan to pursue further in-licensing opportunities which could augment our efforts and accelerate the growth of our pipeline.

We intend to seek approval from the FDA for, and if successful, to commercialize DFC in the United States ourselves. In Europe, we intend to make a future determination whether to commercialize DFC ourselves, or to form a co-commercialization alliance with another company with an established HIV franchise.

**Patents and Other Intellectual Property**

We regard the protection of patents and other enforceable intellectual property rights that we own or license as critical to our business and competitive position. Accordingly, we rely on patent, trade secret and copyright law, as well as nondisclosure and other contractual arrangements, to protect our intellectual property. We have established a patent portfolio of owned or in-licensed patents and patent applications that cover aspects of all our drug candidates, as well as other patents and patent applications that relate to full-length genes and genomics-related technologies obtained as a result of our high-throughput gene sequencing efforts. The patents and patent applications relating to our drug candidates generally include claims directed to the drug candidates, methods of using the drug candidates, formulations of the drug candidates, and methods of manufacturing the drug candidates. Our policy is to pursue patent applications on inventions and discoveries we believe that are commercially important to the development and growth of our business.

We have a number of established patent license agreements relating to our gene patent portfolio and our genomics-related technology patent portfolio. We are presently receiving royalties and other payments under certain of our gene and genomics-related patent license agreements. Under our gene patent license agreements, we may in the future receive royalties and other payments if our partners are successful in their efforts to discover drugs and diagnostics under these license agreements.

Under the terms of our collaborative license agreement relating to DFC, Pharmasset granted us exclusive rights under its patent rights in the United States, Europe, and certain other markets to develop, manufacture and market DFC. The licensed patent rights include coverage of uses of DFC, methods of

making DFC and methods of dosing of DFC. Patent rights that we have exclusively licensed from Pharmasset include three U.S. patents and their related foreign filings in Europe, Canada, Australia and Japan directed to the use of DFC to treat HIV that Pharmasset has exclusively licensed from Emory University. The U.S. patents expire in 2015, provided the applicable maintenance fees are paid and the patents, if challenged, are not held to be invalid. We have also exclusively sublicensed from Pharmasset a U.S. patent application and related foreign filings directed to combinations of DFC with certain other anti-viral agents that Pharmasset has exclusively licensed from Emory University. U.S. patents arising under this application, if issued, will expire in 2020 provided the applicable maintenance fees are paid and the patents, if challenged, are not held to be invalid. In addition, we co-own with Pharmasset a U.S. patent application and related foreign filings directed to enteric dosing regimens. U.S. patents arising under this application, if issued, will expire in 2024 provided the applicable maintenance fees are paid and the patents, if challenged, are not held to be invalid. We have also licensed from Pharmasset a U.S. patent and related foreign filings directed to a method for the manufacture of DFC. The U.S. patent will expire in 2022 provided the applicable maintenance fees are paid and the patents, if challenged, are not held to be invalid. One or more of these patents rights may qualify for a patent term extension to partially compensate for time spent in clinical review by the FDA or corresponding foreign agencies, however, any such patent term extension may only provide limited proprietary protection during the period of extension.

We have obtained some of the patent rights used in our drug discovery and development programs, such as our DFC program, through exclusive licenses with others. We intend to seek to license additional rights relating to compounds or technologies in connection with our drug discovery and development programs. Under these licenses, we may be required to pay up-front fees, license fees, milestone payments and royalties on sales of future products.

Although we believe our rights under patents and patent applications provide a competitive advantage, the patent positions of pharmaceutical and biotechnology companies are highly uncertain and involve complex legal and factual questions. We may not be able to develop patentable products or processes, and may not be able to obtain patents from pending applications. Even if patent claims are allowed, the claims may not issue, or in the event of issuance, may not be sufficient to protect the technology owned by or licensed to us. Any patent or other intellectual property rights that we own or obtain may be circumvented, challenged or invalidated by our competitors. Others may have patents that relate to our business or technology and that may prevent us from marketing our product candidates unless we are able to obtain a license to those patents. In addition, we could incur substantial costs in litigation or other legal proceedings to enforce our patent or other intellectual property rights or to defend ourselves in patent or other intellectual property right suits brought by third parties.

Enactment of legislation implementing the General Agreement on Tariffs and Trade has resulted in certain changes to United States patent laws that became effective on June 8, 1995. Most notably, the term of patent protection for patents issued under patent applications filed on or after June 8, 1995 is no longer a period of 17 years from the date of issuance. The new term of those patents will commence on the date of issuance and terminate 20 years from the earliest effective filing date of the application. Because the time from filing to issuance of biotechnology patent applications is often more than three years, a 20-year term from the effective date of filing may result in a substantially shortened period of patent protection, which may limit the benefit of our patent position.

With respect to proprietary information that is not patentable, and for inventions for which patents are difficult to enforce, we rely on trade secret protection and confidentiality agreements to protect our interests. While we require all employees, consultants and potential business partners to enter into confidentiality agreements, we may not be able to protect adequately our trade secrets or other proprietary information. Others may independently develop substantially equivalent proprietary information and techniques or otherwise gain access to our trade secrets.



**Competition**

Our drug discovery and development activities face, and will continue to face, intense competition from organizations such as pharmaceutical and biotechnology companies, as well as academic and research institutions and government agencies. Our major competitors include fully integrated pharmaceutical companies that have extensive drug discovery efforts and are developing novel small molecule pharmaceuticals. We face significant competition from organizations that are pursuing pharmaceuticals that are competitive with our potential products. With respect to our most advanced product candidate, DFC, several companies are already marketing various NRTIs, including GlaxoSmithKline, Gilead Sciences, and Bristol Myers Squibb.

Many companies and institutions, either alone or together with their collaborative partners, have substantially greater financial resources and larger research and development staffs than we do. In addition, many competitors, either alone or together with their collaborative partners, have significantly greater experience than we do in:

- drug discovery;
- developing products;
- undertaking preclinical testing and clinical trials;
- obtaining FDA and other regulatory approvals of products; and
- manufacturing, marketing, distributing and selling products.

Accordingly, our competitors may succeed in obtaining patent protection, receiving FDA approval or commercializing products before we do. If we commence commercial product sales, we will be competing against companies with greater manufacturing, marketing, distributing and selling capabilities, areas in which we have limited or no experience.

In addition, any drug candidate that we successfully develop may compete with existing therapies that have long histories of safe and effective use. Competition may also arise from:

- other drug development technologies and methods of preventing or reducing the incidence of disease;
- new small molecules; or
- other classes of therapeutic agents.

Developments by others may render our drug candidates obsolete or noncompetitive. We face and will continue to face intense competition from other companies for collaborative arrangements with pharmaceutical and biotechnology companies, for establishing relationships with academic and research institutions and for licenses to proprietary technology. These competitors, either alone or with their collaborative partners, may succeed in developing products that are more effective than ours.

Our ability to compete successfully will depend, in part, on our ability to:

- develop proprietary products;
- develop and maintain products that reach the market first, are technologically superior to and/or are of lower cost than other products in the market;
- attract and retain scientific and product development personnel;
- obtain patent or other proprietary protection for our products and technologies;
- obtain required regulatory approvals; and
- manufacture, market, distribute and sell any products that we develop.



In a number of countries, including in particular, developing countries, government officials and other groups have suggested that pharmaceutical companies should make drugs for HIV infection available at a low cost. In some cases, governmental authorities have indicated that where pharmaceutical companies do not do so, their patents might not be enforceable to prevent generic competition. Some major pharmaceutical companies have greatly reduced prices for HIV drugs in certain developing countries. If certain countries do not permit enforcement of our patents, should DFC be approved for marketing, sales of DFC in those countries, and in other countries by importation from low-price countries, could be reduced by generic competition or by parallel importation of our product. Alternatively, governments in those countries could require that we grant compulsory licenses to allow competitors to manufacture and sell their own versions of DFC in those countries, thereby reducing our DFC sales, or we could respond to governmental concerns by reducing prices for DFC. In all of these situations, our results of operations could be adversely affected.

**Government Regulation**

Our related ongoing research and development activities and any manufacturing and marketing of our potential small molecule products to treat major medical conditions are subject to extensive regulation by numerous governmental authorities in the United States and other countries. Before marketing in the United States, any drug developed by us must undergo rigorous preclinical testing and clinical trials and an extensive regulatory clearance process implemented by the FDA under the United States Food, Drug and Cosmetic Act. The FDA regulates, among other things, the development, testing, manufacture, safety, efficacy, record-keeping, labeling, storage, approval, advertising, promotion, sale and distribution of these products. None of our drug candidates has, to date, been submitted for approval for sale in the United States or any foreign market. The regulatory review and approval process, which includes preclinical testing and clinical trials of each drug candidate, is lengthy, expensive and uncertain. Securing FDA approval requires the submission of extensive preclinical and clinical data and supporting information to the FDA for each indication to establish a drug candidate's safety and efficacy. The approval process takes many years, requires the expenditure of substantial resources, involves post-marketing surveillance and may involve ongoing requirements for post-marketing studies. Before commencing clinical investigations in humans, we must submit to, and receive approval from, the FDA of an IND application. The steps required before a drug may be marketed in the United States include:

- preclinical laboratory tests, animal studies and formulation studies;
- submission to the FDA of an IND for human clinical testing, which must become effective before human clinical trials may commence;
- adequate and well-controlled clinical trials in three phases, as described below, to establish the safety and efficacy of the drug for each indication;
- submission to the FDA of a new drug application, or NDA, which must become effective before marketing can commence;
- satisfactory completion of an FDA inspection of the manufacturing facility or facilities at which the drug is produced to assess compliance with current good manufacturing practices; and
- FDA review and approval of the NDA.

Similar requirements exist within many foreign agencies as well. The time required to satisfy FDA requirements or similar requirements of foreign regulatory agencies may vary substantially based on the type, complexity and novelty of the product or the targeted disease.

Preclinical testing includes laboratory evaluation of product chemistry, toxicity and formulation, as well as animal studies. The results of the preclinical tests, together with manufacturing information and



analytical data, are submitted to the FDA as part of an IND. An IND will automatically become effective 30 days after receipt by the FDA, unless before that time, the FDA raises concerns or questions about issues such as the conduct of the clinical trials as outlined in the IND. In the latter case, the IND sponsor and the FDA must resolve any outstanding FDA concerns or questions before clinical trials can proceed. We cannot be sure that submission of an IND will result in the FDA allowing clinical trials to commence.

Clinical trials involve the administration of the investigational drug to human subjects under the supervision of qualified investigators. Clinical trials are conducted under protocols detailing the objectives of the study, the parameters to be used in monitoring safety and the effectiveness criteria to be evaluated. Each protocol must be submitted to the FDA as part of the IND and each trial must be reviewed and approved by an independent ethics committee or institutional review board (IRB) before it can begin.

Clinical trials typically are conducted in three sequential phases, but the phases may overlap or be combined. Phase I usually involves the initial introduction of the investigational drug into healthy volunteers to evaluate its safety, dosage tolerance, absorption, metabolism, distribution and excretion, and, if possible, to gain an early indication of its effectiveness. Phase II usually involves clinical trials in a limited patient population to:

- evaluate dosage tolerance and optimal dosage;
- identify possible adverse effects and safety risks; and
- evaluate and gain preliminary evidence of the efficacy of the drug for specific indications.

Phase III clinical trials usually further evaluate clinical efficacy and safety by testing the drug in its final form in an expanded patient population, providing statistical evidence of efficacy and safety and providing an adequate basis for physician labeling. We cannot guarantee that Phase I, Phase II or Phase III testing will be completed successfully within any specified period of time, if at all. Furthermore, we or the FDA may suspend clinical trials at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk.

Additional testing (Phase IV) may be conducted after FDA approval for marketing is granted and would be designed to evaluate alternative utilizations of drug products prior to their being marketed for such alternative utilizations as well as to test for complications resulting from long term exposure not revealed in earlier clinical testing.

Clinical trials must meet requirements for IRB oversight, informed consent and good clinical practices. Clinical trials must be conducted under FDA oversight. Before receiving FDA clearance to market a product, we must demonstrate that the product is safe and effective for the patient population that will be treated. If regulatory clearance of a product is granted, this clearance will be limited to those disease states and conditions for which the product is safe and effective, as demonstrated through clinical trials. Marketing or promoting a drug for an unapproved indication is prohibited. Furthermore, clearance may entail ongoing requirements for post-marketing studies. Even if this regulatory clearance is obtained, a marketed product, its manufacturer and its manufacturing facilities are subject to continual review and periodic inspections by the FDA. Discovery of previously unknown problems with a product, manufacturer or facility may result in restrictions on this product, manufacturer or facility, including costly recalls or withdrawal of the product from the market.



The length of time and related costs necessary to complete clinical trials varies significantly and may be difficult to predict. Clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals. Additional factors that can cause delay or termination of our clinical trials, or cause the costs of these clinical trials to increase, include:

- slow patient enrollment due to the nature of the protocol, the proximity of patients to clinical sites, the eligibility criteria for the study, competition with clinical trials for other drug candidates or other factors;
- inadequately trained or insufficient personnel at the study site to assist in overseeing and monitoring clinical trials;
- delays in approvals from a study site's IRB;
- longer than anticipated treatment time required to demonstrate effectiveness or determine the appropriate product dose;
- lack of sufficient supplies of the drug candidate for use in clinical trials;
- adverse medical events or side effects in treated patients; and
- lack of effectiveness of the drug candidate being tested.

Any drug is likely to produce some toxicities or undesirable side effects in animals and in humans when administered at sufficiently high doses and/or for sufficiently long periods of time. Unacceptable toxicities or side effects may occur at any dose level, and at any time in the course of animal studies designed to identify unacceptable effects of a drug candidate, known as toxicological studies, or in clinical trials of our potential products. The appearance of any unacceptable toxicity or side effect could cause us or regulatory authorities to interrupt, limit, delay or abort the development of any of our drug candidates, and could ultimately prevent their marketing clearance by the FDA or foreign regulatory authorities for any or all targeted indications.

The FDA's fast track program is intended to facilitate the development and expedite the review of drug candidates intended for the treatment of serious or life-threatening diseases and that demonstrate the potential to address unmet medical needs for these conditions. Under this program, the FDA can, for example, review portions of an NDA for a fast track product before the entire application is complete, thus potentially beginning the review process at an earlier time. Our lead program, DFC for the treatment of HIV, may be eligible for fast track designation, and we may seek to have some of our current or future drug candidates designated as fast track products, with the goal of reducing the development and review time.

We cannot guarantee that the FDA will grant any of our requests for fast track designation, that any fast track designation would affect the time of review or that the FDA will approve the NDA submitted for any of our drug candidates, whether or not fast track designation is granted. Additionally, FDA approval of a fast track product can include restrictions on the product's use or distribution (such as permitting use only for specified medical procedures or limiting distribution to physicians or facilities with special training or experience). Approval of fast track products can be conditioned on additional clinical trials after approval.

FDA procedures also provide for priority review of NDAs submitted for drugs that, compared to currently marketed products, offer a significant improvement in the treatment, diagnosis or prevention of a disease. The FDA seeks to review NDAs that are granted priority status more quickly than NDAs given standard status. The FDA's stated policy is to act on 90% of priority NDAs within six months of receipt. Although the FDA historically has not met these goals, the agency has made significant improvements in the timeliness of the review process. We anticipate seeking priority review of DFC, and may do so with



regard to some of our other current or future drug candidates. We cannot guarantee that the FDA will grant priority review status in any instance, that priority review status would affect the actual time of review or that the FDA will ultimately approve the NDA submitted for any of our drug candidates, whether or not priority review status is granted.

We and any of our contract manufacturers are also required to comply with applicable FDA current good manufacturing practice regulations. Good manufacturing practices include requirements relating to quality control and quality assurance as well as to corresponding maintenance of records and documentation. Manufacturing facilities are subject to inspection by the applicable regulatory authorities. These facilities, whether our own or our contract manufacturers, must be approved before we can use them in commercial manufacturing of our related products. We or our contract manufacturers may not be able to comply with applicable good manufacturing practices and FDA or other regulatory requirements. If we or our contract manufacturers fail to comply, we or our contract manufacturers may be subject to legal or regulatory action, such as suspension of manufacturing, seizure of product, or voluntary recall of product. Furthermore, continued compliance with applicable good manufacturing practices will require continual expenditure of time, money and effort on

the part of us or our contract manufacturers in the areas of production and quality control and record keeping and reporting, in order to ensure full compliance.

Outside the United States, our ability to market a product is contingent upon receiving a marketing authorization from the appropriate regulatory authorities. The requirements governing the conduct of clinical trials, marketing authorization, pricing and reimbursement vary widely from country to country. At present, foreign marketing authorizations are applied for at a national level, although within the European Union, or EU, regional registration procedures are available to companies wishing to market a product in more than one EU member state. If the regulatory authority is satisfied that adequate evidence of safety, quality and efficacy has been presented, a marketing authorization may be granted. This foreign regulatory approval process involves all of the risks associated with FDA approval discussed above and may also include additional risks.

**Human Resources**

As of December 31, 2005, we had 177 employees, including 141 in research and development and 36 in business development, finance, operations support and administrative positions. None of our employees are covered by collective bargaining agreements, and management considers relations with our employees to be good.

**Research and Development**

Since our inception, we have made substantial investments in research and technology development. During 2005, 2004 and 2003, we incurred research and development expenses of $95.6 million, $88.3 million and $111.4 million, respectively. We incurred no purchased in-process research and development expenses during 2005 or 2004. During 2003, we incurred purchased in-process research and development expenses of $34.0 million.

**Available Information**

Our website is located at *www.incyte.com*. We make available free of charge on our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after we electronically file or furnish such materials to the Securities and Exchange Commission. Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.



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**Item 1A.** ***Risk Factors***

**RISKS RELATING TO OUR BUSINESS**

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

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

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

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

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

We are currently engaged in a number of different approaches to discover and develop novel drug candidates. At the present time, we have three drug candidates, DFC, our lead CCR2 antagonist licensed to Pfizer, and our lead sheddase inhibitor in Phase IIb, Phase IIa, and Phase Ib/IIa clinical trials, respectively. Our other internal drug discovery programs are focused on compounds with potential for applications in HIV, diabetes and cancer. Discovery and development of potential drug candidates are expensive and time-consuming, and we do not know if our efforts will lead to discovery of any drug candidates that can be successfully developed and marketed. If our efforts do not lead to the discovery of a

suitable drug candidate, we may be unable to grow our clinical pipeline or we may be unable to enter into agreements with collaborators who are willing to develop our drug candidates.

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

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

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

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

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



**Our ability to develop and commercialize DFC may be adversely affected if a dispute arose with Pharmasset or between Pharmasset and its licensor Emory University.**

We are developing DFC under a collaborative licensing agreement with Pharmasset entered into in September 2003 under which Pharmasset exclusively sublicensed to us certain rights in DFC, including certain of its analogs and derivatives that were developed by Pharmasset or that were in-licensed by Pharmasset from Emory. If a dispute arose with Pharmasset over the terms of the collaborative license agreement or a dispute arose between Pharmasset and Emory over the terms of the license agreement between them, including the alleged breach of any provision, our development, commercialization and marketing of DFC may be adversely affected. Pharmasset has the right to terminate the agreement if we do not use commercially reasonable efforts to develop or commercialize DFC in our territories. If Pharmasset terminates the agreement for cause, or if we terminate the agreement without cause, all licenses to us under the agreement terminate.

**We depend on our collaboration with Pfizer for the development and commercialization of CCR2 antagonist compounds.**

Under our collaborative research and license agreement with Pfizer, Pfizer gained worldwide development and commercialization rights to our portfolio of CCR2 antagonist compounds. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and one other undisclosed indication.

Although Pfizer is required to use commercially reasonable efforts to develop and commercialize CCR2 antagonists for the indications for which they are responsible, we cannot control the amount and timing of resources Pfizer may devote to the development of CCR2 antagonists. Any failure of Pfizer to perform its obligations under our agreement could negatively impact the development of CCR2 antagonists, lead to our loss of potential revenues from product sales and milestones and delay our achievement, if any, of profitability.

Pfizer has certain rights to terminate the license agreement, including the right to terminate upon 90 days' notice for any reason. Pfizer also has the right to terminate its rights and obligations with respect to certain indications. If Pfizer terminates the license agreement or its rights with respect to certain indications, we may not be able to find a new collaborator to replace Pfizer, and our business could be adversely affected.

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

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

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



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

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

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

We have only limited experience with clinical trials, formulation, manufacturing and commercialization of drug products. We also have limited internal resources and capacity to perform preclinical testing and clinical trials. As a result, we intend to hire Clinical Research Organizations (“CROs”) to perform preclinical testing and clinical trials for drug candidates. If the CROs that we hire to perform our preclinical testing and clinical trials or our collaborators or licensees do not meet deadlines, do not follow proper procedures, or a conflict arises between us and our CROs, our preclinical testing and clinical trials may take longer than expected, may be delayed or may be terminated. If we were forced to find a replacement entity to perform any of our preclinical testing or clinical trials, we may not be able to find a suitable entity on favorable terms, or at all. Even if we were able to find another company to perform a preclinical test or clinical trial, the delay in the test or trial may result in significant expenditures. Events such as these may result in delays in our obtaining regulatory approval for our drug candidates or our ability to commercialize our products and could result in increased expenditures that would adversely affect our operating results.

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

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

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



Completion of clinical trials may take several years and failure may occur at any stage of testing. The length of time required varies substantially according to the type, complexity, novelty and intended use of the product candidate. Interim results of a preclinical test or clinical trial do not necessarily predict final results, and acceptable results in early clinical trials may not be repeated in later clinical trials. For example, a drug candidate that is successful at the preclinical level may cause harmful or dangerous side effects when tested at the clinical level. Our rate of commencement and completion of clinical trials may be delayed by many factors, including:

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

Data obtained from the clinical trials are susceptible to varying interpretation, which may delay, limit or prevent regulatory approval. A number of companies in the pharmaceutical industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after achieving promising results in earlier clinical trials. In addition, regulatory authorities may refuse or delay approval as a result of other factors, such as changes in regulatory policy during the period of product development and regulatory agency review. In September 2005, the FDA requested that we conduct another Phase IIb clinical trial for DFC to support the efficacy and safety demonstrated in the original Phase IIb clinical trial.

Due, in part, to the early stage of our drug candidate research and development process, we cannot predict whether regulatory approval will be obtained for any product we develop. At the present time, we have three drug candidates, DFC, our lead CCR2 antagonist licensed to Pfizer, and our lead sheddase

inhibitor in Phase IIb, Phase IIa, and Phase Ib/IIa clinical trials, respectively. Our other drug candidates are still undergoing preclinical testing. Compounds developed by us, alone or with other parties, may not prove to be safe and effective in clinical trials and may not meet all of the applicable regulatory requirements needed to receive marketing approval. If regulatory approval of a product is granted, this approval will be limited to those disease states and conditions for which the product is demonstrated through clinical trials to be safe and effective. Failure to obtain regulatory approval would delay or prevent us from commercializing products.

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

**Our reliance on other parties to manufacture our drug candidates could result in a short supply of the drugs, delays in development, increased costs and withdrawal or denial of the regulatory authority's approval.**

The FDA requires that drug products be manufactured according to its current Good Manufacturing Practices, or cGMP, regulations and a limited number of manufacturers comply with these requirements. If the other parties that we choose to manufacture our drug products are not compliant with cGMP, the FDA may not approve our application to manufacture our drug products. We may not be able to arrange for our products to be manufactured by one of these parties on reasonable terms, if at all. Failure to comply with



cGMP in the manufacture of our products could result in the FDA withdrawing or denying regulatory approval of our drug product or other enforcement actions.

We may not be able to obtain sufficient quantities of our new drug products if the manufacturers do not have the capacity or capability to manufacture our products according to our schedule and specifications. Also, raw materials that may be required to manufacture any products we develop may only be available from a limited number of suppliers. If we have promised delivery of a new product and are unable to meet the delivery requirement due to manufacturing difficulties, our development programs would be delayed, and we may have to expend additional sums in order to ensure that manufacturing capacity is available when we need it even if we do not use all of the manufacturing capacity. This expense would adversely affect our operating results. Manufacturers of pharmaceutical products often encounter difficulties in production, especially in scaling up initial production. These problems include difficulties with production costs and yields, quality control and assurance and shortages of qualified personnel, as well as compliance with strictly enforced federal, state and foreign regulations. The manufacturers we choose may not perform as agreed or may terminate their agreements with us. Foreign manufacturing approval processes typically include all of the risks associated with the FDA approval process for manufacturing and may also include additional risks.

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

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

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

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



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

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

Our ability to commercialize our products successfully will depend in part on the extent to which appropriate reimbursement levels for the cost of our products and related treatment are obtained by governmental authorities, private health insurers and other organizations, such as HMOs. Third-party payors are increasingly challenging the prices charged for medical products and services. Also, the trend toward managed health care in the United States and the concurrent growth of organizations such as HMOs, which could control or significantly influence the purchase of health care services and products, as well as

legislative proposals to reform health care or reduce government insurance programs, may all result in lower prices for or rejection of our products. The cost containment measures that health care payors and providers are instituting and the effect of any health care reform could materially and adversely affect our ability to generate revenues.

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

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

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

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



collaborations, operations and marketing efforts could be delayed or curtailed. We do not maintain “key person” insurance on any of our employees.

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

As part of our business strategy, we have in the past and may in the future acquire assets, technologies, compounds and businesses. Our past acquisitions, such as the acquisition of Maxia have involved, and our future acquisitions may involve, risks such as the following:

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

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

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

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



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

We are subject to various environmental, health and safety laws and regulations governing, among other things, the use, handling, storage and disposal of regulated substances and the health and safety of our employees. Our research and development processes involve the controlled use of hazardous and

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



## RISKS RELATING TO OUR FINANCIAL RESULTS

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

We had net losses from inception in 1991 through 1996 and in 1999 through 2005. Because of those losses, we had an accumulated deficit of $839.3 million as of December 31, 2005. We will continue to spend significant amounts on our efforts to discover and develop drugs. As a result, we expect to continue to incur losses in 2006 and in future periods as well.

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

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

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

Additional factors that may affect our future funding requirements include:

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

If we require additional capital at a time when investment in companies such as ours, or in the marketplace generally, is limited due to the then prevailing market or other conditions, we may have to scale back our operations, eliminate one or more of our research or development programs, or attempt to obtain funds by entering into an agreement with a collaborative partner that would result in terms that are not favorable to us or relinquishing our rights in certain of our proprietary technologies or drug candidates.



If we are unable to raise funds at the time that we desire or at any time thereafter on acceptable terms, we may not be able to continue to develop our potential drug products. The sale of equity or additional convertible debt securities in the future would be dilutive to our stockholders, and debt financing arrangements may require us to pledge certain assets or enter into covenants that could restrict our operations or our ability to incur further indebtedness.

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

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

**Our investments may decline in value and our losses may increase.**

We have made and may in the future make investments in entities that complement our business. These investments may:

- often be made in securities lacking a public trading market or subject to trading restrictions, either of which increases our risk and reduces the liquidity of our investment;
- require us to record losses and expenses related to our ownership interest;
- require us to record acquisition-related charges, such as in-process research and development;
- require us to record charges related to the impairment in the value of the securities underlying our investment; and
- require us to invest greater amounts than anticipated or to devote substantial management time to the management of research and development relationships or other relationships.

The market values of many of these investments can fluctuate significantly. We evaluate our long-term investments for impairment of their value on a quarterly basis. The value of our investments in private companies can fluctuate significantly. In past periods, market conditions have caused us to write-down the value of our private company investments, sometimes substantially, and market conditions may cause us to write down additional amounts. In addition, we have in the past written down the value of our debt investments in companies experiencing financial difficulties. Impairment could result in future charges to our earnings. Decreases in the value of our strategic investments may cause our losses to increase.

**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 December 31, 2005, we had total consolidated debt of $341.9 million and stockholders' deficit of $19.4 million. The indentures pursuant to which our outstanding convertible subordinated notes were



issued do not limit the issuance of additional indebtedness. Our substantial leverage could have significant negative consequences for our future operations, including:

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

In the past five years, we have had negative cash flow from operations. We likely will not generate sufficient cash flow from our operations in the future to enable us to meet our anticipated fixed charges, including our debt service requirements with respect to our outstanding convertible subordinated notes. As of December 31, 2005, $91.6 million aggregate principal amount of our 5.5% convertible subordinated notes due 2007 were outstanding. Our annual interest payments for the 5.5% notes through 2006, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $5.0 million, and an additional $2.5 million in interest is payable in 2007. As of December 31, 2005, $250 million aggregate principal amount of our 3¼% convertible subordinated notes due 2011 were outstanding. Our annual interest payments for the 3¼% notes through 2010, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $8.8 million, and an additional $4.4 million in interest is payable in 2011. We intend to fulfill our debt service obligations from our existing cash and marketable securities. If we are unable to generate cash from our operations or raise additional cash through financings sufficient to meet these obligations, we will need to use existing cash or liquidate marketable securities in order to fund these obligations, which may delay or curtail our research, development and commercialization programs.

## RISKS RELATING TO INTELLECTUAL PROPERTY AND LEGAL MATTERS

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

In October 2001, Invitrogen Corporation filed an action against us in federal district court for the District of Delaware, alleging infringement of three patents. The complaint seeks unspecified money damages and injunctive relief. In November 2001, we filed our answer to Invitrogen's patent infringement claims, and asserted seven counterclaims against Invitrogen, seeking declaratory relief with respect to the patents at issue, implied license, estoppel, laches and patent misuse. We are also seeking our fees, costs and expenses. Invitrogen filed its answer to our counterclaims in January 2002. In February 2003, we added a counterclaim for unfair business practices.

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



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

The technology that we use to make and develop our drug products, the technology that we incorporate in our products, and the products we are developing may be subject to claims that they infringe the patents or proprietary rights of others. The success of our drug discovery and development efforts will also depend on our ability to develop new compounds, drugs and technologies without infringing or misappropriating the proprietary rights of others. We are aware of patents and patent applications filed in certain countries claiming certain intellectual property relating to CCR5. While the validity of issued

patents, patentability of pending patent applications and applicability of any of them to our programs are uncertain, if any of these patents are asserted against us, our ability to commercialize our products could be harmed.

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

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

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

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

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

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

Additionally, when we do not control the prosecution, maintenance and enforcement of certain important intellectual property, such as a drug compound in-licensed to us, the protection of the intellectual property rights may not be in our hands. In the case of DFC, we do not control the intellectual property rights in-licensed to us with respect to the compound and therefore may be unable to protect



those rights. If the entity that controls the intellectual property rights related to DFC does not adequately protect those rights, our rights may be impaired, which may impact our ability to develop, market and commercialize DFC.

For DFC, a composition of matter patent is not available because the compound is in the public domain. Therefore, only patents covering the "use" and the method of "making" of the product are available. In general, patents covering a new use for a known compound and methods of making a known compound can be more difficult to enforce against infringers.

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

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

We pursue a policy of having our employees, consultants and advisors execute proprietary information and invention agreements when they begin working for us. However, these agreements may not provide meaningful protection for our trade secrets or other proprietary information in the event of unauthorized use or disclosure. If we fail to maintain trade secret and patent protection, our potential, future revenues may be decreased.

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

The value of our patents depends in part on their duration. A shorter period of patent protection could lessen the value of our rights under any patents that we obtain and may decrease the revenues we derive from our patents. The United States patent laws were amended in 1995 to change the term of patent protection from 17 years from patent issuance to 20 years from the earliest effective filing date of the application. Because the time from filing to issuance of biotechnology applications 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 filed before 1995 that claim large numbers of genes or other additional subject matter and, in these situations, the patent term will be measured from the date of the earliest priority application. This would shorten our period of patent exclusivity and may decrease the revenues that we might derive from the patents.

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

Biotechnology and pharmaceutical patent law outside the United States is even more uncertain and costly than in the United States and is currently undergoing review and revision in many countries. Further, the laws of some foreign countries may not protect our intellectual property rights to the same extent as United States laws. For example, certain countries do not grant patent claims that are directed to the treatment of humans. We may participate in opposition proceedings to determine the validity of our foreign patents or our competitors' foreign patents, which could result in substantial costs and diversion of our efforts.

**Item 1B.** ***Unresolved Staff Comments.***

None.

**Item 2.** ***Properties***

Our corporate headquarters is in Wilmington, Delaware, which is where our drug discovery and development operations are also located. These facilities are leased to us until September 2008, and we have options to renew our lease until September 2010. We believe that these facilities are adequate to meet our business requirements for the near-term and that additional space will be available on commercially reasonable terms, if required. In addition to this lease, we had lease agreements as of December 31, 2005 for facilities that were closed as a part of the restructurings in Palo Alto and San Diego, California. As of December 31, 2005, we had multiple sublease and lease agreements covering approximately 286,000 square feet that expire on various dates ranging from May 2006 to March 2011. Of the approximately 286,000 square feet leased, approximately 154,000 square feet of this space has been vacated by us and is currently subleased to others.

**Item 3.** ***Legal Proceedings***

***Invitrogen Corporation***

In October 2001, Invitrogen Corporation ("Invitrogen") filed an action against us in federal district court for the District of Delaware, alleging infringement of three patents. The complaint seeks unspecified money damages and injunctive relief. In November 2001, we filed our answer to Invitrogen's patent infringement claims, and asserted seven counterclaims against Invitrogen, seeking declaratory relief with respect to the patents at issue, implied license, estoppel, laches and patent misuse. We are also seeking our fees, costs and expenses. Invitrogen filed its answer to our counterclaims in January 2002. In February 2003, we added a counterclaim for unfair business practices. In February 2004, the federal district court for the District of Delaware ordered a stay of all proceedings pending disposition of the appeal in a related case of a judgment invalidating the same patents that are asserted in this case. On November 18, 2005, the Court of Appeals for the Federal Circuit issued its opinion vacating the judgment invalidating these patents and remanding for further proceedings in that related case. On January 25, 2006, the federal district court for the District of Delaware lifted the stay of proceedings in this case with respect to discovery related to our license defense. Thereafter, a schedule for possible motion practice and further proceedings is expected to be set.

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

In addition to the matter described above, from time to time we have been involved in certain legal actions arising in the ordinary course of business. In management's opinion, the outcome of such actions will not have a material adverse effect on our financial position, results of operations, or liquidity.

**Item 4.** ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of our security holders during the fourth quarter of 2005.

**Executive Officers of the Registrant**

Our executive officers are as follows:

*Paul A. Friedman,* M.D., age 63, joined Incyte as the Chief Executive Officer and a Director in November 2001. Dr. Friedman also serves as our President. From 1998 until October 2001, Dr. Friedman



served as President of DuPont Pharmaceuticals Research Laboratories, a wholly owned subsidiary of DuPont Pharmaceuticals Company (formerly The DuPont Merck Pharmaceutical Company), from 1994 to 1998 he served as President of Research and Development of The DuPont Merck Pharmaceutical Company, and from 1991 to 1994 he served as Senior Vice President at Merck Research Laboratories. Prior to his work at Merck and DuPont, Dr. Friedman was an Associate Professor of Medicine and Pharmacology at Harvard Medical School. Dr. Friedman is a Diplomat of the American Board of Internal Medicine, Member of the American Society of Pharmacology and Experimental Therapeutics, Member of the American Society of Clinical Investigation and a Member of the American Society of Biological Chemists. He received his A.B. in Biology from Princeton University and his M.D. from Harvard Medical School. Dr. Friedman is also a director of Bausch & Lomb Incorporated.

*David C. Hastings,* age 44, has served as Executive Vice President and Chief Financial Officer since October 2003. From February 2000 to September 2003, Mr. Hastings served as Vice President, Chief Financial Officer, and Treasurer of ArQule, Inc. Prior to his employment with ArQule, Mr. Hastings was Vice President and Corporate Controller at Genzyme, Inc., where he was responsible for the management of the finance department. Prior to his employment with Genzyme, Mr. Hastings was the Director of Finance at Sepracor, Inc., where he was primarily responsible for Sepracor's internal and external reporting. Mr. Hastings is a Certified Public Accountant and received his B.A. in Economics at the University of Vermont.

*John A. Keller,* Ph.D., age 41, has served as Executive Vice President and Chief Business Officer since September 2003. From January 2001 to September 2003, Dr. Keller served as Vice President, Business Development at GlaxoSmithKline. From February 1987 to January 2001, Dr. Keller held a range of positions at SmithKline Beckman and SmithKline Beecham, in areas encompassing discovery research, project management, R&D strategy, alliance management and business development. Dr. Keller received his B.A. from Johns Hopkins University and his Ph.D. in Microbiology from Rutgers University.

*Brian W. Metcalf,* Ph.D., age 60, has served as Executive Vice President and Chief Drug Discovery Scientist since February 2002. From March 2000 to February 2002, Dr. Metcalf served as Senior Vice President and Chief Scientific Officer of Kosan Biosciences Incorporated. From December 1983 to March 2000, Dr. Metcalf held a number of executive management positions with SmithKline Beecham, most recently as Senior Vice President, Discovery Chemistry and Platform Technologies. Prior to joining SmithKline Beecham, Dr. Metcalf held positions with Merrell Research Center from 1973 to 1983. Dr. Metcalf received his B.S. and Ph.D. in Organic Chemistry from the University of Western Australia.

*Patricia A. Schreck,* age 52, joined Incyte as Executive Vice President and General Counsel in December 2003. Prior to joining Incyte, Ms. Schreck was Chief Patent Counsel at Elan Drug Delivery, Inc. Previously, she served as General Counsel for Genomics Collaborative, Inc. and diaDexus, Inc. (a SmithKline Beecham & Incyte joint venture). From 1992 through 1998, Ms. Schreck held a variety of senior patent and corporate legal positions at SmithKline Beecham. Ms. Schreck holds a B.A. in Chemistry and Biology from the University of Colorado and a J.D. from Villanova University School of Law. Ms. Schreck is admitted to practice before the United States Patent bar.

*Paula Swain*, age 48, has served as Executive Vice President, Human Resources, of Incyte since August 2002 and joined the company as Senior Vice President of Human Resources in January 2002. Ms. Swain served as Senior Vice President of Human Resources at Bristol Meyers Squibb from October 2001 to January 2002, after they acquired DuPont Pharmaceuticals Company. From July 1998 to October 2001, Ms. Swain was Senior Vice President of Human Resources at DuPont Pharmaceuticals. From October 1992 to July 1998, Ms. Swain held a variety of human resources positions of increasing responsibility at DuPont Pharmaceuticals. Ms. Swain received her B.A. in Psychology and Industrial Relations from Rockhurst University.



## PART II

**Item 5.** ***Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities***

Our common stock, par value $.001, is traded on the Nasdaq National Market ("Nasdaq") under the symbol "INCY." The following table sets forth, for the periods indicated, the range of high and low sales prices for our common stock on Nasdaq as reported in its consolidated transaction reporting system.

| | High | Low |
|---|---|---|
| **2004** | | |
| First Quarter | $ 10.24 | $ 6.77 |
| Second Quarter | 8.76 | 6.40 |
| Third Quarter | 9.91 | 5.40 |
| Fourth Quarter | 11.16 | 8.23 |
| **2005** | | |
| First Quarter | $ 9.66 | $ 6.59 |
| Second Quarter | 8.43 | 6.55 |
| Third Quarter | 8.95 | 4.27 |
| Fourth Quarter | 6.03 | 4.32 |

As of December 31, 2005, our Common Stock was held by 353 stockholders of record. We have never declared or paid dividends on our capital stock and do not anticipate paying any dividends in the foreseeable future.



**Item 6.** ***Selected Consolidated Financial Data***

**Selected Consolidated Financial Data**
**(in thousands, except per share data)**

The data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Item 7 and the Consolidated Financial Statements and related Notes included in Item 8 of this Report.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| **Consolidated Statement of Operations Data(3):** | | | | | |
| Revenues | $ 7,846 | $ 14,146 | $ 41,197 | $ 95,473 | $ 214,317 |
| Costs and expenses: | | | | | |
| Research and development | 95,618 | 88,271 | 111,404 | 145,308 | 203,465 |
| Selling, general and administrative | 11,656 | 20,551 | 29,370 | 45,148 | 61,949 |
| Loss on sale of assets | — | — | — | 313 | 5,777 |
| Purchased in-process research and development | — | — | 33,952 | — | — |
| Other expenses(1) | 1,356 | 54,177 | 15,823 | 37,331 | 130,372 |
| Total costs and expenses | 108,630 | 162,999 | 190,549 | 228,100 | 401,563 |
| Loss from operations | (100,784) | (148,853) | (149,352) | (132,627) | (187,246) |
| Interest and other income (expense), net | 12,527 | 3,563 | (7,988) | 9,417 | 23,357 |
| Interest expense | (16,052) | (17,241) | (9,561) | (9,797) | (10,128) |
| Gain (loss) on certain derivative financial instruments | (106) | (454) | 151 | (1,782) | 553 |
| Gain (loss) on repurchase of convertible subordinated notes | 506 | (226) | 706 | 1,937 | 2,386 |
| Loss from continuing operations before income taxes and accounting change | (103,909) | (163,211) | (166,044) | (132,852) | (171,078) |
| Provision (benefit) for income taxes | (552) | 453 | 342 | 945 | 930 |
| Loss from continuing operations before accounting change | (103,357) | (163,664) | (166,386) | (133,797) | (172,008) |
| Gain (loss) from discontinued operation, net of tax | 314 | (1,153) | (77) | (3,088) | (13,506) |
| Cumulative effect of accounting change(2) | — | — | — | — | 2,279 |
| Net loss | $ (103,043) | $ (164,817) | $ (166,463) | $ (136,885) | $ (183,235) |
| Basic and diluted per share data | | | | | |
| Continuing operations | $ (1.24) | $ (2.19) | $ (2.33) | $ (1.98) | $ (2.60) |
| Discontinued operation | — | (0.02) | — | (0.05) | (0.20) |
| Cumulative effect of accounting change | — | — | — | — | 0.03 |

| | | | | | |
|---|---|---|---|---|---|
| | $ (1.24) | $ (2.21) | $ (2.33) | $ (2.03) | $ (2.77) |
| Number of shares used in computation of basic and diluted per share data | 83,321 | 74,555 | 71,369 | 67,403 | 66,193 |



| | December 31, | | | | |
|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 | 2001 |
| **Consolidated Balance Sheet Data:** | | | | | |
| Cash, cash equivalents, and marketable securities available-for-sale | $ 344,971 | $ 469,764 | $ 293,807 | $ 429,018 | $ 507,903 |
| Working capital | 326,119 | 449,832 | 268,937 | 394,854 | 510,063 |
| Total assets | 374,108 | 516,919 | 379,545 | 552,139 | 705,559 |
| Convertible subordinated notes | 341,862 | 378,766 | 167,786 | 172,036 | 179,248 |
| Stockholders' equity (deficit) | (19,397) | 78,517 | 154,333 | 302,410 | 440,203 |

(1) 2005 charges relate to restructuring charges. 2004 and 2003 charges relate to restructuring charges and impairment of a long-lived asset. 2002 charges relate to restructuring charges. 2001 charges include the following: $68.7 million—goodwill and intangibles impairment; $55.6 million—restructuring charges and $6.1 million—impairment of a long-lived asset. See Note 17 of Notes to Consolidated Financial Statements.

(2) Reflects the adoption of SFAS 133 related to the recording of warrants held in other companies at fair value at the date of adoption.

(3) In December 2004, we entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts, which transaction subsequently closed in January 2005. All fiscal years presented have been restated to present the operations of our Proteome facility as a discontinued operation.

**Item 7.** ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with "Selected Consolidated Financial Data" and the Consolidated Financial Statements and related Notes included elsewhere in this Report.

**Overview**

Incyte Corporation is focused on the discovery and development of novel drugs to treat major medical conditions. Our three core therapeutic areas are human immunodeficiency virus, or HIV, imflammation and cancer. We have assembled a team of scientists with core competencies in the areas of medicinal chemistry, and molecular, cellular and in vivo biology.

Our most advanced product candidate, dexelvucitabine or DFC (formerly known as Reverset™), is a nucleoside analog reverse transcriptase inhibitor, or NRTI, that is being developed as a once-a day oral therapy for use in combination with other antiviral drugs for patients with HIV infections. In 2005, we completed a Phase IIb trial, Study 203, in treatment-experienced HIV patients which demonstrated that DFC provided potent antiviral effects as compared to placebo and was most effective in patients who were not receiving 3TC, FTC or ddI, currently approved NRTIs. In a meeting with the Food & Drug Administration ("FDA") to discuss moving DFC directly into two Phase III trials, the FDA requested that we conduct a second Phase IIb clinical trial prior to initiating Phase III. This second Phase IIb clinical trial was initiated in February 2006.

In addition to our DFC development program, we have several internal drug development programs underway. The most advanced of these programs is focused on developing antagonists to a key chemokine receptor involved in inflammation called CCR2. We believe that CCR2 receptor antagonists may represent a new class of compounds to treat various inflammation-driven diseases, including rheumatoid arthritis, multiple sclerosis, diabetes, and atherosclerosis. In November 2005, we entered into a collaborative research and license agreement with Pfizer Inc. ("Pfizer") which became effective in January 2006. Pfizer



gained worldwide development and commercialization rights to Incyte's portfolio of CCR2 antagonist compounds, the most advanced of which is currently in Phase IIa clinical trials in rheumatoid arthritis and insulin-resistant obese patients. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and one other undisclosed indication, where Incyte retained worldwide rights, along with certain compounds. Incyte does not have obligations to Pfizer on pre-clinical development candidates it selects for pursuit in these indications.

Our next most-advanced program involves novel sheddase inhibitors that we believe may have application in the treatment of breast cancer and other tumor types. Based on results from single and multiple-dose-rising Phase I clinical trials of our sheddase inhibitor lead candidate in healthy volunteers, we have initiated a Phase Ib/IIa dose-ranging clinical trial in cancer patients.

We have also selected an oral once-a-day CCR5 antagonist compound for HIV that is expected to begin Phase I clinical testing in healthy volunteers in the first half of 2006. Our CCR5 compound in preclinical testing has shown potent anti-HIV activity in cell culture as well as excellent pharmacokinetic properties. We expect to complete Phase I trials in healthy volunteers in the second half of 2006.

We have recently identified a novel proprietary compound with the potential to treat Type 2 diabetes. The compound is a selective orally-available small molecule inhibitor of 11ßHSD1 and is expected to begin Phase I clinical trials in the first half of 2006.

Earlier stage programs have generated other compounds with potential for applications in cancer and inflammation.

We anticipate incurring additional losses for several years as we expand our drug discovery and development programs. We also expect that losses will fluctuate from quarter to quarter and that such fluctuations may be substantial. We do not expect to generate revenues from our drug discovery and development efforts for several years, if at all. If we are unable to successfully develop and market pharmaceutical products over the next several years, our business, financial condition and results of operations would be adversely impacted.

*Transition to Drug Discovery and Development*

We were founded and incorporated in Delaware in 1991. Until 2001, we devoted substantially all of our resources to the development, marketing and sales of genomic technologies and products to the biotechnology and pharmaceutical industries and research and academic institutions. We also licensed access to our gene and genomics-related intellectual property to our customers. However, in recent years, consolidation within the pharmaceutical and biotechnology sectors and a challenging economic environment led to reduced demand for research tools and services. This trend, together with the public availability of genomic information, significantly reduced the market for, and revenues from, our information products.

*Restructuring Programs*

In February 2004, we made the decision to discontinue further development of the information products, close our Palo Alto headquarters and focus solely on the discovery and development of novel drugs. We recorded $42.1 million in restructuring charges in 2004, including charges related to the closure of our facilities, prior tenant improvements and equipment, a workforce reduction and other items. The restructuring charge originally included the present value of future lease obligations for two facilities. In the fourth quarter of 2004, we made a lease termination payment to satisfy our remaining lease obligation with respect to one of the facilities. The lease obligation for the second facility extends through March 2011. As a result of the long term nature of the remaining lease obligation, we will be recording a charge each period through the March 2011 termination date of the lease related to increases in the fair



value of the lease obligations in accordance with the provisions of Financial Accounting Standards Board (“FASB”) Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which total approximately $2.2 million at December 31, 2005. The cash impact in 2005 from restructuring related charges was $6.1 million.

In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded a charge of $12.1 million to adjust the carrying value of previously capitalized costs associated with the preparation, prosecution and maintenance of our gene patent portfolio to its estimated fair market value. In January 2005 we sold certain assets and liabilities related to our Proteome facility in Beverly, Massachusetts. Our consolidated financial statements have been restated to present the operations of our Proteome facility as a discontinued operation.

In 2003, we recorded expense of $11.5 million in connection with a restructuring of our genomic information product line involving the discontinuance of our clone activities and support functions. This restructuring program included the elimination of 75 employees at our Palo Alto location and the write-down of certain assets related to our genomic information product line.

*Acquisition of Maxia*

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

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

| **(in millions)** | |
|---|---|
| Current assets | $ 0.9 |
| Current liabilities | (1.6) |
| Net tangible liabilities assumed | (0.7) |
| In-process research and development | 28.1 |
| Total purchase price | $ 27.4 |

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

The value assigned to purchased in-process research and development was comprised of three compounds which were in stages ranging from discovery to preclinical phases as follows: Type II diabetes valued at $15.6 million; cancer valued at $6.9 million; and metabolic and other disorders valued at $5.6 million. The estimated fair values of these projects were determined by employment of a discounted cash flow model, using discount rates ranging from 20% to 40%. The discount rates used took into account the stage of completion and the risks surrounding the successful development and commercialization of



each of the purchased in-process research and development projects that were valued. At the time of acquisition, the Maxia drug development platform was based on three components: chemistry, biology and an integrated drug discovery/development approach. Features of the chemistry component were novel, small, proprietary molecules. The biology component was based on leading scientific expertise in the nuclear receptor and signal transduction areas. The drug discovery platform was believed to provide an accelerated approach to novel drug discovery and development. Management has determined that each of these projects would require significant further development, including the receipt of marketing approval by the FDA or equivalent foreign agency, before they would be commercially available. The major risks and uncertainties associated with the timely and successful completion of these projects consist of the ability to confirm the safety and efficacy of the technology acquired and to obtain necessary regulatory approvals. The timing and estimated costs to complete these projects are difficult to predict due to their early stage of development. At the date of acquisition, significant further development of the Maxia compounds remained to be completed.

In accordance with Emerging Issues Task Force ("EITF") Issue No. 95-3, we recorded a $2.9 million charge in 2003 related to restructuring costs for Maxia, which consisted of workforce reductions and consolidation of facilities. We recorded employee termination costs of approximately $0.8 million for 28 employee positions. The job eliminations were completed in July 2003. We also recorded restructuring costs related to lease payments for property that has been vacated and other costs of $2.0 million. In 2003, 2004, and 2005 we also recorded additional charges of $0.3 million, $1.6 million and $0.3 million, respectively, relating to facilities lease expenses in excess of amounts originally estimated.

**Collaborations and Licensing Agreements**

*Pharmasset Collaborative Licensing Agreement*

In September 2003, we entered into a collaborative licensing agreement with Pharmasset, Inc. ("Pharmasset") to develop and commercialize DFC. Under our agreement with Pharmasset, we paid Pharmasset an upfront payment of $6.3 million, which we recorded as a charge to purchased in-process research and development expense that is presented as a separate component of operating expenses. In addition to this one-time payment, we also agreed to pay Pharmasset certain future performance milestone payments and future royalties on net sales, in exchange for exclusive rights in the United States, Europe and certain other markets to develop, manufacture and market the drug. One of these milestones was met in the second quarter of 2004, resulting in $0.5 million of research and development expense. An additional performance milestone was achieved in July 2005, resulting in $1.5 million of research and development expense. Pharmasset will retain marketing and commercialization rights in certain territories, including South America, Mexico, Africa, the Middle East and China.

*Pfizer Collaborative Research and License Agreement*

In November 2005, we entered into a collaborative research and license agreement with Pfizer under which Pfizer gained worldwide development and commercialization rights to Incyte's portfolio of CCR2 antagonist compounds.

Incyte received an upfront non refundable payment of $40 million in January 2006 and is eligible to receive additional future development and milestone payments of up to $743 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. Pfizer purchased a $10 million convertible subordinated note in February 2006 and may purchase an additional $10 million note at Incyte's option after Incyte files an Investigational New Drug Application in a retained Incyte indication. The notes will bear no interest, are due seven years from the date of issuance and will be convertible into Incyte common stock. Under the agreement, Pfizer will also provide research funding to Incyte to support the continued expansion of the CCR2 compound portfolio.



**Critical Accounting Policies and Significant Estimates**

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

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

- Revenue recognition;
- Research and development costs;
- Valuation of long-lived assets;
- Accounting for long-term investments; and
- 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 have entered into various types of agreements for access to our information databases and use of our intellectual property. Revenues are deferred for fees received before earned or until no further obligations exist. We exercise judgment in determining that collectibility is reasonably assured or that services have been delivered in accordance with the arrangement. We assess whether the fee is fixed or determinable based on the payment terms associated with the transaction and whether the sales price is subject to refund or adjustment. We assess collectibility based primarily on the customer's payment history and on the creditworthiness of the customer.

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

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

In November 2002, the EITF issued EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"), which addresses certain aspects of the accounting for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. Under EITF 00-21, revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables meet certain criteria, including whether the delivered items have stand alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items.

In addition, the consideration should be allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criteria should be considered separately for each of the separate units of accounting. EITF 00-21 became effective for revenue arrangements we entered into after June 30, 2003.

***Research and Development Costs.*** In accordance with Statement of Financial Accounting Standards No. 2 ("SFAS 2"), *Accounting for Research and Development Costs*, it is our policy to expense research and development costs as incurred. We often contract with clinical research organizations ("CROs") to facilitate, coordinate and perform agreed upon research and development of a new drug. To ensure that research and development costs are expensed as incurred, we record monthly accruals for clinical trials and preclinical testing costs based on the work performed under the contract.

These CRO contracts typically call for the payment of fees for services at the initiation of the contract and/or upon the achievement of certain clinical trial milestones. In the event that we prepay CRO fees for future milestones, we record the prepayment as a prepaid asset and amortize the asset into research and development expense over the period of time the contracted research and development services are performed. Most professional fees, including project and clinical management, data management, monitoring, and medical writing fees are incurred throughout the contract period. These professional fees are expensed based on their percentage of completion at a particular date.

Our CRO contracts generally include pass through fees. Pass through fees include, but are not limited to, regulatory expenses, investigator fees, travel costs, and other miscellaneous costs including shipping and printing fees. Because these fees are incurred at various times during the contract term and they are used throughout the contract term, we record a monthly expense allocation to recognize the fees during the contract period. Fees incurred to set up the clinical trial are expensed during the setup period.

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

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



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

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

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

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

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

that our carrying value per share is equal to the quoted market price per share. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional impairment charges.

***Restructuring Charges.*** Costs associated with restructuring activities initiated after December 31, 2002, are accounted for in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS 146"). Costs associated with restructuring activities initiated prior to December 31, 2002 have been recorded in accordance with EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* ("EITF 94-3") and Staff Accounting Bulletin No. 100, *Restructuring and Impairment Charges* ("SAB 100"). Restructuring costs resulting from the Maxia acquisition have been recorded in accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* ("EITF 95-3"). The restructuring charges are comprised primarily of costs to exit facilities,



reduce our workforce, write-off fixed assets, and pay for outside services incurred in the restructuring. The workforce reduction charge is determined based on the estimated severance and fringe benefit charge for identified employees. In calculating the cost to exit the facilities, we estimate for each location the amount to be paid in lease termination payments, the future lease and operating costs to be paid until the lease is terminated, the amount, if any, of sublease receipts and real estate broker fees. This requires us to estimate the timing and costs of each lease to be terminated, the amount of operating costs, and the timing and rate at which we might be able to sublease the site. To form our estimates for these costs, we perform an assessment of the affected facilities and considered the current market conditions for each site. We also estimate our credit adjusted risk free interest rate in order to discount our projected lease payments in accordance with SFAS 146. Estimates are also used in our calculation of the estimated realizable value on equipment that is being held for sale. These estimates are formed based on recent history of sales of similar equipment and market conditions. Our assumptions on either the lease termination payments, operating costs until terminated, the offsetting sublease receipts and estimated realizable value of fixed assets held for sale may turn out to be incorrect and our actual cost may be materially different from our estimates. Our estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities recorded.

At the end of each reporting period, we evaluate the remaining accrued balances to ensure their adequacy, that no excess accruals are retained and the utilization of the provisions are for their intended purposes in accordance with developed exit plans. We periodically evaluate current available information and adjust our restructuring reserve as necessary. We also make adjustments related to professional fees due to actual amounts being lower than originally estimated. During 2005, such adjustments were made for the 2002 restructuring program, 2004 restructuring program, and Maxia acquisition.

**Results of Operations**

We recorded net losses from continuing operations for the years ended December 31, 2005, 2004 and 2003 of $103.4 million, $163.7 million and $166.4 million, respectively. On a basic and diluted per share basis, net loss from continuing operations was $1.24, $2.19, and $2.33 for the years ended December 31, 2005, 2004 and 2003, respectively.

***Revenues***

Our revenues of $7.8 million, $14.1 million, and $41.2 million in 2005, 2004, and 2003, respectively were derived primarily from information products, which included database subscriptions, licensing of our intellectual property, and partner programs. The decrease in revenues from 2003 through 2005 was due primarily to the 2004 closure of our Palo Alto, California facility and the decision to discontinue offering information products. We expect that revenues generated from information products, including gene and gene technology related intellectual property, will continue to decline as we focus on our drug discovery and development programs.

For the years ended December 31, 2005, 2004, and 2003, revenues from companies considered to be related parties, as defined by FASB Statement No. 57, *Related Party Disclosures* ("SFAS 57") were $0.0 million, $1.1 million, and $1.1 million. Our related parties consist of companies in which members of our Board of Directors have invested, either directly or indirectly, or in which a member of our Board of Directors is an officer or holds a seat on the board of directors (other than an Incyte-held Board seat).

Revenues received from agreements with customers in which we have an equity interest were $0.0 million, $1.1 million, and $0.8 million in 2005, 2004 and 2003, respectively.

Revenues recognized from transactions in which there was originally a concurrent commitment to purchase goods or services from the other party to the transaction for the years ended December 31, 2005, 2004, and 2003 were $0.0 million, $1.5 million, and $3.5 million, respectively. No new transactions in which



we had a concurrent commitment to purchase goods or services from the other party to the transaction were entered into during the year ended December 31, 2005. Of commitments made in prior periods, we expensed $0.0 million, $7.5 million, and $10.8 million for the years ended December 31, 2005, 2004, and 2003, respectively.

The above transactions were recorded at fair value in accordance with our revenue and expense recognition policies.

***Operating Expenses***

*Research and development expenses*

| ($ in millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Salary and benefits related | $ 25.5 | $ 28.0 | $ 45.8 |
| Collaboration and outside services | 49.0 | 30.6 | 25.4 |
| Occupancy and all other costs | 21.1 | 29.7 | 40.2 |
| Total research and development expenses | $ 95.6 | $ 88.3 | $ 111.4 |

We currently track research and development costs by natural expense line and not costs by project. These costs are exclusive of all charges related to the purchase of in-process research and development projects. The decrease in salary and benefits related costs from 2003 through 2005 is due primarily to a reduction in headcount. The number of employees engaged in research and development activities has declined due to the closure of our Palo Alto facility in 2004 and the cessation of the development of the information products developed at this facility. We expect that there will be no further research and development related to our information business. The increase in collaboration and outside services from 2003 through 2005 is due primarily to our increased efforts in our drug discovery and development, the expansion of clinical trials for our compounds and additional preclinical expenditures for potential pharmaceutical candidates partially offset by reduced expenditures related to our information business. The decrease in occupancy and other costs from 2003 through 2005 is due primarily to the reduction in our facility costs resulting from the closure of our Palo Alto facility in 2004.

Research and development expenses may fluctuate from period to period depending upon the stage of certain projects and the level of preclinical and clinical trial-related activities. Many factors can affect the cost and timing of our clinical trials, including inconclusive results requiring additional clinical trials, slow patient enrollment, adverse side effects among patients, the availability of supplies for our clinical trials and real or perceived lack of effectiveness or safety of our investigational drugs in our clinical trials. In addition, the development of all of our product candidates will be subject to extensive governmental regulation. These factors make it difficult for us to predict the timing and costs of the further development and approval of our products.

*Selling, general and administrative expenses*

| ($ in millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Salary and benefits related | $ 7.6 | $ 8.9 | $ 19.6 |
| Other contract services and outside costs | 4.1 | 11.7 | 9.8 |
| Total selling, general and administrative expenses | $ 11.7 | $ 20.6 | $ 29.4 |



The decrease in salary and benefit related costs from 2003 through 2005 are due primarily to a reduction in headcount due to the closure of our Palo Alto facility. The increase in other contract services and outside costs from 2003 to 2004 is due primarily to costs associated with the transition of our corporate offices from Palo Alto, California to Wilmington, Delaware. The decline in other contract and outside costs from 2004 to 2005 is due primarily to the closure of Palo Alto and the elimination of expenses through our restructuring programs.

*Purchased in-process research and development.* Purchased in-process research and development expenses for the year ended December 31, 2003 of $34.0 million consisted of $27.7 million for the acquisition of Maxia and $6.3 million related to a collaborative license agreement with Pharmasset.

*Other expenses.* Other expenses for the years ended December 31, 2005, 2004 and 2003 were $1.4 million, $54.2 million and $15.9 million, respectively, and represent charges recorded in connection with restructuring and long-lived asset impairments.

In 2005, we recorded $1.0 million of expense in connection with our 2004 restructuring program and $0.4 million of expense in connection with our 2002 restructuring program and a facility closed in connection with our acquisition of Maxia.

In 2004, in conjunction with our 2004 restructuring program, we recorded $39.0 million in expense, including charges related to the closure of our Palo Alto facility, previously capitalized tenant improvements and equipment, a workforce reduction and other items. In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded a charge of $12.1 million to adjust the carrying value of previously capitalized costs associated with the preparation, prosecution and maintenance of our gene patent portfolio to its estimated fair market value. During 2004 we also recorded charges of $3.1 million related primarily to a reduction in estimated sublease income for a facility closed in connection with our 2002 restructuring program and a facility closed in connection with our acquisition of Maxia.

In 2003, we restructured our information product line in connection with the discontinuance of our clone activities and support functions and recorded expense of $11.5 million related to the elimination of certain employees and the write-down of certain assets. In 2003, we also recorded expense of $4.4 million related primarily to our 2002 restructuring program.

***Other income (expense)***

*Interest and other income (expense), net.* Interest and other income (expense), net, for the years ended December 31, 2005, 2004, and 2003, was $12.5 million, $3.6 million, and $(8.0) million, respectively. The increase in 2005 from 2004 was primarily due to higher interest rates in 2005, a $2.8 million gain from the 2005 sale of securities of a strategic investee and a $5.2 million decline in long-term investment impairment charges from 2004 to 2005, partially offset by a lower average cash balance. The increase in 2004 from 2003 was primarily due to higher interest income associated with cash invested in connection with the issuance of $250 million of 3¹¤₂% convertible subordinated notes in the first quarter of 2004 and $83.3 million of net proceeds from a public offering of common stock in November 2004 and a $12.8 million decrease in long-term investment impairment charges.

*Interest expense.* Interest expense for the years ended December 31, 2005, 2004, and 2003 was $16.1 million, $17.2 million, and $9.6 million, respectively. The decrease in 2005 from 2004 is related to lower interest expense associated with our repurchase of $36.5 million face value of our 5.5% convertible subordinated notes due 2007. The increase in 2004 from 2003 is related to additional interest expense incurred as a result of the issuance of $250 million of 3¹¤₂% convertible subordinated notes in the first quarter of 2004 partially offset by reduced interest expense associated with our repurchase of $38.4 million face value of our 5.5% convertible subordinated notes due 2007.



*Gain (loss) on certain derivative financial instruments.* Gain (loss) on certain derivative financial instruments for the years ended December 31, 2005, 2004, and 2003 of $(0.1) million, $(0.5) million, and $0.2 million, respectively, represents the change in fair value of certain long-term investments, specifically warrants held in other companies, in accordance with FASB Statement No. 133, *Accounting for Derivative Financial Instruments and Hedging Activities* (“SFAS 133”). Gain or loss on derivative financial instruments may fluctuate in any given period based upon current market conditions and is recognized during the period of change.

*Gain (loss) on repurchase of convertible subordinated notes.* In 2005, 2004, and 2003, we repurchased $36.5 million, $38.4 million, and $3.8 million face value of our 5.5% convertible subordinated notes due 2007 on the open market, respectively. The repurchase resulted in a gain of $0.5 million for the year ended December 31, 2005, a loss of $0.2 million for the year ended December 31, 2004, and a gain of $0.7 million for the year ended December 31, 2003.

*Provision (benefit) for income taxes.* Due to our net losses in 2005, 2004, and 2003, we had a minimal effective annual income tax rate. The provision (benefit) for income taxes for 2005, 2004, and 2003 are primarily attributable to foreign withholding taxes.

*Gain (loss) from discontinued operation.* The gain from discontinued operation of $0.3 million in 2005 and losses from discontinued operation of $1.2 million and $0.1 million in 2004, and 2003, respectively, represent the results of our Proteome facility based in Beverly, Massachusetts. In December 2004, we entered into an agreement to sell certain assets and liabilities related to our Proteome facility, which transaction subsequently closed in January 2005. The consolidated financial statements have been restated to present the operations of our Proteome facility as a discontinued operation for all periods presented. (see note 19 to the consolidated financial statements).

**Recent Accounting Pronouncements**

In November 2005, the FASB issued staff position FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* ("FSP 115-1"). FSP 115-1 address the determination as to when an investment is considered impaired, whether that impairment is other than temporary and the measurement of an impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in FSP 115-1 amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock.*

FSP 115-1 replaces the impairment evaluation guidance of EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-1"), with references to existing other-than-temporary impairment guidance. EITF 03-1's disclosure requirements remain in effect, and are applicable for year-end reporting and for interim periods if there are significant changes from the previous year-end. FSP 115-1 also supersedes EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*, and clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. FSP 115-1 applies to reporting periods beginning after December 15, 2005. We do not expect FSP 115-1 will have a material impact on our financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"). SFAS 123R requires the compensation cost relating to stock-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued on the grant date of such instruments, and will be recognized over the period during which an individual is required to provide service in exchange for the award (typically the vesting period). SFAS 123R covers a wide range of stock-based compensation arrangements including stock



options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. SFAS 123R replaces SFAS 123 and supersedes APB Opinion 25. In April 2005, the Securities and Exchange Commission delayed the effective date of SFAS 123R to the first interim or annual reporting period of a company's first fiscal year beginning on or after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We adopted SFAS 123R on January 1, 2006.

SFAS 123R permits public companies to adopt its requirement using one of two methods: 1) a "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the fair value as measured under SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date; or 2) a "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) to the start of the fiscal year in which SFAS 123R is adopted. We adopted SFAS 123R using the modified prospective method.

As permitted by SFAS 123, prior to January 1, 2006, we accounted for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, generally recognized no compensation cost for employee stock options which had exercise prices equal to the fair market value of our common stock at the date of granting the option. Accordingly, the adoption of SFAS 123R's fair value method will have a significant impact on our result of operations, although it will have no impact on our overall financial position. We expect the adoption of SFAS 123R will result in $5.0 million to $6.0 million of research and development expense and $2.0 million to $3.0 million of selling, general and administrative expense in 2006. The impact of expensing share-based payments, including employee stock options, will be dependent upon the level of share-based payments issued, as well as the market price and other judgmental assumptions used in estimating the fair value of such instruments. Had we adopted SFAS 123R in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net loss and loss per share in Note 1 to our consolidated financial statements. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. It is unlikely that we will have near term benefits from tax deductions. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. We cannot estimate what those amounts will be in the future because of various factors, including the timing of employee exercises and whether we will be in a taxable position. At this time, there would be no tax impact related to the prior periods since we are in a net loss position.

In October 2005, the FASB issued a staff position FSP SFAS No. 123(R)-2, *Practical Accommodation of Grant Date as Defined in FASB Statement No. 123(R)* ("FSP SFAS No. 123(R)-2"). FSP SFAS No. 123(R)-2 is in response to recent inquiries from constituents to provide guidance on the application of grant date as defined in SFAS 123R. One of the criteria in defining the grant date in SFAS 123R is a mutual understanding by the employer and the employee of the key terms and conditions of a share-based payment award. Practice has developed such that the grant date of an award is generally the date the award is approved in accordance with an entity's corporate governance provisions, so long as the approved grant is communicated to employees within a relatively short period of time from the date of approval. For many companies, the number and geographic dispersion of employees receiving share-based awards limit the ability to communicate with each employee immediately after the awards have been approved by the Board of Directors. As a practical accommodation, a mutual understanding of the key terms and conditions of an award to an individual employee shall be presumed to exist at the date the award is approved if the award is a unilateral grant and the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. FSP SFAS No. 123(R)-2 was effective for us on January 1, 2006. We do not expect the adoption of FSP

SFAS No. 123(R)-2 to have a material impact on our consolidated financial position, results of operations or cash flows.

**Liquidity and Capital Resources**

As of December 31, 2005, we had $345.0 million in cash, cash equivalents and marketable securities, compared to $469.8 million as of December 31, 2004. We have historically financed our operations primarily through the sale of equity securities, the issuance of convertible subordinated notes and cash received from our customers. We have classified all of our marketable securities as short-term, as we may choose not to hold our marketable securities until maturity. Available cash is invested in accordance with our investment policy's primary objectives of liquidity, safety of principal and diversity of investments.

Net cash used in operating activities was $101.8 million, $114.7 million, and $118.3 million for the years ended December 31, 2005, 2004, and 2003, respectively. The $12.9 million decrease from 2004 to 2005 was due primarily to a decrease of $21.4 million used to fund restructuring expenses and $1.2 million decrease used to fund interest expense. These items were partially offset by a $7.1 million reduction in cash received from customer sales and an increase of $6.0 million used to fund research and development and selling, general, and administrative expenses.

The $3.6 million decrease in net cash used in 2004 as compared to 2003 was primarily due to a $42.6 million decline in cash used to fund operating expenses and a $6.3 million decline in cash used to purchase in process research and development. These items were partially offset by a $24.6 million reduction in cash received from customers sales, a $12.8 million increase in cash used for restructuring and increased interest costs of $7.7 million.

Our investing activities, other than purchases, sales and maturities of marketable securities, have consisted predominantly of capital expenditures and sales and purchases of long-term investments. Capital expenditures for the years ended December 31, 2005, 2004, and 2003, were $1.6 million, $1.4 million, and $9.7 million, respectively. Capital expenditures decreased in 2004 from 2003 due to reduced operational needs related to our information products activities, partially offset by increased spending in support of drug discovery and development efforts. In 2003, we expended $5.7 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 maturities/sales and purchases of marketable securities.

Net cash used in financing activities was $34.3 million for the year ended December 31, 2005, while net cash provided by financing activities was $294.2 million for the year ended December 31, 2004, and net cash used in financing activities was $1.2 million for the year ended December 31, 2003. During 2005, we paid $35.8 million in connection with repurchases of $36.5 million in face value of our 5.5% convertible subordinated notes due 2007 (the "5.5% Notes"), offset partially by $1.5 million of proceeds from issuance of common stock under our stock plans and employee stock purchase plan. During 2004, we issued a total of $250.0 million of 3 ½% convertible subordinated notes due 2011 (the "3 ½% Notes"), which resulted in net proceeds of approximately $242.5 million. In 2004, we also repurchased $38.4 million face value of 5.5% Notes on the open market for $38.4 million. In November 2004, we completed a public offering of 9 million shares of common stock, resulting in net proceeds of $83.3 million after deducting the underwriting discounts, commissions and offering expenses. Cash proceeds from the issuance of common stock under our stock option and employee stock purchase plans in 2004 were $6.8 million. We repurchased $3.8 million face value of our 5.5% Notes on the open market for $3.1 million in 2003, offset by proceeds from the issuance of common stock under our stock option and employee stock purchase plans of $2.0 million.



The following summarizes our significant contractual obligations as of December 31, 2005 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in millions):

| | Total | Less Than 1 Year | Years 1 - 3 | Years 4 - 5 | Over 5 Years |
|---|---|---|---|---|---|
| **Contractual Obligations:** | | | | | |
| Principal on convertible subordinated debt | $ 341.6 | $ — | $ 91.6 | $ — | $ 250.0 |
| Interest on convertible subordinated debt | 55.7 | 13.8 | 20.0 | 17.5 | 4.4 |
| Non-cancelable operating lease obligations: | | | | | |
| Related to current operations | 11.6 | 4.4 | 7.2 | — | — |
| Related to vacated space | 41.8 | 8.0 | 16.6 | 16.1 | 1.1 |
| Total contractual obligations | $ 450.7 | $ 26.2 | $ 135.4 | $ 33.6 | $ 255.5 |

The amounts and timing of payments related to vacated facilities may vary based on negotiated timing of lease terminations. We have entered into sublease agreements for our vacated space with scheduled payments to us of $2.4 million (less than 1 year), $3.5 million (years 1-3), $3.3 million (years 4-5), and $0.3 million (over 5 years); these scheduled payments are not reflected in the above table.

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

Additional commitments related to Maxia and Pharmasset are also considered contingent commitments as future events must occur to cause these commitments to be enforceable. In February 2003, we completed our acquisition of Maxia. Under the merger agreement, former Maxia stockholders have the right to receive certain earn out amounts of up to a potential aggregate amount of $14.0 million upon the occurrence of certain research and development milestones set forth in the merger agreement. Twenty percent of each earn out payment, if earned, will be paid in cash and the remaining eighty percent will be paid in shares of our common stock such that an aggregate of $2.8 million in cash and $11.2 million in our common stock (based upon the then fair value) could potentially be paid pursuant to the earn out milestones. The milestones are set to occur as Maxia products enter various stages of human clinical trials and may be earned at any time prior to the tenth anniversary of the consummation of the merger. In any event, no more than 13,531,138 shares of our common stock may be issued to former Maxia stockholders in the aggregate pursuant to the merger agreement. None of these milestones has been achieved as of December 31, 2005.

Under the terms of our collaborative licensing agreement with Pharmasset, we agreed to pay Pharmasset certain future performance milestone payments and future royalties on net sales; one of these milestones was met in the second quarter of 2004, resulting in $0.5 million of research and development expense. An additional performance milestone was achieved in July 2005, resulting in $1.5 million of research and development expense.

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

We expect to use net cash in 2006 as we invest in our drug discovery and development programs; make payments related to our restructuring programs; and continue to seek access to technologies through investments, research and development and new alliances, license agreements and/or acquisitions.

We believe that our cash, cash equivalents and marketable securities will be adequate to satisfy our capital needs for at least the next twelve months. Our cash requirements depend on numerous factors, including our expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary products, technologies and businesses; expenditures in connection with



potential repayments of 5.5% Notes and 3½% Notes; expenditures in connection with our drug discovery and development programs; expenditures in connection with litigation; competing technological and market developments; the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights; our receipt of any milestone payments under our collaborative agreement with Pfizer; and costs associated with the integration of new operations assumed through mergers and acquisitions. Changes in our research and development plans or other changes affecting our operating expenses may result in changes in the timing and amount of expenditures of our capital resources. We expect that future revenues generated from information products, including licensing of intellectual property, will continue to decline as we focus on drug discovery and development programs, and in 2006, will not represent a significant source of cash inflow for us.

**Off Balance Sheet Arrangements**

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

**Item 7A.** ***Quantitative and Qualitative Disclosures About Market Risk***

Our investments in marketable securities, which are composed primarily of investment-grade corporate bonds, U.S. government agency debt securities and mortgage and asset-backed securities, are subject to default, changes in credit rating and changes in market value. These investments are also subject to interest rate risk and will decrease in value if market interest rates increase. Our marketable securities also include our investment in the common stock of Genomic Health, Inc. At December 31, 2005, the fair market value of our investment in Genomic Health, Inc. was $14.1 million. This value could decrease based on the volatility of the equity markets and uncertainty of the biotechnology industry, as well as due to specific factors relating to that company's operating results and business. As of December 31, 2005, cash, cash equivalents and marketable securities were $345.0 million. Due to the nature of these investments, if market interest rates were to increase immediately and uniformly by 10% from levels as of December 31, 2005, the decline in fair value would not be material.



**Item 8.** ***Financial Statements and Supplementary Data***

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Stockholders of Incyte Corporation**

We have audited the accompanying consolidated balance sheets of Incyte Corporation, as of December 31, 2005 and 2004, and the related consolidated statements of operations, comprehensive loss, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at item 15 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Incyte Corporation, at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Incyte Corporation's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
February 24, 2006



**INCYTE CORPORATION**

**CONSOLIDATED BALANCE SHEETS**

**(in thousands, except number of shares and par value)**

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 11,494 | $ 132,180 |
| Marketable securities—available-for-sale | 333,477 | 337,584 |
| Accounts receivable, net | 1,423 | 2,143 |
| Prepaid expenses and other current assets | 7,582 | 7,142 |
| Assets of discontinued operation | — | 2,264 |
| Total current assets | 353,976 | 481,313 |
| Property and equipment, net | 7,667 | 9,959 |
| Long-term investments(1) | 1,368 | 11,427 |
| Intangible and other assets, net(2) | 11,097 | 14,220 |
| Total assets | $ 374,108 | $ 516,919 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)** | | |
| Current liabilities: | | |
| Accounts payable | $ 3,573 | $ 2,321 |
| Accrued compensation | 7,590 | 7,876 |
| Interest payable | 5,382 | 6,217 |
| Accrued and other current liabilities(3) | 5,124 | 4,838 |
| Deferred revenue | 604 | 1,807 |
| Accrued restructuring and acquisition costs | 5,584 | 5,873 |
| Liabilities of discontinued operation | — | 2,549 |
| Total current liabilities | 27,857 | 31,481 |
| Convertible subordinated notes | 341,862 | 378,766 |
| Other liabilities | 23,786 | 28,155 |
| Total liabilities | 393,505 | 438,402 |
| Commitments and contingencies | | |
| Stockholders' equity (deficit): | | |
| Preferred stock, $0.001 par value; 5,000,000 shares authorized; none issued andoutstanding as of December 31, 2005 and 2004 | — | — |
| Common stock, $0.001 par value; 200,000,000 shares authorized; 83,597,080 and 83,022,414 shares issued and outstanding as of December 31, 2005 and 2004, respectively | 84 | 83 |
| Additional paid-in capital | 818,638 | 817,150 |
| Deferred stock-based compensation | — | (186) |
| Accumulated other comprehensive income (loss) | 1,228 | (2,226) |
| Accumulated deficit | (839,347) | (736,304) |
| Total stockholders' equity (deficit) | (19,397) | 78,517 |
| Total liabilities and stockholders' equity (deficit) | $ 374,108 | $ 516,919 |

(1) Includes investments in companies considered related parties under SFAS 57 of $1.3 million and $11.3 million as of December 31, 2005 and 2004, respectively.
(2) Includes loans to executive officers, net of amortization, of $0.0 million and $0.1 million as of December 31, 2005 and 2004, respectively. See Note 8.
(3) Includes accruals of payments to companies considered related parties under SFAS 57 of $0.0 million and $0.2 million as of December 31, 2005 and 2004, respectively.

See accompanying notes.



**INCYTE CORPORATION**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(in thousands, except per share amounts)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Revenues(1) | $ 7,846 | $ 14,146 | $ 41,197 |
| Costs and expenses: | | | |
| Research and development(2) | 95,618 | 88,271 | 111,404 |
| Selling, general and administrative(3) | 11,656 | 20,551 | 29,370 |
| Purchased in-process research and development | — | — | 33,952 |
| Other expenses(4) | 1,356 | 54,177 | 15,823 |
| Total costs and expenses | 108,630 | 162,999 | 190,549 |
| Loss from operations | (100,784) | (148,853) | (149,352) |
| Interest and other income (expense), net(5) | 12,527 | 3,563 | (7,988) |
| Interest expense | (16,052) | (17,241) | (9,561) |
| Gain (loss) on certain derivative financial instruments | (106) | (454) | 151 |
| Gain (loss) on repurchase of convertible subordinated notes(6) | 506 | (226) | 706 |
| Loss from continuing operations before income taxes | (103,909) | (163,211) | (166,044) |
| Provision (benefit) for income taxes | (552) | 453 | 342 |
| Loss from continuing operations | (103,357) | (163,664) | (166,386) |
| Gain (loss) from discontinued operation, net of tax | 314 | (1,153) | (77) |
| Net loss | $ (103,043) | $ (164,817) | $ (166,463) |
| Basic and diluted per share data: | | | |
| Continuing operations | $ (1.24) | $ (2.19) | $ (2.33) |
| Discontinued operation | — | (0.02) | — |
| | $ (1.24) | $ (2.21) | $ (2.33) |
| Shares used in computing basic and diluted net loss per share | 83,321 | 74,555 | 71,369 |

(1) Includes revenues from transactions with companies considered related parties under SFAS 57 of $0.0 million, $1.1 million, and $1.1 million for the years ended December 31, 2005, 2004, and 2003, respectively.

(2) Includes expenses from transactions with companies considered related parties under SFAS 57 of $0.1 million, $0.3 million, and $2.1 million for the years ended December 31, 2005, 2004, and 2003, respectively.

(3) Includes stock-based compensation charges of $0.2 million, $0.5 million, and $1.6 million in 2005, 2004, and 2003, respectively, and compensation expense related to loans to executive officers of $0.1 million, $0.1 million, and $0.2 million in 2005, 2004, and 2003, respectively.

(4) 2005 charges related to restructuring charges. 2004 and 2003 charges related to restructuring charges and impairment of a long-lived asset.

(5) Includes a gain on the sale of securities of $2.8 million for the year ended December 31, 2005 and losses on long-term investments in companies considered related parties under SFAS 57 of $4.4 million and $14.4 million for the years ended December 31, 2004 and 2003, respectively.

(6) Includes a gain from a transaction with an individual considered a related party under SFAS 57 of $0.1 million for the year ended December 31, 2005.

See accompanying notes.



**INCYTE CORPORATION**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

**(in thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Net loss | $ (103,043) | $ (164,817) | $ (166,463) |
| Other comprehensive loss: | | | |
| Unrealized gains (losses) on marketable securities | 3,776 | (1,022) | (3,660) |
| Reclassification adjustment for realized gains (losses) on marketable securities | (1,281) | (709) | 722 |
| Foreign currency translation adjustment | 959 | 71 | (82) |
| Other comprehensive gain (loss) | 3,454 | (1,660) | (3,020) |
| Comprehensive loss | $ (99,589) | $ (166,477) | $ (169,483) |

See accompanying notes



**INCYTE CORPORATION**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)**

**(in thousands, except number of shares)**

| | Common Stock | Additional Paid-in | Deferred Compensation | Accumulated Other | Accumulated Deficit | Total Stockholders' |
|---|---|---|---|---|---|---|

| | | Capital | | Comprehensive Income (Loss) | | Equity (Deficit) |
|---|---|---|---|---|---|---|
| Balances at December 31, 2002 | 67 | 708,163 | (3,250) | 2,454 | (405,024) | 302,410 |
| Issuance of 386,759 shares of Common Stock upon exercise of stock options and 534,459 shares of Common Stock under the ESPP | 1 | 1,996 | — | — | — | 1,997 |
| Issuance of 4,476,092 shares of Common Stock upon acquisition of Maxia Pharmaceuticals, Inc. | 5 | 17,498 | — | — | — | 17,503 |
| Adjustment of deferred compensation for terminated employees | — | (590) | 973 | — | — | 383 |
| Amortization of deferred compensation | — | — | 1,628 | — | — | 1,628 |
| Repurchase of 30,000 shares of Common Stock | — | (105) | — | — | — | (105) |
| Other comprehensive loss | — | — | — | (3,020) | — | (3,020) |
| Net loss | — | — | — | — | (166,463) | (166,463) |
| Balances at December 31, 2003 | 73 | 726,962 | (649) | (566) | (571,487) | 154,333 |
| Issuance of 987,911 shares of Common Stock upon exercise of stock options and 448,861 shares of Common Stock under the SPP | 1 | 6,830 | — | — | — | 6,831 |
| Issuance of 9,000,000 shares of Common Stock, net of offering costs. | 9 | 83,310 | — | — | — | 83,319 |
| Stock compensation expense | — | 48 | — | — | — | 48 |
| Amortization of deferred compensation | — | — | 463 | — | — | 463 |
| Other comprehensive loss | — | — | — | (1,660) | — | (1,660) |
| Net loss | — | — | — | — | (164,817) | (164,817) |
| Balances at December 31, 2004 | $ 83 | $ 817,150 | $ (186) | $ (2,226) | $ (736,304) | $ 78,517 |
| Issuance of 184,865 shares of Common Stock upon exercise of stock options and 389,801 shares of Common Stock under the ESPP | 1 | 1,488 | — | — | — | 1,489 |
| Amortization of deferred compensation | — | — | 186 | — | — | 186 |
| Other comprehensive gain | — | — | — | 3,454 | — | 3,454 |
| Net loss | — | — | — | — | (103,043) | (103,043) |
| Balances at December 31, 2005 | $ 84 | $ 818,638 | $ — | $ 1,228 | $ (839,347) | $ (19,397) |

See accompanying notes



## INCYTE CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

**(in thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| **Cash flows from operating activities:** | | | |
| Net loss | (103,043) | $ (164,817) | $ (166,463) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Loss (gain) from discontinued operations | (314) | 1,153 | 77 |
| Non-cash restructuring charges and impairment of long-lived assets | 2,324 | 32,825 | 7,309 |
| Non-cash purchased in-process research and development | — | — | 27,702 |
| Depreciation and amortization | 8,192 | 13,913 | 16,895 |
| Stock-based compensation | 186 | 463 | 1,628 |
| Loss (gain) on repurchase of convertible subordinated notes | (506) | 226 | (706) |
| Compensation expense on executive loans | 75 | 75 | 245 |
| Loss (gain) on derivative financial instruments, net | 106 | 454 | (151) |
| Impairment of long-term investments | — | 5,247 | 17,964 |
| Realized gain on long-term investments, net | (2,791) | (123) | (1,265) |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | 721 | 3,085 | 2,553 |
| Prepaid expenses and other assets | 2 | 513 | (2,426) |
| Accounts payable | 1,252 | (4,151) | (3,392) |
| Accrued and other liabilities | (6,849) | (404) | (13,851) |
| Deferred revenue | (1,203) | (2,728) | (4,689) |
| Net cash used in continuing operating activities | (101,848) | (114,269) | (118,570) |
| Net cash provided (used) in discontinued activities | (24) | (398) | 238 |
| Net cash used in operating activities | (101,872) | (114,667) | (118,332) |
| **Cash flows from investing activities:** | | | |
| Capital expenditures | (1,633) | (1,391) | (9,738) |
| Proceeds from the sale of long-term investments | — | 123 | 2,647 |
| Proceeds from the sale of equipment | 59 | 1,628 | — |
| Acquisition of Maxia Pharmaceuticals, Inc. (net of cash acquired) | — | — | (5,725) |
| Purchases of marketable securities | (348,540) | (830,494) | (575,483) |
| Sales of marketable securities | 134,327 | 378,911 | 457,412 |
| Maturities of marketable securities | 231,315 | 374,151 | 257,238 |
| Investing activities of discontinued operations | — | (88) | — |
| Net cash provided by (used in) investing activities | 15,528 | (77,160) | 126,351 |
| **Cash flows from financing activities:** | | | |
| Proceeds from issuance of common stock under stock plans | 1,489 | 6,831 | 1,997 |
| Repurchase of common stock | — | — | (105) |
| Repurchase of convertible subordinated notes | (35,837) | (38,412) | (3,059) |
| Net proceeds from issuance of convertible subordinated notes | — | 242,500 | — |
| Net proceeds from issuance of common stock | — | 83,319 | — |
| Net cash provided by (used in) financing activities | (34,348) | 294,238 | (1,167) |
| Effect of exchange rate on cash and cash equivalents | 6 | 71 | (82) |
| Net increase (decrease) in cash and cash equivalents | (120,686) | 102,482 | 6,770 |
| Cash and cash equivalents at beginning of period | 132,180 | 29,698 | 22,928 |
| Cash and cash equivalents at end of period | $ 11,494 | $ 132,180 | $ 29,698 |
| **Supplemental Schedule of Cash Flow Information** | | | |
| Interest paid | $ 15,467 | $ 13,554 | $ 9,262 |
| Taxes paid | $ 24 | $ 175 | $ 936 |
| **Supplemental Disclosure of Non-Cash Activity:** | | | |
| Reversal of deferred compensation | $ — | $ — | $ (973) |

See accompanying notes.

**INCYTE CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Organization and Summary of Significant Accounting Policies**

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

We were founded and incorporated in Delaware in 1991. Until 2001, we devoted substantially all of our resources to the development, marketing and sales of genomic technologies and products to the biotechnology and pharmaceutical industries and research and academic institutions. We also licensed access to our gene and genomics-related intellectual property to our customers. However, in recent years, consolidation within the pharmaceutical and biotechnology sectors and a challenging economic environment led to reduced demand for research tools and services. This trend, together with the public availability of genomic information, significantly reduced the market for, and revenues from, our information products.

On February 2, 2004, we announced substantial changes in our information products operations, including the closure of our Palo Alto, California facility and the cessation of development of the information products developed at this facility. In December 2004, we also entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts ("Proteome"), which transaction subsequently closed in January 2005. The consolidated financial statements have been restated to present Proteome as a discontinued operation.

*Principles of Consolidation.* The consolidated financial statements include the accounts of Incyte Corporation and our wholly owned subsidiaries. All material inter-company accounts, transactions, and profits have been eliminated in consolidation.

*Reclassifications.* Certain amounts reported in previous years have been reclassified to conform to the 2005 financial statement presentation.

*Use of Estimates.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

*Foreign Currency Translation.* The financial statements of subsidiaries outside the United States are measured using the local currency as the functional currency. Assets and liabilities of these subsidiaries are translated at the rates of exchange at the balance sheet date, as appropriate. The resulting translation adjustments are included in accumulated other comprehensive income loss, a separate component of stockholders'equity (deficit). Income and expense items are translated at average monthly rates of exchange.

*Concentrations of Credit Risk.* Cash, cash equivalents, marketable securities, trade receivables, and long-term strategic investments are financial instruments which potentially subject us to concentrations of credit risk. The estimated fair value of financial instruments approximates the carrying value based on available market information. We primarily invest our excess available funds in notes and bills issued by the U.S. government and its agencies and corporate debt securities and, by policy, limit the amount of credit exposure to any one issuer and to any one type of investment, other than securities issued or guaranteed by the U.S. government. Our customers for our information products are primarily





pharmaceutical and biotechnology companies which are typically located in the United States and Europe. We have not experienced any significant credit losses on cash, cash equivalents, marketable securities or trade receivables to date and do not require collateral on receivables.

*Cash and Cash Equivalents.* Cash and cash equivalents are held in U.S. banks or in custodial accounts with U.S., and U.K. banks. Cash equivalents are defined as all liquid investments with maturity from date of purchase of 90 days or less that are readily convertible into cash and have insignificant interest rate risk.

*Marketable Securities—Available-for-Sale.* All marketable securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, based on quoted market prices, with unrealized gains and losses, net of tax, reported as a separate component of stockholders' equity (deficit). The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretions of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other than temporary for available-for-sale securities are included in "Interest and other income (expense), net." The cost of securities sold is based on the specific identification method.

*Accounts Receivable.* Accounts receivable as of December 31, 2005 and 2004 were net of an allowance for doubtful accounts of $0.2 million and $0.3 million, respectively.

*Property and Equipment.* Property and equipment is stated at cost, less accumulated depreciation and amortization. Depreciation is recorded using the straight-line method over the estimated useful lives of the respective assets (generally three to five years). Leasehold improvements are amortized over the shorter of the estimated useful life of the assets or lease term.

Certain laboratory and computer equipment used by us could be subject to technological obsolescence in the event that significant advancement is made in competing or developing equipment technologies. Management continually reviews the estimated useful lives of technologically sensitive equipment and believes that those estimates appropriately reflect the current useful life of our assets. In the event that a currently unknown significantly advanced technology became commercially available, we would re-evaluate the value and estimated useful lives of our existing equipment, possibly having a material impact on the financial statements.

*Valuation of Long-Lived Assets.* Long-lived assets, including certain identifiable intangible assets and goodwill, to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable such as a significant industry downturn or a significant decline in our market value. Determination of recoverability is based on an estimate of undiscounted cash flows resulting from the use of the asset and its eventual disposition. Measurement of impairment charges for long-lived assets and certain identifiable intangible assets that management expects to hold and use are based on the fair value of such assets. Long-lived assets and certain identifiable intangible assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

*Long-Term Investments.* We have made equity and debt investments in a number of companies whose businesses may be complementary to our business. Most of these investments were made in connection with the establishment of a collaborative arrangement between us and the investee company. Our long-term investments have historically consisted of investments in both privately and publicly-held companies in which we have owned less than 20% of the outstanding voting stock and have not had the





ability to exert significant influence over the investees. Accordingly, our long-term investments in privately-held companies have been accounted for under the cost method and our investments in publicly-held companies have been accounted for in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investments in publicly-held companies are classified as available-for-sale and are adjusted to their fair value each period based on their quoted market price with any adjustments being recorded in accumulated other comprehensive income (loss) as a separate component of stockholders' equity (deficit).

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

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

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

*Derivative Financial Instruments.* We hold warrants to purchase equity securities of other companies. Warrants that can be exercised and settled by delivery of net shares such that we pay no cash upon exercise or that are held in public companies are deemed derivative financial instruments. Gains and losses resulting from changes in fair value are recognized on the consolidated statement of operations, "Gain (loss) on certain derivative financial instruments" in the period of change. We determine the fair value of our warrants through option pricing models using current market price and volatility assumptions.

*Intangible and Other Assets.* Costs of patents, patent applications and patent defense for gene and genomic patents are capitalized and amortized on a straight-line basis over their estimated useful lives of approximately five 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 three years.

*Income Taxes.* Income taxes are accounted for using SFAS No. 109 "Accounting for Income Taxes." Deferred income taxes are provided at the currently enacted income tax rates for the difference between the financial statement and income tax basis of assets and liabilities and carry-forward items. The effective tax rate and the tax basis of assets and liabilities reflect management's estimates of the ultimate outcome of various tax audits and issues. In addition, valuation allowances are established for deferred tax assets where the amount of expected future taxable income from operations does not support the realization of the asset. We believe that the current assumptions and other considerations used to estimate the current year effective and deferred tax

positions are appropriate. However, if the actual outcome of future tax consequences differs from our estimates and assumptions, the resulting change to the provision for income taxes could have a material impact on our consolidated financial statements.

*Internal Use Software.* We account for software developed or obtained for internal use in accordance with Statement of Position 98-1 *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* ("SOP 98-1"). The statement requires capitalization of certain costs incurred in the development of internal-use software, including external direct material and service costs, employee payroll and payroll related costs. Capitalized software costs, which are included in property and equipment, are depreciated over three to five years.

*Accumulated Other Comprehensive Income (Loss).* Accumulated other comprehensive income (loss) consists of the following:

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| | (in thousands) | |
| Unrealized gains (losses) on marketable securities | $ 1,235 | $ (1,260) |
| Cumulative translation adjustment | (7) | (966) |
| | $ 1,228 | $ (2,226) |

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

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





recognition thereon. Revenues from custom products, such as clones and datasets, were recognized upon completion and delivery.

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

In November 2002, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board issued EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"), which addresses certain aspects of the accounting for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. Under EITF 00-21, revenue arrangements with multiple deliverables should be divided into separate units of accounting if the deliverables meet certain criteria, including whether the delivered items have stand alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. In addition, the consideration should be allocated among the separate units of accounting based on their fair values, and the applicable revenue recognition criteria should be considered separately for each of the separate units of accounting. EITF 00-21 became effective for revenue arrangements we entered into after June 30, 2003. The application of EITF 00-21 did not have a material impact on our revenue arrangements for the years ended December 31, 2005, 2004, and 2003.

Revenues received from agreements with customers in which we have an equity interest were $0.0 million, $1.1 million and $0.8 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Revenues recognized from transactions in which there was originally a concurrent commitment to purchase goods or services from the other party to the transaction for the years ended December 31, 2005, 2004 and 2003 were $0.0 million, $1.5 million and $3.5 million, respectively. No new transactions in which there was a concurrent commitment by us to purchase goods or services from the other party to the transaction were entered into during the year ended December 31, 2005. Of commitments made in prior periods, we expensed $0.0 million, $7.5 million and $10.8 million for the years ended December 2005, 2004 and 2003, respectively.

The above transactions were recorded at fair value in accordance with our revenue and expense recognition policies.

*Research and Development.* Research and development expenses are comprised of the following types of costs incurred in performing research and development activities: salaries and related benefits, collaboration and outside services, and occupancy and all other costs. In accordance with Statement of Financial Accounting Standards No. 2 ("FAS 2"), *Accounting for Research and Development Costs*, it is our policy to expense research and development costs as incurred. We often contract with Clinical Research Organizations ("CROs") to facilitate, coordinate and perform agreed upon research and development of a new drug. To ensure that research and development costs are expensed as incurred, we record monthly accruals for clinical trial and preclinical testing costs based on the work performed under the contract.

These CRO contracts typically call for payment of fees for services at the initiation of the contract and/or upon the achievement of certain clinical trial milestones. In the event that we prepay CRO fees for future milestones, we record the prepayment as a prepaid asset and amortize the asset into research and development expense over the period of time the contracted research and development services are performed. Most professional fees, including project and clinical management, data management, monitoring, and medical writing fees are incurred throughout the contract period. These professional fees are expensed based on their percentage of completion at a particular date.

Our CRO contracts generally include pass through fees. Pass through fees include, but are not limited to, regulatory expenses, investigator fees, travel costs, and other miscellaneous costs including shipping and printing fees. Because these fees are incurred at various times during the contract term and they are used throughout the contract term, we record a monthly expense allocation to recognize the fees during the contract period. Fees incurred to set up the clinical trial are expensed during the setup period.

*Purchased In-process Research and Development.* Costs to purchase in-process research and development projects and technologies which have no alternative future use and which have not reached technological feasibility at the date of acquisition are expensed as incurred.

*Other Expenses.* We recognize other expenses in connection with our plans to exit certain activities. In connection with our exit activities, we record other expenses for employee termination benefit costs, long-lived asset impairments, costs related to leased facilities to be abandoned or subleased, and other exit-related costs. These charges were incurred pursuant to formal plans developed by management and accounted for in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, ("SFAS 146"), 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 EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* ("EITF 95-3"). Fixed assets that are written off or impaired as a result of restructuring plans are typically held for sale or scrapped. The remaining carrying value of such assets was not material as of December 31, 2005 and 2004. The recognition of other expenses requires our management to make judgments and estimates regarding the nature, timing, and amount of costs associated with the planned exit activity, including estimating sublease income and the fair value, less sales costs, of equipment to be disposed of. Management's estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities already recorded. At the end of each reporting period, we evaluate the remaining accrued balances to ensure that they are adequate, that no excess accruals are retained, and that the utilization of the provisions are for their intended purposes in accordance with developed exit plans.





*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 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 Years Ended December 31, | | | Employee Stock Purchase Plan For the Years Ended December 31, | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Average risk-free interest rates | 3.95% | 2.40% | 2.68% | 3.64% | 1.59% | 1.39% |
| Average expected life (in years) | 3.29 | 3.27 | 3.56 | 0.50 | 1.11 | 0.66 |
| Volatility | 86% | 89% | 89% | 90% | 90% | 96% |

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 option's 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 (in thousands, except per share amounts):

| | For the Years Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | (in thousands, except per share amounts) | | |
| Net loss, as reported | $ (103,043) | $ (164,817) | $ (166,463) |
| Add: Stock-based employee compensation | 186 | 511 | 1,950 |
| Deduct: Total stock-based employee compensation determined under the fair value based method for all awards | (9,777) | (6,217) | (11,995) |

| | | | |
|---|---|---|---|
| Pro forma net loss, SFAS 123 adjusted | $ (112,634) | $ (170,523) | $ (176,508) |
| Basic and diluted net loss per share—as reported | $ (1.24) | $ (2.21) | $ (2.33) |
| Basic and diluted net loss per share—SFAS 123 adjusted | $ (1.35) | $ (2.29) | $ (2.47) |





The weighted average fair value of stock awards (including restricted stock units) granted during 2005, 2004, and 2003 was $4.94, $4.87, and $2.80 per share, respectively. The average fair value of the employees' purchase rights under the Employee Stock Purchase Plan during 2005, 2004, and 2003 is estimated at $2.81, $1.99, and $1.81, respectively, on the date of grant using the Black-Scholes multiple-options pricing model.

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.

*Advertising Costs.* All costs associated with advertising products are expensed in the year incurred. Advertising expense for the years ended December 31, 2005, 2004, and 2003, was $0.0 million, $0.1 million, and $0.3 million, respectively.

*Recent Accounting Pronouncements.* In November 2005, the FASB issued staff position FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* ("FSP 115-1"). FSP 115-1 address the determination as to when an investment is considered impaired, whether that impairment is other than temporary and the measurement of an impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in FSP 115-1 amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

FSP 115-1 replaces the impairment evaluation guidance of EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-1"), with references to existing other-than-temporary impairment guidance. EITF 03-1's disclosure requirements remain in effect, and are applicable for year-end reporting and for interim periods if there are significant changes from the previous year-end. FSP 115-1 also supersedes EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*, and clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. FSP 115-1 applies to reporting periods beginning after December 15, 2005. We do not expect FSP 115-1 will have a material impact on our financial position, results of operations, or cash flows.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"). SFAS 123R requires the compensation cost relating to stock-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued on the grant date of such instruments, and will be recognized over the period during which an individual is required to provide service in exchange for the award (typically the vesting period). SFAS 123R covers a wide range of stock-based compensation arrangements including stock options, restricted stock plans, performance-based awards, stock appreciation rights, and employee stock purchase plans. SFAS 123R replaces SFAS 123 and supersedes APB Opinion 25. In April 2005, the Securities and Exchange Commission delayed the effective date of SFAS 123R to the first interim or annual reporting period of a company's first fiscal year beginning on or after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We adopted SFAS 123R on January 1, 2006.

SFAS 123R permits public companies to adopt its requirement using one of two methods: 1) a "modified prospective" method in which compensation cost is recognized beginning with the effective date





(a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the fair value as measured under SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date; or 2) a "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) to the start of the fiscal year in which SFAS 123R is adopted. We adopted SFAS 123R using the modified prospective method.

As permitted by SFAS 123, we currently account for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, generally recognize no compensation cost for employee stock options which have exercise prices equal to the fair market value of our common stock at the date of granting the option. Accordingly, the adoption of SFAS 123R's fair value method will have a significant impact on our result of operations, although it will have no impact on our overall financial position. We expect the adoption of SFAS 123R will result in $5.0 million to $6.0 million of research and development expense and $2.0 million to $3.0 million of selling, general and administrative expense in 2006. The impact of expensing share-based payments, including employee stock options, will be dependent upon the level of share-based payments issued, as well as the market price and other judgmental assumptions used in estimating the fair value of such instruments. Had we adopted SFAS 123R in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net loss and loss per share in Note 1 to our condensed consolidated financial statements. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. It is unlikely that we will have near term benefits from tax deductions. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. We cannot estimate what those amounts will be in the future because of various factors, including but not limited to the timing of employee exercises and whether we will be in a taxable position. At this time, there would be no tax impact related to the prior periods since we are in a net loss position.

In October 2005, the FASB issued a staff position FSP SFAS No. 123(R)-2, *Practical Accommodation of Grant Date as Defined in FASB Statement No. 123(R)* ("FSP SFAS No. 123(R)-2"). FSP SFAS No. 123(R)-2 is in response to recent inquiries from constituents to provide guidance on the application of grant date as defined in SFAS 123R. One of the criteria in defining the grant date in SFAS 123R is a mutual understanding by the employer and the employee of the key terms and conditions of a share-based payment award. Practice has developed such that the grant date of an award is generally the date the award is approved in accordance with an entity's corporate governance provisions, so long as the approved grant is communicated to employees within a relatively short period of time from the date of approval. For many companies, the number and geographic dispersion of employees receiving share-based awards limit the ability to communicate with each employee immediately after the awards have been approved by the Board of Directors. As a practical accommodation, a mutual understanding of the key terms and conditions of an award to an individual employee shall be presumed to exist at the date the award is approved if the award is a unilateral grant and the key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. FSP SFAS No. 123(R)-2 was effective for us on January 1, 2006. We do not expect the adoption of FSP SFAS No. 123(R)-2 to have a material impact on our consolidated financial position, results of operations or cash flows.





**Note 2. Concentrations of Credit Risk**

As of December 31, 2005, we previously had entered into agreements for information products and services, which include licensing a portion of our intellectual property, with pharmaceutical, biotechnology and agricultural companies and academic institutions. Such agreements represented 100% of revenues in 2005, 2004 and 2003. In general, customers agree to pay, during the term of the agreement, fees to receive non-exclusive access to selected modules of our databases and/or licenses of certain of our intellectual property. In addition, if a customer develops certain products utilizing our technology or proprietary information, we could potentially receive royalty and milestone payments.

A single customer contributed 21%, 11%, and 18% of total revenues for the years ended December 31, 2005 and 2004 and 2003, respectively.

Three customers comprised 67% and 46% of the accounts receivable balance as of December 31, 2005 and 2004, respectively.

We had one long-term investment as of December 31, 2005. The activity in our long-term investments, in any given quarter, may result in gains or losses on sales or impairment charges. Amounts realized upon disposition of these investments may be different from their carrying value.

**Note 3. Collaborative License Agreement**

In November 2005, we entered into a collaborative research and license agreement with Pfizer Inc. ("Pfizer") which became effective in January 2006. Pfizer gained worldwide development and commercialization rights to our portfolio of CCR2 antagonist compounds. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and one other undisclosed indication, where Incyte retained worldwide rights, along with certain compounds. Incyte does not have obligations to Pfizer on pre-clinical development candidates it selects for pursuit in these indications.

Incyte received an upfront non refundable payment of $40 million in January 2006 and is eligible to receive additional future development and milestone payments of up to $743 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. The $40 million upfront fee will be recorded as deferred revenue and will be recognized on a straight-line basis over two years, our estimated performance period under the agreement. Future development and milestone payments will be recognized as earned. We will also be recognizing revenue in connection with research services provided to Pfizer.

Pfizer purchased a $10 million convertible subordinated note in February 2006 and may purchase an additional $10 million note at Incyte's option after Incyte files an Investigational New Drug Application in a retained Incyte indication. The $10 million note purchased by Pfizer in February 2006 bears no interest, is due seven years from the date of issuance and is convertible into Incyte common stock at an initial conversion price of $6.8423 per share, subject to adjustments. The note is subordinated to all senior indebtness and pari passu in right of payment with our 3 ½% convertible subordinated notes due 2011 and our 5.5% convertible subordinated notes due 2007. We may, at our option, repay the note beginning February 3, 2009. Pfizer may require us to repay the note upon a change of control, as defined. As the $10 million note is non interest bearing, it will be discounted to its net present value by imputing interest at a rate of 4.5%, which represented market conditions in place at the time the note was issued. We will accrete the note up to its face value over its term of seven years by recording interest expense under the effective interest method. The difference between the cash received and the present value of the note represents additional consideration from Pfizer under the collaborative research and license agreement. We will





account for this additional consideration as deferred revenue and recognize it over two years, our estimated performance period under the collaborative research and license agreement.

**Note 4. Commitments**

As of December 31, 2005, we had noncancelable operating leases on multiple facilities and equipment, including facilities in Palo Alto, California; San Diego, California; Wilmington, Delaware; Beverly, Massachusetts; and Cambridge, England. The leases expire on various dates ranging from May 2006 to March 2011. Certain leases have renewal options for periods ranging up to 5 years. Rent expense, excluding rent expense recognized in the restructuring charges in 2004, for the years ended December 31, 2005, 2004 and 2003, was approximately $4.2 million, $6.7 million, and $8.6 million, respectively.

As of December 31, 2005, future noncancelable minimum payments under operating leases, including leases for sites included in the restructuring programs were as follows:

| Year ended December 31, | Operating Leases (in thousands) |
|---|---|
| 2006 | $ 12,405 |
| 2007 | 12,513 |
| 2008 | 11,206 |
| 2009 | 7,921 |
| 2010 | 8,136 |
| Thereafter | 1,134 |
| Total minimum lease payments | $ 53,315 |

The amounts and timing of payments related to vacated facilities may vary based on negotiated timing of lease terminations. We have entered into sublease agreements for our vacated space with scheduled payments to us of $2.4 million (less than 1 year), $3.5 million (years 1-3), $3.3 million (years 4-5), and $0.3 million (over 5 years).

In addition to the non-cancelable commitments included in the table above, we have entered into contractual arrangements that obligate us to make payments to the contractual counterparties upon the occurrence of future events. We consider these potential obligations contingent, and have summarized all significant arrangements below.

Additional commitments related to Maxia Pharmaceuticals, Inc. (“Maxia”) and Pharmasset Inc. (“Pharmasset”) (see Note 18, Purchased In-process Research and Development) are also considered contingent commitments as future events must occur to cause these commitments to be enforceable. In February 2003, we completed our acquisition of Maxia. Under the merger agreement, former Maxia stockholders have the right to receive certain earn out amounts of up to a potential aggregate amount of $14.0 million upon the occurrence of certain research and development milestones set forth in the merger agreement. Twenty percent of each earn out payment, if earned, will be paid in cash and the remaining eighty percent will be paid in shares of our common stock such that an aggregate of $2.8 million in cash and $11.2 million in our common stock (based upon the then fair value) could potentially be paid pursuant to the earn out milestones. The milestones occur as Maxia products enter various stages of human clinical trials and may be earned at any time prior to the tenth anniversary of the consummation of the merger. In any event, no more than 13,531,138 shares of our common stock may be issued to former Maxia





stockholders in the aggregate pursuant to the merger agreement. None of these milestones had been achieved as of December 31, 2005.

In September 2003, we entered into a collaborative licensing agreement with Pharmasset to develop and commercialize dexelvucitabine, an antiretroviral drug that is currently in Phase IIb clinical development for the treatment of human immunodeficiency virus. Under the terms of the agreement, we agreed to pay Pharmasset certain performance milestone payments and future royalties on net sales. One of these milestones was met in the second quarter of 2004, resulting in $0.5 million of research and development expense. An additional performance milestone was achieved in July 2005, resulting in $1.5 million of research and development expense.

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

### Note 5. Marketable Securities

The following is a summary of our marketable security portfolio as of December 31, 2005 and 2004, respectively.

| | Amortized Cost | Net Unrealized Gains | Net Unrealized (Losses) | Estimated Fair Value |
|---|---|---|---|---|
| | (in thousands) | | | |
| December 31, 2005 | | | | |
| Equity securities | $ 11,000 | $ 3,072 | $ — | $ 14,072 |
| Money markets with maturities over 90 days | 11,585 | — | (35) | 11,550 |
| U.S. Treasury notes and other U.S. government and agency securities | 57,738 | — | (344) | 57,394 |
| Mortgage backed securities | 56,982 | — | (489) | 56,493 |
| Corporate debt securities | 194,938 | — | (970) | 193,968 |
| | $ 332,243 | $ 3,072 | $ (1,838) | $ 333,477 |
| December 31, 2004 | | | | |
| U.S. Treasury notes and other U.S. government and agency securities | $ 79,551 | $ — | $ (579) | $ 78,972 |
| Mortgage backed securities | 62,780 | — | (279) | 62,501 |
| Corporate debt securities | 197,445 | 62 | (1,396) | 196,111 |
| | $ 339,776 | $ 62 | $ (2,254) | $ 337,584 |

As of December 31, 2005 and 2004, all of our marketable securities are classified as short-term because they are available-for-sale and may not be held until maturity. As of December 31, 2005, our marketable securities, excluding equity securities, had the following maturities:

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| | (in thousands) | |
| Less than one year | $ 107,926 | $ 107,432 |
| Between one and two years | 33,000 | 32,740 |
| | 140,926 | 140,172 |
| Mortgage and asset-backed securities | 180,317 | 179,234 |
| Total | $ 321,243 | $ 319,406 |

Actual maturities may differ from those scheduled as a result of prepayments by the issuers. Because of the potential for prepayment on mortgage and asset-backed securities, they are not categorized by contractual maturity.

Net realized gains (losses) of $1.3 million, $(0.7) million, and $0.7 million from sales of marketable securities were included in “Interest and other income/ (expense), net” in 2005, 2004, and 2003, respectively.

**Note 6. Property and Equipment**

Property and equipment consists of the following:

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| | (in thousands) | |
| Office equipment | $ 563 | $ 528 |
| Laboratory equipment | 12,379 | 11,393 |
| Computer equipment | 8,364 | 7,812 |
| Leasehold improvements | 2,016 | 1,957 |
| | 23,322 | 21,690 |
| Less accumulated depreciation and amortization | (15,655) | (11,731) |
| | $ 7,667 | $ 9,959 |

Depreciation expense, including amortization expense of assets under capital leases and leasehold improvements, was $3.9 million, $5.8 million and $11.7 million for 2005, 2004, and 2003, respectively.

**Note 7. Long-Term Investments**

At December 31, 2005, the carrying value of our long-term investments consisted of an equity investment in one privately-held company accounted for under the cost method, and the fair value of warrants to purchase common stock of one publicly held company accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. At December 31, 2004, the carrying value of our long-term investments consisted of equity investments in two privately-held companies accounted for under the cost method, one publicly-held company accounted for under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and the fair value of warrants to





purchase the common stock of one publicly-held company accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

In 2005 we sold our investment in the publicly-held company accounted for under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, for $5.7 million, resulting in a realized gain of $2.8 million.

As of December 31, 2004 we had a put right commitment to purchase up to $5.0 million of equity in an investee at any time on or after January 1, 2005, provided certain conditions were met. On October 4, 2005, these conditions were met and our investee exercised its right under which we were required to acquire $5.0 million of common stock. This investment has been accounted for as a short term investment under FASB Statement No.115, *Accounting for Certain Investments in Debt and Equity Securities*. See Note 5.

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

In 2003, we recorded impairment charges to reduce the carrying value of our investments in three privately-held investees by $12.5 million, $1.9 million and $1.5 million, respectively, because the investees had less than six months of cash and the likelihood of future debt or equity financing by the investees was remote. An impairment charge of $1.9 million was recorded in 2003 to reduce the carrying value of our investment in a privately-held investee because a reorganization by the investee resulted in a decline in ownership percentage. Finally, an impairment charge of $0.2 million was recorded in 2003 to reduce the carrying value of our investment in a privately-held investee due to a proposed acquisition of the investee by a third party under which existing shareholders of the investee would receive no cash or ownership interest in the acquiring entity.

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

**Note 8. Intangible and Other Assets**

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

| | December 31, 2005 | | | December 31, 2004 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, Net | Gross Carrying Amount | Accumulated Amortization | Intangible Assets, Net |
| Gene and genomics-related patent costs | $ 1,381 | $ (325) | $ 1,056 | $ 1,381 | $ — | $ 1,381 |
| Debt issuance cost | 13,222 | (6,724) | 6,498 | 13,520 | (5,082) | 8,438 |
| Other assets | 4,401 | (858) | 3,543 | 4,401 | — | 4,401 |
| Total intangible and other assets | $ 19,004 | $ (7,907) | $ 11,097 | $ 19,302 | $ (5,082) | $ 14,220 |





Amortization expense for the years ended December 31, 2005, 2004 and 2003 related to intangible assets was $2.7 million, $5.0 million and $4.4 million, respectively. The expected future annual amortization expense of our gene and genomics-related patent costs is $0.3 million per year through 2008.

In connection with our review of the recoverability of our long-lived assets during the second quarter of 2004, we revised the estimated useful life of our capitalized gene and genomics-related patent costs from ten to five years based on the increasingly competitive and challenging legal and economic environment for gene and genomics-related intellectual property. This change in accounting estimate increased our net loss by $2.5 million and our basic and diluted net loss per share from continuing operations by $0.03 in 2004. In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded a charge of $12.1 million to adjust the carrying value of previously capitalized costs associated with the preparation, prosecution and maintenance of our gene patent portfolio to its estimated fair market value.

In 2003, as part of our annual review of our existing long-lived assets, we determined, based on certain impairment indicators, that an asset related to capitalized software should be analyzed for impairment. As a result of this analysis, we determined that the net book value of the asset was in excess of future revenues expected from the sale of this asset reduced by costs to sell. It was therefore determined that this capitalized software was impaired, resulting in a $4.7 million impairment charge that has been recorded in “Other expenses.”

In January 2002, in connection with his employment by Incyte as President and Chief Scientific Officer, Robert B. Stein received an interest-free loan from us in the amount of $750,000 to be used toward the purchase of a residence in California. In August 2003, Dr. Stein terminated his employment with Incyte and in accordance with the terms of the loan, the outstanding principal balance of $750,000 was repaid in August 2004.

In March 2002, in connection with his employment by Incyte as Executive Vice President and Chief Drug Discovery Scientist, Brian W. Metcalf received an interest-free loan from us in the amount of $400,000 to be used for financing his residence in California. The loan is evidenced by a promissory note and secured by the residence. On February 6, 2003, 25% of the outstanding principal balance was forgiven, and 1/48 of the principal amount will be forgiven on the last day of each month thereafter, with the remaining outstanding principal balance of the loan forgiven on February 6, 2006. We are amortizing this loan to compensation expense on a straight-line basis over the forgiveness period.

Compensation expense related to amortization of the loans above was $0.1 million, $0.1 million, and $0.2 million in 2005, 2004, and 2003, respectively.

In December 2004, we assigned one of our existing facility operating leases to a third party. Under the terms of the consent agreement with the facility’s landlord, we were required to obtain a letter of credit in favor of the landlord in the amount of $2.6 million. The deposit and the related amount required under the letter of credit declines monthly on a pro-rata basis through March 2011, the remaining term of the lease agreement assigned. The deposit is included in other assets at December 31, 2005.

**Note 9. Convertible Subordinated Notes**

In February and March 2004, in a private placement, we issued a total of $250.0 million of 3¹¤₂% convertible subordinated notes due February 15, 2011 (the “3 ½% Notes”), which resulted in net proceeds of approximately $242.5 million. The notes bear interest at the rate of 3.5% per year, payable semi-





annually on February 15 and August 15. The notes are subordinated to all senior indebtedness and pari passu in right of payment with our 5.5% convertible subordinated notes due 2007. As of December 31, 2005, we had no senior indebtedness, as defined. The notes are convertible into shares of our common stock at an initial conversion price of approximately $11.22 per share, subject to adjustments. Holders may require us to repurchase the notes upon a change in control, as defined. We may redeem the notes beginning February 20, 2007.

In February 2000, in a private placement, we issued $200.0 million of 5.5% convertible subordinated notes due February 1, 2007 (the “5.5% Notes”), which resulted in net proceeds of approximately $196.8 million. The notes bear interest at 5.5%, payable semi-annually on February 1 and August 1. 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.

We repurchased on the open market, and retired, $36.5 million, $38.4 million, and $3.8 million in face value of 5.5% Notes during the years ended December 31, 2005, 2004, and 2003, respectively.

Gains (losses) of $0.5 million, $(0.2) million, and $0.7 million on these transactions were recognized for the years ended December 31, 2005, 2004 and 2003, respectively. As of December 31, 2005, we had repurchased, cumulatively, $108.4 million face value of the notes on the open market. All gains or losses on repurchase are presented as "Gain (loss) on repurchase of convertible subordinated notes" in our statement of operations.

At December 31, 2005 the carrying value of our 3½% Notes was $250.0 million while the fair market value was approximately $194.4 million. The carrying value of our 5.5% Notes approximated fair market value at December 31, 2005.

**Note 10. Stockholders' Equity (Deficit)**

*Preferred Stock.* We are authorized to issue 5,000,000 shares of preferred stock, none of which was outstanding as of December 31, 2005 or 2004. The Board of Directors may determine the rights, preferences and privileges of any preferred stock issued in the future. We have reserved 500,000 shares of preferred stock designated as Series A Participating Preferred Stock for issuance in connection with the Stockholders Rights plan described below.

*Common Stock.* As of December 31, 2005, we had reserved a total of 38,845,257 shares of our common stock for future issuance related to our stock plans, our Employee Stock Purchase Plan ("ESPP") described below and the conversion of the convertible subordinated notes described in Note 9.

On November 5, 2004, we completed a public offering of 9 million shares of our authorized but unissued common stock at $9.75 per share pursuant to an effective shelf registration statement, resulting in net proceeds of $83.3 million after deducting the underwriting discounts, commissions and offering expenses.

In June 2003, our stockholders approved an increase in the number of shares available for grant under the ESPP from 2,100,000 shares to 3,100,000 shares.

In October 2002, we announced that our Board of Directors authorized the expenditure of up to $30 million to repurchase shares of our common stock in the open market and privately negotiated





transactions. In 2002 and 2003 we repurchased and retired an aggregate of 1,165,000 shares for an aggregate purchase price of $5.8 million.

*Stock Compensation Plans.* Summaries of stock option activity for our stock option plans as of December 31, 2005, 2004, and 2003, and related information for the years ended December 31 are included in the plan descriptions below.

*1991 Stock Plan.* In November 1991, the Board of Directors adopted the 1991 Stock Plan (the "Stock Plan"), which was amended and restated for issuance of common stock to employees, consultants, and scientific advisors. Options issued under the plan shall, at the discretion of the compensation committee of the Board of Directors, be either incentive stock options, nonstatutory stock options or restricted stock units. The exercise prices of incentive and non-statutory stock options granted under the plan are not less than the fair market value on the date of the grant, as determined by the Board of Directors. Options generally vest over four years, pursuant to a formula determined by our Board of Directors, and expire after ten years. Certain options granted in 2002 vest pro rata monthly over three years and expire after ten years. In June 2002, our stockholders approved an increase in the number of shares of common stock reserved for issuance under the Stock Plan from 19,900,000 to 22,350,000.

During 2001, we granted 490,000 restricted stock units under the Stock Plan to certain management personnel. In connection with the grant of these restricted stock units, we recorded deferred compensation of $7.9 million in 2001. These restricted stock units have cliff vesting terms over one to four years and are being amortized to stock compensation expense over those vesting terms. During 2002, two executives who were previously granted restricted stock units terminated their employment with us. Accordingly, we reduced deferred compensation by $1.1 million to reflect the restricted stock units forfeited. During 2003, three executives, who were previously granted restricted stock units, terminated their employment with us. As stated in their respective employment agreements, each of these executives was given accelerated vesting with regard to their remaining unvested restricted stock units. Accordingly, we recorded a charge of $0.3 million to "Other expenses" and reduced deferred compensation by this amount to reflect the vesting of these restricted stock units in 2003.

*Non-Employee Directors' Stock Option Plan.* In August 1993, the Board of Directors approved the 1993 Directors' Stock Option Plan (the "Directors' Plan"), which was later amended. The Directors' Plan provides for the automatic grant of options to purchase shares of common stock to our non-employee directors. In June 2005, our stockholders approved an increase in the number of shares of common stock reserved for issuance under the plan from 1,100,000 to 1,500,000.

Under the Directors' Plan, each new non-employee director joining the Board will receive an option to purchase 35,000 shares of common stock. Additionally, members who continue to serve on the Board will receive annual option grants for 20,000 shares exercisable in full on the first anniversary of the date of the grant. All options are exercisable at the fair market value of the stock on the date of grant. As of December 31, 2005, we had options outstanding under the Directors' Plan to purchase 567,919 shares of common stock at a weighted average exercise price of $10.08 (522,919 and 483,000 shares of common stock at a weighted average exercise price of $11.32 and $11.186 as of December 31, 2004 and 2003, respectively); 422,919 shares are vested and exercisable as of December 31, 2005 (371,042 and 319,000 shares were vested and exercisable as of December 31, 2004 and 2003, respectively). In 2004 and 2003, respectively, 75,000 and 160,000 options were exercised to purchase shares of common stock under the Directors' Plan at a weighted average exercise price of $5.09 and $1.222, respectively. No options were exercised under the Directors' Plan in 2005.

In June 2003, the Directors' Plan was amended to allow the Board to increase an initial or annual grant to reflect an increase in job responsibilities of a Nonemployee Director or to induce a Nonemployee Director to become or remain a Nonemployee Director.

Activity under the combined plans was as follows:

| | | Shares Subject to Outstanding Options | |
|---|---|---|---|
| | Shares Available for Grant | Shares | Weighted Average Exercise Price |
| Balance at December 31, 2002 | 4,012,426 | 11,156,773 | $ 12.20 |
| Additional authorization | — | — | — |
| Options granted | (1,338,725) | 1,338,725 | $ 4.64 |
| Options exercised | — | (401,055) | $ 1.32 |
| Options cancelled | 3,554,160 | (3,562,557) | $ 14.39 |
| Balance at December 31, 2003 | 6,227,861 | 8,531,886 | $ 10.58 |
| Additional authorization | — | — | — |
| Options granted | (1,527,375) | 1,527,375 | $ 8.44 |
| Options exercised | — | (987,911) | $ 5.65 |
| Options cancelled | 2,546,751 | (2,552,605) | $ 13.67 |
| Balance at December 31, 2004 | 7,247,237 | 6,518,745 | $ 9.61 |
| Additional authorization | 400,000 | — | — |
| Options granted | (2,794,200) | 2,794,200 | $ 8.53 |
| Options exercised | — | (203,602) | $ 1.33 |
| Options cancelled | 1,295,121 | (1,310,942) | $ 11.97 |
| Balance at December 31, 2005 | 6,148,158 | 7,798,401 | $ 8.99 |

Options to purchase a total of 4,181,999, 3,525,632, and 4,462,976 shares as of December 31, 2005, 2004, and 2003, respectively, were exercisable and vested.

*Options Assumed in Proteome Acquisition.* As part of the Proteome acquisition completed in December 2000, Proteome stock option holders received options to purchase 216,953 shares of our common stock with a weighted average exercise price of $7.60. We recognized $2.5 million of deferred compensation related to these options, which was amortized over the vesting period of the options. In connection with the workforce reduction related to the restructurings in 2002 and 2001, we terminated the employment of certain Proteome stock option holders included in the original calculation and reduced the deferred compensation by $0.1 million as of December 31, 2002. In 2005, the Proteome workforce was terminated in connection with the sale of certain assets and liabilities related to our facility in Beverly, Massachusetts, resulting in the cancellation or exercise of all outstanding options under this plan.





The following table summarizes information about stock options outstanding as of December 31, 2005 for the 1991 Stock Plan and the 1993 Directors' Stock Option Plan:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| $3.10-$5.12 | 868,557 | 7.65 | $ 4.64 | 543,129 | $ 4.58 |
| $5.15-$5.97 | 1,020,503 | 7.11 | $ 5.58 | 926,746 | $ 5.62 |
| $6.03-$7.89 | 845,312 | 8.30 | $ 6.98 | 340,645 | $ 6.81 |
| $8.09-$8.19 | 830,642 | 8.22 | $ 8.18 | 368,300 | $ 8.19 |
| $8.49-$8.93 | 365,000 | 7.88 | $ 8.68 | 169,310 | $ 8.69 |
| $8.99-$8.99 | 1,910,300 | 9.05 | $ 8.99 | 4,270 | $ 8.99 |
| $9.12-$11.69 | 852,269 | 6.51 | $ 10.99 | 729,412 | $ 11.16 |
| $11.89-$16.19 | 853,000 | 5.72 | $ 14.96 | 847,369 | $ 14.97 |
| $17.81-$35.00 | 242,818 | 4.64 | $ 20.13 | 242,818 | $ 20.13 |
| $35.56-$35.56 | 10,000 | 4.43 | $ 35.56 | 10,000 | $ 35.56 |
| | 7,798,401 | 7.63 | $ 8.99 | 4,181,999 | $ 9.71 |

*Employee Stock Purchase Plan.* On May 21, 1997, our stockholders adopted the 1997 Employee Stock Purchase Plan ("ESPP"). In June 2002, our stockholders approved an increase in the number of shares of common stock reserved for issuance under the plan from 1,600,000 to 2,100,000. In June 2003, our stockholders approved an increase in the number of shares available for grant from 2,100,000 shares to 3,100,000 shares. Each regular full-time and part-time employee working 20 hours or more per week is eligible to participate after one month of employment. We issued 389,801, 448,861, and 534,459 shares under the ESPP in 2005, 2004, and 2003, respectively. As of December 31, 2005, 539,888 shares remain available for issuance under the ESPP.

*Stockholders Rights Plan.* On September 25, 1998, the Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan"), pursuant to which one preferred stock purchase right (a "Right") was distributed for each outstanding share of common stock held of record on October 13, 1998. One Right will also attach to each share of common stock issued by the Company subsequent to such date and prior to the distribution date defined below. Each Right represents a right to purchase, under certain circumstances, a fractional share of our Series A Participating Preferred Stock at an exercise price of $100.00, subject to adjustment. In general, the Rights will become exercisable and trade independently from the common stock on a distribution date that will occur on the earlier of (i) the public announcement of the acquisition by a person or group of 15% or more of the common stock or (ii) ten days after commencement of a tender or exchange offer for the common stock that would result in the acquisition of 15% or more of the common stock. Upon the occurrence of certain other events related to changes in ownership of the common stock, each holder of a Right would be entitled to purchase shares of common stock, or an

acquiring corporation's common stock, having a market value of twice the exercise price. Under certain conditions, the Rights may be redeemed at $0.01 per Right by the Board of Directors. The Rights expire on September 25, 2008.





**Note 11. Income Taxes**

The provision (benefit) for income taxes consists of the following (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Current | | | |
| Foreign | $ (228) | $ 385 | $ 419 |
| State | (324) | 68 | (77) |
| Total provision (benefit) for income taxes | $ (552) | $ 453 | $ 342 |

Loss from continuing operations before provision (benefit) for income taxes consists of the following (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| U.S. taxable entities | $ (103,030) | $ (162,044) | $ (164,020) |
| Other | (879) | (1,167) | (2,024) |
| | $ (103,909) | $ (163,211) | $ (166,044) |

The provision (benefit) for income taxes differs from the federal statutory rate as follows (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Provision (benefit) at U.S. federal statutory rate | $ (36,300) | $ (57,100) | $ (58,115) |
| Unbenefitted net operating losses and tax credits | 36,200 | 56,800 | 48,532 |
| In-process research and development | — | — | 9,696 |
| Other | (452) | 753 | 229 |
| Provision (benefit) for income taxes | $ (552) | $ 453 | $ 342 |





Significant components of our deferred tax assets are as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2005 | 2004 |
| Deferred tax assets: | | |
| Federal and state net operating loss carryforwards | $ 334,700 | $ 291,300 |
| Federal and state research credits | 30,000 | 21,600 |
| Investments | 3,600 | 12,100 |
| Federal and state capital loss carryforwards | 14,700 | 7,300 |
| Other, net | 14,700 | 17,400 |
| Total gross deferred tax assets | 397,700 | 349,700 |
| Less valuation allowance for deferred tax assets | (391,800) | (343,000) |
| Net deferred tax assets | 5,900 | 6,700 |
| Deferred tax liabilities: | | |
| Depreciation of fixed assets | 5,900 | 6,100 |
| Purchased intangibles | — | 600 |
| Total gross deferred tax liabilities | 5,900 | 6,700 |
| Net deferred tax assets and liabilities | $ — | $ — |

The valuation allowance for deferred tax assets increased by approximately $48.8 million, $60.2 million, and $77.3 million during the years ended December 31, 2005, 2004, and 2003, respectively. Approximately $61.5 million of the valuation allowance for deferred tax assets relates to benefits from stock option deductions which, when recognized, will be allocated directly to contributed capital.

Management believes the uncertainty regarding the timing of the realization of net deferred tax assets requires a valuation allowance.

As of December 31, 2005, we had federal and state net operating loss carryforwards of approximately $833.0 million. We also had federal and state research and development tax credit carryforwards of approximately $30.0 million. The net operating loss carryforwards and tax credits will expire at various dates, beginning in 2006 through 2024, if not utilized. Utilization of the net operating losses and credits may be subject to an annual limitation, due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. We also had federal and state capital loss carryforwards of approximately $36.6 million that will expire beginning in 2009.





**Note 12. Net Loss Per Share**

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

| | December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Outstanding stock options | 7,798,401 | 6,518,745 | 8,531,886 |
| Common shares issuable upon conversion of 5.5% notes | 1,358,865 | 1,900,043 | 2,469,667 |
| Common shares issuable upon conversion of 3¼% notes | 22,284,625 | 22,284,625 | — |
| Total potential common shares excluded from diluted net loss per share computation | 31,441,891 | 30,703,413 | 11,001,553 |

**Note 13. Defined Contribution Plan**

We have a defined contribution plan qualified under Section 401(k) of the Internal Revenue Code covering all domestic employees. Employees may contribute a portion of their compensation, which is then matched by us, subject to certain limitations. Defined contribution expense was $0.5 million, $0.9 million, and $1.2 million in 2005, 2004, and 2003, respectively.

**Note 14. Segment Reporting**

Our operations are treated as one operating segment, biotechnology drug discovery and development, in accordance with FASB Statement No. 131 ("SFAS 131"). For the twelve months ended December 31, 2005, we recorded revenue from customers throughout the United States and in Canada, Germany, Japan, Sweden, Switzerland, and the United Kingdom. Export revenues for the years ended December 31, 2005, 2004, and 2003 were $2.8 million, $5.3 million, and $13.0 million, respectively.

**Note 15. Litigation**

***Invitrogen***

In October 2001, Invitrogen Corporation ("Invitrogen") filed an action against us in the federal court for the District of Delaware, alleging infringement of three patents. The complaint seeks unspecified money damages and injunctive relief. In November 2001, we filed our answer to Invitrogen's patent infringement claims, and asserted seven counterclaims against Invitrogen, seeking declaratory relief with respect to the patents at issue, implied license, estoppel, laches and patent misuse. We are also seeking our fees, costs and expenses. Invitrogen filed its answer to our counterclaims in January 2002. In February 2003, we added a counterclaim for unfair business practices. In February 2004, the federal court for the District of Delaware ordered a stay of all proceedings pending disposition of the appeal in a related case of a judgment invalidating the same patents that are asserted in this case. On November 18, 2005, the Court of Appeals for the Federal Circuit issued its opinion vacating the judgment invalidating these





patents and remanding for further proceedings in that related case. On January 25, 2006, the federal court for the District of Delaware lifted the stay of proceedings in this case with respect to discovery related to our license defense. Thereafter, a schedule for possible motion practice and further proceedings is expected to be set.

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

In addition to the matter described above, from time to time we have been involved in certain legal actions arising in the ordinary course of business. In management's opinion, the outcome of such actions will not have a material adverse effect on our financial position, results of operations, or liquidity.

**Note 16. Related Party Transactions**

The following summarizes our related party transactions as defined by FASB Statement No. 57, *Related Party Disclosures* ("SFAS 57"). In each of the transactions noted in which a director of Incyte was at the time of the transaction in some way affiliated with the other party to the transaction, such director recused himself from voting on the related party transaction, other than the Senomyx, Inc. transaction.

During 1997, we purchased diaDexus Series B Preferred Stock at a cost of $1.3 million. We do not have the ability to exert significant influence over diaDexus. We have an executive officer who sits on diaDexus' Board of Directors.

During 2000 and 2001 we purchased shares of Series A Preferred Stock and Series C Preferred Stock of Genomic Health, Inc. ("Genomic Health") for an aggregate purchase price of $6.0 million. In connection with the completion of its initial public offering on October 4, 2005, these shares were converted into common shares. Additionally as part of its initial public offering, Genomic Health exercised an election under which we were required to acquire an additional $5.0 million of Genomic Health common stock. Julian C. Baker, one of our directors, is also a director of Genomic Health and holds shares, directly or beneficially, of both companies.

During 2000, we purchased shares of Series D Preferred Stock of Senomyx, Inc. ("Senomyx") for an aggregate purchase price of $6.5 million. In connection with the completion of Senomyx's initial public offering in 2004, our ownership interest was converted into common shares. These shares were sold in 2005 for $5.7 million, resulting in a realized gain of $2.8 million from their carrying value. Frederick B. Craves, one of our directors, is a partner of Bay City Capital, which held shares of Senomyx stock.

During 2003, we acquired Maxia for a total purchase price of approximately $27.4 million in cash and stock and up to $14 million in future clinical performance milestone payments. Frederick B. Craves, one of our directors, is a partner of Bay City Capital, which held shares of Maxia. See Note 18, "In Process Research and Development", for further discussion on this acquisition.

During 2005, we repurchased on the open market, and retired, $36.5 million in face value of 5.5% Notes. One such transaction in 2005 involved the repurchase, at a purchase price of 98.25% of face value, of $5.0 million in face value of such notes from a limited partnership of which Julian C. Baker, one of our directors, is a controlling member of the general partner of the general partner and may have a pecuniary interest. Mr. Baker did not participate in our decision to engage in such a repurchase transaction. The





price paid by us in such repurchase transaction was equal to the price paid by us to an independent third party in a comparable transaction negotiated on an arms'-length basis a short time prior to such repurchase transaction.

**Note 17. Other Expenses**

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

***2004 Restructuring and Other Impairments***

| | 2004 Charges to Operations | 2004 Charges Utilized | Accrual Balance as of December 31, 2004 | 2005 Charges to Operations | 2005 Charges Utilized | Accrual Balance as of December 31, 2005 |
|---|---|---|---|---|---|---|
| | | | (In thousands) | | | |
| Restructuring expenses: | | | | | | |
| Workforce reduction | $ 6,745 | $ (6,743) | $ 2 | $ (2) | $ — | $ — |
| Lease commitment and related costs | 20,207 | (4,710) | 15,497 | 733 | (2,685) | 13,545 |
| Other costs | 671 | (671) | — | 255 | (255) | — |
| Subtotal | 27,623 | (12,124) | 15,499 | 986 | (2,940) | 13,545 |
| Impairment of tenant improvements, equipment and other items | 11,363 | (11,363) | — | — | — | — |
| Impairment of gene and genomics-related patent costs | 12,099 | (12,099) | — | — | — | — |
| Total other expenses | $ 51,085 | $ (35,586) | $ 15,499 | $ 986 | $ (2,940) | $ 13,545 |

In February 2004, we announced a restructuring plan to close our information products research facility and headquarters in Palo Alto, California and move our headquarters to our Wilmington, Delaware pharmaceutical research and development facility. The closure of the Palo Alto facility corresponded with terminating further development activities around our Palo Alto-based information products line. The restructuring plan included the elimination of 183 employees and charges related to the closure of our Palo Alto facilities, previously capitalized tenant improvements and equipment and other items. The lease commitment and related costs originally included the present value of future lease obligations for two facilities. In the fourth quarter of 2004, we made a lease termination payment to satisfy our remaining lease obligation with respect to one of the facilities. The lease obligation for the second facility extends through March 2011. As a result of the long term nature of the remaining lease obligation, we will be recording a charge each period through the March 2011 termination date of the lease related to increases in the fair value of the lease obligations in accordance with the provisions of Financial Accounting Standards Board ("FASB") Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which total approximately $2.2 million at December 31, 2005.

In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded expense of $12.1 million to adjust the carrying value of

previously capitalized costs associated with the preparation, prosecution and maintenance of our gene patent portfolio to its estimated fair market value.

***2003 Restructuring and Other Impairments***

As a result of a decision made in the fourth quarter of 2003 to restructure our information product line in connection with the discontinuation of our clone activities and support functions, we recognized other expenses of $11.5 million. The plan included elimination of certain employees and write-down of certain assets related to our genomic information product line. We recorded charges of approximately $5.0 million related to the severance and benefits of approximately 75 employees, who worked at our Palo Alto, California location. We also recorded a charge of $1.9 million related to the write-off of excess equipment and other assets associated with the activities being exited. The write-down of equipment and other assets relates primarily to computer equipment and related software, lab equipment and office equipment. As of January 2, 2004, all of these employees had been terminated under this restructuring program and the plan was completed in the second quarter of 2004. There were no additional restructuring charges recorded for this program for the year ended December 31, 2005.

As part of our annual review of our existing long-lived assets, we determined, based on significant changes in the strategy of our overall business, that an asset related to capitalized software should be analyzed for impairment. As a result of this analysis, we determined that the net book value of the asset was in excess of future revenues expected from the sale of this asset reduced by costs to sell. It was therefore determined that this capitalized software was impaired, resulting in a $4.7 million impairment charge in 2003. There were no additional impairment charges recorded for this program for the year ended December 31, 2005.

2002 Restructuring (in thousands)

| | Original Charge Recorded in 2002 | Accrual Balance as of December 31, 2002 | 2003 Charges to Operations | 2003 Charges Utilized | Accrual Balance as of December 31, 2003 | 2004 Charges to Operations | 2004 Charges Utilized | Accrual Balance as of December 31, 2004 | 2005 Charges to Operations | 2005 Charges Utilized | Accrual Balance as of December 31, 2005 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 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 | 3,649 | (4,260) | 17,893 | 1,642 | (3,380) | 16,155 | 57 | (2,512) | 13,700 |
| Other expenses | $ 33,911 | $ 23,371 | $ 3,649 | $ (9,127) | $ 17,893 | $ 1,642 | $ (3,380) | $ 16,155 | $ 57 | $ (2,512) | $ 13,700 |

In November 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 plan included elimination of approximately 37% of our approximately 700-person workforce from our offices in Palo Alto, California; Beverly, Massachusetts; and Cambridge, England and the consolidation of our office and research facilities in Palo Alto, California. As a result, we recorded an expense of $33.9 million related to restructuring activities in the fourth quarter of 2002.

Included in the $33.9 million expense was a charge of $7.3 million related to the severance and benefits of approximately 250 employees who primarily worked at our Palo Alto, California location. As of





January 11, 2003, all of these employees had been terminated. Through 2003, we fully utilized this accrual. Also included in the $33.9 million expense was a charge of $8.7 million related to the write-down of excess equipment and other assets associated with the activities being exited and related infrastructure reductions. The write-down of equipment and other assets relates primarily to computer equipment and related software, lab equipment and office equipment. We fully utilized this accrual during 2002. Lease commitments and other restructuring related charges of $17.9 million were included in the $33.9 million expense to accrue for facilities leases related to the sites being exited and for related professional fees.

We currently have one remaining lease related to an exited site that is due to expire in December 2010. During the years ended December 31, 2005, 2004, and 2003, we recognized additional charges of $0.1 million, $1.6 million, and $3.7 million, respectively, primarily relating to this facility for lease expenses in excess of amounts originally estimated. We estimated the costs based on the contractual terms of agreements and current real estate market conditions. We may incur additional costs associated with these subleasing and lease termination activities.

***2001 Restructuring and Other Impairments***

In October 2001, we announced a restructuring of our operations in order to focus on our database licensing and partnership programs and our drug discovery and development programs. As a part of the restructuring, we discontinued our microarray-based gene expression products and services, genomic screening products and services, public domain clone products and related services, contract sequencing services and internal program on single nucleotide polymorphism discovery. As a result, we recorded an expense of $55.6 million related to restructuring activities in the fourth quarter of 2001. In 2001, we recorded a charge of approximately $8.1 million related to severance and fringe benefit charges for approximately 400 employees who primarily worked in the activities being exited as described above and related infrastructure support positions. As of December 31, 2002, all such employees had been terminated and the related accrual was fully utilized. In 2001, we also recorded a charge of $32.6 million related to the write-down of excess equipment and other assets associated with the activities being exited and related infrastructure reductions. The write-down of equipment and other assets primarily relates to leasehold improvements, computer equipment and related software, lab equipment and office equipment associated with the activities being exited and related infrastructure reductions. In 2001, we incurred charges of $14.9 million related to lease commitments and other restructuring related charges for facilities and

equipment leases related to the activities being exited and contract-related provisions and settlement and professional fees. In addition, in the fourth quarter of 2001 we recorded a reduction in goodwill and other intangible assets and impairment of other long-lived assets totaling $74.8 million.

During 2002, we also recorded an additional charge of $3.4 million, which is comprised of a $0.7 million charge related to assets disposed of at prices less than originally estimated, a $3.3 million charge related to contract-related settlements and facilities lease expenses in excess of amounts originally estimated and a $0.6 million benefit related to reserves in excess of amounts originally estimated. In 2003, we recognized an additional charge of $0.7 million primarily relating to contract-related settlements and facilities lease expenses in excess of amounts originally estimated and utilized $8.7 million of accrued facilities and other restructuring charges. In 2004, the remaining facility operating leases expired and all restructuring related activities were completed. There were no additional restructuring or impairment charges recorded for this program for the year ended December 31, 2005.





**Note 18. Purchased in-process research and development expenses**

During 2003, we recorded $34.0 million of purchased in-process research and development expenses, consisting of $27.7 million for the acquisition of Maxia and $6.3 million related to a collaborative license agreement with Pharmasset. Below is a summary of the activity related to purchased in-process research and development expenses for the year ended December 31, 2003.

***Acquisition of Maxia Pharmaceuticals, Inc.***

In November 2002, we entered into an agreement to acquire Maxia, a privately-held company based in San Diego, California. On February 18, 2003, the acquisition was completed. Maxia was a drug discovery and development company that specialized in small molecule drugs targeting diabetes and other metabolic disorders, cancer, inflammatory diseases and heart disease. We acquired Maxia to create a more advanced and robust pipeline of discovery projects and product candidates and to further our drug discovery and development efforts.

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

| **(in millions)** | |
|---|---|
| Current assets | $ 0.9 |
| Current liabilities | (1.6) |
| Net tangible liabilities assumed | (0.7) |
| In-process research and development | 28.1 |
| Total purchase price | $ 27.4 |

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

The value assigned to purchased in-process research and development was comprised of three compounds which were in stages ranging from discovery to preclinical phases as follows: Type II diabetes valued at $15.6 million; cancer valued at $6.9 million; and metabolic and other disorders valued at $5.6 million. The estimated fair values of these projects were determined by employment of a discounted cash flow model, using discount rates ranging from 20% to 40%. The discount rates used took into account the stage of completion and the risks surrounding the successful development and commercialization of each of the purchased in-process research and development projects that were valued. At the time of





acquisition, the Maxia drug development platform was based on three components: chemistry, biology and an integrated drug discovery/development approach. Features of the chemistry component were novel, small, proprietary molecules. The biology component was based on leading scientific expertise in the nuclear receptor and signal transduction areas. The drug discovery platform was believed to provide an accelerated approach to novel drug discovery and development. Management has determined that each of these projects would require significant further development, including the receipt of marketing approval by the U.S. Food and Drug Administration or equivalent foreign agency, before they would be commercially available. The major risks and uncertainties associated with the timely and successful completion of these projects consist of the ability to confirm the safety and efficacy of the technology acquired and to obtain necessary regulatory approvals. The timing and estimated costs to complete these projects are difficult to predict due to their early stage of development. At the date of acquisition, significant further development of the Maxia compounds remained to be completed. In the fourth quarter of 2003, we reviewed these estimates further and decided to reverse a net $0.4 million to in-process research and development expenses, primarily due to lower

than estimated transaction fees and other adjustments of $0.7 million, partially offset by an additional charge of $0.3 million related to facilities expenses in excess of amounts originally estimated.

The total purchase price of approximately $27.4 million consists of approximately 4,476,092 shares of our 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 restructuring costs incurred as part of the acquisition of $2.9 million, in accordance with EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* ("EITF 95-3"). The value of the 4,476,092 shares of our common stock was based on a per share price of $3.91. For valuation purposes, this per share price of our common stock was determined as the average closing market price for the five trading days preceding February 18, 2003, the date on which the number of shares to be issued became determinable. As of December 31, 2004, 3,600,820 shares have been issued and $3.1 million has been paid to the former Maxia stockholders. 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 and issued these shares into a third party escrow account.

In accordance with EITF 95-3, we recorded a $2.9 million charge in 2003 related to restructuring costs for Maxia, which consisted of workforce reductions and consolidation of facilities. We recorded employee termination costs of approximately $0.8 million for 28 employee positions. The job eliminations were completed in July 2003. We also recorded restructuring costs related to lease payments for property that has been vacated and other costs of $2.0 million. In 2004 and 2003, we also recorded additional charges of $1.6 million and $0.3 million, respectively, relating to facilities lease expenses in excess of amounts originally estimated. The operating lease related to the vacated facility expires in November 2008.

We also recorded transaction costs related to the acquisition of $1.5 million. After further review of our estimate of transaction costs, we determined that the remaining $0.5 million was not required and credited this amount against in-process research and development expenses in the fourth quarter of 2003.





Below is a summary of activity related to accrued acquisition costs for the year ended December 31, 2005 (in thousands):

| | Original Accrual | 2003 Additions | 2003 Accrual Utilized | Accrual Balance as of December 31, 2003 | 2004 Charges to Operations | 2004 Accrual Utilized | Accrual Balance as of December 31, 2004 | 2005 Charges to Operations | 2005 Accrual Utilized | Accrual Balance as of December 31, 2005 |
|---|---|---|---|---|---|---|---|---|---|---|
| Accrued acquisition costs: | | | | | | | | | | |
| Workforce reduction | $ 845 | $ — | $ (845) | $ — | $ — | $ — | $ — | $ — | $ — | $ — |
| Lease commitments and other costs | 2,016 | 326 | (1,008) | 1,334 | 1,628 | (589) | 2,373 | 312 | (616) | 2,069 |
| Transaction fees | 1,450 | — | (1,450) | — | — | — | — | — | — | — |
| Accrued acquisition costs | $ 4,311 | $ 326 | $ (3,303) | $ 1,334 | $ 1,628 | $ (589) | $ 2,373 | $ 312 | $ (616) | $ 2,069 |

The estimates above have been made based upon management's best estimate of the amounts and timing of certain events that will occur in the future.

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.

***Collaborative License Agreement with Pharmasset, Inc.***

In September 2003, we entered into a collaborative licensing agreement with Pharmasset to develop and commercialize DFC, an antiretroviral drug that is currently in Phase IIb clinical development for the treatment of HIV. Under the terms of the agreement we paid Pharmasset $6.3 million, which we recorded as a charge to purchased in-process research and development expense that is presented as a separate component of operating expenses. In addition to this payment, we also agreed to pay Pharmasset certain performance milestone payments and future royalties on net sales, in exchange for exclusive rights in the United States, Europe and certain other markets to develop, manufacture and market the drug. One of these milestones was met in the second quarter of 2004, resulting in $0.5 million of research and development expense. An additional performance milestone was achieved in July 2005, resulting in $1.5 million of research and development expense. Pharmasset will retain marketing and commercialization rights in certain territories, including South America, Mexico, Africa, the Middle East and China.

**Note 19. Discontinued Operations**

In December 2004, we also entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts ("Proteome"), which transaction subsequently

closed in January 2005. The consolidated financial statements have been restated to present Proteome as a discontinued operation for all years presented.

**Note 20. Interim Consolidated Financial Information (Unaudited)**

**(in thousands, except per share data)**

| | Fiscal 2005 Quarter Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| Revenues(1) | $ 2,915 | $ 2,676 | $ 1,228 | $ 1,027 |
| Net loss(2) | (20,131) | (25,145) | (30,210) | (27,557) |
| Basic and diluted net loss per share | $ (0.24) | $ (0.30) | $ (0.36) | $ (0.33) |
| Shares used in computation of basic and diluted net loss per share | 83,049 | 83,303 | 83,414 | 83,520 |

| | Fiscal 2004 Quarter Ended | | | |
|---|---|---|---|---|
| | March 31 | June 30 | September 30 | December 31 |
| Revenues(1) | $ 5,483 | $ 4,006 | $ 2,332 | $ 2,325 |
| Net loss(3) | (37,715) | (63,600) | (25,976) | (37,526) |
| Basic and diluted net loss per share | $ (0.52) | $ (0.87) | $ (0.35) | $ (0.47) |
| Shares used in computation of basic and diluted net loss per share | 72,643 | 72,929 | 73,323 | 79,289 |

(1) In December 2004, we entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts, which transaction subsequently closed in January 2005. Fiscal years 2005, 2004 and 2003 have been restated to present the operations of our Proteome facility as a discontinued operation.

(2) The March 31, 2005, June 30, 2005, September 30, 2005, and December 31, 2005 quarters include $0.3 million, $0.4 million, $0.3 million, and $0.3 million, respectively, of other expenses relating primarily to restructuring charges.

(3) The March 31, 2004, June 30, 2004 and December 31, 2004 quarters include $8.1 million, $34.5 million and $11.6 million, respectively, of other expenses relating primarily to restructuring charges and long-lived asset write-downs.



**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**

| Description—Year Ended December 31, | Balance at Beginning of Period | Charged to Costs and Expenses | Deductions | Balance at End of Period |
|---|---|---|---|---|
| | | (in thousands) | | |
| Allowance for doubtful accounts—2003 | $ 533 | $ 100 | $ 56 | $ 577 |
| Allowance for doubtful accounts—2004 | 577 | 57 | 360 | 274 |
| Allowance for doubtful accounts—2005 | 274 | 35 | 114 | 195 |



**Item 9.** ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not applicable.

**Item 9A.** ***Controls and Procedures***

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

Based on their evaluation as of the end of the period covered by this Annual Report on Form 10-K, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

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

control over financial reporting.

***Management's annual report on internal control over financial reporting.*** Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2005. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.



## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

**The Board of Directors and Stockholders of Incyte Corporation**

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Incyte Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Incyte Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Incyte Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Incyte Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Incyte Corporation as of December 31, 2005 and 2004, and the related consolidated statements of operations, comprehensive loss, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2005 of Incyte Corporation and our report dated February 24, 2006 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 24, 2006



**Item 9B.** ***Other Information***

None.

## PART III

**Item 10.** ***Directors and Executive Officers of the Registrant***

The information required by this item (with respect to Directors) is incorporated by reference from the information under the caption "Election of Directors" contained in our Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for our 2006 Annual Meeting of Stockholders to be held on May 23, 2006 (the "Proxy Statement"). Certain information required by this item concerning executive officers is set forth in Part I of this Report under the caption "Executive Officers of the Registrant" and is incorporated herein by reference.

Item 405 of Regulation S-K calls for disclosure of any known late filing or failure by an insider to file a report required by Section 16(a) of the Exchange Act. This disclosure is contained in the section entitled "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement and is

incorporated herein by reference.

We have adopted a Code of Business Conduct and Ethics that applies to all of our officers and employees, including our Chief Executive Officer, Chief Financial Officer, Corporate Controller and other employees who perform financial or accounting functions. The Code of Business Conduct and Ethics sets forth the basic principles that guide the business conduct of our employees. We have also adopted a Senior Financial Officers' Code of Ethics that specifically applies to our Chief Executive Officer, Chief Financial Officer, Corporate Controller, and others providing similar functions. Stockholders may request a free copy of our Code of Business Conduct and Ethics and our Senior Financial Officers' Code of Ethics by contacting Incyte Corporation, Attention: Investor Relations, Experimental Station, Route 141 & Henry Clay Road, Building E336, Wilmington, DE 19880.

To date, there have been no waivers under our Code of Business Conduct and Ethics or Senior Financial Officers' Code of Ethics. We intend to disclose future amendments to certain provisions of our Code of Business Conduct and Ethics or Senior Financial Officers' Code of Ethics or any waivers, if and when granted, of our Code of Business Conduct and Ethics or Senior Financial Officers' Code of Ethics on our website at *http://www.incyte.com* within four business days following the date of such amendment or waiver.

Our Board of Directors has appointed an Audit Committee, comprised of Mr. Barry M. Ariko, as Chairman, Mr. Richard U. De Schutter and Dr. Frederick B. Craves. The Board of Directors has also determined that all three members of the Audit Committee are qualified as Audit Committee Financial Experts under the definition outlined by the Securities and Exchange Commission. In addition, each of the members of the Audit Committee qualifies as an "independent director" under applicable Nasdaq Stock Market standards.

**Item 11.** ***Executive Compensation***

The information required by this item is incorporated by reference from the information under the captions "Election of Directors—Compensation of Directors" and "Executive Compensation" contained in the Proxy Statement.



**Item 12.** ***Security Ownership of Certain Beneficial Owners and Management, and Related Stockholder Matters***

The information required by this item is incorporated by reference from the information under the caption "Security Ownership of Certain Beneficial Owners and Management, and Related Stockholder Matters" contained in the Proxy Statement.

Information about securities authorized for issuance under our equity compensation plans appears under the caption "Equity Compensation Plan Information" in the Proxy Statement. That portion of the Proxy Statement is incorporated by reference into this report.

**Item 13.** ***Certain Relationships and Related Transactions***

The information required by this Item 13 is incorporated by reference from the information under the caption "Certain Relationships and Related Transactions" contained in the Proxy Statement.

**Item 14.** ***Principal Accountant Fees and Services***

The information required by this Item 14 is incorporated by reference from the information under the caption "Principal Accountant Fees and Services" contained in the Proxy Statement.



## PART IV

**Item 15.** ***Exhibits, Financial Statement Schedules***

**(a) Documents filed as part of this report:**

(1) Financial Statements

Reference is made to the Index to Consolidated Financial Statements of Incyte Corporation under Item 8 of Part II hereof.

(2) Financial Statement Schedules

The following financial statement schedule of Incyte Corporation is filed as part of this Form 10-K included in Item 8 of Part II:

Schedule II—Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2005.

All other financial statement schedules have been omitted because they are not applicable or not required or because the information is included elsewhere in the Consolidated Financial Statements or the Notes thereto.

(3) Exhibits

See Item 15(b) below. Each management contract or compensatory plan or arrangement required to be filed has been identified.

**(b) Exhibits**

| Exhibit Number | Description of Document |
|---|---|
| 2.1 | Agreement and Plan of Merger, dated as of November 11, 2002, by and among the Company, Maxia Pharmaceuticals, Inc. and other parties signatory thereto (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed February 25, 2003). |
| 2.2 | Amendment to Agreement and Plan of Merger, dated as of December 19, 2002, by and among the Company, Monaco Acquisition Corporation, Maxia Pharmaceuticals, Inc. and Maxia Pharmaceuticals, LLC (incorporated by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K filed February 25, 2003). |
| 3(i)(a) | Integrated copy of the Restated Certificate of Incorporation, as amended (incorporated by reference to |

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| | the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002). |
| 3(i)(c) | Certificate of Ownership and Merger merging Incyte Corporation into Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002). |
| 3(ii) | Bylaws of the Company, as amended as of May 25, 2004 (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004). |
| 4.1 | Form of Common Stock Certificate (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002). |
| 4.2 | Rights Agreement dated as of September 25, 1998 between the Company and Chase Mellon Shareholder Services, L.L.C., which includes as Exhibit B, the rights certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed September 30, 1998). |



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| 4.3 | Indenture dated as of February 4, 2000 between the Company and State Street Bank and Trust Company of California, N.A., as trustee (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 1999). |
| 4.4 | Indenture dated as of February 19, 2004 between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 (File No. 333-114863)). |
| 4.5† | Form of Convertible Subordinated Promissory Note (incorporated by reference to the Company's Current Report on Form 8-K/A filed February 6, 2006). |
| 10.1# | 1991 Stock Plan of Incyte Genomics, Inc., as amended and restated on February 27, 2002 (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 (File No. 333-91542)). |
| 10.2# | Form of Incentive Stock Option Agreement under the 1991 Plan (incorporated by reference to the exhibit of the same number to the Company's Registration Statement on Form S-1 (File No. 33-68138)). |
| 10.3# | Form of Nonstatutory Stock Option Agreement under the 1991 Plan (incorporated by reference to the exhibit of the same number to the Company's Registration Statement on Form S-1 (File No. 33-68138)). |
| 10.4# | 1993 Directors' Stock Option Plan of Incyte Genomics, Inc., as amended and restated (incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005). |
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| 10.14 | Lease Agreement dated June 19, 1997 between the Company and The Board of Trustees of the Leland Stanford Junior University (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 1999). |
| 10.15# | 1997 Employee Stock Purchase Plan of Incyte Corporation, as amended July 28, 2004 (incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2004). |
| 10.23# | Form of Restricted Stock Unit Agreement under the 1991 Stock Plan of Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2001). |
| 10.30# | Offer of Employment Letter, dated November 21, 2001, from the Company to Paul A. Friedman (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2001). |
| 10.32# | Employment Agreement, dated November 26, 2001, between Paul A. Friedman and Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2001). |
| 10.34† | Settlement Agreement dated December 21, 2001, between Affymetrix, Inc. and Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2001). |
| 10.35 | Lease Agreement, dated February 28, 2002, between E.I. DuPont De Nemours and Company and Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2001). |



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| 10.36# | Promissory Note dated April 22, 2002 between Incyte Genomics, Inc. and Brian Metcalf and Heather Metcalf (incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002). |

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| 10.42† | Letter Agreement, dated September 5, 2002, between the Company and Schering-Plough, Ltd. (incorporated by reference to Exhibit 10.44 to the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002). |
| 10.45 | Sublease Agreement, dated June 16, 2003, between E. I. DuPont de Nemours and Company and Incyte Corporation (incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003). |
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| 10.49*† | Collaborative Research and License Agreement, dated as of November 18, 2005, by and between the Company and Pfizer Inc. |
| 10.50 | Note Purchase Agreement, dated as of November 18, 2005, by and between the Company and Pfizer Overseas Pharmaceuticals (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed February 6, 2006). |
| 21.1* | Subsidiaries of the Company. |
| 23.1* | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. |
| 24.1* | Power of Attorney (see page 93 of this Form 10-K). |
| 31.1* | Rule 13a-14(a) Certification of Chief Executive Officer. |
| 31.2* | Rule 13a-14(a) Certification of the Chief Financial Officer. |
| 32.1** | Statement of the Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350). |
| 32.2** | Statement of the Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350). |

* Filed herewith.

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

† Confidential treatment has been requested with respect to certain portions of these agreements.

# Indicates management contract or compensatory plan or arrangement.

**(c) Financial Statements and Schedules**

Reference is made to Item 15(a)(2) above.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, we have duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

INCYTE CORPORATION

By: /s/ PAUL A. FRIEDMAN
Paul A. Friedman
Chief Executive Officer

Date: March 3, 2006

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Paul A. Friedman, David C. Hastings, and Patricia A. Schreck, and each of them, his true and lawful attorneys-in-fact, each with full power of substitution, for him or her in any and all capacities, to sign any amendments to this report on Form 10-K and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact or their substitute or substitutes may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ PAUL A. FRIEDMAN<br>Paul A. Friedman | Chief Executive Officer (Principal Executive Officer) and Director | March 3, 2006 |

| | | |
|---|---|---|
| /s/ DAVID C. HASTINGS<br>David C. Hastings | Chief Financial Officer (Principal Financial Officer) | March 3, 2006 |
| /s/ LAURENT CHARDONNET<br>Laurent Chardonnet | Vice President, Finance and Treasurer (Principal Accounting Officer) | March 3, 2006 |
| /s/ ROY A. WHITFIELD<br>Roy A. Whitfield | Director | March 3, 2006 |
| /s/ FREDERICK B. CRAVES<br>Frederick B. Craves | Director | March 3, 2006 |
| /s/ BARRY M. ARIKO<br>Barry M. Ariko | Director | March 3, 2006 |
| /s/ RICHARD U. DESCHUTTER<br>Richard U. De Schutter | Chairman | March 3, 2006 |
| /s/ PAUL A. BROOKE<br>Paul A. Brooke | Director | March 3, 2006 |
| /s/ JULIAN C. BAKER<br>Julian C. Baker | Director | March 3, 2006 |



## EXHIBIT INDEX

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| 10.49*† | Collaborative Research and License Agreement, dated as of November 18, 2005, by and between the Company and Pfizer Inc. |

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| 21.1* | Subsidiaries of the Company. |
| 23.1* | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. |
| 24.1* | Power of Attorney (see page 93 of this Form 10-K). |
| 31.1* | Rule 13a-14(a) Certification of Chief Executive Officer. |
| 31.2* | Rule 13a-14(a) Certification of the Chief Financial Officer. |
| 32.1** | Statement of the Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 |

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| | U.S.C Section 1350). |
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* Filed herewith.

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

† Confidential treatment has been requested with respect to certain portions of these agreements.

# Indicates management contract or compensatory plan or arrangement.

Copies of above exhibits not contained herein are available to any stockholder upon written request to: Investor Relations, Incyte Corporation, Experimental Station, Route 141 & Henry Clay Road, Building E336, Wilmington, DE 19880.

**Exhibit 10.49**

Confidential Treatment Requested. Confidential portions of this document have been redacted and have been separately filed with the Commission.

# COLLABORATIVE RESEARCH AND LICENSE AGREEMENT

Between

INCYTE CORPORATION

and

PFIZER INC.

Dated as of November 18, 2005

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TABLE OF CONTENTS

*** Confidential material redacted and filed separately with the Commission.

*** Confidential material redacted and filed separately with the Commission.





*** Confidential material redacted and filed separately with the Commission.

# COLLABORATIVE RESEARCH AND LICENSE AGREEMENT

THIS COLLABORATIVE RESEARCH AND LICENSE AGREEMENT (the "**Agreement**") is entered into as of November 18, 2005 by and between INCYTE CORPORATION, a Delaware corporation with its offices at Experimental Station, Route 141 and Henry Clay Road, Building E336, Wilmington, DE 19880 ("**Incyte**"), and PFIZER INC., a Delaware corporation with its offices at 235 East 42nd Street, New York, New York 10017 ("**Pfizer**"). Incyte and Pfizer may be referred to herein individually as a "**Party**" or collectively, as the "**Parties**".

## RECITALS

WHEREAS, Incyte owns certain patents, patent applications, technology, know-how and scientific and technical information relating to CCR2 Antagonists;

WHEREAS, Pfizer has extensive experience and expertise in the development and commercialization of pharmaceutical products, and desires to acquire an exclusive license in the Territory (as defined below) to such patents, patent applications, technology, know-how and scientific and technical information;

WHEREAS, Incyte desires to grant such license to Pfizer but also desires to secure a grantback of certain rights and to have a right of reversion under certain circumstances;

NOW, THEREFORE, in consideration of the foregoing and the covenants and promises contained in this Agreement, the Parties agree as follows:

## 1. DEFINITIONS

**1.1** "**Affiliate**" means a person, corporation, partnership, or other entity that controls, is controlled by or is under common control with a Party. For the purposes of this Section 1.1, the word "control" (including, with correlative meaning, the terms "controlled by" or "under common control with")

means the actual power, either directly or indirectly through one or more intermediaries, to direct the management and policies of such entity, whether by the ownership of at least fifty percent (50%) of the Voting Stock of such entity, or by contract or otherwise.

**1.2** "**Animal Product**" has the meaning assigned to it in Section 8.12.

**1.3** "**API**" has the meaning assigned to it in Section 11.5(c)(iii).

**1.4** *** means, as diagnosed by a physician or other health care provider, a ***. A drug developed for the treatment of ***, respectively.

**1.5** *** means an inflammatory or autoimmune disease of the *** diagnosed by a physician or other healthcare provider, *** shall also include ***



*** Confidential material redacted and filed separately with the Commission.

**1.6** "**Business Day**" means a day other than a Saturday, Sunday, bank or other public holiday in the state of New York.

**1.7** "**CCR2 Antagonist**" means a compound of less than 1,000 Daltons Molecular Weight (MW) as the free base that is an inhibitor of CCR-2 (alpha and/or beta isoforms) binding and activation by known ligands (Macrophage Chemotactic Protein (MCP)-1, MCP-2, MCP-3 or MCP-4) with Inhibitory Concentration (IC) 50 potency less than (a) *** as described in Schedule 1.7(b) and (b) *** as described in Schedule 1.7(c). The Parties agree that the JRC may amend, modify, replace or delete any of the assays described in Schedules 1.7(a)-(c) from time to time as it deems appropriate in accordance with Section 2.4(f).

**1.8** "**Change of Control**" means that any of the following has occurred:

**(a)** any Person or group that is a *** becomes the beneficial owner, directly or indirectly, of fifty percent (50%) or more of the outstanding Voting Stock or voting power over Voting Stock of (i) Incyte or (ii) any one or more Persons which are direct or indirect parent holding companies of Incyte or Affiliates controlling Incyte (Incyte, together with the Persons described in clause (ii), each hereinafter referred to, individually, as an "Incyte Group Company" and, collectively, as the "Incyte Group Companies"); or

**(b)** any Incyte Group Company enters into an agreement with any Person or group that is a *** providing for the sale or disposition of all or substantially all of the assets of the Incyte Group Companies, on a consolidated basis; or

**(c)** any Incyte Group Company enters into an agreement with any Person or group providing for a merger, reorganization, consolidation or other similar transaction (or series of related transactions) of any Incyte Group Company with such Person or any Affiliate of such Person, in each case, that is a *** (other than with any of the Incyte Group Company's wholly-owned subsidiaries) or with such group that contains a ***, that results in the shareholders of the applicable Incyte Group Company immediately before the occurrence of such transaction (or series of transactions) beneficially owning less than a majority of the outstanding Voting Stock or voting power over Voting Stock of the surviving or newly-created entity in such transaction (or series of transactions); or

**(d)** a change in the board of directors of any Incyte Group Company in which the individuals who constituted the board of directors of such Incyte Group Company at the beginning of the two (2)-year period immediately preceding such change (together with any other director whose election by the board of directors of such Incyte Group Company or whose nomination for election by the stockholders of such Incyte Group Company was approved by a vote of at least a majority of the directors then in office either who were directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the directors then in office. This subsection (d) shall not apply if a majority of the votes cast in favor of a majority of directors following such change were cast by a single stockholder that is a ***; or



*** Confidential material redacted and filed separately with the Commission.

**(e)** any Incyte Group Company enters into an agreement with any Person providing for the matters described in subsection (a), (b) or (d) above;

For purposes of this definition of "Change of Control" only: (A) references to any Incyte Group Company shall be deemed to include all successors in any merger, consolidation, reorganization or similar transaction (or series of related transactions) preceding any transaction (or series of related transactions) described above; (B) "beneficial ownership" (and other correlative terms) means beneficial ownership as defined in Rule 13d-3 under the United States Securities and Exchange Act of 1934, as amended; it being understood and agreed that "beneficial ownership" shall also include any securities which any person or any of such person's Affiliates has the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, rights, warrants or options, or otherwise; (C) "group" means group as defined in the Securities Exchange Act of 1934, as amended and the rules of the Securities and Exchange Commission thereunder as in effect on the date hereof; (D) "control" (including, with correlative meanings, "controlled by", "controlling" and "under common control with") of an entity means possession, direct or indirect, of (I) the power to direct or cause direction of the management and policies of such entity (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise), or (II) at least fifty percent (50%) of the voting securities (whether directly or pursuant to any option, warrant or other similar arrangement) or other comparable equity interests of such entity; (E) *** means (x) any *** that had ***, (y) any one or more Persons that are direct or indirect parent holding companies of subsidiaries of the *** described in clause (x) above, or (z) any Affiliate of the *** described in clause (x) above; and (F) *** means (x) any *** that had ***, (y) any one or more Persons that are direct or indirect parent holding companies of subsidiaries of the *** described in clause (x) above, or (z) any Affiliate of the *** described in clause (x) above.

**1.9** "**Claim**" has the meaning assigned to it in Section 13.1.

**1.10** "**Combination Product**" means any human pharmaceutical product in which one or more active pharmaceutical ingredients are either (i) physically, chemically or otherwise combined or mixed with a Compound to produce a single entity for commercial distribution or (ii) packaged together with a Compound or any Pfizer Product in a single package or unit for commercial distribution.

**1.11** "**Commence**" or "**Commencement**" when used to describe a Phase I Trial, Phase II Trial, Phase II(b) Trial or Phase III Trial, means the first dosing of the first patient for such trial.



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**1.12** "**Commercially Reasonable Efforts**" means those efforts and resources that Pfizer would use were it developing or commercializing its own pharmaceutical products that are of similar market potential as the Pfizer Products, taking into account product labeling or anticipated labeling, present and future market potential, past performance of Pfizer Products and Pfizer's own pharmaceutical products that are of similar market potential, financial return, medical and clinical considerations, present and future regulatory environment and competitive market conditions, all as measured by the facts and circumstances at the time such efforts are due. For the avoidance of doubt, in evaluating financial return, Pfizer shall not consider any payments due to Incyte pursuant to Sections 8.1, 8.2, 8.3 and 8.4.

**1.13** "**Competing Product**" means any CCR2 Antagonist that ***

**1.14** "**Compound**" means any CCR2 Antagonist *** that is covered by a claim contained in any ***. All salts, prodrugs, esters, metabolites, solvates, stereoisomers and polymorphs of a given Compound shall be considered to be the same Compound.

**1.15** "**Control**" means, with respect to any intellectual property right, that a Party or an Affiliate of a Party owns or has a license to such item or right, and has the ability to grant a license or sublicense in or to such right without violating the terms of any agreement or other arrangement with any Third Party.

**1.16** "**Damages**" has the meaning assigned to it in Section 13.1.

**1.17** "**Development Plan**" has the meaning assigned to it in Section 5.2.

**1.18** *** means *** disorders that are diagnosed by a physician or other health care provider as ***.

**1.19** "**Effective Date**" means the later of (i) the date that the applicable waiting period under the HSR Act shall have expired or been terminated with respect to this Agreement and (ii) the date on which any investigations opened by means of a second request or otherwise shall have been closed.

**1.20** "**FDA**" means the United States Food and Drug Administration, or any successor federal agency thereto.

**1.21** "**FDCA**" means the U.S. Federal Food, Drug and Cosmetic Act, as amended, and the regulations promulgated thereunder.

**1.22** "**FTE**" means the equivalent of one person working full time for a twelve (12)-month period in a research or other relevant capacity, with full time being defined as at least 1800 hours per year. In the interests of clarity, a single individual who works more than 1800 hours in a single year shall be treated as one FTE regardless of the number of hours worked.



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**1.23** "**Generic Market Share**" means a fraction (expressed as a percentage), the numerator of which shall be the aggregate total unit sales of all Generic Products in a country in the Territory, and the denominator of which shall be the aggregate total unit sales of all such Generic Products and the relevant Pfizer Product in such country, based on data provided by IMS International, or, if such data is not available from IMS International, such other reliable data source as reasonably determined by Pfizer and reasonably agreed to by Incyte. In the event IMS International data (or such other data source) is not sufficient to determine the percentage market share for each country in the European Union, the average percent market share of the countries in the European Union for which data is available will be deemed to be the percent market share for those countries in which the data is not available.

**1.24** "**Generic Product**" means any pharmaceutical product, other than a Pfizer Product, that (i) is sold under a marketing authorization granted by a Regulatory Authority to a Third Party (who is not a permitted sublicensee pursuant to Section 7.1), (ii) contains the same Compound as the relevant Pfizer Product as its active pharmaceutical ingredient and (iii) can be or is reasonably used for the same indication or indications as the relevant Pfizer Product.

**1.25** "**Governmental Authority**" means any court, agency, department or other instrumentality of any foreign, federal, state, county, city or other political subdivision.

**1.26** "**HSR Act**" means the United States Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

**1.27** "**INCB-3284**" means the Compound referred to by Incyte as INCB-3284 as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.27 attached hereto.

**1.28** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.28 attached hereto.

**1.29** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.29 attached hereto.

**1.30** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.30 attached hereto.

**1.31** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.31 attached hereto.

**1.32** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.32 attached hereto.

**1.33** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.33 attached hereto.



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**1.34** *** means the Compound referred to by Incyte as *** as of the date of this Agreement, which Compound is as described in *** and as depicted on Schedule 1.34 attached hereto.

**1.35** "**Incyte Compound**" means (i) *** and as depicted on Schedule 1.35 attached hereto and (ii) *** Schedule 1.35 shall be updated from time to time, upon the request of either Party, to reflect additions or deletions that have occurred after the Effective Date.

**1.36** "**Incyte Confidential Information**" means all information about any element of Incyte Technology, as well as any other information regarding the business and operations of Incyte, that is disclosed (whether orally or in writing) prior to or after the Effective Date by Incyte to Pfizer or its Affiliates and (a) in the case of oral information, is outlined in a summary prepared by Incyte and delivered to Pfizer promptly after such disclosure and (b) in the case of written information, is designated "Confidential" in writing by Incyte at the time of disclosure to Pfizer, to the extent that such information is not (i) as of the date of disclosure to Pfizer, known to Pfizer other than by virtue of a prior confidential disclosure to Pfizer by Incyte; (ii) disclosed in published literature, or otherwise generally known to the public through no fault or omission of Pfizer; (iii) obtained from a Third Party free from any obligation of confidentiality to Incyte; (iv) independently developed by Pfizer without access to the Incyte Confidential Information as shown by competent written proof; or (v) is, in the reasonable opinion of legal counsel, required to be disclosed under Law or in connection with any legal proceeding; provided that, in the case of clause (v), Pfizer provides Incyte sufficient prior notice (to the extent practicable) of such disclosure and agrees to cooperate, at the request and sole expense of Incyte with Incyte's efforts to preserve the confidentiality of such information. All information about the existence and terms of this Agreement shall be considered both Incyte Confidential Information and Pfizer Confidential Information.

**1.37** "**Incyte Indication**" means the treatment in humans of (i) MS or, (ii)
***

**1.38** "**Incyte Key Decision Points**" means any of the following: (i) a decision to progress an Incyte Compound from preclinical to clinical development in an Incyte Indication or, if applicable, a Reverted Indication, (ii) with respect to any Incyte Product, a decision with respect to whether Incyte's relevant go/no go criteria have been met prior to the Commencement of any Phase II Trial or Phase III Trial and (iii) a decision to terminate research and development for any Incyte Compound or Incyte Product or to terminate research and development for a particular Incyte Indication or, if applicable, a Reverted Indication.

**1.39** "**Incyte Patent Rights**" means the Patent Rights listed in Exhibit A and all Patent Rights that are Controlled by Incyte or any of its Affiliates and cover Incyte Technology.

**1.40** "**Incyte Product**" means any human or animal pharmaceutical product, whether commercialized or in development, that contains at least one Incyte Compound, alone or in combination with one or more active pharmaceutical ingredients, and developed and indicated solely for the treatment of one or more Incyte Indications or, if applicable, Reverted Indications.



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**1.41** "**Incyte Product Patent Rights**" means all Incyte Patent Rights that become Incyte Product Patent Rights pursuant to Sections 9.2(b)(ii) or 9.2(e).

**1.42** "**Incyte Program Patent Rights**" means all Program Patent Rights that become Incyte Program Patent Rights pursuant to Sections 9.2(c)(ii) or 9.2(e).

**1.43** "**Incyte Technology**" means Technology that is or was (a) invented by officers, employees or agents of, or consultants to, Incyte or any of its Affiliates, alone or jointly with Third Parties, at any time outside of the Research Program or (b) acquired by purchase, license, assignment or other means from Third Parties by Incyte or any of its Affiliates, alone or jointly with Third Parties, at any time outside of the Research Program; provided that ***, then *** if (x) Incyte and all of its Affiliates comply with the provisions of *** and (y) ***.

**1.44** "**IND**" means an Investigational New Drug Application filed with the FDA or the analogous application or filing filed with any analogous agency or Government Authority outside of the United States (including any supra-national agency such as in the European Union) necessary to Commence human clinical trials in such jurisdiction, and including all regulations at 21 CFR § 312 et. seq. and analogous foreign regulations.

**1.45** **"Joint Research Committee**" or "**JRC**" has the meaning assigned to it in Section 2.1(a).

**1.46** "**Launch**" means, on a country-by-country and Pfizer Product-by-Pfizer Product basis, the date of the first shipment of a Pfizer Product for commercial sale (excluding any shipments for clinical trial purposes, compassionate use programs or other similar programs) by Pfizer, its Affiliates or its sublicensees to an unaffiliated Third Party in a country after receipt by Pfizer of the first Regulatory Approval (and, in any country in which Price Approval is necessary or relevant for a majority of the population to obtain access to pharmaceutical products, Price Approval) for such Pfizer Product in such country.

**1.47** "**Law**" or "**Laws**" means all laws, statutes, rules, regulations, orders, judgments and/or ordinances of any Governmental Authority.

**1.48** "**Major European Country**" means the United Kingdom, Spain, France, Germany or Italy.

**1.49** "**MS**" means a demyelinating disease of the central nervous system diagnosed by a physician or other health care provider as multiple sclerosis. MS includes (i) relapsing-remitting MS (RRMS), (ii) secondary progressive MS (SPMS), (iii) primary progressive MS (PMS), (iv) progressive-relapsing MS (PRMS), (v) clinical isolated syndrome (CIS) with MRI lesions and (vi) optic neuritis due to MS.



**1.50** "**NDA**" means a New Drug Application under the FDCA filed with the FDA with respect to a pharmaceutical product or the analogous application or filing filed with any analogous agency or Governmental Authority outside of the United States (including any supra-national agency such as in the European Union) necessary for approval of a pharmaceutical product in such jurisdiction.

**1.51** "**Net Sales**" means

**(a)** with respect to a Pfizer Product (subject to subsection (b) below), the amount invoiced by a Party or its Affiliate or a Third Party sublicensee for sales of such Pfizer Product, to Third Parties, less, without duplication, (i) actual bad debts related to such Pfizer Product and (ii) sales returns and allowances actually paid, granted or accrued, including trade, quantity and cash discounts and any other adjustments including those granted on account of billing errors, rejected goods, damaged or defective goods, recalls, returns, rebates, chargeback rebates, reimbursements or similar payments granted or given to wholesalers or other distributors, buying groups, health care insurance carriers or other institutions, adjustments arising from consumer discount programs or other similar programs, customs or excise duties, sales tax, consumption tax, value added tax, and other taxes (except income taxes) or duties relating to sales, and any payment in respect of sales to the United States government, any State government or any foreign government, or to any Governmental Authority, or with respect to any government-subsidized program or managed care organization; provided that all such deductions for payments in respect of sales to the United States government, any State government, any foreign government, any Governmental Authority, any government-subsidized program or any managed care organization that apply collectively to multiple pharmaceutical products shall be fairly allocated to the amounts invoiced for Pfizer Products; and

**(b)** in the case of a Combination Product,

(i) if Pfizer and/or its Affiliates and/or any Third Party separately sells in such country during such year when it sells such Combination Product both (1) one or more Pfizer Products as a single chemical entity and (2) other products containing active pharmaceutical ingredient(s) as a single chemical entity, both of which are also contained in such Combination Product, then the Net Sales attributable to such Combination Product during such year shall be calculated by multiplying actual Net Sales of such Combination Product by the fraction A/(A+B) where: A is the sum of Pfizer's (or its Affiliates' or Third Parties', as applicable) average Net Sales prices per daily dose during such year for each Pfizer Product in such Combination Product as a single chemical entity in such country and B is the sum of the average of Pfizer's (or its Affiliates' or Third Parties', as applicable) Net Sales prices per daily dose during such year in such country, for each product(s) containing the active pharmaceutical ingredient(s) in such Combination Product (other than the Pfizer Product) as a single chemical entity;

(ii) if Pfizer and/or its Affiliates and/or any Third Party separately sells, in such country during such year when it sells such Combination Product, one or more Pfizer Products as a single chemical entity but does not separately sell, in such country, other products containing the active pharmaceutical ingredient(s) that are also contained in such Combination Product, then the Net Sales attributable to such Combination Product during such year shall be calculated by multiplying the Net Sales of such Combination Product by the fraction A/C where: A is the sum of Pfizer's (or its Affiliates' or Third Parties', as applicable) average Net Sales prices per daily dose during such year for each Pfizer Product



in such Combination Product as a single chemical entity in such country, and C is Pfizer's (or its Affiliates' or Third Parties', as applicable) average Net Sales price per daily dose during such year for the Combination Product in such country;

(iii) if Pfizer and/or its Affiliates and/or Third Parties do not separately sell, in such country during such year when it sells such Combination Products, each Pfizer Product contained in the Combination Product, then the Net Sales attributable to such Combination Product during such year shall be calculated by multiplying the Net Sales of such Combination Product by the fraction 1/1+D where D is the number of active pharmaceutical ingredients in such Combination Product other than the Pfizer Products.

In all cases, Net Sales shall be determined from books and records maintained in accordance with generally acceptable accounting principles in the United States, consistently applied.

**1.52** "**Non-Proprietary Drug Product**" has the meaning assigned to it in Section 11.5(c)(iii).

**1.53** "**Note Purchase Agreement**" means the Note Purchase Agreement, dated the date hereof, between Pfizer Overseas Pharmaceuticals and Incyte, as amended from time to time.

**1.54** "**Notes**" means has the meaning assigned to it in the Note Purchase Agreement.

**1.55** "**Patent Rights**" means all claims contained in patent applications and issued or granted patents, whether domestic or foreign, including continuations, continuations-in-part, divisionals, provisionals and renewals, and letters of patent granted with respect to any of the foregoing, patents of addition, supplementary protection certificates, registration or confirmation patents and all reissues, re-examination and extensions thereof and any patent restoration or extension period granted by a Governmental Authority, including compensation for patent term lost during the clinical trial or Regulatory Approval process. Inventorship of Patent Rights, including sole and joint inventorship, shall be determined according to applicable United States Law at the time such determination is made.

**1.56** "**Person**" means an individual, corporation, partnership, company, joint venture, unincorporated organization, limited liability company or partnership, sole proprietorship, association, bank, trust company or trust, whether or not legal entities, or any Governmental Authority.

**1.57** "**Pfizer Confidential Information**" means all information about any element of Pfizer Technology, as well as any other information regarding the business and operations of Pfizer, that is disclosed (whether orally or in writing) prior to or after the Effective Date by Pfizer to Incyte or its Affiliates and (a) in the case of oral information, is outlined in a summary prepared by Pfizer and delivered to Incyte promptly after such disclosure and (b) in the case of written information, is designated "Confidential" in writing by Pfizer at the time of disclosure to Incyte, to the extent that such information is not (i) as of the date of disclosure to Incyte, known to Incyte other than by virtue of a prior confidential disclosure to Incyte by Pfizer; (ii) disclosed in published literature, or otherwise generally known to the public through no fault or omission of Incyte; (iii) obtained from a Third Party free from any obligation of confidentiality to Pfizer; (iv) independently developed by Incyte without access to the Pfizer Confidential Information as shown by competent written proof; or (v) is, in the reasonable opinion of legal counsel, required to be disclosed under Law or in connection with a legal proceeding; provided that, in the case of



clause (v), Incyte provides Pfizer sufficient prior notice (to the extent practicable) of such disclosure and agrees to cooperate, at the request and sole expense of Pfizer with Pfizer's efforts to preserve the confidentiality of such information. All information about the existence and terms of this Agreement shall be considered both Incyte Confidential Information and Pfizer Confidential Information.

**1.58** "**Pfizer Indication**" means any indication that is not an Incyte Indication or, if applicable, a Reverted Indication.

**1.59** "**Pfizer Key Decision Points**" means any of the following: (i) with respect to any Pfizer Product, a decision with respect to whether Pfizer's relevant go/no go criteria have been met prior to the Commencement of any Phase II Trial or Phase III Trial and (ii) a decision to terminate research and development for any Pfizer Product or to terminate research and development for a particular Pfizer Indication.

**1.60** "**Pfizer Patent Rights**" means all Patent Rights that are Controlled by Pfizer or any of its Affiliates, claim any CCR2 Antagonist (or any salt, prodrug, ester, metabolite, solvate, stereoisomer or polymorph of any such CCR2 Antagonist) as a composition of matter and are (a) invented by officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, (b) invented by officers, employees or agents of, or consultants to, a Third Party or (c) jointly invented by officers, employees or agents of, or consultants to, both Incyte and Pfizer or any of their respective Affiliates, in each case, alone or jointly with Third Parties; provided that, in the case of each of clauses (a), (b) and (c), such CCR2 Antagonist (or any salt, prodrug, ester, metabolite, solvate, stereoisomer or polymorph of any such CCR2 Antagonist) covered by such claim was invented in a research program directed toward the identification of CCR2 Antagonists during the period beginning on the first day after the expiration of the Research Term and ending on the one (1) year anniversary of such day.

**1.61** "**Pfizer Process Patent Claims**" means any claim contained in a Patent Right that is Controlled by Pfizer or any of its Affiliates, the subject matter of which (i) was invented by either (a) officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, or (b) officers, employees or agents of, or consultants to, a Third Party, in the case of each of clauses (a) and (b), during the Term in a program directed toward the development of CCR2 Antagonists (other than the Research Program) and (ii) is directed to a manufacturing process (including synthesis, purification, formulation or analytical methods or intermediates) that was actually used by Pfizer or any of its Affiliates in the manufacturing or processing of active pharmaceutical ingredient for a Compound or a Pfizer Product that contains a Compound as the sole active pharmaceutical ingredient.

**1.62** "**Pfizer Product**" means any human pharmaceutical product (including any Combination Product), whether commercialized or in development, in all dosage forms and formulations that contains a Compound.

**1.63** "**Pfizer Proprietary Process Patent Claims**" means any claim contained in a Patent Right that is Controlled by Pfizer or any of its Affiliates, the subject matter of which (i) was invented by either (a) officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, or (b) officers, employees, or agents of, or consultants to, a Third Party, in the case of each of clauses (a) and (b), at any time outside of a program directed toward the development of CCR2 Antagonists and (ii) is directed to a manufacturing process (including purification, formulation or analytical methods) that was



actually used by Pfizer or any of its Affiliates in the manufacturing or processing of an applicable Pfizer Product that contains a Compound as the sole active pharmaceutical ingredient, which process was used to manufacture the formulated Pfizer Product from active pharmaceutical ingredient. For clarity, Pfizer Proprietary Process Patent Claims do not include claims to the extent they cover a process for manufacturing bulk active pharmaceutical ingredient.

**1.64** "**Pfizer Quarter**" means (i) in the United States, each of the four (4) thirteen (13)-week periods used by Pfizer in its audited financial reports, the first such period commencing on January 1 of any year and (ii) in any country in the Territory other than the United States, each of the four (4) thirteen (13)-week periods used by Pfizer in its audited financial reports, the first such period commencing on December 1 of any year.

**1.65** "**Pfizer Technology**" means Technology that is or was (a) invented by officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, at any time outside of the Research Program or (b) acquired by purchase, license, assignment or other means from Third Parties by Pfizer or any of its Affiliates, alone or jointly with Third Parties, at any time outside of the Research Program; provided that such Technology was (i) disclosed to Incyte during the Term or in the course of Pfizer's performance of its obligations pursuant to Section 11.6(b)(ii) and (ii) actually used in connection with the discovery or development of any Compound, Incyte Compound or Pfizer Product.

**1.66** "**Pfizer Use Patent Claims**" means any claim contained in a Patent Right that is Controlled by Pfizer or any of its Affiliates, the subject matter of which (i) was invented by (a) officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, or (b) officers, employees or agents of, or consultants to, a Third Party, in the case of each of clauses (a) and (b), during the Term in a program directed toward the development of CCR2 Antagonists (other than the Research Program) and (ii) is directed to the therapeutic use of a Compound or an Incyte Compound or Incyte Product for an Incyte Indication or, if applicable, a Reverted Indication or, in the case of Section 11.6(b)(ii)(E) only, any indication.

**1.67** "**Phase I Trial**" means a clinical trial that is the first introduction into humans of a Pfizer Product.

**1.68** "**Phase II Trial**" means a clinical trial, other than a Phase III Trial, that is intended to test the effectiveness of a Pfizer Product, or an Incyte Product, as the case may be, for a specific indication in patients with the disease or condition under study.

**1.69** "**Phase II(b) Trial**" means a Phase II Trial that is intended to establish the dosing regimen for use in a Phase III Trial of a Pfizer Product or an Incyte Product, as the case may be, for a specific indication.

**1.70** "**Phase III Trial**" means a clinical trial that is intended to form the primary basis of an effectiveness claim in approved product labeling for a Pfizer Product or an Incyte Product, as the case may be.

**1.71** "**Price Approval**" means, in countries where Governmental Authorities or Regulatory Authorities authorize for reimbursement, or approve or determine pricing for pharmaceutical products for reimbursement or otherwise, receipt (or, if required to make such



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authorization, approval or determination effective, publication) of such reimbursement authorization or pricing approval or determination.

**1.72** "**Program Patent Rights**" means all Patent Rights that are Controlled by Pfizer or any of its Affiliates and cover Program Technology.

**1.73** "**Program Technology**" means Technology that is or was (a) invented by officers, employees or agents of, or consultants to, Incyte or any of its Affiliates, alone or jointly with Third Parties, in the course of performing the Research Plan during the Research Term, (b) jointly invented by officers, employees or agents of, or consultants to, both Incyte and Pfizer or any of their respective Affiliates, in each case, alone or jointly with Third Parties, in the course of performing the Research Plan during the Research Term, (c) invented by officers, employees or agents of, or consultants to, Pfizer or any of its Affiliates, alone or jointly with Third Parties, in the course of performing the Research Plan during the Research Term or (d) acquired by purchase, license, assignment or other means from Third Parties by Incyte or any of its Affiliates, by Incyte and Pfizer or any of their respective Affiliates or by Pfizer or any of its Affiliates, in each case, alone or jointly with Third Parties, in order for such Party (or Parties) to perform the Research Plan during the Research Term; provided that ***, then *** if (x) Incyte and all of its Affiliates comply with the provisions of *** and (y) ***.

**1.74** *** means an *** disease that is characterized by ***. A patient is diagnosed with ***.

**1.75** *** means the indications set forth on Schedule 1.75 attached hereto.

**1.76** "**Regulatory Approval**" means any and all approvals, excluding any INDs, but including supplements and amendments, licenses, registrations or authorizations (other than Price Approvals) of any national, supra-national (e.g., the European Commission or the Council of the European Union), regional, state or local regulatory agency, department, bureau,



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commission, council or other Governmental Authority, that are necessary for the manufacture, distribution, use, marketing or sale of a pharmaceutical product in a regulatory jurisdiction.

**1.77** "**Regulatory Authority**" means any Governmental Authority with responsibility for granting any Regulatory Approval or with whom an IND is filed, including the FDA and any drug regulatory authority of countries of the European Union and Japan, and, where applicable, any ethics committee or any equivalent review board.

**1.78** "**Regulatory Filing**" means any NDA, IND, or any foreign counterparts thereof and any other filings required by Regulatory Authorities relating to the study, manufacture or commercialization of a pharmaceutical product.

**1.79** "**Representatives**" has the meaning assigned to it in Section 13.1.

**1.80** "**Research Plan**" has the meaning assigned to it in Section 3.1.

**1.81** "**Research Program**" means the research program established by the Parties pursuant to Article 3.

**1.82** "**Research Term**" means the period beginning on the Effective Date and ending on ***.

**1.83** "**Reverted Indication**" means any Pfizer Indication that has been reverted to Incyte pursuant to Section 11.4.

**1.84** "**Royalty Term Expiration Date**" means on a country-by-country and Pfizer Product-by-Pfizer Product basis, the later to occur of: (A) the date on which the manufacture, use, sale, offer for sale or importation of such Pfizer Product (i) ceases to be covered by a Valid Claim under any ***, (ii) ceases to be covered by a Valid Claim under any *** and (iii) ceases to be covered by a Valid Claim under any ***, as applicable, or (B) the *** year anniversary of the Launch of such Pfizer Product in such country.

**1.85** "**Security Agreement**" means the Security Agreement, dated the date hereof, between Pfizer and Incyte.

**1.86** "**Technology**" means all scientific and technical information and data, including know-how, trade secrets and technology related thereto, that are or were used in connection with the discovery, development or commercialization of any CCR2 Antagonist. Technology does not include any Patent Rights.

**1.87** "**Term**" has the meaning assigned to it in Section 11.1.

**1.88** "**Territory**" means worldwide.

**1.89** "**Third Party**" means a Person other than (a) Pfizer, (b) Incyte or (c) an Affiliate of either of them.

**1.90** "**Transition Plan**" has the meaning assigned to it in Section 5.1.



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**1.91** "**Valid Claim**" means a claim of any issued, unexpired United States or granted foreign patent included within the patents under the ***, as the case may be, that has not been revoked, dedicated to the public, disclaimed, abandoned or held invalid or unenforceable by a court or other Governmental Authority of competent jurisdiction in an unappealed or unappealable decision, and that has not been explicitly disclaimed, or admitted by Incyte with respect to ***, as the case may be, in writing to be invalid or unenforceable or of a scope not covering Pfizer Products through reissue, disclaimer or otherwise.

**1.92** "**Voting Stock**" means securities of any class or series of a corporation, association or other entity, the holders of which are ordinarily, in the absence of contingencies, entitled to vote generally in matters put before the shareholders or members of such corporation, association or other entity.

**1.93** **Construction**. Except where expressly stated otherwise in this Agreement, the following rules of interpretation apply to this Agreement: (i) "include", "includes" and "including" are not limiting; (ii) definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms; (iii) references to an agreement or instrument mean such agreement or instrument as from time to time amended, modified or supplemented; (iv) references to a Person are also to its permitted successors and assigns; (v) references to an "Article", "Section", "Exhibit" or "Schedule" refer to an Article or Section of, or any Exhibit or Schedule to, this Agreement unless otherwise indicated; (vi) the word "will" shall be construed to have the same meaning and effect as the word "shall"; and (vii) the word "any" shall mean "any and all" unless otherwise indicated by context. In the event an ambiguity or a question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by the Parties, and no presumption or burden of proof shall arise favoring or disfavoring any Party by virtue of the authorship of any provisions of this Agreement.

## 2. MANAGEMENT OF THE RESEARCH PROGRAM

**2.1** **Joint Research Committee**.

**(a)** The Research Program established by this Agreement shall be overseen by a joint research committee composed of three (3) representatives from each Party (the "**Joint Research Committee**" or "**JRC**"). The Parties shall designate their JRC representatives within ten (10) Business Days after the Effective Date. An alternate member designated by a Party may serve temporarily in the absence of a permanent member of the JRC for such Party. Each Party shall designate one of its representatives as a co-chair of the JRC. The co-chairs of the JRC shall be jointly responsible for setting the agenda for each meeting, and each co-chair will be responsible for chairing alternating JRC meetings. From time to time, the JRC may establish subcommittees or subordinate committees (that may or may not include members of the JRC itself) to oversee particular projects or activities, and such subcommittees or subordinate committees shall be constituted and shall operate as the JRC agrees. After the end of the Research Term, the JRC shall only meet if necessary to fulfill its duties under Sections 2.4(f) and 2.4(g).

**(b)** All decisions of the JRC made pursuant to this Agreement shall be made by consensus; provided, however, that in the event of a disagreement between Pfizer and Incyte,



subject to Sections 2.1(c) and 2.1(d) below, the Pfizer co-chair of the JRC shall have the final decision-making authority.

**(c)** Any changes to the Research Plan that materially expand Incyte's obligations or require Incyte to materially increase its efforts or materially alter the nature of the services provided by Incyte shall require the unanimous consent of the JRC. If the JRC fails to reach unanimous consent regarding any such change to the Research Plan, then the obligations of Incyte shall not be increased and the nature of the services provided by Incyte shall not be altered.

**(d)** Any changes to the assays used to define CCR2 Antagonists that are described in Schedules 1.7(a)-(c) shall require the unanimous consent of the JRC. If the JRC fails to reach unanimous consent regarding any such change to such assays, then such assays shall not be changed.

**2.2 Meetings**. The JRC shall hold meetings at such times and places as shall be determined by the JRC (it being expected that any in-person meetings will alternate between the appropriate offices of each Party), but in no event shall such meetings be held less frequently than once every calendar quarter during the Research Term; and the JRC may:

**(a)** conduct meetings in person, by videoconference or by telephone conference;

**(b)** invite other personnel of the Parties to attend meetings of the JRC as appropriate to the agenda for such meeting, after giving advance notice to the other Party;

**(c)** act without a meeting if, prior to such action, a consent thereto is signed by the co-chairs of the JRC; and

**(d)** by unanimous consent, amend or expand upon the foregoing procedures for its internal operation.

**2.3 Minutes**. At each meeting, the JRC shall elect a secretary who will prepare minutes after each meeting, reporting in reasonable detail the actions taken by the JRC during such meeting, issues requiring resolution, and resolutions of previously reported issues. Such minutes are to be reviewed and, if reasonably complete and accurate, signed by one JRC member from each Party. The secretary shall revise such minutes as necessary to obtain such signatures.

**2.4 JRC Functions and Powers**. The research activities of the Parties under the Research Plan shall be managed by the JRC only to the extent set forth herein (unless otherwise mutually agreed in writing by the Parties). The JRC shall foster the collaborative relationship between the Parties in order to assist each Party in fulfilling its obligations under the Research Plan, and shall in particular:

**(a)** encourage and facilitate ongoing cooperation and information exchange between the Parties;

**(b)** monitor the progress of the Research Program and the Parties' diligence in carrying out their responsibilities thereunder;



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**(c)** subject to Section 2.1 (c), prepare any amendments to the Research Plan, if the JRC should determine that any such amendments are necessary;

**(d)** set priorities, allocate tasks and coordinate activities between the Parties, in each case as required to perform the Research Program;

**(e)** perform such other functions as appropriate to further the purposes of the Research Plan as mutually determined by the Parties;

**(f)** subject to Section 2.1(d), amend, modify, replace or delete any of the assays used to define CCR2 Antagonists, as described in Schedules 1.7(a)-(c), if the JRC should determine that any such change is necessary; and

**(g)** discuss issues relating to the ***, including if *** from the ***, the *** and ***

Except as set forth in Sections 2.4(c) and 2.4(f), the JRC shall have no power to amend this Agreement and shall have only such powers as are specifically delegated to it in this Agreement.

**2.5 Independence**. Subject to the terms of this Agreement, the activities and resources of each Party shall be managed by such Party, acting independently and in its individual capacity. The relationship between Incyte and Pfizer is that of independent contractors and neither Party shall have the power to bind or obligate the other Party in any manner, other than as is expressly set forth in this Agreement. Incyte and Pfizer are not joint venturers, partners, principal and agent, employer and employee, and have no other relationship other than independent contracting parties.

## 3. CONDUCT OF THE RESEARCH PROGRAM

**3.1 Research Plan**. The Parties shall conduct the Research Program according to the research plan (as amended from time to time, the "**Research Plan**"). The initial Research Plan has been approved by the Parties concurrent with the execution of this Agreement and is attached hereto as Exhibit B. The Research Plan may be amended from time to time by the JRC during the Research Term based upon the data obtained in the Research Program and in accordance with Sections 2.1(c) and 2.4(c); provided that such amendments (i) are in writing and signed by both Parties if required by Section 2.1(c) and (ii) do not violate or contradict any provision of this Agreement. In the event of an inconsistency or disagreement between the Research Plan and this Agreement, the terms of this Agreement shall prevail.

**3.2 Conduct of Research**. The Parties shall conduct the Research Program in compliance in all material respects with the requirements of applicable Laws and use reasonably diligent efforts to achieve the objectives of the Research Program and the Research Plan efficiently and expeditiously. Each Party shall promptly inform the other about all inventions within Program Technology that are made in the performance of the Research Program or the Research Plan.

**3.3 Research Costs**. Except as provided in this Section 3.3, each Party shall bear its own internal costs and any external payments to Third Parties that it incurs in the course of the

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Research Program unless otherwise agreed by the JRC. Pfizer shall reimburse Incyte for the number of FTEs specified in the Research Plan at a rate equal to (i) *** and *** and (ii) *** for *** and ***. Incyte shall bill Pfizer for such FTE costs at the beginning of each calendar quarter, and Pfizer shall make all such payments by wire transfer, in accordance with the wire instructions set forth in Section 8.6, within thirty (30) days after its receipt of each such invoice from Incyte.

**3.4 Records**. Each Party shall maintain complete and accurate records of all work conducted under the Research Program and all results, data and developments made pursuant to its efforts under the Research Program. Such records shall reflect work done and results achieved in the performance of the Research Program in sufficient detail and in a manner appropriate for patent and regulatory purposes. Subject to bona fide confidentiality obligations to a Third Party, each Party shall have the right to request copies of such records of the other Party at reasonable times and upon reasonable notice to the extent necessary or useful for such Party to conduct its research or perform its other obligations under this Agreement, or to secure or enforce patents licensed under this Agreement.

**3.5 Reports**. During the Research Term, each Party shall report to the JRC no less than once per calendar quarter, and such reports shall consist of a written progress report summarizing the work performed under the Research Plan since the previous report. The JRC shall define the format and the nature of the content of such quarterly reports, which format and nature shall be adopted by both Parties.

**3.6 Termination of Research Program**. The Research Program and the Research Plan shall automatically terminate on the effective date of any termination of this Agreement pursuant to Section 11.2 or 11.3. In addition, Pfizer may terminate the Research Program and the Research Plan if Incyte has materially breached its obligations under Article 3 of this Agreement or under the Research Plan, such termination to be effective thirty (30) days after Incyte's receipt of a notice from Pfizer to such effect in accordance with Section 15.3; provided that if Incyte has cured such breach prior to the expiration of such thirty (30)-day period, then the Research Program and Research Plan shall remain in effect pursuant to the terms thereof. As a result of any termination in accordance with this Section 3.6, Article 2 (other than Sections 2.4(f) and 2.4(g)), Article 3, the Research Program and the Research Plan shall cease to be in effect and neither Party shall have any further obligations with respect thereto.

**4. HSR**.

**4.1 HSR**. Pfizer (or its Affiliate) and Incyte (or its Affiliate) shall take (or shall cause such Affiliate to take, if applicable) (i) all actions necessary at the earliest practicable date to make the filing required under the HSR Act and (ii) reply at the earliest practicable date with any requests for information received from the United States Federal Trade Commission ("**FTC**") or Antitrust Division of the United States Department of Justice ("**DoJ**") pursuant to the HSR Act. The Parties shall, to the extent reasonably practicable, consult with one another prior to making any filings, responses to inquiries or other contacts with the FTC or DoJ concerning the transactions contemplated hereby. Pfizer shall pay any fees in connection in with the HSR filing, other than any Incyte legal fees or expenses.



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**5. DEVELOPMENT AND COMMERCIALIZATION**

**5.1 Transition Plan**. In order to ensure the smooth transition of ongoing development activities for the Compounds that Incyte has licensed to Pfizer pursuant to Section 7.1 and to facilitate the transfer of the Incyte Technology to Pfizer, the Parties hereby agree to comply with the provisions of the transition plan (the "**Transition Plan**"), which is attached hereto as Exhibit C. In the event of an inconsistency or disagreement between the Transition Plan and this Agreement, the terms of this Agreement shall prevail.

**5.2 Development Plan**. The development of each Pfizer Product shall be governed by a development plan that describes the proposed overall program of development (the "**Development Plan**"). The initial Development Plans for *** and *** are attached hereto as Exhibits D-1, D-2 and D-3, respectively (collectively, the "**Initial Development Plan**"). Pfizer shall have the sole right and responsibility for preparing the Development Plan for each Pfizer Product. All decisions with respect to the creation, modification and implementation of the Initial Development Plan, all other such Development Plans and all development activities shall be made by Pfizer in its sole discretion; provided that Pfizer will present a draft Development Plan for each Pfizer Product and any material changes to the Initial Development Plan to the Development Committee and will give due consideration to any comments of Incyte thereto.

**5.3 Development Information Exchange**.

**(a)** Development Committee. The Parties shall establish a development committee (the "**Development Committee**") for the sole purpose of reviewing and discussing (i) past and current material development activities and (ii) as appropriate, future material development activities for Pfizer Products and Incyte Products. The Development Committee shall have no decision-making authority.

**(b)** Members. The Development Committee shall consist of no more than four (4) representatives of Incyte and no less than four (4) representatives of Pfizer. Depending on the number of Pfizer Products in development at any given time, Pfizer shall have the flexibility to add additional members to the Development Committee, as appropriate. The Development Committee shall be chaired by one of the Pfizer representatives (the "**Committee Chair**").

**(c)** Meetings. During the period beginning on the Effective Date and ending, on a Pfizer Product-by-Pfizer Product basis, after the first Launch of such Pfizer Product (the "**Meeting Period**"), the Development Committee shall meet quarterly (each such meeting, a "**Development Committee Meeting**"). The Parties agree that the ***. The Parties further agree that a Development Committee Meeting will be ***; provided that in no event will the Parties be required to meet more than four (4) times in any calendar year as a result of such scheduling. All Development Committee Meetings may be conducted in person, by videoconference or by teleconference at such times and such Pfizer or Incyte locations as shall be determined by the

Development Committee. In-person meetings of the Development Committee will alternate between appropriate offices of each Party. The Parties shall each bear all expenses of their respective representatives relating to their participation on the Development Committee.



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**(d)** Reports. During the Meeting Period, (i) Pfizer shall provide quarterly written reports ("**Pfizer Development Reports**") to the Incyte representatives on the Development Committee, which contain (x) a summary of material development activities with respect to Pfizer Products since the last Pfizer Development Report and (y) if applicable, draft Development Plans for Pfizer Products and (ii) Incyte shall provide quarterly written reports ("**Incyte Development Reports**" and, together with Pfizer Development Reports, "**Development Reports**") to the Pfizer representatives on the Development Committee, which contain (x) a summary of material development activities with respect to Incyte Products since the last Incyte Development Report and (y) if applicable, draft development plans for Incyte Products. The Parties will use reasonable efforts to provide their respective Development Reports to the Development Committee representatives at least five (5) Business Days before the next Development Committee Meeting. All Pfizer Development Reports and Development Plans for Pfizer Products shall be deemed Pfizer Confidential Information. All Incyte Development Reports and development plans for Incyte Products shall be deemed Incyte Confidential Information.

**(e)** Notices. Each Party shall deliver to the other Party the following notices: (i) prior to any decision being made by a Party with respect to a Pfizer Key Decision Point or an Incyte Key Decision Point, as the case may be, such Party shall notify the other Party that such Pfizer Key Decision Point or Incyte Key Decision Point is under consideration; provided that Pfizer will use reasonable efforts to deliver any such notice sufficiently in advance of a decision being made with respect to a Pfizer Key Decision Point ***, (ii) no later than ten (10) Business Days after a Party has made a final decision with respect to a Pfizer Key Decision Point or an Incyte Key Decision Point, as the case may be, such Party shall notify the other Party of such decision, (iii) no later than ten (10) Business Days (x) after a Party receives Regulatory Approval of an NDA in the United States for a Pfizer Product or an Incyte Product, as the case may be, or (y) after the Launch of a Pfizer Product or an Incyte Product, as the case may be, in a Major European Country or Japan, the Party receiving such Regulatory Approval or Launching such Pfizer Product or Incyte Product, as the case may be, shall notify the other Party of the receipt of such Regulatory Approval or such Launch, as the case may be.

**5.4 Diligence**.

**(a)** Pfizer will use Commercially Reasonable Efforts to carry out the Initial Development Plan, as it may be amended in accordance with Section 5.2.

**(b)** Pfizer will use Commercially Reasonable Efforts to develop, seek Regulatory Approval for and commercialize Pfizer Products on a country-by-country and Pfizer Product-by-Pfizer Product basis.

**5.5 Regulatory Affairs**. Pfizer shall own and be responsible for preparing and submitting all Regulatory Filings and seeking and maintaining all Regulatory Approvals for all Pfizer Products, including preparing all reports necessary as part of a Regulatory Filing or Regulatory Approval.

**5.6 Manufacture and Supply**. Pfizer shall be responsible for the manufacture of all preclinical and clinical materials for each Pfizer Product, for the commercial supply of each Pfizer Product and for all costs associated therewith.



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**5.7 Costs**. Pfizer shall be responsible for all costs associated with the development and commercialization of Pfizer Products that are incurred by it after the Effective Date. In addition, Pfizer agrees to pay the costs that are specified in the Transition Plan.

**5.8 Trademarks**. Pfizer shall select all trademarks for all Pfizer Products and shall own all such trademarks.

**5.9 Pricing**. Pfizer shall be solely responsible for the pricing and other terms of sale for all Pfizer Products.

## 6. INCYTE PRODUCTS

**6.1 Development Plan**. The development of each Incyte Product shall be governed by a development plan that describes the proposed overall program of development. Incyte shall have the sole right and responsibility for preparing the development plan for each Incyte Product. All decisions with respect to the creation, modification and implementation of such development plans and all development activities shall be made by Incyte in its sole discretion; provided that Incyte will present a draft development plan for each Incyte Product and any material changes thereto to the Development Committee and will give due consideration to any comments of Pfizer thereto.

**6.2 Regulatory Affairs**. Incyte shall own and be responsible for preparing and submitting all Regulatory Filings and seeking and maintaining all Regulatory Approvals for all Incyte Products, including preparing all reports necessary as part of a Regulatory Filing or Regulatory Approval.

**6.3 Manufacture and Supply**. Incyte shall be responsible for the manufacture of all preclinical and clinical materials for each Incyte Product, for the commercial supply of each Incyte Product and for all costs associated therewith.

**6.4 Costs**. Incyte shall be responsible for all costs associated with the development and commercialization of Incyte Products.

**6.5 Trademarks**. Incyte shall select all trademarks for all Incyte Products and shall own all such trademarks.

**6.6** **Pricing**. Incyte shall be solely responsible for the pricing and other terms of sale for all Incyte Products.

**6.7** **Incyte Compounds**.

**(a)** Designation of Initial Back-Up Incyte Compound. The Parties agree that Incyte shall choose the first back-up Incyte Compound only in accordance with the procedures set forth below:

**(i)** Incyte shall run the studies set forth on Schedule 6.7(a) under the heading ***, in parallel and at Incyte's sole expense, on the following *** Compounds: *** (each, individually, a "**Test Compound**" and,



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collectively, and together with the additional Compounds permitted to be designated by Incyte as Test Compounds pursuant to Section 6.7(a)(v), the "**Test Compounds**"). Promptly after completion of such ***, Incyte shall provide Pfizer with a copy of all information, data and test results of such *** for each of the Test Compounds.

**(ii)** If any of the Test Compounds successfully completes the *** and meets Incyte's criteria for advancement, as determined by Incyte in its sole discretion, then Incyte shall select one of such Test Compounds and shall analyze such Test Compound, at Incyte's sole expense, by ***. Promptly after completion of such ***, Incyte shall provide Pfizer with a copy of all information, data and test results of such *** for such Test Compound. If any of the Test Compounds do not successfully complete the *** or do not meet Incyte's criteria for advancement, then (x) *** and (y) ***.

**(iii)** If the first Test Compound selected by Incyte pursuant to Section 6.7(a)(ii) successfully completes the *** and meets Incyte's criteria for advancement, as determined by Incyte in its sole discretion, then Incyte shall promptly notify Pfizer that it would like to designate such Test Compound as an Incyte Compound. Effective upon Pfizer's receipt of such notice pursuant to Section 15.3, (x) ***, (y) *** and (z) ***.

**(iv)** If the first Test Compound selected by Incyte pursuant to Section 6.7(a)(ii) does not successfully complete the ** or does not meet Incyte's criteria for advancement, then (x) ***, (y) ***. Promptly after completion of such ***, Incyte shall provide Pfizer with a copy of all information, data and test results of such *** for such Test Compound. If the *** Test Compound successfully completes the *** and meets Incyte's criteria for advancement, then Section 6.7(a)(iii) shall apply with respect to such Test Compound and the other Test Compounds. If the *** Test Compound does not successfully complete the *** or does not meet Incyte's criteria for advancement, then this Section 6.7(a)(iv) shall apply with respect to such Test Compound and the other Test Compounds. Sections 6.7(a)(iii) and (iv) shall continue to be applied until Incyte either designates an Incyte Compound from the Test Compounds or notifies Pfizer that it will not designate any of the Test Compounds as an Incyte Compound, in which case ***.



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**(v)** If Incyte notifies Pfizer that it will not designate any of the Test Compounds listed in Section 6.7(a)(i) as an Incyte Compound because none of the Test Compounds successfully completed both the *** and the *** and met Incyte's criteria for advancement, then Incyte may designate up to an additional *** Compounds as Test Compounds under the following circumstances: (A) ***, (B) *** and (C) ***. After Incyte and Pfizer have agreed which Compounds will be designated as additional Test Compounds, Incyte shall follow the procedures set forth in this Section 6.7(a) with respect to such additional Test Compounds until Incyte either designates an Incyte Compound from such additional Test Compounds or notifies Pfizer that it will not designate any of the additional Test Compounds as an Incyte Compound, in which case ***.

**(b)** Designation of Future Incyte Compounds. If Incyte does not *** either because such Incyte Compounds have not yet been selected or because Incyte has notified Pfizer pursuant to Section 5.3(e) that it is not going to pursue any further research or development of an Incyte Compound that is either a lead or a back-up compound for an Incyte Indication, then (x) *** or ***, (I) *** (II) *** to *** (y) ***.

**(i)** *** "**Incyte Pool Compounds**"; provided that ***. If Pfizer wishes to designate a Compound as an Incyte Pool Compound and any of the assays set forth on Schedule 6.7(b) under the heading "Assays" (the "**Assays**") has been conducted with respect to such Compound, Pfizer will only be permitted to designate such Compound as an Incyte Pool Compound, if such Compound meets the guidelines set forth on Schedule 6.7(b) under the heading "Requirement for Designation" for each Assay that has been conducted or if Incyte agrees that Pfizer may designate such Compound as an Incyte Pool



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Compound. The Parties agree that Pfizer will not be obligated to perform any Assays with respect to any Compound, other than pursuant to the Research Plan.

**(ii)** *** Incyte Pool Compound, Pfizer will provide Incyte with a list of the then current Incyte Pool Compounds and a copy of all information, data and test results that Pfizer has with respect to such Incyte Pool Compounds that have not been previously provided to Incyte. When Pfizer provides Incyte with such information, data and test results, Pfizer may ***. All information, data or test results, whether or not so marked, will be Pfizer Confidential Information, and Incyte shall treat such information, data or test results in accordance with the provisions of Sections 10.2 and 10.4. After its receipt of such information, data and test results, Incyte, in its sole discretion, may conduct additional Assays, *** or *** with respect to any or all Incyte Pool Compounds, in each case, at Incyte's sole expense, but in no event may ***. Promptly after completion of any such Assays, *** or ***, Incyte shall provide Pfizer with a copy of all information, data and test results with respect to each applicable Incyte Pool Compound.

**(iii)** After Incyte has notified Pfizer that it would like to designate an Incyte Pool Compound as an Incyte Compound then, effective upon Pfizer's receipt of such notice pursuant to Section 15.3, such Incyte Pool Compound shall be deemed an Incyte Compound and added to Schedule 1.35.

**(iv)** ***

**(c)** Designation of an Incyte Compound due to Reverted Indication. If a Pfizer Indication becomes a Reverted Indication pursuant to Section 11.4 and Pfizer decides not to revert a Compound to Incyte with such Reverted Indication, then Incyte shall have the right but not the obligation to designate an additional Incyte Compound ***

## 7. LICENSES AND RELATED RIGHTS

**7.1 License to Pfizer**. Subject to the terms of this Agreement, Incyte grants, and shall cause its Affiliates to grant, to Pfizer the following:

**(a)** an exclusive (even as to Incyte and its Affiliates) license, with the right to sublicense, to use the Incyte Technology, Incyte Confidential Information and Program Technology to the extent necessary or useful, to make, have made, use, import, offer for sale or sell Compounds, Incyte Compounds, Pfizer Products, Animal Products or Incyte Products for the



treatment, control or prevention of the Pfizer Indications or the Incyte Indications in the Territory;

**(b)** an exclusive (even as to Incyte and its Affiliates) license, with the right to sublicense, under the Incyte Patent Rights, Incyte Product Patent Rights and Incyte Program Patent Rights to the extent necessary or useful to make, have made, use, import, offer for sale or sell Compounds, Incyte Compounds, Pfizer Products, Animal Products or Incyte Products for the treatment, control or prevention of the Pfizer Indications or the Incyte Indications in the Territory; and

**(c)** a non-exclusive, irrevocable, worldwide, royalty-free, perpetual license, with the right to sublicense, under the Incyte Program Patent Rights for any and all purposes.

Notwithstanding the foregoing, with respect to any Incyte Technology, Incyte Patent Rights or Incyte Product Patent Rights, that Incyte acquires by purchase, license, assignment or other means from a Third Party, Incyte shall only be required to grant to Pfizer a license to such Incyte Technology, Incyte Patent Rights or Incyte Product Patent Rights (x) to the extent permitted under its agreement with such Third Party and (y) if Pfizer agrees to be responsible for all payments to such Third Party under such Third Party agreement that may be incurred as a result of such sublicense to Pfizer and executes documentation reasonably satisfactory to Incyte to such effect.

**7.2 Sublicenses and License to Incyte**. Subject to the terms of this Agreement, Pfizer grants, and shall cause its Affiliates to grant, to Incyte the following fully paid, royalty-free, worldwide sublicenses and licenses:

**(a)** an exclusive (even as to Pfizer and its Affiliates) sublicense, with the right to further sublicense, to use the Incyte Technology, Incyte Confidential Information, Pfizer Technology, Pfizer Confidential Information and Program Technology to the extent necessary or useful to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory;

**(b)** an exclusive (even as to Pfizer and its Affiliates) sublicense, with the right to further sublicense, under the Incyte Patent Rights, Incyte Product Patent Rights and Incyte Program Patent Rights to the extent necessary or useful to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory;

**(c)** an exclusive (even as to Pfizer and its Affiliates) license, with the right to sublicense, under the Program Patent Rights and Pfizer Use Patent Claims to the extent necessary to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory;



**(d)** an exclusive (even as to Pfizer and its Affiliates) license, with the right to sublicense, under the Pfizer Process Patent Claims to the extent necessary to manufacture Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Incyte Indications in the Territory; and

**(e)** a non-exclusive license, with the right to sublicense, under the Program Patent Rights for any and all purposes, except to make, have made, use, import, offer for sale or sell Compounds, Incyte Compounds, Pfizer Products, Animal Products or Incyte Products (other than as permitted under Sections 7.2 and 11.4).

Notwithstanding the foregoing, with respect to any Pfizer Technology, Pfizer Use Patent Claims or Pfizer Process Patent Claims, that Pfizer acquires by purchase, license, assignment or other means from a Third Party, Pfizer shall only be required to grant to Incyte a license to such Pfizer Technology, Pfizer Use Patent Claims or Pfizer Process Patent Claims (x) to the extent permitted under its agreement with such Third Party and (y) if Incyte agrees to be responsible for all payments to such Third Party under such Third Party agreement that may be incurred as a result of such sublicense to Incyte and executes documentation reasonably satisfactory to Pfizer to such effect.

**7.3 Research Licenses**.

(a) Subject to Section 7.4(a), and without limiting any of the licenses granted in Section 7.1, Incyte grants, and shall cause its Affiliates to grant, to Pfizer a nonexclusive, irrevocable, worldwide, royalty-free, perpetual license, with the right to sublicense to Affiliates, to use for all research purposes the Incyte Technology, Incyte Confidential Information and Program Technology disclosed to Pfizer during the Term; provided that Pfizer shall not have any right to use the Incyte Technology, Incyte Confidential Information or Program Technology for the sale or manufacture for sale of pharmaceutical products or processes. Subject to Section 7.4(a), without limiting any of the sublicenses or licenses granted in Section 7.2, Pfizer grants, and shall cause its Affiliates to grant, to Incyte a nonexclusive, irrevocable, worldwide, royalty-free, perpetual license, with the right to sublicense to Affiliates, to use for all research purposes (i) the Incyte Technology, Incyte Confidential Information and Program Technology and (ii) the Pfizer Technology and Pfizer Confidential Information disclosed to Incyte during the Term; provided that Incyte shall not have any right to use the Pfizer Technology, Pfizer Confidential Information or Program Technology for the sale or manufacture for sale of pharmaceutical products or processes.

(b) Subject to Section 7.4(a), and without limiting any of the licenses granted in Section 7.1, Incyte grants, and shall cause its Affiliates to grant, to Pfizer a non-exclusive, irrevocable, worldwide, royalty-free, perpetual license, with the right to sublicense to Affiliates, under the Incyte Product Patent Rights to use for all research purposes; provided that Pfizer shall not have any right to use the Incyte Product Patent Rights for the sale or manufacture for sale of pharmaceutical products or processes.



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**7.4 Non-Compete**.

**(a)** Research Non-Compete. During the Research Term, except pursuant to this Agreement or the Research Plan, the Parties will not, and will cause their respective Affiliates not to, directly or indirectly, by itself (or themselves) or with any Third Party, conduct research on or develop any CCR2 Antagonist in the Territory; provided that this Section shall not ***.

**(b)** Commercial Non-Compete. Subject to Section 7.5, during the Term, except for Pfizer Products, Animal Products and Incyte Products, the Parties will not, and will cause their respective Affiliates not to, directly or indirectly, by itself (or themselves) or with any Third Party, market, sell, detail, promote or distribute any human or animal pharmaceutical product that contains any CCR2 Antagonist in the Territory; provided that this Section 7.4(b) (x) shall not apply to Pfizer (i) with respect to any Reverted Indication and (ii) after the Royalty Term Expiration Date for a given Pfizer Product in a country in the Territory, with respect to the Pfizer Indication (or Pfizer Indications) for which such Pfizer Product received Regulatory Approval in such country and (y) shall not ***.

**(c)** Indication Non-Compete. During the Term (i) Pfizer will not, and will cause its Affiliates not to, develop, market, detail or promote any human or animal pharmaceutical product that contains a CCR2 Antagonist for an indication that is an Incyte Indication, (ii) Pfizer will not, and will cause its Affiliates not to, develop, market, detail or promote any human or animal pharmaceutical product that contains a Compound for a Reverted Indication and (iii) Incyte will not, and will cause its Affiliates not to, develop, market, detail or promote any human or animal pharmaceutical product that contains a CCR2 Antagonist for a Pfizer Indication; provided that this Section 7.4(c) shall not ***.

**7.5 Acquisition of Competing Product**. Notwithstanding the provisions of Section 7.4, which provisions shall not be deemed breached as a result of an acquisition or merger described in this Section 7.5 (unless such acquisition or merger involves a Third Party whose sole pharmaceutical product is a Competing Product), if Pfizer acquires a Competing Product through an acquisition of the whole or substantially the whole of the business or assets of another Person or through a merger with another Person (each, an "**Acquisition Transaction**"), then Pfizer shall, within sixty (60) days from the date of Pfizer's board approval of such Acquisition Transaction, notify Incyte of such Acquisition Transaction and as to whether Pfizer (i) is required by a Governmental Authority to, or elects to, divest its interest in such Competing Product or (ii) elects to retain such Competing Product. If Pfizer is required or elects to divest its interest in such Competing Product, then Pfizer shall use reasonable efforts to identify a Third Party purchaser to whom Pfizer will divest its interest in such Competing Product and to enter into a definitive agreement with such Third Party for such divestiture as soon as reasonably practicable under the circumstances (which may be subject to the terms of a Hold Separate



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Transaction (as defined below) as applicable). If Pfizer fails to enter into a definitive agreement with a Third Party to divest such Competing Products (other than as part of any Hold Separate Transaction) within six (6) months after the closing of the acquisition or merger for which Pfizer has provided Incyte with notice, or if such divestiture is subject to the terms of a Hold Separate Transaction, within twelve (12) months after the closing of the acquisition or merger for which Pfizer has provided Incyte with notice, then Pfizer will ***. If Pfizer elects to retain such Competing Product, then Pfizer will ***.

As used herein, a "**Hold Separate Transaction**" shall mean any "hold separate" transaction (whether through the establishment of a trust or otherwise) involving the proposed sale of the applicable Competing Product pursuant to an agreement with any Governmental Authority responsible for antitrust laws.

**8. FINANCIAL TERMS**

**8.1 Upfront Payment**. Pfizer shall pay to Incyte an upfront, non-creditable, non-refundable, payment of forty million dollars ($40,000,000) payable within fifteen (15) Business Days after the Effective Date.

**8.2 Milestone Payments**.

**(a)** Pfizer shall pay Incyte, a non-creditable (except as set forth in this Section 8.2), non-refundable, milestone payment (each, an "**Event Milestone Payment**") for Pfizer Products in respect of each of the following events (each, an "**Event Milestone**") in the particular amounts specified below within twenty (20) Business Days after the occurrence of the relevant Event Milestone.

| Event Milestone<br>"M" means million | *** |
|---|---|
| *** | *** |
| *** | *** |



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| Event Milestone<br>"M" means million | *** |
|---|---|
| *** | *** |
| *** | *** |
| *** | *** |
| *** | *** |
| *** | *** |
| *** | *** |



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| Event Milestone<br>"M" means million | *** |
|---|---|
| *** | *** |
| TOTAL | *** |

*The Event Milestone Payments in this column shall only apply if the Compound that Pfizer develops for any Pfizer Indication in the *** is ***.
** The Event Milestone Payments in this column shall apply to any Compound that Pfizer develops for any Pfizer Indication in the ***, other than ***.

**(b)** All Event Milestone Payments set forth in this Section 8.2 shall be paid ***. For purposes of this Section 8.2, ***.

**(c)** *** if a Phase II(b) Trial or a Phase III Trial of a Pfizer Product Commences, or a Pfizer Product is the subject of an NDA that has been filed or accepted for filing, such Pfizer Product shall be deemed to have achieved all the Event Milestones prior to that stage of development, and if the related Event Milestone Payment for any of such earlier Event Milestones has not been previously paid and would otherwise be due under this Section 8.2, it shall then be paid. *** within *** Business Days after the occurrence of the earlier of (i) the *** or (ii) the ***.

**(d)** Notwithstanding anything to the contrary in this Section 8.2, ***. The Parties agree that for purposes of determining the Event Milestone Payments payable under this Section 8.2, ***.



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***

The examples below are for illustrative purposes only.

*Example 1*: ***

*Example 2*: ***

*Example 3*: ***

*Example 4*: ***



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***

**(e)** In the event that a Party has given the other Party any notice of termination of this Agreement under Section 11, no further Event Milestone Payments shall become due during such notice period. If such notice of termination is the subject of a dispute, such dispute shall be resolved in accordance with Section 11.3(d) and Article 14.

**8.3 Sales Milestone Payments**. In addition to the Event Milestone Payments, in consideration of the rights granted hereunder, and subject to the terms and conditions of this Agreement, Pfizer shall make the following non-creditable, non-refundable, one-time payments to Incyte (collectively, the "**Sales Milestone Payments**") when aggregate Net Sales of all Pfizer Products in a calendar year in the Territory first reach the respective thresholds indicated below:

| Worldwide Annual Net Sales | Sales Milestone Payment |
|---|---|
| Net Sales in a calendar year exceed *** | *** |
| Net Sales in a calendar year exceed *** | *** |
| Net Sales in a calendar year exceed *** | *** |

Pfizer shall make any Sales Milestone Payment payable with respect to a calendar year within sixty (60) days after the end of such calendar year, and such payment shall be accompanied by a report identifying the Pfizer Products, the relevant countries, Net Sales of each Pfizer Product for each such country, and the amount payable to Incyte.

**8.4 Royalty Payments**.

**(a)** U.S. Royalty Payments. Until the Royalty Term Expiration Date for a given Pfizer Product, Pfizer shall pay Incyte the following non-creditable, non-refundable royalty payments based on the following increments of Net Sales in the United States of each such Pfizer Product that contains a given Compound:

**(i)** *** percent (***%) for Net Sales in a calendar year up to ***;



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**(ii)** *** percent (***%) for Net Sales in a calendar year over *** and up to ***; and

**(iii)** *** percent (***%) for Net Sales in a calendar year over ***.

**(b)** Ex-U.S. Royalty Payments. Until the Royalty Term Expiration Date for a given Pfizer Product, Pfizer shall pay Incyte the following non-creditable, non-refundable royalty payments based on the following increments of Net Sales in all countries in the Territory other than the United States of each such Pfizer Product that contains a given Compound:

**(i)** *** percent (***%) for Net Sales in a calendar year up to ***;

**(ii)** *** percent (***%) for Net Sales in a calendar year over *** and up to ***; and

**(iii)** *** percent (***%) for Net Sales in a calendar year over ***.

**(c)** Royalty Calculations. Royalty payments due pursuant to Sections 8.4(a) and 8.4(b) shall be calculated ***. Therefore, ***

The example below is for illustrative purposes only.

*Example*: ***

**(d)** Royalty Reductions. Notwithstanding anything to the contrary in this Section 8.4, (i) for Net Sales based on sales of a Pfizer Product in the United States, any payments owed with respect to such Pfizer Product pursuant to this Section 8.4 shall be reduced

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(x) by *** percent (***%) for *** and (y) by *** percent (***%) if ***; provided that in no event shall such payments be reduced by more than *** percent (***%) as a result of the events described in clauses (x) and (y) above occurring; and (ii) for Net Sales based on sales of a Pfizer Product in a country in the Territory other than the United States, any payments owed with respect to such Pfizer Product pursuant to this Section 8.4 shall be reduced by *** percent (***%) in the relevant country if ***

**8.5 Payments and Payment Reports**. All royalties due under Section 8.4 shall be paid within sixty (60) days of the end of the relevant Pfizer Quarter for which such royalties are due. Each royalty payment shall be accompanied by a statement identifying the Pfizer Product, the relevant countries, Net Sales for each Pfizer Product for each such country, the amount payable to Incyte, and the computation thereof, which computation will include all the itemized deductions subtracted from gross sales to arrive at Net Sales. All such statements shall be kept confidential by Incyte and not disclosed to any Third Party other than Incyte's accountants who Incyte shall cause to be obligated to keep such information confidential, and such information and statements shall only be used for purposes of this Agreement.

**8.6 Payment Method**. All payments due under this Agreement to Incyte shall be made by electronic transfer in immediately available funds via either a bank wire transfer, an ACH (automated clearing house) mechanism, or any other means of electronic funds transfer, at Pfizer's election, to ***, For credit to: *** or to such other bank accounts as Incyte shall designate in writing at least five (5) Business Days before the payment is due. All payments hereunder shall be made in the legal currency of the United States of America.

**8.7 Taxes**. It is understood and agreed between the Parties that any payments made under Sections 8.1, 8.2 or 8.3 of this Agreement are inclusive of any value added or similar tax imposed upon such payments. In addition, in the event any of the payments made by Pfizer pursuant to Article 8 become subject to withholding taxes under the laws of any jurisdiction, Pfizer shall deduct and withhold the amount of such taxes for the account of Incyte to the extent required by Law, such amounts payable to Incyte shall be reduced by the amount of taxes deducted and withheld, and Pfizer shall pay the amounts of such taxes to the proper Governmental Authority in a timely manner and promptly transmit to Incyte an official tax certificate or other evidence of such tax obligations together with proof of payment from the relevant Governmental Authority of all amounts deducted and withheld sufficient to enable Incyte to claim such payment of taxes. Any such withholding taxes required under applicable Law to be paid or withheld shall be an expense of, and borne solely by, Incyte. Pfizer will provide Incyte with reasonable assistance to enable Incyte to recover such taxes as permitted by Law.



**8.8 Foreign Exchange**. Conversion of sales recorded in local currencies to U.S. dollars for the purpose of calculating the Sales Milestone Payments or royalty payments will be performed in a manner consistent with Pfizer's normal practices used to prepare its audited financial reports; provided that such practices use a widely accepted source of published exchange rates.

**8.9 Interest**. If Pfizer fails to make any payment due to Incyte under this Agreement, then interest shall accrue on a daily basis at a rate equal to the thirty (30)-day U.S. dollar LIBOR rate effective for the date that payment was due, as published by *The Wall Street Journal*.

**8.10 Records; Audits**. Pfizer shall, and shall cause its Affiliates and sublicensees to, keep accurate books and records setting forth gross sales of each Pfizer Product, Net Sales of each Pfizer Product, and amounts payable hereunder to Incyte for each such Pfizer Product. Pfizer shall permit Incyte, by independent qualified public accountants employed by Incyte and reasonably acceptable to Pfizer, to examine such books and records at any reasonable time, but not later than two (2) years following the rendering of any corresponding reports, accountings and payments pursuant to Section 8.4. The foregoing right of examination may be exercised only once during each twelve (12)-month period. Such accountants may be required by Pfizer to enter into a reasonably acceptable confidentiality agreement, and in no event shall such accountants disclose to Incyte any information other than such as relates to the accuracy of reports and payments made or due hereunder. The opinion of such accountants regarding such reports, accountings and payments shall be binding on the Parties, other than in the case of manifest error. Incyte shall bear the cost of any such examination; provided that if such examination shows an underpayment of royalty payments of more than five percent (5%) of the amount due for the applicable period, then Pfizer shall promptly reimburse Incyte for all costs incurred in connection with such examination. Pfizer shall promptly pay to Incyte the amount of any underpayment of royalties revealed by an examination, including interest payable in accordance with Section 8.9. Any overpayment of royalties by Pfizer revealed by an examination shall be fully-creditable against future royalty payments payable to Incyte under Section 8.4.

**8.11 Inter-Company Sales**. Sales between or among Pfizer, its Affiliates or sublicensees shall not be subject to royalty payments. Royalty payments shall only be calculated upon Net Sales to a Third Party. Pfizer shall be responsible for payments on Net Sales by its Affiliates and sublicensees.

**8.12 Animal Products**. If at any time Pfizer wishes to develop a Compound or a Pfizer Product for a therapeutic use for animals, other than humans (an "**Animal Product**"), then Pfizer and Incyte agree to negotiate in good faith to determine appropriate commercial terms for such Animal Product prior to the commencement of any study that is intended to form the primary basis of an effectiveness claim in approved product labeling for the Animal Product. For the avoidance of doubt, Pfizer shall not be obligated to negotiate commercial terms for an Animal Product until after the FDA renders a binding decision regarding the investigational requirements for any such Animal Product in accordance with Section 512(b)(3) of the FDCA. The Parties agree that Pfizer shall have no obligation whatsoever to research, develop or commercialize an Animal Product.



## 9. INTELLECTUAL PROPERTY

**9.1 Ownership**.

**(a)** Incyte Technology and Patent Rights. Incyte or its Affiliates shall Control all Incyte Confidential Information and Incyte Technology and, in compliance with Section 9.3(b), all Incyte Patent Rights.

**(b)** Pfizer Technology and Patent Rights. Pfizer or its Affiliates shall Control all Pfizer Confidential Information, Pfizer Technology, Pfizer Process Patent Claims, Pfizer Proprietary Process Patent Claims, Pfizer Use Patent Claims and Pfizer Patent Rights.

**(c)** Program Technology and Patent Rights. In the course of performing the Research Plan during the Research Term, Incyte and Pfizer contemplate the invention of Program Technology and Program Patent Rights. Incyte and Pfizer (or their respective Affiliates) shall have joint Control of any and all Program Technology. Pfizer or its Affiliates shall Control any and all Program Patent Rights. Accordingly, Incyte assigns and transfers, and shall cause its Representatives and the relevant inventors to assign and transfer, to Pfizer all of its and their rights, title and interest in and to any and all Program Patent Rights, free and clear of all liens, encumbrances, charges, security interests, mortgages or other similar restrictions. Incyte shall, and shall cause its Representatives and the relevant inventors to, execute and deliver such documents, agreements and instruments of assignment and transfer as Pfizer reasonably requests in order to give effect to this Section 9.1(c).

**9.2 Filing, Prosecution and Maintenance**.

**(a)** Cooperation. Incyte and Pfizer shall cooperate and assist one another in connection with the filing, prosecution and maintenance of the Incyte Patent Rights and the Program Patent Rights, including by jointly discussing strategies, providing relevant information, data and files, as appropriate, and timely executing powers of attorney, assignments and other relevant documents and transferring files, in each case as shall be reasonably requested in order to implement the provisions of this Article 9. Incyte shall have reasonable access to all material documentation, filings and substantive communications to or from the respective patent offices and Pfizer shall use reasonable efforts to keep Incyte advised in a timely manner as to the status of all pending applications to the extent pertaining to any Compound, Incyte Compound, Pfizer Product or Incyte Product. Whenever possible, Pfizer and Incyte agree that patent claims covering Incyte Compounds or Incyte Products should be split from pending patent applications that cover Compounds or Pfizer Products in all countries in the Territory in which such patent applications have been filed. The Parties shall work cooperatively to attempt to cover Incyte Compounds and Incyte Products in patent applications with claims that are as broad as is reasonable, taking into account relevant patent laws and, where appropriate to the filing strategy, taking into account a desire not to cover, generically or specifically, Pfizer Products or Compounds that may be used in Pfizer Products. The Parties recognize that both designations of Incyte Compounds and selections by Pfizer of Compounds for use in Pfizer Products can change during the Term and that patent filing strategies (including altering claim scope or re-assigning filing, prosecution or maintenance responsibility and costs from time to time as warranted) that take this fact into account may need to be developed. The Parties agree that all costs associated with any such re-assignment of filing, prosecution or maintenance responsibility and costs shall be borne solely by the Party that will bear such responsibility and costs after such re-assignment takes effect.



**(b)** Incyte Patent Rights.

**(i)** Pfizer shall have the first right, but not the obligation, to file, prosecute and maintain all Incyte Patent Rights that are necessary or useful, as determined by Pfizer in its sole discretion, to make, have made, use, import, offer for sale or sell any Compound or Pfizer Product, including any of the foregoing that are also necessary or useful to make, have made, use, import, offer for sale, or sell any Incyte Compound or Incyte Product, in each case, in all countries in the Territory. If Pfizer files, prosecutes or maintains any such Incyte Patent Rights, then Pfizer shall be responsible for all costs associated with such filings, prosecutions and maintenance. As soon as practicable after the Effective Date, Incyte shall, and shall cause its Representatives and the relevant inventors to, (A) grant Pfizer a power of attorney that allows Pfizer to file, prosecute and maintain all Incyte Patent Rights, such power of attorney to be in a form that is reasonably acceptable to Pfizer and to Incyte and (B) sign such further instruments, affidavits or other documentation as shall be reasonably requested by Pfizer to implement the foregoing provisions of this Section 9.2(b). Pfizer, its agents and attorneys shall give Incyte at least thirty (30) days to comment on the filings and prosecution of such Incyte Patent Rights and shall give due consideration to all Incyte comments, but Pfizer's decisions with respect to such filings and prosecution shall be final. No later than thirty (30) days prior to the applicable Paris Convention date or PCT nationalization date, as the case may be, for a given Incyte Patent Right, Pfizer shall provide Incyte with a list of the countries in which Pfizer has decided to file or prosecute such Incyte Patent Right. Incyte agrees that, so long as Pfizer has acted in good faith in connection with the filing, prosecution and maintenance of the Incyte Patent Rights that Pfizer has chosen, in its sole discretion, to file, prosecute and maintain, neither Pfizer nor any of its Representatives shall be liable for any act or omission with respect to any such Incyte Patent Rights or the filing, prosecution or maintenance thereof. If Pfizer decides not to file or prosecute a patent application containing an Incyte Patent Right, then the provisions of Section 9.2(e) shall apply with respect to such patent application.

**(ii)** Incyte shall have the first right, but not the obligation, to file and prosecute any patent application and, if granted, maintain any patent containing an Incyte Patent Right that is not necessary or useful, as determined by Pfizer, in its sole discretion, to make, have made, use, import, offer for sale or sell any Compound or Pfizer Product. If Incyte files, prosecutes or maintains any such Incyte Patent Rights, then (x) Incyte shall be responsible for all costs associated with such filings, prosecutions and maintenance and (y) all such Incyte Patent Rights shall thereafter cease to be "Incyte Patent Rights" and become "Incyte Product Patent Rights".

**(c)** Program Patent Rights.

**(i)** Pfizer shall have the first right but not the obligation to file, prosecute and maintain all Program Patent Rights, except as provided in Section 9.2(c)(ii) below. If Pfizer files, prosecutes and maintains any Program Patent Rights, then Pfizer shall be responsible for all costs associated with such filings, prosecutions, and maintenance. Pfizer, its agents and attorneys shall give Incyte at least thirty (30) days to comment on the filings and prosecution of such Program Patent Rights and shall give due consideration to all Incyte comments, but Pfizer's decisions with respect to such filings and prosecutions shall be final. No later than thirty (30) days prior to the applicable Paris



Convention date or PCT nationalization date, as the case may be, for a given Program Patent Right, Pfizer shall provide Incyte with a list of the countries in which Pfizer has decided to file or prosecute such Program Patent Right. Incyte agrees that, so long as Pfizer has acted in good faith in connection with the filing, prosecution and maintenance of the Program Patent Rights that it has chosen, in its sole discretion, to file, prosecute and maintain, neither Pfizer nor any of its Representatives shall be liable for any act or omission with respect to any such Program Patent Rights or the filing, prosecution or maintenance thereof. If Pfizer has decided not to file or prosecute a patent application containing a Program Patent Right, then the provisions of Section 9.2(e) shall apply with respect to such patent application.

**(ii)** Incyte shall have the first right, but not the obligation, to file and prosecute any patent application and, if granted, maintain any patent containing a Program Patent Right that is not necessary or useful as determined by Pfizer, in its sole discretion, to make, have made, use, import, offer for sale or sell any Compound or Pfizer Product. If Incyte files, prosecutes, or maintains any such Program Patent Rights, then (x) Incyte shall be responsible for all costs associated with such filings, prosecutions and maintenance and (y) all such Program Patent Rights shall thereafter cease to be "Program Patent Rights" and become "Incyte Program Patent Rights".

**(d)** Pfizer Patent Rights. Except as set forth in Section 9.2(e), Pfizer shall have the only right, but not the obligation, to file, prosecute and maintain all Pfizer Patent Rights, Pfizer Process Patent Claims and Pfizer Use Patent Claims. If Pfizer files, prosecutes or maintains any such Pfizer Patent Rights, Pfizer Process Patent Claims or Pfizer Use Patent Claims, then Pfizer shall be responsible for all costs associated with such filings, prosecutions and maintenance.

**(e)** Abandonment. Pfizer shall not abandon any patent application or patent containing a (i) Pfizer Process Patent Claim or Pfizer Use Patent Claim that (x) solely covers Incyte Compounds or Incyte Products or (y) covers both (I) Incyte Compounds or Incyte Products and (II) Compounds or Pfizer Products or (ii) an Incyte Patent Right or Program Patent Right, in the case of each of clauses (i) and (ii), without at least ninety (90) days' prior notice to Incyte. If Pfizer decides to abandon any such patent applications or patents referred to in the previous sentence of this Section 9.2(e) in any country, then (A) subject to Pfizer's consent (which consent shall not be unreasonably withheld), Incyte shall have the option to obtain ownership of such patent applications and patents free of charge (other than any costs associated with the transfer of ownership from Pfizer to Incyte) and to continue the prosecution of such patent applications and maintenance of such patents in such country in Incyte's name, (B) if Incyte elects to obtain ownership and continue the prosecution of any patent applications or maintenance of any patents referred to in clause (A) of this Section 9.2(e), then (I) Incyte shall be responsible for all costs associated with such prosecution and maintenance, and (II) all such Patent Rights that were previously designated Incyte Patent Rights shall thereafter cease to be "Incyte Patent Rights" and become "Incyte Product Patent Rights" and those that were previously designated Program Patent Rights, Pfizer Process Patent Claims or Pfizer Use Patent Claims shall thereafter cease to be "Program Patent Rights", "Pfizer Process Patent Claims" or "Pfizer Use Patent Claims", as applicable, and become "Incyte Program Patent Rights". The Parties acknowledge and agree that a terminal disclaimer with respect to an Incyte Patent Right, or a Program Patent Right, Pfizer Process Patent Claim or a Pfizer Use Patent Claim could



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adversely affect Pfizer and would be a valid reason for Pfizer to withhold its consent pursuant to clause (A) of this Section 9.2(e).

**9.3 Notices, Maintenance and Restrictions on Transfer**.

**(a)** Each Party agrees that it will, and will cause its Representatives to execute and file those notices and other filings as the other Party shall reasonably request be made from time to time with the United States Patent and Trademark Office (or any successor agency) or any other patent office in the Territory with respect to the rights granted under this Agreement in connection with Incyte Patent Rights, Incyte Product Patent Rights, Incyte Program Patent Rights, Program Patent Rights, Pfizer Patent Rights, Pfizer Process Patent Claims and Pfizer Use Patent Claims. Each Party will be responsible (at its own cost and expense) for any recordings with relevant Governmental Authorities in the Territory of licenses granted to it under this Agreement that are necessary in order to initiate patent infringement actions in accordance with this Agreement.

**(b)** During the Term, ***; provided that ***. For the avoidance of doubt, a ***

**(c)** During the Term, Incyte shall, and shall cause its Affiliates to, maintain at all times sole Control (in compliance with Section 9.3(b)) of the Incyte Patent Rights and Incyte Technology and its or its Affiliates' share of the Program Technology that is jointly owned with Pfizer, in each case, free and clear of any and all liens, encumbrances, charges, security interests, mortgages or other similar restrictions (other than the security interest created by the Security Agreement).

**(d)** During the Term, Pfizer shall, and shall cause its Affiliates to, maintain at all times sole Control of Patent Rights that are (or, but for an assignment or other grant of rights to a Third Party, would be) (i) Pfizer Process Patent Claims or Pfizer Use Patent Claims that (x) solely cover Incyte Compounds or Incyte Products or (y) cover both (I) Incyte Compounds or Incyte Products and (II) Compounds or Pfizer Products or (ii) Program Patent Rights.



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**9.4 Patent Term Extensions**. Pfizer shall have the first right, but not the obligation, to seek patent term extensions, supplementary protection certificates or the like (each, a "**Patent Term Extension**") in any country in the Territory for a Pfizer Product under the Incyte Patent Rights (except as set forth in the last sentence of this Section 9.4), Program Patent Rights, Pfizer Patent Rights, Pfizer Process Patent Claims and Pfizer Use Patent Claims. If Pfizer decides to seek a Patent Term Extension under any Incyte Patent Rights, Incyte shall, and shall cause its Affiliates to, make any filings reasonably requested by Pfizer in order to implement the provisions of this Section 9.4 and otherwise reasonably cooperate with Pfizer in seeking such Patent Term Extensions. If (x) Pfizer has decided not to seek a Patent Term Extension for a Pfizer Product under a patent that is an Incyte Patent Right or a Program Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim in a given country and has so notified Incyte or (y) in jurisdictions where the same patent can be extended more than once, then, in the case of each of clauses (x) and (y), Incyte shall have the right, but not the obligation, to seek a Patent Term Extension in such country for an Incyte Product under such patent. At Incyte's request, Pfizer shall reasonably cooperate with Incyte in seeking such Patent Term Extensions. In addition, Incyte shall have the first right, but not the obligation, to seek a Patent Term Extension for an Incyte Product under (i) Incyte Product Patent Rights or Incyte Program Patent Rights and (ii) Incyte Patent Rights that solely cover an Incyte Compound or Incyte Product.

**9.5 Interpretation of Patent Judgments**. If any claim relating to a patent under the Incyte Patent Rights becomes the subject of a judgment, decree or decision of a court, tribunal, or other authority of competent jurisdiction in any country, which judgment, decree, or decision is or becomes final

(there being no further right of review) and adjudicates the validity, enforceability, scope, or infringement of the same, the construction of such claim in such judgment, decree or decision shall be followed thereafter in such country in determining whether a product is licensed hereunder, not only as to such claim but also as to all other claims in such country to which such construction reasonably applies.

**9.6 Anti-Stacking**.

**(a)** Anti-Stack. If Pfizer (i) reasonably determines in good faith that, in order to avoid infringement of any patent not licensed hereunder, it is reasonably necessary to obtain a license from a Third Party in order to make, use, sell, offer for sale or import a Pfizer Product in a country in the Territory and to pay a royalty under such license (including in connection with settlement of a patent infringement claim), or (ii) shall be subject to a final court or other binding order or ruling requiring the payment of a royalty or other payment to a Third Party patent holder in respect of sales of any Pfizer Product in a country in the Territory, then the amount of royalty payments payable by Pfizer to Incyte with respect to Net Sales for such Pfizer Product in such country shall be reduced by *** percent (***%) of *** and (y) *** (the amount of such reduction being hereinafter referred to as, the "**Anti-Stack Amount**"); provided that in no event shall the royalties payable by Pfizer to Incyte under this Agreement be reduced to less than *** percent (***%) of the amounts that would be otherwise payable by Pfizer to Incyte at such time under Section 8.4.; provided, further, that if the Anti-Stack Amount is more than *** percent (***%) of the amount payable by Pfizer to Incyte under Section 8.4 in any given period, the Parties agree that the balance of any Anti-Stack Amount that has not been deducted from the royalties payable by Pfizer to Incyte under Section 8.4 due to the first proviso in this Section 9.6(a) (the "**Deferred**



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**Amount**") shall be carried forward to the succeeding payment period and deducted from amounts payable by Pfizer to Incyte under Section 8.4 during such succeeding payment period, and, following this, if all or any portion of the Deferred Amount due in such succeeding payment period would be more than *** percent (***%) of the amount payable by Pfizer to Incyte under Section 8.4 in such succeeding payment period, then as much of the Deferred Amount shall be payable as soon as possible thereafter after giving effect to the deferral provisions contained in this Section 9.6(a) and continuing to carry forward the Deferred Amount to the next succeeding payment period until the Deferred Amount equals zero. Effective immediately after the expiration of the Term of this Agreement, all Deferred Amounts shall be deemed to equal zero. Pfizer will notify Incyte prior to entering into any license with a Third Party referred to in clause (i) of this Section 9.6(a) and, to the extent legally possible, shall give Incyte an opportunity to consult with Pfizer regarding such license before entering into a binding agreement with any such Third Party; provided that Pfizer's decision with respect to all aspects of any such Third Party license shall be final.

**(b)** Restrictions on Anti-Stack.

**(i)** Notwithstanding anything to the contrary in Section 9.6(a), the Parties agree that the amount of royalty payments payable to Incyte with respect to Net Sales for a Pfizer Product, shall only be reduced by the Anti-Stack Amount arising from clause (ii) of Section 9.6(a) if such Anti-Stack Amount is the result of (x) *** and (y) the Third Party's patent or published patent application claims (i) ***, (ii) *** or (iii) ***; provided that, in the case of each of clauses (i), (ii) and (iii), the ***. For purposes of clause (y) of this Section 9.6(b)(i), a Third Party shall be any Person that is a Third Party on the date of this Agreement.

**(ii)** Pfizer shall be the "**Indemnifying Party**" solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition arising in connection with this Section 9.6, as provided in Section 13.3.

**9.7 Infringement**.

**(a)** Infringement by a Third Party. Each of the Parties shall promptly notify the other in the event of any potential infringement by any Third Party of an Incyte Product Patent Right, Incyte Program Patent Right, Incyte Patent Right, Program Patent Right, Pfizer Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim of which it becomes aware. Pfizer shall have the only right, but no obligation, to institute litigation in connection with any potential infringement by any Third Party of a Pfizer Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, in its own name, and any such litigation shall be at Pfizer's expense and for Pfizer's sole benefit. Incyte, upon request of Pfizer, shall reasonably cooperate with Pfizer in any such litigation, at Pfizer's expense. Pfizer shall have the first right, but no obligation, to institute litigation in connection with any potential infringement by any Third Party of an Incyte Patent Right or a Program Patent Right, in its own name, and any such litigation shall be at Pfizer's expense; provided that Incyte shall be entitled to receive twenty-five percent



(25%) of any damages or settlements recovered by Pfizer from such Third Party based upon any such claim for infringement against such Third Party, but only after deducting all of Pfizer's out-of-pocket expenses (including counsel fees and expenses) for pursuing such claim. Incyte, upon request of Pfizer, agrees to join in any such litigation at Pfizer's expense and in any event to cooperate with Pfizer at Pfizer's expense. If Pfizer institutes any such litigation and requires that Incyte be joined as a party to such litigation, and there is a counterclaim (other than a counterclaim whose subject matter is covered by and shall be governed by Section 9.6) that creates a potential liability for Incyte, then Pfizer shall indemnify and hold harmless Incyte against Damages that may be awarded as a result of such counterclaim and shall be the Indemnifying Party solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition in connection therewith, as provided in Section 13.3. If Pfizer fails to institute litigation in connection with any potential infringement by any Third Party of an Incyte Patent Right or a Program Patent Right within sixty (60) days of its receipt of notice thereof, then Incyte shall have the right, but no obligation, upon ten (10) days' prior notice to Pfizer, at Incyte's expense and for Incyte's sole benefit (with respect to monetary damages or settlements only), to institute any such litigation, but only if such litigation (x) involves an Incyte Compound or Incyte Product and (y) does not involve a Pfizer Product or a Compound that Pfizer has selected for development. Pfizer, upon request of Incyte, shall reasonably cooperate with Incyte in any such litigation at Incyte's expense. Pfizer will not elect to institute litigation hereunder if the potential infringement by the Third Party solely involves an Incyte Patent Right, Program Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim that solely covers an Incyte Compound or Incyte Product. Incyte shall have the only right, but no obligation, to institute litigation in connection with any potential infringement by

any Third Party of an Incyte Product Patent Right or Incyte Program Patent Right. Pfizer, upon request of Incyte, shall reasonably cooperate with Incyte in any such litigation at Incyte's expense.

**(b)** Alleged Infringement by Pfizer or Incyte. Each of the Parties shall promptly notify the other in the event of any claims by a Third Party of alleged patent infringement by Pfizer or Incyte or any of their respective Affiliates with respect to the manufacture, use, sale, offer for sale or importation of a Compound, Pfizer Product, Animal Product, Incyte Compound or Incyte Product. In the case of any such claim that relates to a Compound, Pfizer Product or Animal Product, regardless of whether such claim also relates to an Incyte Compound or Incyte Product, Pfizer shall be entitled to control the defense of such claim and shall be the Indemnifying Party solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition arising in connection therewith as provided in Section 13.3. Incyte, upon request of Pfizer, agrees to join in any such litigation at Pfizer's expense and in any event to cooperate with Pfizer at Pfizer's expense. If Pfizer requires that Incyte be joined as a party to such litigation and there is a counterclaim (other than a counterclaim whose subject matter is covered by and shall be governed by Section 9.6,) that creates a potential liability for Incyte, then Pfizer shall indemnify and hold harmless Incyte against Damages that may be awarded as a result of such counterclaim and shall be the Indemnifying Party solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition in connection therewith, as provided in Section 13.3. In the case of any such claim that solely covers an Incyte Compound or Incyte Product, Incyte shall be entitled to control the defense of such claim and shall be the Indemnifying Party solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition in connection therewith as provided in Section 13.3. Pfizer, upon request of Incyte,



agrees to join in any such litigation at Incyte's expense and in any event to cooperate with Incyte at Incyte's expense. If Incyte requires that Pfizer be joined as a party to such litigation and there is a counterclaim (other than a counterclaim whose subject matter is covered by and shall be governed by Section 9.6,) that creates a potential liability for Pfizer, then Incyte shall indemnify and hold harmless Pfizer against Damages that may be awarded as a result of such counterclaim and shall be the Indemnifying Party solely for purposes of determining which Party will assume direction and control of any defense, litigation, settlement, appeal or other disposition in connection therewith, as provided in Section 13.3.

**(c)** Paragraph IV Notices. If either Party receives a notice under 21 U.S.C. §355(b)(2)(A)(iv) or 355(j)(2)(A)(vii)(IV) ("**Paragraph IV Notice**") concerning an Incyte Product Patent Right, Incyte Program Patent Right or Incyte Patent Right or a Program Patent Right, Pfizer Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, then it shall use reasonable efforts to provide a copy of such notice to the other Party within two (2) Business Days after its receipt thereof and best efforts to provide such copy as promptly as practicable thereafter. Pfizer shall have the only right, but no obligation, to initiate patent infringement litigation based on a Paragraph IV Notice concerning a Pfizer Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, at its own expense. Pfizer shall have the first right, but no obligation, to initiate patent infringement litigation based on a Paragraph IV Notice concerning an Incyte Patent Right or a Program Patent Right, at its own expense. If Pfizer fails to initiate such litigation within thirty (30) days of its receipt of the applicable Paragraph IV Notice, then Incyte shall have the right, but no obligation, to initiate such litigation, at Incyte's expense, but only if such litigation (x) involves an Incyte Compound or Incyte Product and (y) does not involve a Pfizer Product or a Compound that Pfizer has selected for development. Incyte shall have the only right, but no obligation, to initiate patent infringement litigation based on a Paragraph IV Notice concerning an Incyte Product Patent Right or Incyte Program Patent Right. Each Party, upon request of the other Party, shall reasonably cooperate with the requesting Party in any such litigation at the requesting Party's expense.

**(d)** Actions by a Third Party Against Incyte Patents or Pfizer Patents. Each of the Parties shall promptly notify the other in the event of any legal or administrative action by any Third Party against an Incyte Product Patent Right, Incyte Program Patent Right, Incyte Patent Right, Program Patent Right, Pfizer Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, of which it becomes aware, including any nullity, revocation, reexamination, or compulsory license proceeding but excluding a counterclaim brought in an infringement proceeding initiated under Section 9.7(a), which shall be governed by Section 9.7(a). Pfizer shall have the only right, but no obligation, to defend against any such action involving a Pfizer Patent Right, in its own name, and any such defense shall be at Pfizer's expense. Incyte, upon request of Pfizer, agrees to join in any such action at Pfizer's expense and in any event to cooperate with Pfizer at Pfizer's expense. Pfizer shall have the first right, but no obligation, to defend against any such action involving an Incyte Patent Right or a Program Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, in its own name, and any such defense shall be at Pfizer's expense. Incyte, upon request of Pfizer, agrees to join in any such action at Pfizer's expense and in any event to cooperate with Pfizer at Pfizer's expense. If Pfizer fails to defend against any such action involving an Incyte Patent Right or a Program Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim, then Incyte shall have the right to defend such action, in its own name, and any such defense shall be at Incyte's expense. Pfizer will not elect to defend an action hereunder if the action by the Third Party solely involves an Incyte Patent Right, Program Patent Right, Pfizer Process Patent Claim or Pfizer Use Patent Claim that solely



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covers an Incyte Compound or an Incyte Product. Incyte shall have the only right, but no obligation, to defend against any such action involving an Incyte Product Patent Right or Incyte Program Patent Right. Pfizer, upon request of Incyte, shall reasonably cooperate with Incyte in any such action at Incyte's expense.

## 10. CONFIDENTIALITY

**10.1 Treatment of Confidential Information**. The Parties agree that during the Term, and for a period of three (3) years after the end of the Term but in no event for less than five (5) years after the Effective Date, each Party will, and will cause its Affiliates, (a) to maintain in confidence all Incyte Confidential Information or Pfizer Confidential Information, as the case may be, to the same extent such Party maintains its own proprietary information of similar kind and value and (b) not to use such Incyte Confidential Information or Pfizer Confidential Information, as the case may be, for any purpose except those permitted by this Agreement. Except as permitted by Sections 10.2, 10.3, 10.4 or 10.5 below, Pfizer and its Affiliates agree not to disclose (i) any Incyte Confidential Information or (ii) any Pfizer Technology that is Pfizer Confidential Information, in the case of each of clauses (i) and (ii), that relates solely to an Incyte Compound or Incyte Product, to any Third Parties under any circumstance without the prior consent of Incyte. Except as permitted by Sections 10.2, 10.3, 10.4 or 10.5 below, Incyte and its Affiliates agree not to disclose (A) any Incyte Technology that is Incyte Confidential Information and

that does not relate solely to (I) an Incyte Compound or Incyte Product or (II) *** or that are needed to permit an external contractor to ***, or (B) any Pfizer Confidential Information, to any Third Parties under any circumstance without the prior consent of Pfizer. Incyte further agrees that it will not, and will cause its Representatives not to, share any Pfizer Confidential Information with (x) any Affiliate that becomes an Affiliate in connection with a Change of Control (including, for purpose of this Section 10.1, any Change of Control that does not involve a *** or does involve a ***) or (y) any Representatives of Incyte who become Representatives in connection with such Change of Control (including any Change of Control that does not involve a *** or does involve a ***). If any Change of Control (including any Change of Control that does not involve a *** or does involve a ***) of Incyte occurs, Incyte shall promptly notify Pfizer, share with Pfizer the polices and procedures it plans to implement in order to protect the confidentiality of Pfizer Confidential Information prior to such implementation and make any adjustments to such policies and procedures that are reasonably requested by Pfizer.

**10.2 Authorized Disclosure**. Pfizer and Incyte each agree that any disclosure (i) by Pfizer or any of its Affiliates of Incyte Confidential Information, or (ii) by Incyte or any of its Affiliates of Pfizer Confidential Information, to any of their respective officers, employees or agents shall be made only if and to the extent reasonably necessary to carry out its rights and obligations under this Agreement and shall be limited to the maximum extent possible consistent with such rights and obligations. Incyte and Pfizer each represent that all of its officers, employees and agents who shall have access to Pfizer Technology, Incyte Technology, Program Technology, Pfizer Confidential Information or Incyte Confidential Information are bound by agreement to maintain such information in confidence. Notwithstanding the foregoing, (x) Pfizer may disclose (i) any Incyte Confidential Information or (ii) any Pfizer Technology that is Pfizer Confidential Information, in the case of each of clauses (i) and (ii), that relates solely to an Incyte Compound or Incyte Product, only to the limited extent such information is relevant to the



research, development or commercialization of a Compound, Pfizer Product or Animal Product, to (I) Governmental Authorities (a) to the extent desirable to obtain or maintain INDs or Regulatory Approvals for any Compound, Pfizer Product or Animal Product and (b) in order to respond to inquiries, requests or investigations, (II) to outside consultants, scientific advisory boards, managed care organizations, and non-clinical and clinical investigators to the extent desirable to patent, trademark, develop, register or market any Compound, Pfizer Product or Animal Product and (III) to the extent necessary or desirable in order to enforce Pfizer's rights under this Agreement; and (y) Incyte may disclose (i) any Incyte Technology that is Incyte Confidential Information and that is derived from the research, development or commercialization of an Incyte Compound or Incyte Product or (ii) any Pfizer Confidential Information that relates solely to an Incyte Compound or Incyte Product (other than Pfizer Confidential Information that is designated by Pfizer as highly proprietary and marked "Not to be Disclosed" in accordance with Section 6.7(b)(ii)) to (I) Governmental Authorities (a) to the extent desirable to obtain or maintain INDs or Regulatory Approvals for any Incyte Compound or Incyte Product and (b) in order to respond to inquiries, requests or investigations; (II) to outside consultants, scientific advisory boards, managed care organizations, and non-clinical and clinical investigators to the extent desirable to patent, trademark, develop, register or market any Incyte Compound or Incyte Product and (III) to the extent necessary or desirable in order to enforce Incyte's rights under this Agreement; provided that, in each case enumerated in clauses (x) and (y) of this Section 10.2, the disclosing Party shall obtain the same confidentiality obligations from such Third Parties as it obtains with respect to its own proprietary information of similar kind and value.

**10.3 Publicity**. The public announcement of the execution of this Agreement, which Incyte shall be permitted to make upon execution of this Agreement by both Parties, is set forth on Schedule 10.3(a) attached hereto. In addition, notwithstanding anything to the contrary in Section 10.2, either Party may make a public statement (written or oral), including in analyst meetings, concerning this Agreement or the progress of the Compounds or Pfizer Products where such statement: (a) is required by Law, or legal proceedings, (b) concerns one of the events described in Schedule 10.3(b); provided that Incyte may only make a public statement concerning the events described in Schedule 10.3(b) as follows: (i) jointly with Pfizer, (ii) with Pfizer's prior approval of the text of such statement and in compliance with the other provisions of this Section 10.3, which text shall, at any time that Incyte is a company that has at least ten percent (10%) of its common stock listed on a United States national securities exchange or approved for quotation on the Nasdaq National Market or any similar United States system of automated dissemination of quotations of securities prices and that has such common stock registered under the Securities Exchange Act of 1934, as amended, include for milestone announcements, the Event Milestone and the amount of the applicable Event Milestone Payment but shall not include the Pfizer Indication for any Event Milestone that occurs as a result of the development of a Compound for a Pfizer Indication other than those included in the *** or (iii) after Pfizer has made a public statement with respect thereto, so long as Incyte's public statement is consistent therewith, (c) is contained in Pfizer's or Incyte's financial statements prepared in accordance with generally acceptable accounting principles in the United States, or (d) has been announced previously under this Section 10.3, so long as such statement is consistent with any such previous announcement. *** (referred to by Incyte as of the date of this Agreement as ***), Incyte may (but shall not be obligated to) make a public statement (written or oral), including in analyst meetings, that discloses *** disclosing *** but only under the following circumstances: (A) the ***



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***; (B) *** (I) *** (II) ***; and (C) *** (y) ***. In all cases, the Party required to or proposing to make such statement shall (x) endeavor to obtain confidential treatment of economic and trade secret information and (y) give the other Party sufficient advance notice of the text of any proposed statement (written or oral) so that the other Party will have the opportunity to comment upon the statement, and such comments will be taken into account in the final statement. If a Pfizer Indication becomes a Reverted Indication pursuant to Section 11.4 or if this Agreement is terminated by either Party pursuant to Sections 11.2 or 11.3, the Parties will agree on the text of any proposed public statement (written or oral) in connection therewith. Pfizer agrees that it will disclose *** in a manner consistent with its public statements for its other pharmaceutical products. Except as provided in this Section 10.3, neither Party will make any public announcement regarding the terms of, or events related to, this Agreement without the prior consent of the other Party. Notwithstanding anything to the contrary in this Section 10.3, so long as Incyte complies with Section 10.1 and 10.2, Incyte may make public statements (written or oral), including in analyst meetings, concerning the progress of the Incyte Compounds or Incyte Products without being subject to the requirements of this Section 10.3; provided that if such statement covers information that could be relevant to the filing or prosecution of any Patent Rights, Incyte will use reasonable efforts to provide Pfizer with ten (10) Business Days' notice (or as much advance notice as is practicable under the circumstances) prior to making any such written or oral public statement.

**10.4 Publications**. Pfizer, its Affiliates or any of its or its Affiliates' employees, contractors, consultants, licensees or agents may publish or present any information with respect to a Compound, Pfizer Product or Animal Product, including the results of the Research Program or preclinical or clinical studies, without Incyte's prior consent, but Pfizer shall use reasonable efforts to provide Incyte with ten (10) Business Days' notice (or such shorter notice period as is practicable under the circumstances) prior to any such publication or presentation. Incyte will not, and will cause its Affiliates and its or its

Affiliates' employees, contractors, consultants, licensees or agents not to, publish or present any information with respect to a Compound, Pfizer Product or Animal Product, including the results of the Research Program or preclinical or clinical studies, without Pfizer's prior consent (which may be withheld in its sole and final discretion). Incyte, its Affiliates or any of its or its Affiliates' employees, contractors, consultants, licensees or agents may publish or present any information with respect to an Incyte Compound or Incyte Product, including the results of the Research Program or preclinical or clinical studies (other than Pfizer Confidential Information that is designated by Pfizer as highly proprietary and marked "Not to be Disclosed" in accordance with Section 6.7(b)(ii)), without Pfizer's prior consent, but Incyte shall use reasonable efforts to provide Pfizer with ten (10) Business Days' notice (or such shorter notice period as is practicable under the circumstances) prior to any publication or presentation. Pfizer will not, and will cause its Affiliates and its or its Affiliates' employees, contractors, consultants, licensees or agents not to, publish or present any information with respect to an Incyte Compound or Incyte Product, including the results of the Research Program or preclinical or clinical studies, without Incyte's prior consent (which may be withheld in its sole and final discretion). Notwithstanding the foregoing, nothing in Article 10 shall be construed to limit the right of Pfizer's or Incyte's clinical investigators to publish the



results of their studies. The provisions of this Section 10.4 shall, to the extent applicable, be subject to the terms of the agreements listed in Schedule 10.4.

**10.5 Registration and Filing of this Agreement**. To the extent, if any, that a Party concludes that it is required under applicable Laws to file or register this Agreement or a notification thereof with any Governmental Authority, including the US Securities and Exchange Commission, the FTC or the DOJ, such Party may do so; provided that such Party shall provide the other Party with a written copy of all proposed filings, registrations or notifications within such time frame as to allow for a reasonably sufficient time for review and comment by the other Party prior to the submission of such proposed filing, registration or notification. The other Party shall cooperate with such filing, registration or notification and shall execute all documents reasonably required in connection therewith. To the extent permitted by applicable Law, the Parties will request confidential treatment of sensitive provisions of this Agreement. The Parties shall promptly inform each other as to the activities or inquiries of any such Governmental Authority relating to this Agreement and shall cooperate to respond to any request for further information therefrom. Each Party shall be responsible for its own legal and other external costs in connection with any such filings, registrations or notifications.

## 11. TERM; TERMINATION; CHANGE OF CONTROL

**11.1 Term**.

**(a)** This Agreement shall become effective on the Effective Date and shall continue until the earlier of (i) the last Royalty Term Expiration Date for the last Pfizer Product, and (ii) the effective date of termination pursuant to Section 11.2 or 11.3 (the "**Term**").

**(b)** Prior to the Effective Date, neither Incyte nor Pfizer shall have any rights or obligations hereunder. Notwithstanding the foregoing, effective as of the signing of this Agreement, each of Incyte and Pfizer covenant and agree that (a) Articles 4 (HSR), 10 (Confidentiality) and 14 (Dispute Resolution) and this Section 11.1(b) shall be in full force and effect, (b) Incyte shall not, and shall cause each of its Affiliates not to, negotiate, engage in or otherwise enter into any transaction involving (i) any sale or grant of any rights or licenses to the Incyte Patent Rights or the Incyte Technology in the Territory, or (ii) any joint venture, co-promotion or similar relationship involving the Incyte Patent Rights or the Incyte Technology in the Territory and (c) neither Party may terminate this Agreement prior to the Effective Date, except pursuant to Section 11.3(c).

**11.2 Termination by Pfizer**. After the Effective Date, Pfizer may terminate this Agreement at any time in its sole discretion upon ninety (90) days' advance notice to Incyte, with such termination becoming effective at the end of such ninety (90)-day period.

**11.3 Mutual Termination Rights**. Either Party may terminate this Agreement if:

**(a)** it believes that the other Party is in material breach of this Agreement, in which case the non-breaching Party may deliver notice of such material breach to the other Party, such notice to describe in detail the nature of such breach. For purposes of this Section 11.3(a), a material breach shall include a material inaccuracy in any representation or warranty contained herein. The allegedly breaching Party shall have ninety (90) days from its receipt of such notice to cure such breach (or, if such breach cannot be cured within such ninety (90)-day period, the breaching Party must commence and diligently continue actions to cure such breach during such



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ninety (90)-day period). Any such termination shall become effective at the end of such ninety (90)-day period unless the breaching Party has cured any such breach prior to the expiration of such ninety (90)-day period (or, if such breach is capable of being cured but cannot be cured within such ninety (90)-day period, the breaching Party has commenced and diligently continued actions to cure such breach; provided that, in any such instance, such cure must have occurred within one hundred eighty (180) days after notice thereof was provided to the breaching Party by the non-breaching Party to remedy such breach). Notwithstanding Incyte's right of termination pursuant to this Section 11.3(a), Incyte acknowledges and agrees that it ***; or

**(b)** the other Party is generally unable to meet its debts when due, or makes a general assignment for the benefit of its creditors, or there shall have been appointed a receiver, trustee or other custodian for such Party for or a substantial part of its assets, or any case or proceeding shall have been commenced or other action taken by or against such Party in bankruptcy or seeking the reorganization, liquidation, dissolution or winding-up of such Party or any other relief under any bankruptcy, insolvency, reorganization or other similar act or law, and any such event shall have continued for sixty (60) days undismissed, unstayed, unbonded and undischarged. In such circumstances, the other Party may, upon notice to such Party, terminate this Agreement, such termination to be effective upon such Party's receipt of such notice; or

**(c)** the Effective Date has not occurred on or prior to the date that is one hundred eighty (180) days after the Parties make their respective HSR filings, with such termination becoming effective upon one Party's receipt of a notice of termination from the other Party at any time after the end of such one hundred eighty (180)-day period.

**(d)** if a Party gives notice of termination under this Section 11.3, and the other Party disputes whether such notice was proper, then the issue of whether or not this Agreement was properly terminated shall be resolved in accordance with Article 14, and the Agreement shall remain in full force and effect until such dispute is resolved. If as a result of such dispute resolution process it is determined that the notice of termination was proper, then such termination shall be deemed to be effective on the date on which such dispute is resolved. On the other hand, if as a result of the dispute resolution process it is determined that the notice of termination was improper, then no termination shall have occurred, this Agreement shall remain in full force and effect and Pfizer will pay to Incyte any Event Milestone Payment that became due during the termination notice period or during the term of the dispute, together with interest in accordance with Section 8.9.

**11.4 Termination by Pfizer of Pfizer Indication**.

**(a)** If, at any time, Pfizer, in its sole discretion, elects to terminate development for all Compounds for either ***, then Pfizer will notify Incyte of its intent to terminate such indications (each such notice being hereinafter referred to as "**Reversion Notice**"). Effective upon the effective date of the Reversion Notice pursuant to Section 15.3, (x) the indications referred to in such Reversion Notice will revert to Incyte and become "**Reverted Indications**", (y) Pfizer's license under Section 7.1 with respect to such Reverted Indications shall terminate and (z) Section 7.4(b) shall



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no longer apply to Pfizer with respect to such Reverted Indications. ***

**(b)** Effective upon the effective date of the Reversion Notice pursuant to Section 15.3, Pfizer grants, and shall cause its Affiliates to grant, to Incyte the following fully paid, royalty-free worldwide sublicenses and licenses:

**(i)** an exclusive (even as to Pfizer and its Affiliates), sublicense, with the right to further sublicense, to use the Incyte Technology, Incyte Confidential Information, Pfizer Technology, Pfizer Confidential Information and Program Technology to the extent necessary or useful to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory;

**(ii)** an exclusive (even as to Pfizer and its Affiliates), sublicense, with the right to further sublicense, to use the Incyte Patent Rights, Incyte Product Patent Rights and Incyte Program Patent Rights to the extent necessary or useful to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, prevention or control of the Reverted Indications that are the subject of such Reversion Notice in the Territory;

**(iii)** an exclusive (even as to Pfizer and its Affiliates) license, with the right to sublicense, under the Program Patent Rights and Pfizer Use Patent Claims to the extent necessary to make, have made, use, import, offer for sale or sell Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory; and

**(iv)** an exclusive license (even as to Pfizer and its Affiliates), with the right to sublicense, under the Pfizer Process Patent Claims to the extent necessary to manufacture Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling Incyte Compounds or Incyte Products for the treatment, control or prevention of the Reverted Indications that are the subject of such Reversion Notice in the Territory.

Notwithstanding anything to the contrary in this Section 11.4(b), with respect to any Pfizer Technology, Pfizer Use Patent Claim or Pfizer Process Patent Claim, as the case may be, that Pfizer acquires by purchase, license, assignment or other means from a Third Party, Pfizer shall only be required to grant to Incyte a license to such Pfizer Technology, Pfizer Use Patent Claim or Pfizer Process Patent Claim (x) to the extent permitted under its agreement with such Third



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Party and (y) if Incyte agrees to be responsible for all payments to such Third Party under such Third Party agreement that may be incurred as a result of such sublicense to Incyte and executes documentation reasonably satisfactory to Pfizer to such effect.

**11.5 Termination by Pfizer of *****

**(a)** Termination of ***. If Pfizer (i) in its sole discretion, makes a final decision to terminate *** (ii) in its reasonable discretion, *** then Pfizer will so notify Incyte. No later than thirty (30) days after its receipt of such notice, Incyte will notify Pfizer as to ***. If Incyte ***. If Incyte ***.

**(b)** Incyte Election Conditions. ***

***

**(c)** Pfizer Responsibilities. ***

**11.6 Effect of Termination**.

**(a)** Survival.

**(i)** The following provisions shall survive any expiration or termination of this Agreement, except for any termination pursuant to Section 11.3(c): Articles 1 (Definitions), 10 (Confidentiality), 13 (Indemnities), 14 (Dispute Resolution), and 15 (Miscellaneous), and Sections 7.1(c) (License to Pfizer), 7.2(a) (with respect to Pfizer Technology and Pfizer Confidential Information only), 7.2(c) and 7.2(d) (Sublicenses and Licenses to Incyte), 7.3 (Research License) and 11.6 (Effect of Termination), together with any sections or defined terms referred to in such surviving provisions or necessary to give them effect.

**(ii)** Except as set forth in Section 8.2(e), termination of this Agreement shall not relieve the Parties of any liability that accrued hereunder prior to the effective date of such termination. In addition, termination of this Agreement shall not preclude either Party from pursuing all rights and remedies it may have hereunder or at Law or in equity



with respect to any breach of this Agreement nor prejudice either Party's right to obtain performance of any obligation. The remedies provided in Section 11.6(b) are not exclusive of other remedies available to a Party at Law or in equity.

**(b)** Rights Upon Termination.

**(i)** Except as set forth in Sections 11.6(a)(i), 11.6(b)(ii)(E) and 11.6(b)(v), upon termination of this Agreement by Pfizer pursuant to Section 11.2 or by either Party pursuant to Section 11.3, all licenses and sublicenses hereunder shall terminate.

**(ii)** As promptly as practicable after termination by Pfizer pursuant to Section 11.2 or termination by Incyte pursuant to Sections 11.3(a) or 11.3(b) (but in no event if (x) any such termination results, arises from or relates to, or is deemed to result, arise from or relate to, by operation of law or otherwise, any termination or deemed termination hereof that occurs during the course of any bankruptcy or other insolvency proceeding involving Incyte or (y) Incyte rejects this Agreement pursuant to Sections 363, 365 or 1123 of Title 11 of the United States Code, as amended), Pfizer shall do the following:

**(A)** Regulatory Matters. transfer to Incyte ownership of all Regulatory Filings, INDs and Regulatory Approvals relating to the Pfizer Products in the same form in which Pfizer maintains such items;

**(B)** Pre-Clinical and Clinical Matters. deliver to Incyte all material pre-clinical and clinical data and information in Pfizer's possession relating to the Pfizer Products, including copies of all material reports, records, regulatory correspondence and other materials in Pfizer's possession or control relating to the pre-clinical and clinical development of the Pfizer Products and, if applicable, any material information contained in the global safety database established and maintained by Pfizer, in each case, in the same form in which Pfizer maintains such items;

**(C)** Trademarks. assign to Incyte all of Pfizer's, and cause its Affiliates to assign to Incyte any of their respective, rights, title and interest in and to any trademarks (other than the Pfizer name) that Pfizer or any of its Affiliates are using in connection with a Pfizer Product (i) in the United States after the NDA for such Pfizer Product has been accepted for filing, (ii) in the Major European Countries after Regulatory Approval for such Pfizer Product has been filed before the European Agency for the Evaluation of Medicinal Products (or any successor agency) or such Major European Country, as applicable, (iii) in Japan after the Regulatory Approval for such Pfizer Product has been accepted for filing before the Japanese Ministry of Health and Welfare (or any successor agency) and (iv) in the countries not covered by clauses (i), (ii) and (iii), after Launch in such country;

**(D)** Manufacturing Matters.

**(I)** at Incyte's option, to be exercised no later than (x) sixty (60) days after receiving any notice of termination by Pfizer pursuant to Section 11.2 or (y) thirty (30) days after the effective date of any termination by Incyte



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pursuant to Section 11.3(a) or 11.3(b), *** (A) *** and/or (B) ***, in the case of each of clauses (A) and (B), that ***, but only if the following conditions have been met: (a) *** and (b) ***. No later than ten (10) Business Days before Incyte is required to exercise its option to ***. If, at the time of Incyte's request, ***, then, at Incyte's request, Pfizer may (but shall not be obligated to) elect to ***, in which case Incyte shall be required to ***, as the case may be, and Incyte will also be responsible for all out-of-pocket costs associated with ***;

**(II)** if the effective date of termination occurs prior to the Launch of any Pfizer Product in any country in the Territory, then, following such effective date, Pfizer shall have no further obligations to Incyte regarding manufacturing matters, other ***;

**(III)** if the effective date of termination occurs after a Pfizer Product has been Launched in any country in the Territory, then, (a) pursuant to a transition supply agreement to be negotiated in good faith by the Parties, Pfizer will provide Incyte with commercial supplies of such Pfizer Product for a period of time to be specified in the transition supply agreement but in no event to exceed *** from the effective date of termination; provided that Incyte shall reimburse Pfizer for all of Pfizer's fully-loaded costs associated with the transition supply agreement and with the manufacture of such Pfizer Product, plus a royalty to be specified in the transition supply agreement if Pfizer's



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manufacture of such Pfizer Product uses a process covered by Pfizer Proprietary Process Patent Claims (a "**Proprietary Manufacturing Process**"); (b) if the manufacture of the Pfizer Product that has been Launched does not involve the use of a Proprietary Manufacturing Process, then Pfizer shall have no further obligations to Incyte regarding manufacturing matters after the expiration of the transition supply agreement, (c) if the manufacture of the Pfizer Product that has been Launched involves the use of a Proprietary Manufacturing Process, then prior to the expiration of the transition supply agreement, Pfizer will notify Incyte as to whether (x) it will continue to supply Incyte with such Pfizer Product, with Incyte reimbursing Pfizer for all of Pfizer's fully-loaded costs associated with the manufacture of such Pfizer Product, plus a royalty to be specified in a supply agreement that the Parties will negotiate in good faith or (y) it will grant Incyte a license to the Pfizer Proprietary Process Patent Claims for a royalty to be specified in a license agreement that the Parties will negotiate in good faith; if Pfizer decides to grant Incyte a license pursuant to clause (y), then Incyte agrees to use its best efforts to effect a transfer of the manufacturing activities for such Pfizer Product to another supplier as soon as practicable and agrees to spend the resources reasonably necessary to do so.

**(IV)** For purposes of this Section 11.6(b)(ii)(D), the following terms shall have the following meanings: (x) "***" shall mean *** and (y) "***" shall mean ***.

**(E)** License Grant. Pfizer shall, and shall cause its Affiliates to, grant to Incyte a non-exclusive, royalty-free, perpetual license, with the right to sublicense, (i) to *** to the extent necessary to make, have made, use import, offer for sale or sell CCR2 Antagonists in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling CCR2 Antagonists in the Territory, (ii) *** to the extent necessary to manufacture CCR2 Antagonists in the Territory for the sole purpose of making, having made, using, importing, offering for sale or selling CCR2 Antagonists in the Territory; provided that with respect to ***, (x) Pfizer shall only be required to grant Incyte a license to ***



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to the extent permitted under its agreement with such Third Party and (y) Incyte shall be responsible for all payments to such Third Party under such Third Party agreement which become due after the effective date of termination to the extent such payments relate to the use of *** with any Compound or Pfizer Product, and Incyte shall execute such documentation reasonably satisfactory to Pfizer to such effect.

**(iii)** Upon any termination of this Agreement, Pfizer shall, as promptly as practicable, do the following:

**(A)** Program Patent Rights. execute and deliver to Incyte such documents, agreements and instruments of assignment and transfer as Incyte reasonably requests in order to establish joint ownership of all rights, title, and interest in and to Incyte Program Patent Rights and Program Patent Rights.

**(B)** Prosecution and Maintenance of Incyte Patent Rights and Program Patent Rights. cause its Affiliates to, grant to Incyte the first right but not the obligation to prosecute and maintain all Incyte Patent Rights. If Incyte prosecutes or maintains any such Incyte Patent Rights or Program Patent Rights, then Incyte shall be responsible for all costs associated with such prosecutions and maintenance. Pursuant to Section 9.2(c), Pfizer, its agents and attorneys, shall continue to give Incyte at least thirty (30) days to comment on all prosecutions and related filings of all Program Patent Rights and shall give due consideration to all Incyte comments, but Pfizer's decisions with respect to such prosecutions and related filings shall be final. Pfizer shall not abandon any Program Patent Rights without at least ninety (90) days' prior notice to Incyte. If Pfizer decides to abandon any Program Patent Right, then Incyte shall have the option to obtain sole ownership of such patents and patent applications in Incyte's name and Incyte shall be responsible for all costs associated with such prosecution and maintenance.

**(C)** Security Interests. comply with the termination provisions contained in Section 18 of the Security Agreement.

The Parties agree that (A) any failure by Pfizer to provide immaterial data, information, reports, records, correspondence or other materials to Incyte pursuant to Section 11.6(b)(ii) or 11.6(b)(iii) shall not be a breach of Pfizer's obligations; (B) in no event shall Pfizer be required by any Third Party to retain any obligations or liabilities relating to the Compounds or the Pfizer Products following any delivery or transfer pursuant to this Section 11.6(b)(ii) or 11.6(b)(iii), except to the extent that such obligations or liabilities result from events that transpired prior to such delivery or transfer; (C) except as otherwise provided in Sections 11.6(b)(ii) and 11.6(b)(iii), Incyte shall reimburse Pfizer only for out-of-pocket expenses relating to any delivery or transfer pursuant to Section 11.6(b)(ii) or 11.6(b)(iii); (D) Incyte hereby releases Pfizer from any and all liabilities in connection with any delivery or transfer pursuant to Sections 11.6(b)(ii) and 11.6(b)(iii) *** and shall not hold Pfizer liable for any inaccuracy or incompleteness of any data, information, reports, records, correspondence or

other materials delivered or transferred pursuant to this Section 11.6(b)(ii); and (E) Incyte fully indemnifies Pfizer for all Damages relating to any sale or use of the API or Drug Product resulting from any Claims by Third Parties except, in the case of



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clauses (D) and (E) only, to the extent that such liabilities or Damages result from the gross negligence or willful misconduct of Pfizer.

**(iv)** For clarity, if either Pfizer terminates this Agreement under Section 11.2 or Incyte terminates this Agreement under Section 11.3(a) or 11.3(b), and Pfizer researches, develops, markets, sells, or offers to sell any Compound or Pfizer Product covered by the Valid Claim of a ***, then such Compound or Pfizer Product shall be subject to all the financial provisions of Article 8 as if such Agreement had not been terminated.

**(v)** Upon termination by reason of the passing of the Royalty Term Expiration Date with respect to any Pfizer Product, as of the effective date of such termination and on a country-by-country basis, the licenses from Incyte to Pfizer under Section 7.1 shall convert to fully-paid, royalty-free, perpetual, non-exclusive licenses, with the right to sublicense, under the Incyte Technology, Incyte Confidential Information and Program Technology to make, have made, use, import, offer for sale and sell such Pfizer Product in such country.

**11.7 Change of Control**. In the event of any Change of Control, Incyte shall notify Pfizer promptly, but in no event later than five (5) Business Days, following approval by Incyte's board of directors of any transaction that constitutes a Change of Control. Pfizer shall have the right upon sixty (60) days' notice following any such Change of Control or following a breach by Incyte of Sections 9.3(b) or 9.3(c), to elect that any one or more of the following shall be deleted, in whole or in part, from this Agreement: Sections 2.1-2.4, 3.1-3.5, 5.2 and 5.3 and the Research Plan. If Pfizer makes any election as provided in this Section 11.7 to delete any Section, each of the Parties hereto will enter into an appropriate and customary written amendment and no Party shall have any further obligations with respect to any such deleted Section. For the avoidance of doubt, Pfizer shall be entitled, in its sole discretion, to make the elections provided for in this Section 11.7 upon each occurrence of a Change of Control.

**11.8 Bankruptcy**. Pfizer may, in addition to any other remedies available to it by Law or in equity, exercise the rights set forth below in this Section 11.8 by notice to Incyte, if Incyte shall have become insolvent or bankrupt, or shall have made a general assignment for the benefit of its creditors, or there shall have been appointed a trustee or receiver of Incyte or for all or a substantial part of its property, or any case or proceeding shall have been commenced or other action taken by or against Incyte in bankruptcy or seeking reorganization, liquidation, dissolution, winding-up arrangement, composition or readjustment of its debts or any other relief under any bankruptcy, insolvency, reorganization or other similar act or law of any jurisdiction now or hereafter in effect, and any such event shall have continued for ninety (90) days undismissed, unbonded and undischarged. All rights and licenses granted under or pursuant to this Agreement by Incyte are, and shall otherwise be deemed to be, for purposes of Section 365(n) of the U.S. Bankruptcy Code, licenses of rights to "intellectual property" as defined under Section 101(35A) of the U.S. Bankruptcy Code. The Parties agree that Pfizer, as licensee of such rights under this Agreement, shall retain and may fully exercise all of its rights and elections under the U.S. Bankruptcy Code. The Parties further agree that, in the event of the commencement of a bankruptcy proceeding by or against Incyte under the U.S. Bankruptcy Code, Pfizer shall be entitled to a complete duplicate of (or complete access to, as Pfizer deems appropriate) any such intellectual property and all embodiments of such intellectual property, and same, if not already in their possession, shall be promptly delivered to Pfizer (a) upon any



such commencement of a bankruptcy proceeding upon Pfizer's written request therefor, unless Incyte elects to continue to perform all of its obligations under this Agreement or (b) if not delivered under (a) above, upon the rejection of this Agreement by or on behalf of Incyte upon written request therefor by Pfizer.

## 12. REPRESENTATIONS AND WARRANTIES

**12.1 General Representations and Warranties**. Each Party represents and warrants to the other that, as of the date hereof:

**(a)** it is duly incorporated and validly existing under the Laws of its state of incorporation, and has full corporate power and authority to enter into this Agreement and to carry out the provisions hereof;

**(b)** it is duly and validly authorized to execute and deliver this Agreement and to perform its obligations hereunder, the execution, delivery and performance of this Agreement have been approved by proper corporate action, it has taken all other action required by Law, its certificate of incorporation or by-laws or any agreement to which it is a party or to which it may be subject required to authorize such execution, delivery and performance (other than compliance with all applicable requirements of the HSR Act), and the person or persons executing this Agreement on its behalf has been duly authorized to do so by all requisite corporate action;

**(c)** assuming due authorization, execution and delivery by the other Party, this Agreement is legally binding upon it and enforceable in accordance with its terms, except as such enforceability may be limited by bankruptcy, insolvency, reorganization, moratorium and similar Laws. The execution, delivery and performance of this Agreement by it does not conflict with any agreement, instrument or understanding, oral or written, to which it is a party or by which it may be bound, nor violate any Laws or order of any court or Governmental Authority having jurisdiction over it;

**(d)** it has not granted, and will not grant during the Term of the Agreement, any right to any Third Party that would conflict with the rights granted to the other Party hereunder. It has (or will have at the time performance is due) maintained and will maintain and keep in full force and effect all agreements necessary to perform its obligations hereunder; and

**(e)** it is aware of no action, suit or inquiry or investigation instituted by any Governmental Authority that questions or threatens the validity of this Agreement.

**12.2 Representations and Warranties of Incyte.** As of the date hereof, Incyte hereby represents and warrants to Pfizer as follows:

**(a)** to the knowledge of Incyte and its Affiliates, there is no reason why the claims that may issue from the patent applications set forth on Exhibit A would not be valid and enforceable;

**(b)** none of Incyte or any of its Affiliates has received any written notice or claim that Incyte or any of its Affiliates is infringing any Third Party intellectual property rights through activities related to Compounds or Incyte Compounds, and to the knowledge of Incyte and its Affiliates, none of Incyte or any of its Affiliates has in the past infringed or is currently



infringing any Third Party intellectual property rights through activities related to Compounds or Incyte Compounds;

**(c)** to the knowledge of Incyte and its Affiliates, no Third Party is infringing any Incyte Patent Rights;

**(d)** (i) Incyte is the legal and beneficial owner of, or has the right to grant to Pfizer the rights granted herein, to all Incyte Patent Rights and all Incyte Technology, (ii) no other Person has any right, interest or claim in or to such rights and Incyte has not entered into any agreement granting any right or interest in or to (x) such Incyte Patent Rights or (y) except for research licenses for non-commercial purposes granted to academic or non-profit research entities or to other Third Parties involved in research for non-commercial purposes, such Incyte Technology and (iii) all assignments to Incyte of inventorship rights relating to the Incyte Patent Rights Controlled by Incyte are valid and enforceable;

**(e)** Exhibit A contains a complete and correct list as of the date hereof of all patents and patent applications in the Territory Controlled by Incyte or any of its Affiliates relating to the manufacture, use, sale, offer for sale or importation of any Compound or Incyte Compound;

**(f)** none of the rights of Incyte or its Affiliates under the Incyte Patent Rights set forth on Exhibit A have been licensed to Incyte or its Affiliates from any Third Party, and none of such rights were developed with federal funding from the United States government or any other Governmental Authority;

**(g)** each of the Incyte Patent Rights are free of any lien, encumbrances, charge, security interest, mortgage or other similar restriction;

**(h)** Incyte and its Affiliates have disclosed to Pfizer all material information known to it and its Affiliates with respect to the safety and efficacy of each of the Compounds and Incyte Compounds;

**(i)** Incyte and its Affiliates have disclosed to Pfizer all material correspondence and contact information between each of them and the FDA and any other Regulatory Authorities regarding the Compounds and Incyte Compounds.

For purposes of this Section 12.2, "to the knowledge of Incyte and its Affiliates" shall mean to the actual knowledge of Incyte and its Affiliates (including the knowledge of those officers, employees and agents of Incyte and its Affiliates whose duties include responsibility for the matters specified in this Section 12.2).

## 13. INDEMNITIES

### 13.1 Indemnification.

**(a)** Mutual Indemnification. Each Party hereby agrees to indemnify and hold the other Party and its Representatives harmless from and against any and all damages or other amounts payable to a Third Party claimant, as well as any reasonable out-of-pocket attorneys' fees and costs of litigation arising out of any such Claim, (collectively, "**Damages**") resulting from claims, suits, proceedings or causes of action ("**Claims**") brought by a Third Party against a



Party or any of its Representatives based on: (a) breach of any representation, warranty, covenant or agreement contained in this Agreement by the indemnifying Party or any of its Representatives, (b) breach of any applicable Law by such indemnifying Party or any of its Representatives, or (c) gross negligence or willful misconduct by such indemnifying Party, or any of its Representatives; provided that the indemnification in this Section 13.1 shall not apply to the extent that any Damages are the result of (x) any breach of any representation, warranty, covenant or agreement contained in this Agreement by the indemnified Party or any of its Representatives or (y) any gross negligence or willful misconduct of the indemnified Party or any of its Representatives. "**Representatives**" means, with respect to a Party, such Party's Affiliates, licensees, officers, directors, employees, consultants, contractors, sublicensees and agents.

**(b)** Incyte Indemnification. Incyte shall indemnify and hold Pfizer and its Representatives harmless from and against all Damages resulting from Claims brought by a Third Party based on any actual or alleged infringement, misappropriation or other violation of a Third Party's patent rights resulting from the making, having made, using, importation, offering for sale, sale, promotion, manufacture, commercialization or distribution of any Incyte Compound or Incyte Product by or on behalf of Incyte.

**(c)** Pfizer Indemnification. Except as provided in Section 9.6, Pfizer shall indemnify and hold Incyte and its Representatives harmless from and against all Damages resulting from Claims brought by a Third Party based on any actual or alleged infringement, misappropriation or other violation of a Third Party's patent rights resulting from the making, having made, using, importation, offering for sale, sale, promotion, manufacture, commercialization or distribution of any Compound or Pfizer Product by or on behalf of Pfizer.

### 13.2 Product Liability Indemnification.

**(a)** Pfizer hereby agrees to indemnify and hold Incyte and its Representatives harmless from and against any Damages resulting from Claims brought by a Third Party against Incyte or any of its Representatives resulting from the sale of any Compound or Pfizer Product by Pfizer or any of its Representatives, or the use of any Compound or Pfizer Product, except to the extent that such Damages are covered by Incyte's indemnification of Pfizer pursuant to Section 13.1.

**(b)** Incyte hereby agrees to indemnify and hold Pfizer and its Representatives harmless from and against any Damages resulting from Claims brought by a Third Party against Pfizer or any of its Representatives resulting from the sale of any Incyte Compound or Incyte Product by Incyte or any of its Representatives, or the use of any Incyte Compound or Incyte Product, except to the extent that such Damages are covered by Pfizer's indemnification of Incyte pursuant to Section 13.1.

**13.3 Conditions to Indemnification**.

**(a)** In the event that any Third Party asserts a claim with respect to any matter for which a Party (the "**Indemnified Party**") is entitled to indemnification under Section 9.7, 13.1, or 13.2 (a "**Third Party Claim**"), then the Indemnified Party shall promptly notify the Party obligated to indemnify the Indemnified Party (the "**Indemnifying Party**") thereof; provided, however, that no delay on the part of the Indemnified Party in notifying the



Indemnifying Party shall relieve the Indemnifying Party from any obligation hereunder unless (and then only to the extent that) the Indemnifying Party is prejudiced thereby.

**(b)** The Indemnifying Party shall have the right, exercisable by notice to the Indemnified Party within ten (10) Business Days of receipt of notice from the Indemnified Party of the commencement of or assertion of any Third Party Claim, to assume direction and control of the defense, litigation, settlement, appeal or other disposition of the Third Party Claim (including the right to settle the claim solely for monetary consideration) with counsel selected by the Indemnifying Party and reasonably acceptable to the Indemnified Party; provided that (i) the Indemnifying Party has sufficient financial resources, in the reasonable judgment of the Indemnified Party, to satisfy the amount of any adverse monetary judgment that is sought, (ii) the Third Party Claim solely seeks monetary damages and (iii) the Indemnifying Party expressly agrees in writing that as between the Indemnifying Party and the Indemnified Party, the Indemnifying Party shall be solely obligated to satisfy and discharge the Third Party Claim in full (the conditions set forth in clauses (i), (ii) and (iii) above are collectively referred to as the "**Litigation Conditions**").

**(c)** Within ten (10) Business Days after the Indemnifying Party has given notice to the Indemnified Party of its intended exercise of its right to defend a Third Party Claim, the Indemnified Party shall give notice to the Indemnifying Party of any objection thereto based upon the Litigation Conditions. If the Indemnified Party reasonably so objects, the Indemnified Party shall continue to defend the Third Party Claim, at the expense of the Indemnifying Party, until such time as such objection is withdrawn. If no such notice is given, or if any such objection is withdrawn, the Indemnifying Party shall be entitled, at its sole cost and expense, to assume and conduct such defense, with counsel selected by the Indemnifying Party. During such time as the Indemnifying Party is controlling the defense of such Third Party Claim, the Indemnified Party shall cooperate, and cause its Affiliates and agents to cooperate upon request of the Indemnifying Party in the defense or prosecution of the Third Party Claim, including by furnishing such records, information and testimony and attending such conferences, discovery proceedings, hearings, trials or appeals as may reasonably be requested by the Indemnifying Party. In the event that the Indemnifying Party does not satisfy the Litigation Conditions or does not notify the Indemnified Party of the Indemnifying Party's intent to defend any Third Party Claim within ten (10) Business Days after notice thereof, the Indemnified Party may (without further notice to the Indemnifying Party) undertake the defense thereof with counsel of its choice and at the Indemnifying Party's reasonable expense (including reasonable, out-of-pocket attorneys' fees and costs and expenses of enforcement or defense). The Indemnifying Party or the Indemnified Party, as the case may be, shall have the right to join in (including the right to conduct discovery, interview and examine witnesses and participate in all settlement conferences), but not control, at its own expense, the defense of any Third Party Claim that the other Party is defending as provided in this Agreement.

**(d)** The Indemnifying Party shall not, without the prior consent of the Indemnified Party, enter into any compromise or settlement which commits the Indemnified Party to take or forbear to take any action.

**(e)** In no event may an Indemnified Party settle or compromise any Third Party Claim for which it/he/she intends to seek indemnification from the Indemnifying Party hereunder without the prior consent of the Indemnifying Party, or the indemnification provided under such Section 13.1, 13.2 or 13.3 as to such Third Party Claim shall be null and void.



**13.4 Exclusion of Damages**. IN NO EVENT SHALL EITHER PARTY OR ITS AFFILIATES BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, INCIDENTAL, SPECIAL, PUNITIVE, EXEMPLARY OR CONSEQUENTIAL DAMAGES, WHETHER BASED UPON A CLAIM OR ACTION OF CONTRACT, WARRANTY, NEGLIGENCE, STRICT LIABILITY OR OTHER TORT, OR OTHERWISE, ARISING OUT OF THIS AGREEMENT, (A) UNLESS SUCH DAMAGES ARE DUE TO THE WILLFUL MISCONDUCT OR INTENTIONAL OR WILLFUL BREACH IN BAD FAITH OF ANY REPRESENTATION, WARRANTY, COVENANT OR AGREEMENT BY THE LIABLE PARTY OR ITS AFFILIATES OF THIS AGREEMENT OR (B) EXCEPT TO THE EXTENT ANY SUCH DAMAGES ARE PAID TO A THIRD PARTY AS A PART OF A THIRD PARTY CLAIM. EXCEPT AS EXPRESSLY PROVIDED IN THIS AGREEMENT, INDEMNIFICATION PURSUANT TO THIS ARTICLE 13 SHALL BE THE SOLE AND EXCLUSIVE REMEDY (WHETHER BASED ON CONTRACT, TORT OR ANY OTHER LEGAL THEORY) AVAILABLE TO INCYTE OR PFIZER FOR ANY MATTER COVERED THEREIN.

## 14. DISPUTE RESOLUTION

**14.1 Disputes**. The Parties recognize that disputes as to certain matters may from time to time arise during the Term that relate to either Party's rights and/or obligations hereunder. It is the objective of the Parties to facilitate the resolution of disputes arising under this Agreement in an expedient manner by mutual cooperation and without resort to litigation. To accomplish this objective, the Parties agree that, in the event of any disputes, controversies or differences that may arise between the Parties, out of or in relation to or in connection with this Agreement, or for the breach thereof, upon the request of either Party, the Parties agree to meet and discuss in good faith a possible resolution thereof. If the matter is not resolved within sixty (60) days following the request for discussions, then, other than with respect to disputes over reports, accounting or payments that are subject to Section 8.10, either Party may

commence an action in accordance with Section 14.2 below. Notwithstanding anything to the contrary in Section 14.1 or 14.2, each Party shall be entitled to seek injunctive relief and specific performance in any court in the world without waiting for the expiration of any such sixty (60)-day period.

**14.2 Governing Law; Jurisdiction**. Resolution of all disputes arising out of or related to this Agreement or the performance, enforcement, breach or termination of this Agreement and any remedies relating thereto, shall be governed by and construed under the substantive laws of the State of New York, without regard to conflicts of law rules that would provide for application of the law of a jurisdiction outside New York. If such controversy or claim cannot be resolved by means of negotiations as described in Section 14.1, then such controversy or claim shall be resolved by the United States District Court for the Southern District of New York, a New York state court sitting in New York, New York, the United States District Court for the District of Delaware, or a Delaware state court sitting in Wilmington, Delaware (collectively, the "**Courts**"). Each Party (a) irrevocably submits to the exclusive jurisdiction in the Courts, for purposes of any action, suit or other proceeding relating to or arising out of this Agreement, and (b) agrees not to raise any objection at any time to the laying or maintaining of the venue of any such action, suit or proceeding in any of the Courts, irrevocably waives any claim that such action, suit or other proceeding has been brought in an inconvenient forum and further irrevocably waives the right to object, with respect to such action, suit or other proceeding, that such Court does not have any jurisdiction over such Party. Incyte hereby irrevocably designates, appoints and empowers Corporation Service Company, located at 2711 Centerville Road, Suite



400, Wilmington, DE 19808, as its true and lawful agent and attorney in fact in its name, place and stead to receive and accept on its behalf service of process in any action, suit or proceeding in the Courts of New York with respect to matters as to which it has submitted to jurisdiction as set forth in the immediately preceding sentence.

**15. MISCELLANEOUS**

**15.1 Entire Agreement; Amendment**. This Agreement, including the exhibits attached hereto, sets forth the complete, final and exclusive agreement and all the covenants, promises, agreements, warranties, representations, conditions and understandings between the Parties hereto and supersedes and terminates all prior agreements and understandings between the Parties, including the Confidentiality Agreement between the Parties, dated June 21, 2004, as amended, and the Common Interest and Joint Purpose Agreement between the Parties, dated April 29, 2005. There are no covenants, promises, agreements, warranties, representations, conditions or understandings, either oral or written, between the Parties other than as are set forth herein and therein. No subsequent alteration, amendment, change or addition to this Agreement shall be binding upon the Parties unless reduced to writing and signed by an authorized officer of each Party.

**15.2 Force Majeure**. Both Parties shall be excused from the performance of their obligations under this Agreement to the extent that such performance is prevented by force majeure and the nonperforming Party promptly provides notice of the prevention to the other Party. Such excuse shall be continued so long as the condition constituting force majeure continues and the nonperforming Party takes reasonable efforts to remove the condition. For purposes of this Agreement, force majeure shall include conditions beyond the control of the Parties, including an act of God, voluntary or involuntary compliance with any regulation, law or order of any government, war, civil commotion, labor strike or lock-out, epidemic, failure or default of public utilities or common carriers, destruction of production facilities or materials by fire, earthquake, storm or like catastrophe. Notwithstanding the foregoing, any payment due and owing hereunder shall not be delayed by the payer because of a force majeure affecting the payer, unless such force majeure specifically precludes the payment process.

**15.3 Notices**. Any notices, approvals, or consents required or permitted to be given under this Agreement shall be in writing, shall specifically refer to this Agreement and shall be deemed to have been sufficiently given for all purposes if mailed by first class certified or registered mail, postage prepaid, internationally recognized overnight courier or personally delivered. Unless otherwise specified in writing, the mailing addresses of the Parties shall be as described below:



| | |
|---|---|
| For Incyte: | Incyte Corporation<br>Experimental Station<br>Route 141 & Henry Clay Road<br>Building E336<br>Wilmington, DE 19880<br><br>Attention: Chief Business Officer<br>Facsimile No.: (302) 425-2707 |
| with a copy to: | Attention: General Counsel<br>Facsimile No.: (302) 425-2722 |
| For Pfizer: | Pfizer Inc.<br>235 East 42nd Street<br>New York, New York 10017<br><br>Attention: President, Pfizer Human Health<br>Facsimile No.: 212-808-8652 |
| with a copy to: | Attention: Executive Vice President and General Counsel<br>Facsimile No.: 212-808-8924 |

Notices hereunder shall be deemed to be effective (a) upon receipt if personally delivered, (b) on the tenth (10th) Business Day following the date of mailing if sent by first class certified or registered mail, and (c) on the second (2nd) Business Day following the date of transmission or delivery to the overnight

courier if sent by overnight courier. A Party may change its address listed above by sending notice to the other Party in accordance with this Section 14.3.

**15.4 United States Dollars**. References in this Agreement to "Dollars" or "$" shall mean the legal tender of the United States of America

**15.5 Assignment.** Neither Party may assign or transfer this Agreement or any rights or obligations hereunder without the prior consent of the other; provided, however, that a Party may make such an assignment without the other Party's consent (a) to an Affiliate, so long as such Party shall remain jointly and severally liable with such Affiliate with respect to all obligations so assigned, (b) to a Third Party in conjunction with a merger or consolidation involving such Party and the Third Party or (c) to a Third Party to whom a Party is required to, or reasonably believes that it will be required to, divest any Pfizer Product or Incyte Product, as the case may be, to the extent necessary to comply with Law or the order of any Governmental Authority as a result of such transaction; provided that any such assignment by a Party is subject to the compliance by such Party with Sections 9.3(b) and (c). Any assignment or attempted assignment by either Party in violation of the terms of this Section 15.5 shall be null and void and of no legal effect.

**15.6 Counterparts**. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.



**15.7 Further Actions**. Each Party agrees to execute, acknowledge and deliver such further instruments, and to do all such other acts, as may be necessary or appropriate in order to carry out the purposes and intent of this Agreement.

**15.8 Severability**. If any one or more of the provisions of this Agreement is held to be invalid or unenforceable by any court of competent jurisdiction from which no appeal can be or is taken, the provision shall be considered severed from this Agreement and shall not serve to invalidate any remaining provisions hereof. The Parties shall make a good faith effort to replace any invalid or unenforceable provision with a valid and enforceable one such that the objectives contemplated by the Parties when entering into this Agreement may be realized.

**15.9 Headings**. The headings for each article and section in this Agreement have been inserted for convenience of reference only and are not intended to limit or expand on the meaning of the language contained in the particular article or section.

**15.10 No Waiver**. Any delay in enforcing a Party's rights under this Agreement or any waiver as to a particular default or other matter shall not constitute a waiver of such Party's rights to the future enforcement of its rights under this Agreement, excepting only as to an express written and signed waiver as to a particular matter for a particular period of time.

**15.11 Non-Solicitation of Employees**. During the term of this Agreement, neither Party shall, directly or indirectly, recruit or solicit any employee of the other Party with whom such Party has come into contact or interacted for the purposes of performing this Agreement, without the prior consent of the other Party, except pursuant to general solicitations not targeted at such employees.

**15.12 Third-Party Beneficiaries**. None of the provisions of this Agreement shall be for the benefit of or enforceable by any Third Party, including any creditor of either Party. No such Third Party shall obtain any right under any provision of this Agreement or shall by reasons of any such provision make any claim in respect of any debt, liability or obligation (or otherwise) against either Party.

**15.13 Binding Effect**. This Agreement shall be binding upon and inure to the benefit of the Parties hereto and their respective heirs, successors and permitted assigns.

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IN WITNESS WHEREOF, the Parties have executed this Agreement in duplicate originals by their proper officers as of the date and year first above written.

| | | | |
|---|---|---|---|
| INCYTE CORPORATION | | PFIZER INC. | |
| BY: | /S/ PAUL A FRIEDMAN | BY: | /S/ LISA RICCIARDI |
| NAME: | PAUL A. FRIEDMAN | NAME: | LISA RICCIARDI |
| TITLE: | PRESIDENT & CEO | TITLE: | SR. VICE PRESIDENT |



*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT A**

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*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT B**

Research Plan

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*** Confidential material redacted and filed separately with the Commission.

**Exhibit B-1**

**Testing Activities at Incyte**

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*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT C**

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*** Confidential material redacted and filed separately with the Commission.

**ATTACHMENT C-1**

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*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT D-1**

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*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT D-2**

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*** Confidential material redacted and filed separately with the Commission.

**EXHIBIT D-3**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.7(a)**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.7(b)**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.7(c)**

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**SCHEDULE 1.27**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.28**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.29**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.30**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.31**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.32**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.33**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.34**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.35**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 1.75**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 6.7(a)**

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*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 6.7(b)**

***



**SCHEDULE 10.3(a)**

Press Release

For immediate release:
November 21, 2005

Contacts:

Paul Fitzhenry
Pfizer Inc
(212) 733-4637

Pam Murphy
Incyte Corporation
(302) 498 6944

**Pfizer and Incyte Enter Collaborative Research and License Agreement for the Development and Commercialization of CCR2 Antagonists**

***Pfizer gains worldwide development and commercialization rights across a broad range of indications***

***Incyte may receive up to $803 million in payments and retains rights in multiple sclerosis and an additional undisclosed indication***

**New York, NY, and Wilmington, DE – November 21, 2005** Pfizer Inc., (NYSE: PFE) and Incyte Corporation (NASDAQ: INCY) announced today that the two companies have entered into a global collaborative research and license agreement for the development, manufacture and marketing of novel oral CCR2 antagonists.

Under the agreement:

- Pfizer gains exclusive worldwide development and commercialization rights to Incyte's portfolio of CCR2 antagonist compounds, the most advanced of which is currently in Phase IIa studies in rheumatoid arthritis and insulin-resistant obese patients. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and one other undisclosed indication, where Incyte retains exclusive worldwide rights, along with certain compounds. Incyte will not have obligations to Pfizer on pre-clinical development candidates it selects for pursuit in these indications.

- Incyte will receive an upfront payment of $40 million and will be eligible to receive additional milestone payments of up to $743 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales.

- Pfizer will purchase $20 million in convertible subordinated notes, with $10 million to be issued within 20 days after the effective date of the agreement and another $10 million to be issued after Incyte files an Investigational New Drug Application in a retained Incyte indication. The notes will bear no interest and will be convertible into Incyte common stock at a premium.



- Pfizer will also provide research funding to Incyte to support the continued expansion of the CCR2 compound portfolio.

The agreement is subject to antitrust review and approval, and other standard closing conditions.

"This transaction is a further step in our strategy to augment Pfizer's internal research and development efforts with high-potential, externally sourced product candidates and technologies," said Martin Mackay, Pfizer Senior Vice President Worldwide Research and Technology. "We are excited about Incyte's CCR2 antagonist program and its potential use in treating a range of chronic diseases with significant unmet medical need."

Paul A. Friedman, M.D., President and CEO of Incyte, stated: “Our CCR2 antagonist program has the potential to generate multiple products in a variety of major indications, and Pfizer, with its unique breadth of capabilities, is ideally positioned to maximize the value of the program to patients. The deal structure, which provides for us to retain certain compounds for our independent pursuit in two potentially high-value specialty indications, supports our efforts to build a leading drug discovery and development company. We look forward to working with Pfizer to realize the full potential of our first internally-developed program.”

**About CCR2 Antagonism**

The chemokine receptor CCR2 has a central role in the establishment and maintenance of chronic inflammatory processes. CCR2 and its primary ligand, MCP-1, represent a critical signaling pathway for the recruitment of peripheral blood monocytes to sites of immune-mediated inflammation, where they become inflammatory macrophages. Macrophages are among the predominant cell types found at sites of chronic inflammation, and clinical observations show a close correlation between lower macrophage burden, reduced severity of disease, and improved outcomes in rheumatoid arthritis. There is a growing body of evidence that the presence of inflammatory macrophages contributes to the pathogenesis of numerous other disorders, and positive effects of blockade of the CCR2/MCP-1 axis have been shown in animal models of rheumatoid arthritis, multiple sclerosis, diabetes, atherosclerosis, neuropathic pain and inflammatory bowel disease.

**About Pfizer**

Pfizer Inc discovers, develops, manufactures and markets leading prescription medicines, for humans and animals, and many of the world’s best-known consumer brands.

**About Incyte**

Incyte Corporation is a Wilmington, Delaware-based drug discovery and development company with a growing pipeline of oral compounds to treat HIV, inflammation, cancer and diabetes. The company’s most advanced product candidate, dexelvucitabine, DFC (formerly Reverset) is an oral, once-a-day therapy in Phase IIb clinical development to treat patients with HIV infections. The company’s lead internal compounds include INCB3284, a proprietary oral CCR2 antagonist that is in Phase II development for a number of inflammation-driven diseases, and INCB7839, a proprietary oral sheddase inhibitor that is in



Phase I development as a potential treatment for cancer. Incyte has several other early drug discovery programs underway in the areas of cancer, inflammation, diabetes and HIV.

**Forward Looking Statements**

PFIZER DISCLOSURE NOTICE: The information contained in this release is as of November 21, 2005. Pfizer assumes no obligation to update any forward-looking statements contained in this release as the result of new information or future events or developments.

This release contains forward-looking information about an agreement between Pfizer Inc. and Incyte Corporation and about possible product candidates that may be developed from Incyte’s portfolio of compounds and the potential benefits of such product candidates. This information involves substantial risks and uncertainties including, among other things, the satisfaction of conditions to closing the agreement; the uncertainties inherent in research and development activities; decisions by regulatory authorities regarding whether and when to approve any drug applications for product candidates that may be developed from Incyte’s portfolio of compounds as well as their decisions regarding labeling and other matters that could affect the commercial potential of any such product candidates; and competitive developments.

A further list and description of risks and uncertainties can be found in Pfizer’s Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and in its reports on Form 10-Q and Form 8-K.

INCYTE DISCLOSURE NOTICE: Except for the historical information contained herein, the matters set forth in this press release, including statements with respect to the purchase of convertible subordinated notes, the potential indications and benefits of CCR2 antagonist compounds, and the potential benefits from and payments under the agreement, are all forward-looking statements within the meaning of the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially, including the satisfaction of conditions to closing the agreement and the sale of the convertible subordinated notes, the high degree of risk associated with drug development and clinical trials, results of further research and development, the impact of competition and of technological advances, and other risks detailed from time to time in Incyte’s filings with the Securities Exchange Commission, including its Quarterly Report on Form 10-Q for the quarter ended September 30, 2005. Incyte disclaims any intent or obligation to update these forward-looking statements.



*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 10.3(b)**

Permitted Disclosures

- Signing of this Agreement
- Effective Date of this Agreement and receipt of payment pursuant to Section 8.1
- Achievement of Event Milestones set forth in Section 8.2(a)
- Achievement of Commercial Milestones set forth in Section 8.3

- ***
- If a Pfizer Indication becomes a Reverted Indication pursuant to Section 11.4 and reversion, if any, of any Compound for such Reverted Indication
- Termination of the Agreement pursuant to Section 11.2 or 11.3



*** Confidential material redacted and filed separately with the Commission.

**SCHEDULE 10.4**

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**EXHIBIT 21.1**

## SUBSIDIARIES OF INCYTE CORPORATION

| Name | Jurisdiction of Organization |
|---|---|
| Incyte Europe Holdings Limited | England and Wales |
| Incyte Corporation Limited | England and Wales |
| Incyte Dormant Company Limited | England and Wales |
| Incyte Asia, Inc. | Delaware |
| Incyte San Diego, Inc. | Delaware |
| Proteome, Inc. | Delaware |

**EXHIBIT 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 33-93668 and 333-91556 and 333-125995) pertaining to the 1993 Directors' Stock Option Plan of Incyte Corporation, (Form S-8 Nos. 333-47178, 333-63069, 333-67598, 333-83291 and 333-91542) pertaining to the 1991 Stock Plan of Incyte Corporation, (Form S-8 No. 333-108013) pertaining to the 1997 Employee Stock Purchase Plan of Incyte Corporation, (Form S-8 No. 333-54496) pertaining to Options Assumed by Incyte Corporation Originally Granted Under The Proteome, Inc. 1998 Employee, Director, and Consultant Stock Option Plan, (Form S-3 No. 333-114863) pertaining to the 3 ½% Convertible Subordinated Notes Due 2011 and Shares of Common Stock Issuable Upon Conversion of the Notes, and (Form S-3 No. 333-119603) pertaining to the registration of Common Stock, as applicable, of our reports dated February 24, 2006, with respect to the consolidated financial statements and schedule of Incyte Corporation, Incyte Corporation management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of Incyte Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2005.

/s/ ERNST & YOUNG LLP

Philadelphia, PA
March 2, 2006

**Exhibit 31.1**

**CERTIFICATION**

I, Paul A. Friedman, certify that:

1. I have reviewed this annual report on Form 10-K of Incyte Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or cause such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 3, 2006

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

**Exhibit 31.2**

**CERTIFICATION**

I, David C. Hastings, certify that:

1. I have reviewed this annual report on Form 10-K of Incyte Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or cause such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial data; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 3, 2006

/s/ DAVID C. HASTINGS
David C. Hastings
Chief Financial Officer

**EXHIBIT 32.1**

**STATEMENT PURSUANT TO**
**18 U.S.C. SECTION 1350**

With reference to the Annual Report of Incyte Corporation (the "Company") on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul A. Friedman, Chief Executive Officer of the Company, certify, for the purposes of 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

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

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

March 3, 2006

**EXHIBIT 32.2**

**STATEMENT PURSUANT TO**
**18 U.S.C. SECTION 1350**

With reference to the Annual Report of Incyte Corporation (the "Company") on Form 10-K for the year ended December 31, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, David C. Hastings, Chief Financial Officer of the Company, certify, for the purposes of 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

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

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

/s/ DAVID C. HASTINGS
David C. Hastings
Chief Financial Officer

March 3, 2006