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genentech business events in 1998 and early 1999

In 1998, Genentech continued to deliver the results of its disciplined business plan and strategies to the bottom line. Seeking strong growth into the next century, in 1998 Genentech defined its goals and identified a five-point strategy for growth:

1 Maximize Our Revenue Growth

- 1998 revenues: $1.15 billion.
- Received approval from the U.S. Food and Drug Administration (FDA) to market Herceptin for use as first line therapy in combination with paclitaxel and as a single agent in second and third line therapy for patients with metastatic breast cancer who have tumors that overexpress the HER2 (human epidermal growth factor receptor2) protein.
- Received FDA approval for a label change for Pulmozyme to include the safety and alternative administration of Pulmozyme in cystic fibrosis patients under the age of five.
- Genentech and IDEC Pharmaceuticals Corporation's international partner, Roche, received approval to market MabThera (marketed as Rituxan in the United States) from the European Comission. MabThera was approved for treating non-Hodgkin's lymphoma (NHL) patients who have had two or more relapses or are resistant to chemotherapy.
- Received FDA approval for the large-scale (12,000-liter) manufacture of Rituxan, enabling Genentech to supplement the Rituxan manufactured by partner IDEC.
- Settled patent litigation with Novo Nordisk A/S relating to human growth hormone (hGH) and insulin. Novo Nordisk and Genentech cross-licensed worldwide certain patents relating to hGH. Novo Nordisk received a worldwide license under Genentech patents relating to insulin and Genentech received certain payments.
- Received three new patents related to variant forms of tissue-plasminogen activator (t-PA). Filed patent infringement suits against Centocor, Inc., alleging that Centocor's sale, offer for sale, use and importation of Retavase® (Reteplase, recombinant) rPA in the United States infringe on these three new Genentech patents. Genentech is seeking a permanent injunction and damages.
- Signed multiparty agreements with Schering-Plough Corporation, Biogen, Inc. and Roche settling a 1996 lawsuit that Biogen filed against Roche and Genentech related to a disputed alpha interferon invention. As a result of the settlement, the U.S. Patent Office is expected to issue a patent to Genentech/Roche for the disputed alpha interferon claim. Genentech expects to receive certain future payments.

2 Further Our Discovery and Development of Innovative Products

- Dedicated a new $250 million, 310,000-square-foot manufacturing facility, the world's largest biotech manufacturing facility for the large-scale production of biopharmaceutical proteins in Vacaville, California.
- With partner Alkermes, Inc., began preparing a New Drug Application for FDA filing seeking approval to market Nutropin Depot for the treatment of growth hormone deficiency in children.
- Completed enrollment ahead of schedule in a U.S. Phase III trial of Neuleze in patients with diabetic peripheral neuropathy.
- With partner Boehringer Ingelheim GmbH, completed enrollment in a worldwide Phase III trial of TNK (a t-PA) in patients with acute myocardial infarction.
- Based on positive results of Phase II trials, with partners Novartis AG and Tanox Biosystems, Inc., initiated Phase III trials of the anti-IgE antibody in allergic asthma and allergic rhinitis patients.
- With partner IDEC, announced results of a Phase II pilot study combining Rituxan with standard chemotherapy in patients with previously untreated intermediate- or high-grade NHL.
- Discontinued development of Activase for treating acute ischemic stroke (AIS) in patients presenting later than three hours from symptom onset after two clinical trials showed no clinical benefit when treating in this time frame. Activase is approved for the treatment of AIS within three hours of symptom onset.

- The AIDS Clinical Trials Group completed a Phase II trial of Genentech's Neuleze for the potential treatment of HIV-associated neuropathy and presented positive preliminary results.
- Began Phase II trials of:
  - vascular endothelial growth factor (VEGF) for the potential treatment of coronary artery disease
  - an anti-VEGF antibody in patients with advanced solid tumors
  - an anti-CD18 antibody for the potential treatment of acute myocardial infarction.
- Through partner LeukoSite, Inc., began Phase Ib/IIa trials of LDP-02 in patients with ulcerative colitis (an inflammatory bowel disease) in Canada and Europe.

3 Invest in Our People

- Named to *FORTUNE* magazine's annual list of "100 Best Companies to Work for in America."
- Celebrated the 10th anniversary of Genentech's Second Generation child care center — one of the largest corporate-sponsored daycare centers in the country.
- Introduced a variety of new programs for employees, including charitable contribution matching, a retiree medical account and a grant program to support child care alternatives at Genentech's Vacaville site.
- Named Stephen G. Juelsgaard as senior vice president, general counsel and secretary and named Dennis J. Henner, Ph.D., as senior vice president — Research.
- Named J. Joseph Barta as vice president — Quality; Stephen G. Dilly, M.D., Ph.D., as vice president — Medical Affairs; David A. Ebersman as vice president — Product Developement; Sean A. Johnston, Ph.D., as vice president — Intellectual Property; and Walter K. Moore as vice president — Government Affairs.
- Named Steven Shak, M.D., as staff scientist in Medical Affairs.

4 Leverage Our Assets

- Entered into an agreement with Roche providing Roche exclusive ex-U.S. marketing rights for Herceptin. As part of the agreement, Roche paid $40 million to Genentech.
- Agreed with DAKO A/S for DAKO to develop a laboratory diagnostic kit to screen breast cancer patients for over-expression of HER2 and potential eligibility for Herceptin treatment. DAKO received FDA approval on September 25, 1998, for its diagnostic kit, HercepTest™.
- Entered into an agreement with Schwarz Pharma AG for the development and distribution of Nutropin and Nutropin Depot for the treatment of certain pediatric and adult growth disorders in Europe and certain other countries outside of the United States, Canada and Japan.
- Licensed to Connetics Corporation the U.S. development and marketing rights to interferon gamma, including Actimmune, for the management of chronic granulomatous disease and the potential treatment of various other diseases.
- Agreed with Abgenix, Inc. that it will provide Genentech access to Abgenix's XenoMouse™ technology for generating fully human antibodies.
- Agreed with Protein Design Labs, Inc. to cross-license rights to certain intellectual property in the field of monoclonal antibodies.
- Made $2 million milestone payment to partner XOMA Ltd. for its successful completion of Phase II clinical trials of Genentech's anti-CD11a antibody (hu1124) for the potential treatment of psoriasis.
- Completed Phase III studies with pimagedine. The drug did not demonstrate clinical benefit based on analysis of the primary endpoints. Genentech has terminated its support of pimagedine development and is in discussions with Alteon Inc. as to the future direction of the collaboration.
- Discontinued relationship with CytoTherapeutics, Inc. for the development of encapsulated delivery of nervous system compounds.

5 Improve Our Financial Returns

- 1998 net income: $181.9 million.
- 1998 diluted earning per share: $1.40.
- 1998 net income as a percent of revenues: 16 percent.

Actimmune® (Interferon gamma-1b); Activase® (Alteplase, recombinant), a tissue-plasminogen activator (t-PA); Herceptin® (Trastuzumab) anti-HER2 antibody; Neuleze™ nerve growth factor; Nutropin® [somatropin (rDNA origin) for injection] growth hormone; Nutropin AQ® [somatropin (rDNA origin) injection] liquid formulation growth hormone; Nutropin Depot™ encapsulated sustained-release growth hormone; Protropin® (somatrem for injection) growth hormone; Pulmozyme® (dornase alfa, recombinant) Inhalation Solution; Rituxan® (Rituximab); Xubix™ (sibrafiban) oral IIb/IIIa antagonist.

in business for results

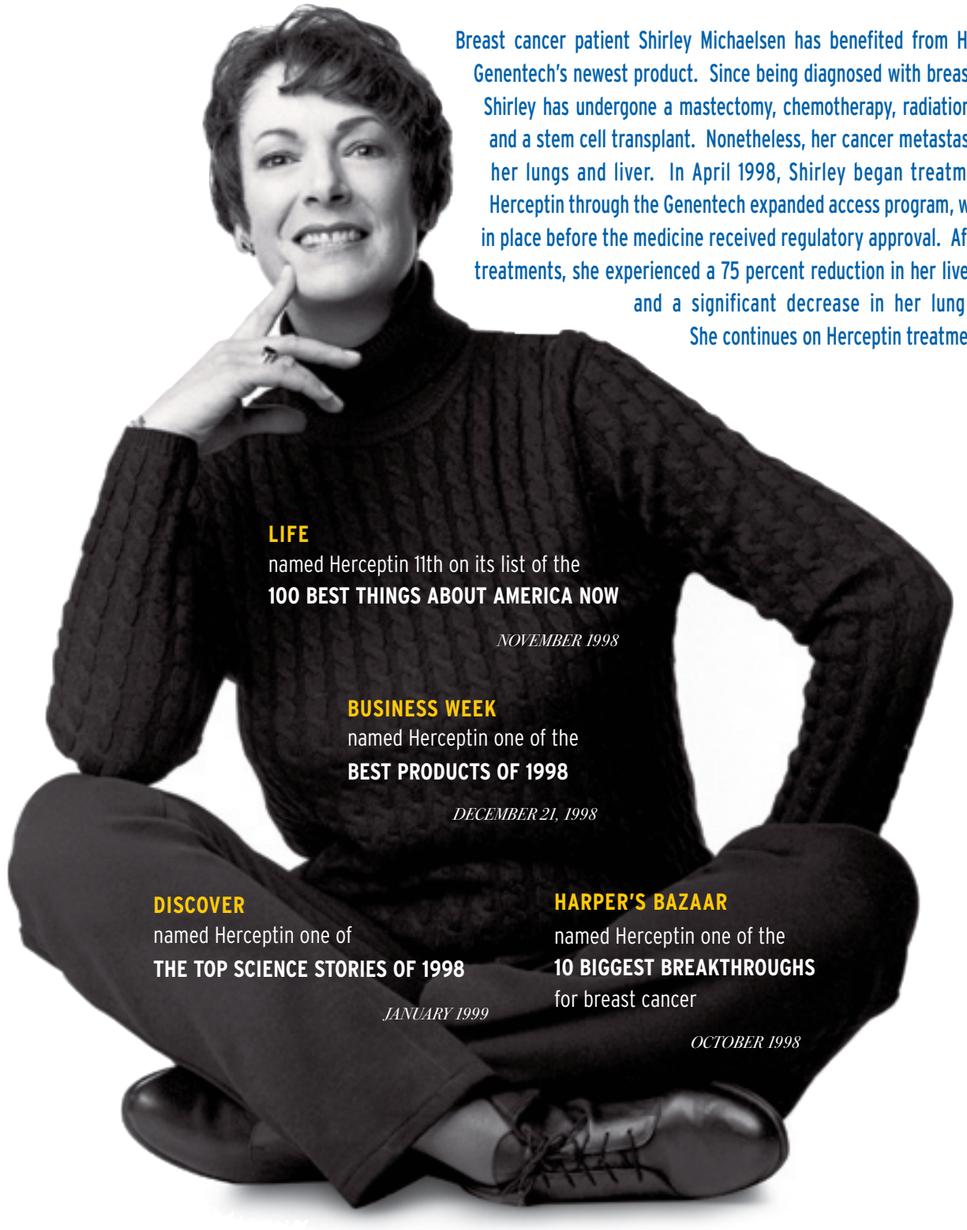
5 Improve Our Financial Returns

To continue to be in business for life, Genentech must also be in business for results. By striving to improve financial returns, Genentech aims to build value for stockholders, new opportunities for employees and a foundation to continue the pursuit of excellent science addressing further unmet needs.

Genentech's ability to help people is dependent upon its business success. The final component of Genentech's five-point strategy for growth is to "Improve Financial Returns." Success in doing so will stem from success with the first four components of that strategy. But it will also require success with Genentech's efforts to increase productivity while carefully managing costs. While Genentech expects that expenses will continue to increase in absolute terms as the company moves projects through its clinical pipeline, it will seek to decrease expenses as a percent of revenues as revenues increase with new-product introductions. In the 21st century, Genentech seeks to achieve a level of profitable growth and productivity — when measured by net income as a percentage of revenues — that is in the top quartile of the biopharmaceutical industry. An ambitious goal, yes. One that might not be achieved due to many factors, some of which — like changes in the industry — are beyond the company's control. But Genentech believes it has laid the groundwork to accomplish this goal.

From its founding, Genentech's efforts have helped people. They have helped employees by providing unparalleled career opportunities. They have provided stockholders with a unique investment opportunity. Since the company launched its first product, Protropin, through the introduction of its latest, Herceptin, the company's efforts have helped hundreds of thousands of patients.

Now 23, former Protropin patient Chris Ratteree benefited from Genentech's first product, Protropin. Chris was treated for growth hormone deficiency with a Genentech growth hormone product from 1989 to 1994. In high school, Chris wrote a biology paper about how taking Protropin changed his life by boosting his confidence.



Breast cancer patient Shirley Michaelsen has benefited from Herceptin, Genentech's newest product. Since being diagnosed with breast cancer, Shirley has undergone a mastectomy, chemotherapy, radiation therapy and a stem cell transplant. Nonetheless, her cancer metastasized into her lungs and liver. In April 1998, Shirley began treatment with Herceptin through the Genentech expanded access program, which was in place before the medicine received regulatory approval. After eight treatments, she experienced a 75 percent reduction in her liver tumors and a significant decrease in her lung tumors. She continues on Herceptin treatment today.

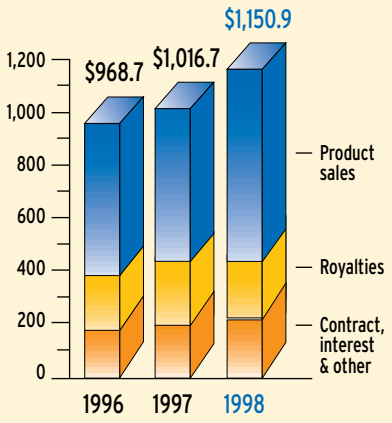
Genentech's strategy seeks to take the company's business to new heights. Achieving the goals of the strategy and Long-Range Plan will enable Genentech to continue its pursuit of excellent science. It will provide exciting new opportunities for even more employees, while at the same time building value for stockholders. Most important, it will allow Genentech to help even more patients. Thanks to a solid business plan, Genentech truly is in business for life.

Financial Highlights

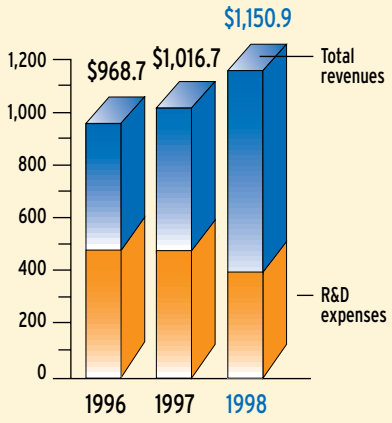
(dollars in millions, except per share data)

Years ended December 31	1998	1997	1996	% Change from Preceding Year 1998	1997
Total revenues	$ 1,150.9	$ 1,016.7	$ 968.7	13%	5%
Product sales	717.8	584.9	582.8	23	–
Cost of sales	138.6	102.5	104.5	35	(2)
Research and development (R&D) expenses	396.2	470.9	471.1	(16)	–
Marketing, general and administrative expenses	358.9	269.9	240.1	33	12
Net income	181.9	129.0	118.3	41	9
Diluted earnings per share	1.40	1.02	0.95	37	7
R&D expense as a % of revenues	34%	46%	49%		
Net income as a % of revenues	16%	13%	12%		
Shares used to compute diluted earnings per share (millions)	129.9	126.4	124.0	3	2
Actual shares at year-end (millions)	127.1	124.2	121.4	2	2
Stock price at year-end	$ 79.69	$ 60.63	$ 53.63	31	13
The Company has paid no dividends					
Cash, short-term investments and long-term marketable securities	$ 1,604.6	$ 1,286.5	$ 1,159.1	25	11
Property, plant and equipment, net	700.2	683.3	586.2	2	17
Total assets	2,855.4	2,507.6	2,226.4	14	13
Total stockholders' equity	2,343.8	2,031.2	1,801.1	15	13
Capital expenditures	88.1	154.9	141.8	(43)	9
Number of stockholders of record	13,374	15,122	16,748	(12)	(10)
Number of employees	3,389	3,242	3,071	5	6

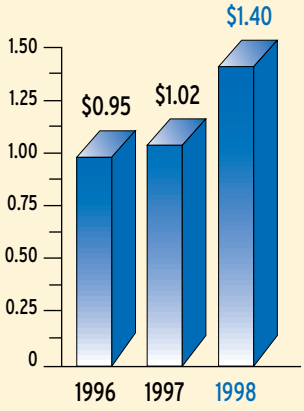
Revenues



R&D Expenses and Total Revenues



Diluted Earnings Per Share

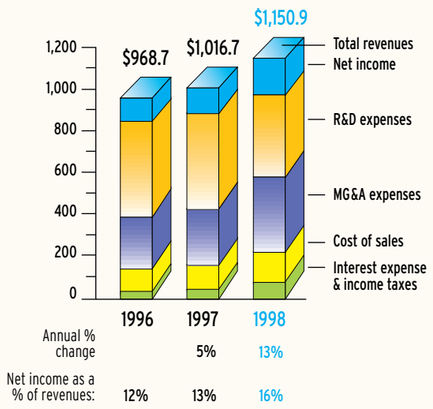


Financial Review

(dollars in millions, except per share amounts)

Financial Contents

Distribution of Revenue Dollars



Overview

Genentech, Inc. (the Company) is a biotechnology company that uses human genetic information to discover, develop, manufacture and market human pharmaceuticals for significant unmet medical needs. Twelve of the approved products of biotechnology stem from Genentech science. The Company manufactures and markets eight products (see *Actimmune* discussion below) directly in the United States (U.S.), including:

- Herceptin® (trastuzumab) for the treatment of patients with metastatic breast cancer whose tumors overexpress the human epidermal growth factor receptor2 (HER2) protein;
- Rituxan® (rituximab) for the treatment of patients with relapsed or refractory low-grade or follicular, CD20-positive B-cell non-Hodgkins lymphoma;
- Activase® (alteplase, recombinant) a tissue plasminogen activator (t-PA) for the treatment of heart attack, acute ischemic stroke and acute massive pulmonary embolism;
- Protropin® (somatrem for injection) growth hormone for the treatment of growth hormone deficiency (GHD) in children;
- Nutropin® [somatropin (rDNA origin) for injection] growth hormone for the treatment of GHD in children and in adults, growth failure associated with chronic renal insufficiency (CRI) prior to kidney transplantation and short stature associated with Turner syndrome;
- Nutropin AQ® [somatropin (rDNA origin) injection], a liquid formulation of Nutropin for the same indications as Nutropin;
- Pulmozyme® (dornase alfa, recombinant) inhalation solution for the management of cystic fibrosis; and
- Actimmune® (interferon gamma-1b) for the treatment of chronic granulomatous disease, a rare, inherited disorder of the immune system. In 1998, the Company licensed its marketing and development rights to Actimmune to Connetics Corporation (Connetics). Following a transition period ending January 1999, the Company will no longer market Actimmune, and Connetics has agreed to pay the Company royalties on its sales of Actimmune.

The Company receives royalties on sales of its products outside of the United States from F. Hoffmann-La Roche Ltd (HLR), a subsidiary of Roche Holdings, Inc. (Roche) (see below for further discussion). The Company also receives royalties on sales of growth hormone and t-PA outside of the U.S. and Canada through other licensees. The Company receives worldwide royalties on five additional licensed products, and received royalties on one other licensed product for which those royalties expired in August 1998 (see below), that originated from the Company's technology and are marketed by other companies.

Relationship with Roche Holdings, Inc.

On June 30, 1999, Roche's option to cause the Company to redeem (call) the outstanding Callable Putable Common Stock (Special Common Stock) of the Company at predetermined prices will expire. This arrangement was the result of the October 1995 agreement (the Agreement) between the Company and Roche. Should the call be exercised, Roche will concurrently purchase from the Company a like number of shares of Common Stock for a price equal to the Company's cost to redeem the Special Common Stock. If Roche does not cause the redemption as of June 30, 1999, within thirty business days commencing July 1, 1999, the Company's stockholders will have the option (put) to cause the Company to redeem none, some, or all of their shares of Special Common Stock at $60.00 per share (and Roche will concurrently provide the necessary redemption funds to the Company by purchasing a like number of shares of Common Stock at $60.00 per share).

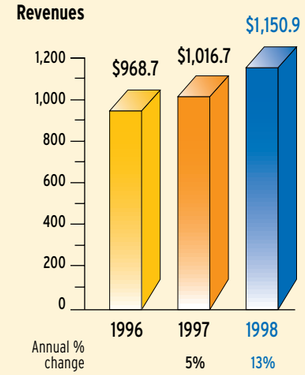
In conjunction with the Agreement, HLR was granted an option for ten years for licenses to use and sell certain of the Company's products in non-U.S. markets (the License Agreement). As of May 1997, the Company and HLR agreed in principle to changes to the License Agreement that, in general, allow for the sharing of U.S. and European development costs regardless of location or purpose of studies. Under the License Agreement, as revised, HLR may exercise its option to license any such future product of the Company either when the Company determines to move such product into development or at the end of Phase II clinical trials. Also, as part of this Agreement, the Company receives royalties on sales of certain of its products in Canada, on sales of Pulmozyme outside of the U.S. and on sales of rituximab outside of the U.S., excluding Japan.

In addition, on July 6, 1998, the Company entered into an agreement with HLR to provide HLR exclusive marketing rights outside of the U.S. for Herceptin. Under the agreement, HLR paid $40.0 million and has agreed to pay cash milestones tied to future product development activities, to contribute equally with the Company up to a maximum of $40.0 million on global development costs and to make royalty payments on product sales. As of December 31, 1998, no additional amounts have been paid.

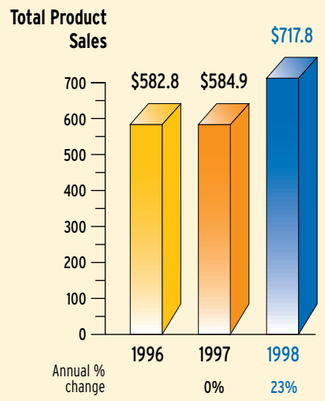
See the *Relationship with Roche Holdings, Inc.* note in the *Notes to Consolidated Financial Statements* for further information.

Results of Operations

(dollars in millions, except per share amounts)



Revenues for 1998 increased from 1997 primarily as a result of higher product sales. Revenues for 1997 increased from 1996 in all areas, but primarily from royalties and contract revenues.

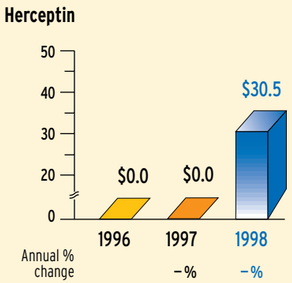


Product sales increased in 1998 as a result of a full year of Rituxan sales and initial Herceptin sales. These increases were partly offset by lower Activase and growth hormone sales. Product sales in 1997 increased over 1996 due to increases in Pulmozyme, growth hormone, new sales from the introduction of Rituxan, offset by a decrease in Activase sales. Product sales

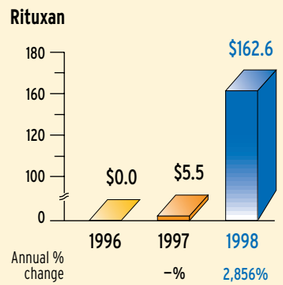
Financial Review

(continued)

to HLR in conjunction with the License Agreement were $28.7 million in 1998, $17.4 million in 1997, and $13.2 million in 1996.



Herceptin: In September 1998, the Company received U.S. Food and Drug Administration (FDA) approval to market Herceptin in the U.S. for use as first line therapy in combination with paclitaxel and as a single agent in second and third line therapy in patients with metastatic breast cancer who have tumors that overexpress the HER2 protein. The Company recorded $30.5 million of initial net sales of Herceptin in 1998. However, not enough time has passed for this figure to be indicative of the future trend of Herceptin sales. Herceptin is the first humanized monoclonal antibody for the treatment of HER2 overexpressing metastatic breast cancer and the second U.S. approval in this new class of biotherapeutic cancer drugs; the first was Rituxan, which was approved in November 1997. Pursuant to an agreement entered into with the Company, HLR received exclusive marketing rights to Herceptin outside of the U.S.



Rituxan: Rituxan was approved for marketing by the FDA in late November 1997. The Company launched Rituxan on December 16, 1997, and recorded initial sales of $5.5 million for 1997. Net sales of Rituxan were $162.6 million in 1998. The increase from 1997 was the result of one full year of sales. Rituxan was co-developed by the Company and IDEC Pharmaceuticals Corporation (IDEC), from whom the Company licenses Rituxan, and is the first monoclonal antibody approved to treat cancer. IDEC and the Company are jointly promoting Rituxan in the U.S. and share responsibility for the manufacturing of the product. HLR holds marketing rights for MabThera™ (rituximab) outside of the U.S., excluding Japan, and has agreed to pay to the Company royalties and a mark-up on MabThera supplied to HLR.

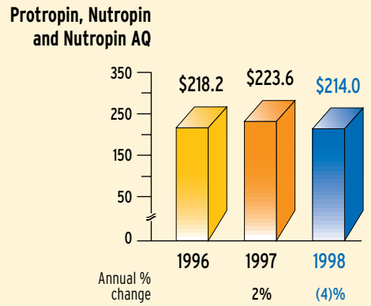
In December 1998, a letter was sent to physicians advising them of some deaths associated with administration of Rituxan. As a result, the Company and IDEC have updated the Warning section of the package insert to include information on infusion-related reactions and cardiovascular events.

During the first quarter of 1998, the Company received FDA approval for the large-scale (12,000-liter) manufacture of rituximab. Rituximab manufactured by the Company will supplement the rituximab manufactured by IDEC on the Company's behalf. Also in 1998, the Company's and IDEC's partner, HLR, received approval from the European Commission to market rituximab under the tradename MabThera in the European Union.

Activase: Sales of Activase in 1998 and 1997 decreased primarily due to a competitive thrombolytic agent, Centocor Inc.'s (Centocor) Retavase®. This decrease also resulted, to a lesser extent, from a decline in the size of the thrombolytic market due to increasing use of mechanical reperfusion and from a temporary decrease in the available commercial market due to patients receiving therapy through large recently completed Phase III clinical trials.

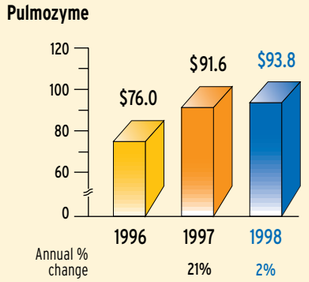
In March 1998, the Company received two new patents related to variant forms of t-PA. Based on these patents, the Company filed an infringement action against Centocor in the Northern District of California which alleges that Centocor's sale, offer for sale, use in, and importation into, the U.S. of Retavase (reteplase, recombinant), a t-PA, infringes these two new patents of the Company. The Company is seeking a permanent injunction and damages.

In July 1998, the Company discontinued development of Activase for treating acute ischemic stroke (AIS) in patients presenting later than three hours from symptom onset after the termination of two clinical trials, one in AIS patients presenting three to five hours from symptom onset, and another in AIS patients presenting zero to six hours from symptom onset. Neither study showed clinical benefit. Activase is approved for the treatment of AIS within three hours of symptom onset.



Protropin, Nutropin and Nutropin AQ: Net sales of the Company's three growth hormone products – Protropin, Nutropin and Nutropin AQ, decreased in 1998 from 1997, but increased slightly in 1997 from 1996. A small loss of market share has been seen in 1998 due to increased competition. The Company continues to face increased competition from five other companies with growth hormone products, although one company has been preliminarily enjoined from selling its product. In December 1997, the Company received approval from the FDA to market Nutropin and Nutropin AQ, respectively, in the U.S. for the treatment of growth hormone deficiency in adults. In December 1996 and January 1997, the Company received approval from the FDA to market Nutropin and Nutropin AQ, respectively, in the U.S. for the treatment of short stature associated with Turner syndrome.

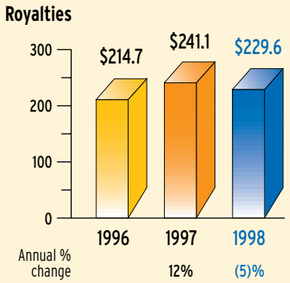
Pulmozyme: Net sales of Pulmozyme were slightly higher in 1998 compared to 1997 as a result of new patients in the mild to moderate cystic fibrosis (CF) patient population in addition to new patients from the 1998 FDA approval for a label extension to include CF patients under the age of five. Net sales in 1997 were higher primarily due to continued penetration in the mild to moderate CF patient populations as well as from



variations in customer ordering patterns for U.S. sales. In February 1998, the Company received approval from the FDA for a label extension which includes the safety and alternative administration of Pulmozyme in children with CF under the age of five, adding to the product's previous approvals for patients five years of age and older. In November 1996, Pulmozyme was approved by the FDA for marketing in the U.S. for the management of CF patients with advanced disease.

				Annual % Change	
	1998	1997	1996	**98/97**	97/96
Actimmune	**$ 3.9**	$ 3.5	$ 4.5	**11**	(22)

Actimmune: In the second quarter of 1998, the Company licensed U.S. marketing and development rights to interferon gamma, including Actimmune, to Connetics. Following a transition period ending January 1999, the Company will no longer market Actimmune, but has agreed to supply bulk materials to Connetics at cost plus a mark-up. The Company will receive royalties on Connetics' sales of Actimmune.

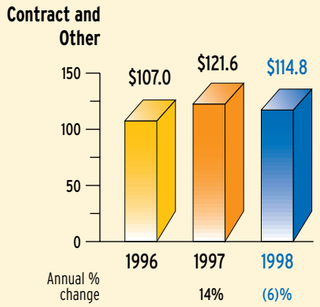


Total royalties decreased in 1998 over 1997 due to the expiration of royalties from Eli Lilly and Company (Lilly) in August 1998. Royalties in 1997 increased over 1996 primarily due to

Financial Review

(continued)

increased licensee sales from various licensees. Under a December 1994 settlement agreement with Lilly, royalties of $30.0 million per year were payable, subject to possible offsets and contingent upon Humulin® continuing to be marketed in the U.S., to the Company through 1998. These royalty obligations have now expired. Under a prior license agreement with Lilly, the Company received royalties from Lilly's sales of its human insulin product until this royalty obligation expired in August 1998. Cash flows from royalty income include nondollar denominated revenues. The Company currently purchases simple foreign currency put option contracts (options) to hedge these royalty cash flows. All options expire within the next two years. See below for discussion of market risks related to these financial instruments.



Contract and other revenues in 1998 decreased from 1997 as a result of higher 1997 contract payments and gains from the sale of biotechnology equity securities. Although the Company received significant nonrecurring payments from HLR for exclusive marketing rights outside of the U.S. for Herceptin (discussed above) and from Novo Nordisk A/S (Novo) on the patent infringement litigation settlement (discussed below), other contract revenues from HLR decreased significantly from 1997 primarily due to the discontinuation of several projects or indications in development. Contract and other revenues were higher in 1997 compared to 1996 primarily due to $30.9 million from Sumitomo Pharmaceuticals Co., Ltd. (Sumitomo) and Pharmacia & Upjohn (P&U) for strategic alliances and $11.7 million of gains from the sale of biotechnology equity securities in 1997. These increases were partly offset by higher revenues from HLR in 1996.

In July 1998, the Company and Novo agreed to settle a lawsuit brought by the Company in the U.S. District Court for the Southern District of New York relating to the Company's patents for human growth hormone and insulin and a lawsuit brought in October 1997, by Novo in the U.S. District Court for the District of New Jersey alleging infringement of a patent held by Novo relating to the Company's manufacture, use and sale of its Nutropin human growth hormone products. Under the settlement agreement, Novo and the Company agreed to cross-license worldwide certain patents relating to human growth hormone. In August 1998, Novo received a worldwide license under the Company patents relating to insulin and the Company received certain payments from Novo that were recorded in contract revenues.

As part of a strategic alliance with Sumitomo, the Company has agreed to provide Sumitomo exclusive distributorship rights in Japan for Nutropin AQ and a sustained release formulation of human growth hormone.

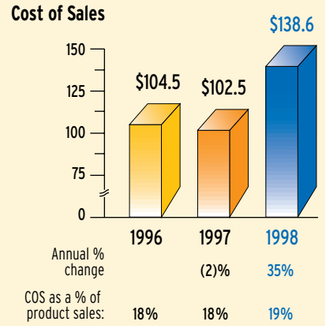
In an agreement with P&U, in exchange for development costs, fees and, upon regulatory approval, royalties, the Company agreed to provide P&U exclusive worldwide rights for thrombopoietin (TPO), which is in Phase II trials for potential use in treating patients with complications of cancer chemotherapy. P&U and the Company are jointly developing TPO for one indication; however, the Company has no marketing rights for this indication.

The Company recorded nonrecurring contract revenues from HLR of $40.0 million for Herceptin marketing rights outside of the U.S. in 1998 and $44.7 million for the exercise of their options under the License Agreement with respect to three development projects [Rituxan, insulin-like growth factor (IGF-I) which was subsequently terminated, and nerve growth factor] in 1996. All other contract revenue from HLR, including reimbursement for ongoing development expenses after the option exercise date, totaled $21.6 million in 1998, $67.6 million in 1997 and $50.6 million in 1996.

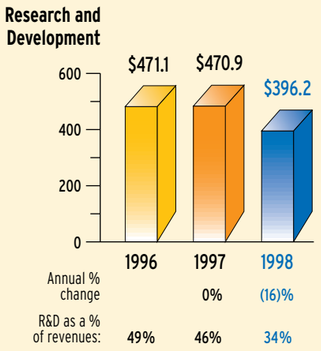
				Annual % Change	
	1998	1997	1996	**98/97**	97/96
Interest income	**$ 88.7**	$ 69.1	$ 64.2	**28**	8

Interest income increased in 1998 primarily due to an increase in the investment portfolio and, to a lesser extent, a higher average yield on the investment portfolio. The increase in 1997 from 1996 was due to an increase in the average yield on the investment portfolio. The Company enters into interest rate swaps (swaps) as part of its overall strategy of managing the duration of its investment portfolio. See below for discussion of market risks related to these swaps and also the *Financial Instruments* note in the *Notes to Consolidated Financial Statements*.

Total Costs and Expenses				Annual % Change	
	1998	1997	1996	**98/97**	97/96
Total costs and expenses	**$ 898.3**	$ 846.9	$ 820.8	**6**	3
% of revenues	**78%**	83%	85%		

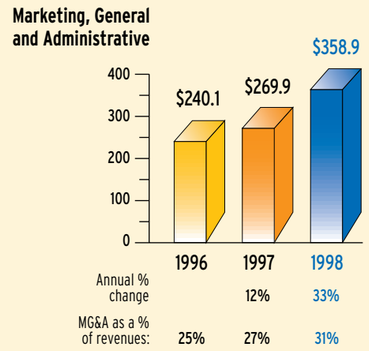


Cost of sales as a percent of product sales increased in 1998 to 19%. This increase was primarily the result of increased sales to HLR as well as a shift in the product mix, including the first full year of Rituxan sales and the introduction of Herceptin. Cost of sales as a percent of product sales was 18% in 1997, which was comparable to 1996. The economic benefits from sales to HLR are reflected in product sales and royalties.



Research and development (R&D) expenses decreased in 1998 from 1997 primarily due to the wind-down of certain large late-stage clinical trials and lower costs to license technology from third parties. These decreases were partly offset by higher costs related to large scale development collaborations. In 1997, R&D expenses were flat compared to 1996. R&D as a percentage of revenues decreased to 34% in 1998, from 46% in 1997 and from 49% in 1996. The decrease in this percentage from year to year reflects growing revenues and more recently in 1998 a decrease in R&D expenses.

To gain additional access to potential new products and technologies, and to utilize other companies to help develop the Company's potential new products, the Company has established strategic alliances with companies developing technologies that fall outside the Company's research focus and with companies having the potential to generate new products through technology exchanges and investments. This has included the acquisition by the Company of the equity and convertible debt of such companies. The Company has also entered into product-specific collaborations to acquire development and marketing rights for products.



Marketing, general and administrative (MG&A) expenses increased in 1998 from 1997. The marketing and sales (M&S) increases were driven by the introduction of Rituxan and the resultant profit sharing with IDEC, the launch of Herceptin, and the defense of Activase and the Company's growth hormone products against new competition and the launch of a new indication, growth hormone deficiency in adults, for Nutropin and Nutropin AQ. General and administrative expenses were higher principally as a result of the write down of certain biotechnology equity securities. MG&A expenses were also higher in 1997 compared to 1996

Financial Review
(continued)

primarily due to increased M&S expenses in the oncology area and competitive conditions with other marketed products.

				Annual % Change	
	1998	1997	1996	**98/97**	97/96
Interest expense	**$ 4.6**	$ 3.6	$ 5.1	**28**	(29)

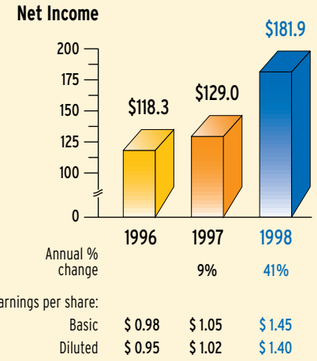
Interest expense will fluctuate depending on the amount of capitalized interest related to the amount of construction projects. Interest expense, net of amounts capitalized, relates to interest on the Company's 5% convertible subordinated debentures.

Income Before Taxes and Income Taxes

	1998	1997	1996
Income before taxes	**$ 252.6**	$ 169.8	$ 147.9
Income tax provision	**70.7**	40.8	29.6
Effective tax rate	**28%**	24%	20%

The Company's effective tax rate increased in 1998 over 1997 to 28%. This increase is primarily due to the decreased benefit of R&D tax credits. The tax rate for 1998 and 1997 reflected the legislative extension of R&D tax credits effective beginning in the third quarter of 1997. The increase in the effective tax rate in 1997 over 1996 was attributable to the proportionally decreased realization of previously reserved deferred tax assets. The valuation allowance for deferred tax assets was fully realized in 1996, with the exception of the portion attributable to the realization of tax benefits on stock option deductions which will be credited to additional paid-in-capital when realized. The effective tax rate in 1998, 1997 and 1996 was less than the U.S. statutory rate of 35% due in part to the R&D tax credits, tax benefit of certain realized gains on securities available-for-sale, and realized foreign losses, except in 1997.

The increase in net income in 1998 from 1997 was driven primarily by sales of Rituxan and Herceptin, lower R&D expenses and higher interest income. These revenue increases and savings were partly offset by higher MG&A expenses, a decrease in Activase sales, higher cost of sales and higher income



taxes. Net income in 1997 increased over 1996 primarily due to higher royalties and contract and other revenues partly offset by higher MG&A expenses.

Liquidity and Capital Resources

	1998	1997	1996
Cash, cash equivalents, short-term investments and long-term marketable debt and equity securities	**$ 1,604.6**	$ 1,286.5	$ 1,159.1
Working capital	**950.6**	904.4	705.1
Cash provided by (used in):			
Operating activities	**349.9**	118.3	139.7
Investing activities	**(421.1)**	(168.4)	(141.7)
Financing activities	**107.9**	87.3	72.2
Capital expenditures (included in investing activities above)	**(88.1)**	(154.9)	(141.8)
Current ratio	**4.3:1**	4.1:1	3.8:1

Cash generated from operations, income from investments and proceeds from stock issuances were used to purchase marketable securities and make capital investments in 1998.

Capital expenditures in 1998 included improvements to existing office and laboratory facilities and equipment, and equipment purchases. In 1997, capital expenditures primarily included building improvements to existing manufacturing and office facilities and production systems. In 1996, capital expenditures primarily included building and land purchases and improvements to existing manufacturing and office facilities.

Forward-Looking Statements

The following section contains forward-looking statements that are based on the Company's current expectations. Because the Company's actual results may differ materially from these and any other forward-looking statements made by or on behalf of the Company, this section also includes a discussion of important factors that could affect the Company's actual future results, including its product sales, royalties, contract revenues, expenses and net income.

Product Sales: The Company's product sales may vary from period to period for several reasons including, but not limited to: the overall competitive environment for the Company's products; the amount of sales to customers in the U.S.; the amount and timing of the Company's sales to HLR; the timing and volume of bulk shipments to licensees; the availability of third-party reimbursements for the cost of therapy; the effectiveness and safety of the products; the rate of adoption and use of the Company's products for approved indications and additional indications; and the potential introduction of new products and additional indications for existing products in 1999 and beyond.

Competition: The Company faces growing competition in two of its therapeutic markets and expects new competition in a third. First, Activase lost market share and could lose additional market share in the thrombolytic market to Centocor's Retavase and the resulting adverse effect on sales could be material. Retavase received FDA approval in October 1996 for the treatment of AMI. In addition, there is an increasing use of mechanical reperfusion in lieu of thrombolytic therapy for the treatment of AMI, which is expected to continue. Second, in the growth hormone market, the Company continues to face increased competition from five other companies with growth hormone products, although one company has been preliminarily enjoined from selling its product. As a result of this competition, the Company has experienced a loss in new patient market share. Four of these competitors have also received approval to market their existing human growth hormone products for additional indications. The Company expects that such competition could have an adverse effect on its sales of Protropin, Nutropin and Nutropin AQ and such effect could be material. Third, in the NHL market, Coulter recently filed for approval with the FDA with respect to a product for a similar indication for which Rituxan is approved. Genentech is aware of other potentially competitive biologic therapies in development.

Other competitive factors affecting the Company's product sales include, but are not limited to: the timing of FDA approval, if any, of additional competitive products, pricing decisions made by the Company, the degree of patent protection afforded to particular products, the outcome of litigation involving the Company's patents and patents of competing companies for products and processes related to production and formulation of those products, the increasing use and development of alternate therapies, and the rate of market penetration by competing products.

Royalty and Contract Revenues: Royalty and contract revenues in future periods could vary significantly from 1998 levels. Major factors affecting these revenues include, but are not limited to: HLR's decisions to exercise or not to exercise its option to develop and sell the Company's future products in non-U.S. markets and the timing and amount of related development cost reimbursements, if any; variations in HLR's sales and other licensees' sales of licensed products; fluctuations in foreign currency exchange rates; the initiation of other new contractual arrangements with other companies; the timing of non-U.S. approvals, if any, for products licensed to HLR and other licensees; whether and when contract benchmarks are achieved; and the conclusion of existing arrangements with other companies and HLR.

R&D: The Company is committed to aggressive R&D investment to discover and develop new products. The Company currently has several products in late-stage clinical testing and anticipates that its R&D expenses will continue at a high percentage of revenues over the short-term. Over the long-term, as revenues increase, R&D as a percent of revenues should decrease to the 20% to 25% range.

Successful pharmaceutical product development is highly uncertain and is dependent on numerous factors, many of which are beyond the Company's control. Products that appear promising in the early phases of development may fail to reach the market for numerous reasons: they may be found to be ineffective or to have harmful side effects in preclinical or clinical testing; they may fail to receive necessary regulatory approvals; they may turn out to be uneconomical because of manufacturing costs or other factors; or they may be precluded from commercialization by the proprietary rights of others or by competing products or technologies for the same indication. Success in preclinical and early clinical trials does not ensure that large scale clinical trials will be successful. Clinical results are frequently susceptible to varying interpretations that may delay, limit or prevent regulatory approvals. The length of time necessary to complete clinical trials and to submit an application for marketing approval for a final decision by a regulatory authority varies significantly

and may be difficult to predict. Factors affecting the Company's R&D expenses include, but are not limited to: the number of and the outcome of clinical trials currently being conducted by the Company and/or its collaborators; the number of products entering into development from late-stage research; in-licensing activities, including the timing and amount of related development funding or milestone payments; and future levels of revenues.

Income Tax Provision: The Company expects its effective tax rate to be at or near 35% for the next several years dependent upon several factors. These factors include, but are not limited to, changes in tax laws and rates, interpretation of existing tax laws, future levels of R&D spending, the outcome of clinical trials of certain development products, the Company's success in commercializing such products, and potential competition regarding the products.

Uncertainties Surrounding Proprietary Rights: The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. Accordingly, the breadth of claims allowed in such companies' patents cannot be predicted. Patent disputes are frequent and can preclude commercialization of products. The Company has in the past been, is currently, and may in the future be involved in material patent litigation. Such litigation is costly in its own right and could subject the Company to significant liabilities to third-parties and, if decided adversely, the Company may need to obtain third-party licenses at a material cost or cease using the technology or product in dispute. The presence of patents or other proprietary rights belonging to other parties may lead to the termination of R&D of a particular product. The Company believes it has strong patent protection or the potential for strong patent protection for a number of its products that generate sales and royalty revenue or that the Company is developing; however, the courts will determine the ultimate strength of patent protection of the Company's products and those on which the Company earns royalties.

Year 2000: The Company uses and relies on a wide variety of information technologies, computer systems and scientific and manufacturing equipment containing computer related components (such as programmable logic controllers and other embedded systems). Some of the Company's older computer software programs and equipment are unable to distinguish between the year 1900 and the year 2000. As a result, time-sensitive functions of those software programs and equipment may misinterpret dates after January 1, 2000, to refer to the twentieth century rather than the twenty-first century. This could cause system or equipment shutdowns, failures or miscalculations resulting in inaccuracies in computer output or disruptions of operations, including, among other things, inaccurate processing of financial information and/or temporary inabilities to process transactions, manufacture products, or engage in similar normal business activities.

The Company has a Year 2000 Project (Y2K Project) in place to address the potential exposures related to the impact on its computer systems and scientific and manufacturing equipment containing computer related components for the Year 2000 and beyond. Approximately half of the Company's Year 2000 (Y2K) scheduled work is complete. The remaining work is scheduled to be completed by the end of the third quarter of 1999. The Y2K Project phases include: (1) inventorying and prioritizing business critical systems; (2) Y2K compliance analysis; (3) remediation activities including repairing or replacing identified systems; (4) testing; and (5) developing contingency plans.

An inventory of business critical financial, informational and operational systems, including manufacturing control systems, has been completed. Compliance analysis is approximately 80% complete for these systems. Remediation activities vary by department, however, on the average, remediation activities are approximately 50% complete. Testing of the Company's information technology infrastructure is 60% complete. Testing of business critical application programs began in the third quarter of 1998, and is scheduled to be complete by the third quarter of 1999. Contingency planning will begin in the first quarter of 1999. The Company believes that with the completed modifications, the Y2K issue will not pose significant operational problems for its computer systems and equipment. However, if such modifications and conversions are not made, or are not completed in a timely fashion, the Year 2000 issue could have a material impact on the operations of the Company, the precise degree of which cannot be known at this time.

In addition to risks associated with the Company's own computer systems and equipment, the Company has relationships with, and is to varying degrees dependent upon, a large number of third parties that provide information, goods and services to the Company. These include financial institutions, suppliers, vendors, research partners, governmental entities and customers. If significant numbers of these third parties experience failures in their computer systems or equipment due to Year 2000 noncompliance, it could affect the Company's ability to process transactions, manufacture products, or engage in similar normal business activities. While some of these risks are outside the control of the Company, the Company has instituted programs, including internal records review and use of external questionnaires, to identify key third parties, assess their level of Year 2000 compliance, update contracts and address any noncompliance issues.

The total cost of the Year 2000 systems assessments and conversions is funded through operating cash flows and the Company is expensing these costs as they are incurred. The Company has created a mechanism to trace costs directly related to the Year 2000 issue and has budgeted funds to address the issues of assessment and conversion. The financial impact of making the required systems changes cannot be known precisely at this time, but it is currently expected to be less than $10.0 million. The actual financial impact could, however, exceed this estimate.

Liquidity: The Company believes that its cash, cash equivalents and short-term investments, together with funds provided by operations and leasing arrangements, will be sufficient to meet its foreseeable operating cash requirements. In addition, the Company believes it could access additional funds from the capital and debt markets. Factors affecting the Company's cash position include, but are not limited to, future levels of the Company's product sales, royalty and contract revenues, expenses, in-licensing activities, including the timing and amount of related development funding or milestone payments, and capital expenditures.

Roche Holdings, Inc.: At December 31, 1998, Roche held approximately 65.3% of the Company's outstanding common equity. The Company expects to continue to have material transactions with Roche, including royalty and contract revenues, product sales and joint product development costs. See also *Relationship with Roche Holdings, Inc.* note in *Notes to Consolidated Financial Statements* for a discussion of the terms of the put and call pursuant to the Agreement.

Market Risk: The Company is exposed to market risk, including changes to interest rates, foreign currency exchange rates and equity investment prices. To reduce the volatility relating to these exposures, the Company enters into various derivative investment transactions pursuant to the Company's investment and risk management policies and procedures in areas such as hedging and counterparty exposure practices. The Company does not use derivatives for speculative purposes.

A discussion of the Company's accounting policies for financial instruments and further disclosures relating to financial instruments is included in the *Description of Business and Significant Accounting Policies* and the *Financial Instruments* notes in the *Notes to Consolidated Financial Statements*.

The Company maintains risk management control systems to monitor the risks associated with interest rates, foreign currency exchange rates and equity investment price changes, and its derivative and financial instrument positions. The risk management control systems use analytical techniques, including sensitivity analysis and market values. Though the Company intends for its risk management control systems to be comprehensive, there are inherent risks which may only be partially offset by the Company's hedging programs should there be unfavorable movements in interest rates, foreign currency exchange rates or equity investment prices.

The estimated exposures discussed below are intended to measure the maximum amount the Company could lose from adverse market movements in interest rates, foreign currency exchange rates and equity investment prices, given a specified confidence level, over a given period of time. Loss is defined in the value at risk estimation as fair market value loss. The exposures to interest rate, foreign currency exchange rate and equity investment price changes are calculated based on proprietary modeling techniques from a Monte Carlo simulation value at risk model (value at risk model) using a 30-day holding period and a 95% confidence level. The value at risk model assumes non-linear financial returns and generates potential paths various market prices could take and tracks the hypothetical performance of a portfolio under each scenario to approximate its financial return. The value at risk model takes into account correlations and diversification across market factors, including interest rates, foreign currencies and equity prices. Market volatilities and correlations are based on JP Morgan Riskmetrics™ dataset as of December 31, 1998.

The Company evaluates this potential value at risk throughout the year. During 1998, there were no significant changes in the estimated exposures to market risk from those disclosed as of December 31, 1997.

Interest Rates – The Company's interest income is sensitive to changes in the general level of interest rates, primarily U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash equivalents, short-term investments, convertible preferred stock investments, convertible loans and long-term investments. To mitigate the impact of fluctuations in U.S. interest rates, the Company may enter into swap transactions, which involve the receipt of fixed rate interest and the payment of floating rate interest without the exchange of the underlying principal. By investing the Company's cash in an amount equal to the notional amount of the swap contract, with a maturity date equal to the maturity date of the floating rate obligation, the Company hedges itself from any potential earnings impact due to changes in interest rates.

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Based on the Company's overall interest rate exposure at December 31, 1998, including derivative and other interest rate sensitive instruments, a near-term change in interest rates, within a 95% confidence level based on historical interest rate movements, would not materially affect the fair value of interest rate sensitive instruments.

Foreign Currency Exchange Rates – The Company receives royalty revenues from licensees selling products in countries throughout the world. As a result, the Company's financial results could be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company's licensed products are sold. The Company is exposed to changes in exchange rates in Europe, Asia (primarily Japan) and Canada. The Company's exposure to foreign exchange rates primarily exists with the Euro. When the U.S. dollar strengthens against the currencies in these countries, the U.S. dollar value of non-U.S. dollar-based revenue decreases; when the U.S. dollar weakens, the U.S. dollar value of the non-U.S. dollar-based revenues increases. Accordingly, changes in exchange rates, and in particular a strengthening of the U.S. dollar, may adversely affect the Company's royalty revenues as expressed in U.S. dollars. In addition, as part of its overall investment strategy, the Company has a portion of its portfolio primarily in nondollar denominated investments. As a result, the Company is exposed to changes in the exchange rates of the countries in which these nondollar denominated investments are made.

To mitigate this risk, the Company hedges certain of its anticipated revenues by purchasing option contracts with expiration dates and amounts of currency that are based on 25% to 90% of probable future revenues so that the potential adverse impact of movements in currency exchange rates on the nondollar denominated revenues will be at least partly offset by an associated increase in the value of the option. The duration of these options is generally one to four years. The Company may also enter into foreign currency forward contracts (forward contracts) to lock in the dollar value of a portion of these anticipated revenues. The duration of these forward contracts is generally less than one year. Also, to hedge the nondollar denominated investments in the portfolio, the Company also enters into forward contracts.

Based on the Company's overall currency rate exposure at December 31, 1998, including derivative and other foreign currency sensitive instruments, a near-term change in currency rates within a 95% confidence level based on historical currency rate movements, would not materially affect the fair value of foreign currency sensitive instruments.

Equity Investment Securities – As part of its strategic alliance efforts, the Company invests in equity instruments of biotechnology companies that are subject to fluctuations from market value changes in stock prices. To mitigate this risk, certain equity securities are hedged with costless collars. A costless collar is a purchased put option and a written call option in which the cost of the purchased put and the proceeds of the written call offset each other; therefore, there is no initial cost or cash outflow for these instruments at the time of purchase. The purchased put protects the Company from a decline in the market value of the security below a certain minimum level (the put "strike" level), while the call effectively limits the Company's potential to benefit from an increase in the market value of the security above a certain maximum level (the call "strike" level). In addition, as part of its strategic alliance efforts, the Company holds dividend bearing convertible preferred stock and has made interest bearing loans that are convertible into the equity securities of the debtor.

Based on the Company's overall exposure to fluctuations from market value changes in marketable equity prices at December 31, 1998, a near-term change in equity prices within a 95% confidence level based on historic volatilities could result in a potential loss in fair value of the equity securities portfolio of $10.6 million.

Credit Risk of Counterparties: The Company could be exposed to losses related to the above financial instruments should one of its counterparties default. This risk is mitigated through credit monitoring procedures.

New Accounting Standard: In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (FAS) 133, "Accounting for Derivative Instruments and Hedging Activities," effective beginning in the first quarter of 2000. FAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires companies to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting under FAS 133. Based on the requirements of FAS 133, there may be changes to the balance sheet and reported assets and liabilities. The Company is currently evaluating the impact of FAS 133 on its financial position and results of operations.

Legal Proceedings: The Company is a party to various legal proceedings including patent infringement cases and other matters. See the *Leases, Commitments and Contingencies* note in the *Notes to Consolidated Financial Statements* for further information.

Report of Management

Genentech, Inc. is responsible for the preparation, integrity and fair presentation of its published financial statements. The Company has prepared the financial statements in accordance with generally accepted accounting principles. As such, the statements include amounts based on judgments and estimates made by management. The Company also prepared the other information included in the annual report and is responsible for its accuracy and consistency with the financial statements.

The financial statements have been audited by the independent auditing firm, Ernst & Young LLP, which was given unrestricted access to all financial records and related data, including minutes of all meetings of stockholders, the Board of Directors and committees of the Board. The Company believes that all representations made to the independent auditors during their audit were valid and appropriate. Ernst & Young LLP's audit report is included in this Annual Report.

Systems of internal accounting controls, applied by operating and financial management, are designed to provide reasonable assurance as to the integrity and reliability of the financial statements and reasonable, but not absolute, assurance that assets are safeguarded from unauthorized use or disposition, and that transactions are recorded according to management's policies and procedures. The Company continually reviews and modifies these systems, where appropriate, to maintain such assurance. Through the Company's general audit activities, the adequacy and effectiveness of the systems and controls are reviewed and the resultant findings are communicated to management and the Audit Committee of the Board of Directors.

The selection of Ernst & Young LLP as the Company's independent auditors has been approved by the Company's Board of Directors and ratified by the stockholders. The Audit Committee of the Board of Directors is composed of four non-management directors who meet regularly with management, the independent auditors and the general auditor, jointly and separately, to review the adequacy of internal accounting controls and auditing and financial reporting matters to ascertain that each is properly discharging its responsibilities.

/s/ Arthur D. Levinson

Arthur D. Levinson, Ph.D.
President and
Chief Executive Officer

/s/ Louis J. Lavigne, Jr.

Louis J. Lavigne, Jr.
Executive Vice President
and Chief Financial Officer

/s/ Bradford S. Goodwin

Bradford S. Goodwin
Vice President -
Finance

Consolidated Statements of Income

(thousands, except per share amounts)

Year ended December 31	1998	1997	1996
Revenues			
Product sales (including amounts from related parties: 1998–$28,738; 1997–$17,396; 1996–$13,216)	**$ 717,795**	$ 584,889	$ 582,829
Royalties (including amounts from related parties: 1998–$35,028; 1997–$25,362; 1996–$26,240)	**229,589**	241,112	214,702
Contract and other (including amounts from related parties: 1998–$61,583; 1997–$67,596; 1996–$95,299)	**114,795**	121,587	107,037
Interest	**88,764**	69,160	64,110
Total revenues	**1,150,943**	1,016,748	968,678
Costs and expenses			
Cost of sales (including amounts from related parties: 1998–$23,155; 1997–$14,348; 1996–$10,900)	**138,623**	102,536	104,527
Research and development (including contract related: 1998–$27,660; 1997–$67,596; 1996–$50,586)	**396,186**	470,923	471,143
Marketing, general and administrative	**358,931**	269,852	240,063
Interest	**4,552**	3,642	5,010
Total costs and expenses	**898,292**	846,953	820,743
Income before taxes	**252,651**	169,795	147,935
Income tax provision	**70,742**	40,751	29,587
Net income	**$ 181,909**	$ 129,044	$ 118,348
Earnings per share:			
Basic	**$ 1.45**	$ 1.05	$ 0.98
Diluted	**$ 1.40**	$ 1.02	$ 0.95
Weighted average shares used to compute diluted earnings per share	**129,872**	126,397	123,969

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(thousands)

	Increase (Decrease) in Cash and Cash Equivalents		
Year ended December 31	1998	1997	1996
Cash flows from operating activities:			
Net income	**$ 181,909**	$ 129,044	$ 118,348
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**78,101**	65,533	62,124
Deferred income taxes	**29,792**	19,660	(34,021)
Gain on sales of securities available-for-sale	**(9,542)**	(13,203)	(1,010)
Loss on sales of securities available-for-sale	**1,809**	2,096	663
Write-down of nonmarketable securities	**16,689**	–	–
Write-down of securities available-for-sale	**20,249**	4,000	–
Loss on fixed asset dispositions	**1,015**	318	5,309
Changes in assets and liabilities:			
Net cash flow from trading securities	**12,725**	(109,132)	(8,184)
Receivables and other current assets	**33,767**	11,194	(30,416)
Inventories	**(32,600)**	(24,083)	1,705
Accounts payable, other current liabilities and other long-term liabilities	**15,937**	32,897	25,153
Net cash provided by operating activities	**349,851**	118,324	139,671
Cash flows from investing activities:			
Purchases of securities held-to-maturity	**(327,690)**	(304,932)	(634,124)
Proceeds from maturities of securities held-to-maturity	**410,729**	455,317	772,922
Purchases of securities available-for-sale	**(800,788)**	(512,727)	(304,806)
Proceeds from sales of securities available-for-sale	**430,936**	410,395	182,564
Purchases of nonmarketable equity securities	**(29,044)**	–	(9,323)
Capital expenditures	**(88,088)**	(154,902)	(141,837)
Change in other assets	**(17,151)**	(61,529)	(7,046)
Net cash used in investing activities	**(421,096)**	(168,378)	(141,650)
Cash flows from financing activities:			
Stock issuances	**107,938**	87,259	72,558
Reduction in long-term debt, including current portion	**–**	–	(358)
Net cash provided by financing activities	**107,938**	87,259	72,200
Increase in cash and cash equivalents	**36,693**	37,205	70,221
Cash and cash equivalents at beginning of year	**244,469**	207,264	137,043
Cash and cash equivalents at end of year	**$ 281,162**	$ 244,469	$ 207,264
Supplemental cash flow data:			
Cash paid during the year for:			
Interest, net of portion capitalized	**$ 4,552**	$ 3,642	$ 5,010
Income taxes	**26,189**	15,474	52,243

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

(dollars in thousands, except par value)

December 31	1998	1997
Assets:		
Current assets:		
Cash and cash equivalents	$ 281,162	$ 244,469
Short-term investments	606,544	588,853
Accounts receivable – trade (net of allowances of: 1998–$14,661; 1997–$8,826)	79,411	71,415
Accounts receivable – other (net of allowances of: 1998–$2,757; 1997–$5,709)	47,480	73,444
Accounts receivable – related party	22,850	44,386
Inventories	148,626	116,026
Prepaid expenses and other current assets	55,885	55,325
Total current assets	1,241,958	1,193,918
Long-term marketable securities	716,888	453,188
Property, plant and equipment, net	700,249	683,304
Other assets	196,307	177,202
Total assets	$ 2,855,402	$ 2,507,612
Liabilities and stockholders' equity:		
Current liabilities:		
Accounts payable	$ 40,895	$ 48,992
Income taxes payable	46,447	40,293
Accrued liabilities – related party	10,945	15,427
Other accrued liabilities	193,040	184,845
Total current liabilities	291,327	289,557
Long-term debt	149,990	150,000
Other long-term liabilities	70,240	36,830
Total liabilities	511,557	476,387
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.02 par value; authorized: 100,000,000 shares; none issued	–	–
Special common stock, $0.02 par value; authorized: 100,000,000 shares; outstanding: 1998–50,493,631 ; 1997–47,606,785	1,010	952
Common stock, $0.02 par value; authorized: 200,000,000 shares; outstanding: 1998 and 1997–76,621,009	1,532	1,532
Additional paid-in capital	1,588,990	1,463,768
Retained earnings	693,050	511,141
Accumulated other comprehensive income	59,263	53,832
Total stockholders' equity	2,343,845	2,031,225
Total liabilities and stockholders' equity	$ 2,855,402	$ 2,507,612

See Notes to Consolidated Financial Statements.

Consolidated Statements of Stockholders' Equity

(thousands)

	Special Common Shares	Common Shares	Special Common Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance December 31, 1995	42,647	76,621	$ 853	$ 1,532	$ 1,281,640	$ 263,749	$ 54,273	**$ 1,602,047**
Comprehensive income: Net income						118,348		**118,348**
Net unrealized (loss) on securities available-for-sale							(324)	**(324)**
Comprehensive income								**118,024**
Issuance of stock upon exercise of options and warrants	1,738		35		55,103			**55,138**
Issuance of stock under employee stock plan	421		8		17,412			**17,420**
Income tax benefits realized from employee stock option exercises					8,430			**8,430**
Balance December 31, 1996	44,806	76,621	$ 896	$ 1,532	$ 1,362,585	$ 382,097	$ 53,949	**$ 1,801,059**
Comprehensive income: Net income						129,044		**129,044**
Net unrealized (loss) on securities available-for-sale							(117)	**(117)**
Comprehensive income								**128,927**
Issuance of stock upon exercise of options and warrants	2,350		47		68,346			**68,393**
Issuance of stock under employee stock plan	451		9		18,857			**18,866**
Income tax benefits realized from employee stock option exercises					13,980			**13,980**
Balance December 31, 1997	47,607	76,621	$ 952	$ 1,532	$ 1,463,768	$ 511,141	$ 53,832	**$ 2,031,225**
Comprehensive income: Net income						**181,909**		**181,909**
Net unrealized gain on securities available-for-sale							**5,431**	**5,431**
Comprehensive income								**187,340**
Issuance of stock upon exercise of options and warrants	**2,460**		**49**		**86,835**			**86,884**
Issuance of stock under employee stock plan	**427**		**9**		**21,055**			**21,064**
Income tax benefits realized from employee stock option exercises					**17,332**			**17,332**
Balance December 31, 1998	**50,494**	**76,621**	**$ 1,010**	**$ 1,532**	**$ 1,588,990**	**$ 693,050**	**$ 59,263**	**$ 2,343,845**

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Description of Business and Significant Accounting Policies

Genentech, Inc. (the Company) is a biotechnology company that uses human genetic information to discover, develop, manufacture and market human pharmaceuticals for significant unmet medical needs. Twelve of the approved products of biotechnology stem from Genentech science. The Company manufactures and markets eight products directly in the United States (U.S.). In 1998, the Company licensed its marketing and development rights to Actimmune® to Connetics Corporation (Connetics). Following a transition period ending January 1999, the Company will no longer market Actimmune, and Connetics has agreed to pay the Company royalties on its sales of Actimmune.

In conjunction with the October 1995 agreement (the Agreement), the Company receives royalties on sales of certain of its products in Canada, on sales of Pulmozyme® outside of the U.S. and on sales of rituximab, outside of the U.S. (excluding Japan) from F. Hoffmann-La Roche Ltd (HLR), a subsidiary of Roche Holdings, Inc. (Roche). See *Relationship with Roche Holdings, Inc.* note for further discussion.

The Company receives royalties on sales of two of its products, growth hormone and tissue-plasminogen activator, outside of the U.S. and Canada through other licensees. The Company also receives worldwide royalties on five additional licensed products, and received royalties on the sale of one other licensed product for which those royalties expired in August 1998, that originated from the Company's technology and are marketed by other companies.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and all significant subsidiaries. Material intercompany balances and transactions are eliminated.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles 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.

Cash and Cash Equivalents: The Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents.

Short-term Investments and Long-term Marketable Securities: The Company invests its excess cash balances in short-term and long-term marketable securities, primarily corporate notes, certificates of deposit, treasury notes, asset-backed securities and municipal bonds. As part of its strategic alliance efforts, the Company also invests in equity securities, dividend bearing convertible preferred stock and interest bearing convertible debt of other biotechnology companies. Marketable equity securities are accounted for as available-for-sale investment securities as described below. Nonmarketable equity securities and convertible debt are carried at cost. At December 31, 1998 and 1997, the Company had investments of $55.8 million and $55.2 million, respectively, in convertible debt of various biotechnology companies.

Investment securities are classified into one of three categories: held-to-maturity, available-for-sale, or trading. Securities are considered held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. These securities are recorded as either short-term investments or long-term marketable securities on the balance sheet depending upon their original contractual maturity dates. Held-to-maturity securities are stated at amortized cost, including adjustments for amortization of premiums and accretion of discounts. Securities are considered trading when bought principally for the purpose of selling in the near term. These securities are recorded as short-term investments and are carried at market value. Unrealized holding gains and losses on trading securities are included in interest income. Securities not classified as held-to-maturity or as trading are considered available-for-sale. These securities are recorded as either short-term investments or long-term marketable securities and are carried at market value with unrealized gains and losses included in accumulated other comprehensive income in stockholders' equity. If a decline in fair value below cost is considered other than temporary, such securities are written down to estimated fair value with a charge to marketing, general and administrative expenses. The cost of all securities sold is based on the specific identification method.

Property, Plant and Equipment: The costs of buildings and equipment are depreciated using the straight-line method over the following estimated useful lives of the assets: buildings – 25 years; certain manufacturing equipment – 15 years; other equipment – 4 or 8 years; leasehold improvements – length of applicable lease. The costs of repairs and maintenance are expensed as incurred. Repairs and maintenance expenses for the years ended December 31, 1998, 1997 and 1996 were $35.9 million, $32.9 million and $28.8 million, respectively. Capitalized interest on construction in progress of $3.0 million in 1998, $3.9 million in 1997 and $2.5 million in 1996 is included in property, plant and equipment.

Property, plant and equipment balances at December 31 are summarized below (in thousands):

	1998	1997
At cost:		
Land	$ 69,437	$ 69,010
Buildings	378,133	339,708
Equipment	607,369	494,874
Leasehold improvements	3,565	3,270
Construction in progress	86,960	152,533
	1,145,464	1,059,395
Less: accumulated depreciation	445,215	376,091
Net property, plant and equipment	$ 700,249	$ 683,304

Patents and Other Intangible Assets: As a result of its research and development (R&D) programs, the Company owns or is in the process of applying for patents in the U.S. and other countries which relate to products and processes of significant importance to the Company. Costs of patents and patent applications are capitalized and amortized on a straight-line basis over their estimated useful lives of approximately 12 years. Intangible assets are generally amortized on a straight-line basis over their estimated useful lives.

Contract Revenue: Contract revenue for R&D is recorded as earned based on the performance requirements of the contract. Nonrefundable contract fees for which no further performance obligations exist are recognized when the payments are received or when collection is assured. In return for contract payments, contract partners may receive certain marketing and manufacturing rights, products for clinical use and testing, and/or R&D services.

Royalty Expenses: Royalty expenses directly related to product sales are classified in cost of sales. Other royalty expenses, relating to royalty revenue, totaled $38.3 million, $39.8 million and $36.0 million in 1998, 1997 and 1996, respectively, and are classified in marketing, general and administrative expenses.

Advertising Expenses: The Company expenses the costs of advertising, which also includes promotional expenses, as incurred. Advertising expenses for the years ended December 31, 1998, 1997 and 1996, were $47.7 million, $41.8 million and $28.0 million, respectively.

Income Taxes: The Company accounts for income taxes by the asset and liability approach for financial accounting and reporting of income taxes.

Earnings Per Share: Basic earnings per share is computed based on the weighted average number of shares of the Company's Callable Putable Common Stock (Special Common Stock) and Common Stock outstanding. Diluted earnings per share is computed based on the weighted average number of shares of the Company's Special Common Stock, Common Stock and other dilutive securities. See also *Earnings Per Share* note.

Financial Instruments: As part of its overall portfolio, the Company uses two external money managers to manage its investment portfolios that are held for trading purposes and one external manager that manages an available-for-sale portfolio. The investment portfolios consist entirely of debt securities. When the money managers purchase securities denominated in a foreign currency, they enter into foreign currency forward contracts which are recorded at fair value with the related gain or loss recorded in interest income.

The Company purchases simple foreign currency put options (options) with expiration dates and amounts of currency that are based on a portion of probable nondollar revenues so that the potential adverse impact of movements in currency exchange rates on the nondollar denominated revenues will be at least partially offset by an associated increase in the value of the options. See the *Financial Instruments* note for further discussion. At the time the options are purchased they have little or no intrinsic value. Realized and unrealized gains related to the options are deferred until the designated hedged revenues are recorded. The associated costs, which are deferred and classified as other current assets, are amortized over the term of the options and recorded as a reduction of the hedged revenues. Realized gains, if any, are recorded in the income statement with the related hedged revenues. Options are generally terminated, or offsetting contracts are entered into, upon determination that purchased options no longer qualify as a hedge or are determined to exceed probable anticipated net foreign revenues. The realized gains and losses are recorded as a

component of other revenues. For early termination of options that qualify as hedges, the gain or loss on termination will be deferred through the original term of the option and then recognized as a component of the hedged revenues. Changes in the fair value of hedging instruments that qualify as a hedge are not recognized and changes in the fair value of instruments that do not qualify as a hedge would be recognized in other revenues.

The Company may also enter into foreign currency forward contracts (forward contracts) as hedging instruments. Forward contracts are recorded at fair value, and any gains and losses from these forward contracts are recorded in the income statement with the related hedged revenues. Financial instruments, such as forward contracts, not qualifying as hedges under generally accepted accounting principles are marked to market with gains or losses recorded in other revenues if they occur.

Interest rate swaps (swaps) have been used and may be used in the future to adjust the duration of the investment portfolio in order to meet duration targets. Interest rate swaps are contracts in which two parties agree to swap future streams of payments over a specified period. See the *Financial Instruments* note for further discussion. The accrued net settlement amounts on swaps are reflected on the balance sheet as other accounts receivable or other accrued liabilities. Net payments made or received on swaps are included in interest income as adjustments to the interest received on invested cash. Amounts deferred on terminated swaps are classified as other assets and are amortized to interest income over the original contractual term of the swaps by a method that approximates the level-yield method. For early termination of swaps where the underlying asset is not sold, the amount of the terminated swap is deferred and amortized over the remaining life of the original swap. For early termination of swaps with the corresponding termination or sale of the underlying asset, the amounts are recognized through interest income. Changes in the fair value of swap hedging instruments that qualify as a hedge are not recognized and changes in the fair value of swap instruments that do not qualify as a hedge would be recognized in other income.

The Company's marketable equity portfolio consists primarily of investments in biotechnology companies whose risk of market fluctuations is greater than the stock market in general. To manage a portion of this risk, the Company enters into certain costless collar instruments to hedge certain equity securities against changes in market value. See the *Financial Instruments* note for further discussion. Gains and losses on these instruments are recorded as an adjustment to unrealized gains and losses on marketable securities with a corresponding receivable or payable recorded in short-term or long-term other assets or liabilities. Equity collar instruments that do not qualify for hedge accounting and early termination of these instruments with the sale of the underlying security would be recognized through earnings. For early termination of these instruments without the sale of the underlying security, the time value would be recognized through earnings and the intrinsic value will adjust the cost basis of the underlying security.

401(k) Plan: The Company's 401(k) Plan (Plan) covers substantially all of its employees. Under the Plan, eligible employees may contribute up to 15% of their eligible compensation, subject to certain Internal Revenue Service restrictions. The Company matches a portion of employee contributions, up to a maximum of 4% of each employee's eligible compensation. The match is effective December 31 of each year and is fully vested when made. During 1998, 1997 and 1996, the Company provided $7.3 million, $6.7 million and $6.1 million, respectively, for the Company match under the Plan.

Comprehensive Income: The Company adopted Statement of Financial Accounting Standards (FAS) 130, "Reporting Comprehensive Income," at December 31, 1998. Under FAS 130, the Company is required to display comprehensive income and its components as part of the Company's full set of financial statements. The measurement and presentation of net income did not change. Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes certain changes in equity of the Company that are excluded from net income. Specifically, FAS 130 requires unrealized holding gains and losses on the Company's available-for-sale securities, which were reported separately in stockholders' equity, to be included in accumulated other comprehensive income. Comprehensive income for years ended December 31, 1998, 1997 and 1996 has been reflected in the *Consolidated Statements of Stockholders' Equity*.

New Accounting Standard: In June 1998, the Financial Accounting Standards Board issued FAS 133, "Accounting for Derivative Instruments and Hedging Activities," effective beginning in the first quarter of 2000. FAS 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. It requires companies to recognize all derivatives as either assets or liabilities on the balance sheet and measure those instruments at fair value. Gains or losses resulting from changes in the values of those derivatives would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting under FAS 133. The Company is currently evaluating the impact of FAS 133 on its financial position and results of operations.

Inventories: Inventories are stated at the lower of cost or market. Cost is determined using a weighted-average approach which approximates the first-in first-out method. Inventories at December 31, 1998 and 1997 are summarized below (in thousands):

	1998	1997
Raw materials and supplies	$ 21,414	$ 17,544
Work in process	106,383	84,831
Finished goods	20,829	13,651
Total inventories	$ 148,626	$ 116,026

Reclassifications: Certain reclassifications of prior year amounts have been made to conform with the current year presentation.

Segment, Significant Customer and Geographic Information

The Company adopted FAS 131, "Disclosure about Segments of an Enterprise and Related Information," at December 31, 1998. FAS 131 establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. Under FAS 131, the Company's operations are treated as one operating segment as it only reports profit and loss information on an aggregate basis to chief operating decision makers of the Company. Information about the Company's product sales and major customers are as follows (in millions):

Product Sales

	1998	1997	1996
Herceptin	$ 30.5	–	–
Rituxan	162.6	$ 5.5	–
Activase	213.0	260.7	$284.1
Growth hormone (Protropin, Nutropin and Nutropin AQ)	214.0	223.6	218.2
Pulmozyme	93.8	91.6	76.0
Actimmune	3.9	3.5	4.5
Total product sales	$ 717.8	$ 584.9	$ 582.8

HLR contributed approximately 11% of the Company's total revenues in 1998, 11% in 1997 and 14% in 1996. See the *Related Party Transactions* note below for further information. Three other major customers, Caremark, Inc., Bergen Brunswig, and Cardinal Distribution, Inc., each contributed 10% or more of the Company's total revenues in at least one of the last three years. Caremark, Inc., a national distributor, which accounted for 10%, 14% and 15% of total revenues in 1998, 1997 and 1996, respectively, distributes the Company's growth hormone products, Pulmozyme and Actimmune through its extensive branch network and is then reimbursed through a variety of sources. Bergen Brunswig, a national wholesale distributor of all of the Company's products, contributed 11% in 1998 and 10% in 1997 and 1996. Cardinal Distribution, Inc., a national wholesaler distributor of all the Company's products, contributed 11% in 1998.

Approximate foreign sources of revenues were as follows (in millions):

	1998	1997	1996
Europe	**$ 171.0**	$ 139.5	$ 146.4
Asia (primarily Japan)	**16.9**	34.2	17.8
Canada	**11.7**	11.7	11.1

The Company currently sells primarily to distributors and health care companies throughout the U.S., performs ongoing credit evaluations of its customers' financial condition and extends credit generally without collateral. In 1998, 1997 and 1996, the Company did not record any material additions to, or losses against, its provision for doubtful accounts.

Research and Development Arrangements

To gain access to potential new products and technologies and to utilize other companies to help develop the Company's potential new products, the Company has established strategic alliances with various companies. These strategic alliances include the acquisition of both marketable and nonmarketable equity investments and convertible debt of companies developing technologies that fall outside the Company's research focus and include companies having the potential to generate new products through technology exchanges and investments. Potential future payments may be due to certain collaborative partners achieving certain benchmarks as defined in the collaborative agreements. The Company has also entered into product-specific collaborations to acquire development and marketing rights for products.

In December 1997, the Company and Alteon, Inc. (Alteon) entered into a collaborative agreement to develop and market pimagedine, an advanced glycosylation end-product formation inhibitor to treat kidney disease in diabetic patients. Under the terms of the agreement, the Company licensed pimagedine and second generation compounds from Alteon and has made investments in Alteon stock of $37.5 million. In 1998, as a result of unsuccessful clinical trials with pimagedine and the decline in the value of the Company's investment in Alteon, the Company wrote down $24.2 million of its marketable and nonmarketable equity investments in Alteon. The Company is in discussions with Alteon as to the future direction of the collaboration.

Income Taxes

The income tax provision consists of the following amounts (in thousands):

	1998	1997	1996
Current:			
Federal	**$ 39,945**	$ 30,617	$ 61,502
State	**1,004**	432	2,104
Foreign	**–**	2	2
Total current	**40,949**	31,051	63,608
Deferred:			
Federal	**29,006**	23,799	(34,021)
State	**787**	(14,099)	–
Total deferred	**29,793**	9,700	(34,021)
Total income tax provision	**$ 70,742**	$ 40,751	$ 29,587

Actual current tax liabilities are lower by $17.3 million, $14.0 million and $8.4 million in 1998, 1997 and 1996, respectively, due to employee stock option related tax benefits which were credited to stockholders' equity.

A reconciliation between the Company's effective tax rate and the U.S. statutory rate follows:

	1998 Amount (thousands)	Tax Rate 1998	1997	1996
Tax at U.S. statutory rate	**$ 88,428**	35.0%	35.0%	35.0%
R&D credits realized	**(11,919)**	(4.7)	(11.4)	(3.0)
Tax benefit of certain realized gains on securities available-for-sale	**(2,982)**	(1.2)	(3.8)	–
Adjustment of deferred tax assets valuation allowance	**–**	–	–	(15.3)
Foreign losses realized	**(10,500)**	(4.2)	–	(3.4)
State taxes	**7,491**	3.0	2.3	2.3
Other	**224**	0.1	1.9	4.4
Income tax provision	**$ 70,742**	28.0%	24.0%	20.0%

The components of deferred taxes consist of the following at December 31 (in thousands):

	1998	1997
Deferred tax liabilities:		
Depreciation	**$ 66,471**	$ 55,137
Unrealized gain on securities available-for-sale	**30,617**	25,086
Other	**20,016**	2,173
Total deferred tax liabilities	**117,104**	82,396
Deferred tax assets:		
Capitalized R&D costs	**42,317**	33,950
Federal credit carryforwards	**86,725**	100,400
Expenses not currently deductible	**56,699**	35,000
State credit carryforwards	**30,632**	28,365
Other	**4,992**	4,398
Total deferred tax assets	**221,365**	202,113
Valuation allowance	**(62,844)**	(48,508)
Total net deferred tax assets	**158,521**	153,605
Total net deferred taxes	**$ 41,417**	$ 71,209

Total tax credit carryforwards of $117.4 million expire in the years 1999 through 2012, except for $43.0 million of alternative minimum tax credits which have no expiration date. The valuation allowance at December 31, 1998, reflected above relates to the tax benefits of stock option deductions which will be credited to additional paid-in-capital when realized.

The valuation allowance increased by $14.3 million and $12.7 million in 1998 and 1997, respectively, and decreased by $17.0 million in 1996. Realization of net deferred taxes depends on future earnings from existing and new products and new indications for existing products. The timing and amount of future earnings will depend on continued success in marketing and sales of the Company's current products, as well as the scientific success, results of clinical trials, availability of third party reimbursement for therapies and regulatory approval of products under development.

Earnings Per Share

The following is a reconciliation of the numerator and denominators of the basic and diluted EPS computations for the years ended December 31, 1998, 1997 and 1996 (in thousands):

	1998	1997	1996
Numerator:			
Net income – numerator for basic and diluted EPS:	**$ 181,909**	$ 129,044	$ 118,348
Denominator:			
Denominator for basic EPS–weighted-average shares	**125,767**	123,042	120,623
Effect of dilutive securities:			
Stock options	**4,105**	3,355	3,325
Warrants	**–**	–	21
Denominator for diluted EPS–adjusted weighted-average shares and assumed conversions	**129,872**	126,397	123,969

Options to purchase 178,575 shares of the Company's Special Common Stock ranging from $70.50 to $71.13 per share, 103,700 shares of Special Common Stock at $59.00 per share and 5,251,665 shares of Special Common Stock at $54.25 per share were outstanding during 1998, 1997 and 1996, respectively, but were not included in the computation of diluted earnings per share. These options' exercise price was greater than the average market price of the Special Common Stock and therefore, the effect would be anti-dilutive. See *Capital Stock* note for information on option expiration dates.

During 1998, 1997 and 1996, the Company had convertible subordinated debentures which were convertible to 1,013,447, 1,013,514 and 1,013,514 shares, respectively, of Special Common Stock, but were not included in the computation of diluted earnings per share because they were anti-dilutive. See the *Long-term Debt* note for additional information on the convertible subordinated debentures.

Investment Securities

Securities classified as trading, available-for-sale and held-to-maturity at December 31, 1998 and 1997, are summarized below. Estimated fair value is based on quoted market prices for these or similar investments.

December 31, 1998	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(thousands)			
Total Trading Securities (carried at estimated fair value)	$ 236,330	$ 3,817	$ (246)	$ 239,901
Securities Available-for-Sale (carried at estimated fair value):				
Equity securities	$ 42,024	$ 77,364	$ (1,042)	$ 118,346
U.S. Treasury securities and obligations of other U.S. government agencies maturing:				
between 5-10 years	31,294	1,812	(74)	33,032
Corporate debt securities maturing:				
within 1 year	251,238	233	(515)	250,956
between 1-5 years	309,762	3,525	(934)	312,353
between 5-10 years	149,410	6,603	(472)	155,541
Other debt securities maturing:				
between 1-5 years	70,768	172	(2,502)	68,438
between 5-10 years	19,836	267	–	20,103
greater than 10 years	9,033	49	(7)	9,075
Total Available-for-Sale	$ 883,365	$ 90,025	$ (5,546)	$ 967,844
Securities Held-to-Maturity (carried at amortized cost):				
Corporate debt securities maturing:				
within 1 year	$ 115,687	–	$ (79)	$ 115,608
Total Held-to-Maturity	$ 115,687	–	$ (79)	$ 115,608

December 31, 1997	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(thousands)			
Total Trading Securities (carried at estimated fair value)	$ 256,428	$ 686	$ (4,487)	$ 252,627
Securities Available-for-Sale (carried at estimated fair value):				
Equity securities	$ 46,262	$ 75,796	$ (2,147)	$ 119,911
U.S. Treasury securities and obligations of other U.S. government agencies maturing:				
between 5-10 years	38,979	577	(3)	39,553
Corporate debt securities maturing:				
within 1 year	100,178	51	(8)	100,221
between 1-5 years	100,713	770	(103)	101,380
between 5-10 years	149,242	4,053	–	153,295
Other debt securities maturing:				
within 1 year	41,061	–	(578)	40,483
between 1-5 years	41,057	–	(2,008)	39,049
Total Available-for-Sale	$ 517,492	$ 81,247	$ (4,847)	$ 593,892
Securities Held-to-Maturity (carried at amortized cost):				
Corporate debt securities maturing:				
within 1 year	$ 195,522	$ 19	–	$ 195,541
Total Held-to-Maturity	$ 195,522	$ 19	–	$ 195,541

The carrying value of all investment securities held at December 31, 1998 and 1997, is summarized below (in thousands):

Security	1998	1997
Trading Securities	$ 239,901	$ 252,627
Securities Available-for-Sale maturing within one year	250,956	140,704
Securities Held-to-Maturity maturing within one year	115,687	195,522
Total short-term investments	$ 606,544	$ 588,853
Securities Available-for-Sale maturing between 1-10 years, including equity securities	$ 716,888	$ 453,188
Total long-term marketable securities	$ 716,888	$ 453,188

In 1998, proceeds from the sales of available-for-sale securities totaled $431.0 million; gross realized gains totaled $9.5 million and gross realized losses totaled $1.8 million. In 1997, proceeds from the sales of available-for-sale securities totaled $410.4 million; gross realized gains totaled $13.2 million and gross realized losses totaled $2.1 million. In 1996, proceeds from sales of available-for-sale securities totaled $182.6 million; gross realized gains totaled $1.0 million and gross realized losses totaled $0.7 million. The Company recorded charges in 1998 and 1997 of $20.2 million and $4.0 million, respectively, to write down certain available-for-sale biotechnology equity securities for which the decline in fair value below cost was other than temporary. In 1996, there were no such write-downs.

During the year ended December 31, 1998, 1997 and 1996, net change in unrealized holding gains/(losses) on trading securities included in net income totaled $7.4 million, ($3.8) million and ($1.0) million, respectively.

Marketable debt securities held by the Company are issued by a diversified selection of corporate and financial institutions with strong credit ratings. The Company's investment policy limits the amount of credit exposure with any one institution. Other than asset-backed securities, these debt securities are generally not collateralized. The Company has not experienced any material losses due to credit impairment on its investments in marketable debt securities in the years 1998, 1997 and 1996.

Financial Instruments

Foreign Currency Instruments: Certain of the Company's revenues are earned outside of the U.S. Moreover, the Company's foreign currency denominated revenues exceed its foreign currency denominated expenses; therefore, risk exists that net income may be impacted by changes in the exchange rates between the U.S. dollar and foreign currencies. To hedge a portion of anticipated nondollar denominated net revenues, the Company currently purchases options and may enter into forward contracts. At December 31, 1998, the Company had hedged approximately 75% of probable net foreign revenues anticipated within 12 months and 40% of its probable net foreign revenues through the year 2000. At December 31, 1998 and 1997, the notional amounts of the options totaled $75.0 million and $122.9 million, respectively, and consisted of the following currencies: German marks, Spanish pesetas, French francs, British pounds, Italian lire, Japanese yen and Swedish krona. All option contracts mature within the next two years. The fair value of the options was based on exchange rates and market conditions at December 31, 1998 and 1997. All forward contracts were closed out at the end of 1997 and no forward contracts were entered into in 1998.

Credit exposure is limited to the unrealized gains on these contracts. All agreements are with a diversified selection of institutions with strong credit ratings which minimizes risk of loss due to nonpayment from the counterparty. The Company has not experienced any material losses due to credit impairment of its foreign currency instruments.

Interest Rate Swaps: Interest income is subject to fluctuations as interest rates change, primarily U.S. interest rates. To manage this risk, the Company periodically establishes duration targets for its investment portfolio that reflect its anticipated use of cash and fluctuations in market rates of interest. The Company may enter into swaps as part of its overall strategy of managing the duration of its investment portfolio. For each swap, the Company receives interest based on fixed rates and pays interest to counterparties based on floating rates on a notional principal amount. The Company's swap counterparties have strong credit ratings which minimize the risk of non-performance on the swaps. The Company has not experienced any material losses due to credit impairment. At December 31, 1998 and 1997, the Company had three swap contracts outstanding with notional amounts totaling $150.0 million. The Company's credit

exposure on swaps and the net carrying amounts of swaps held at December 31, 1998 and 1997, were not material. Net interest income from swaps in 1998, 1997 and 1996 was also immaterial.

Equity Collar Instruments: To hedge against fluctuations in the market value of a portion of the marketable equity portfolio, the Company has entered into costless collar instruments, a form of equity collar instrument, that expire in 1999 and will require settlement in equity securities or cash. A costless collar instrument is a purchased put option and a written call option on a specific equity security such that the cost of the purchased put and the proceeds of the written call offset each other; therefore, there is no initial cost or cash outflow for these instruments. The fair value of the purchased puts and the written calls were determined based on quoted market prices at year end. At December 31, 1998, the notional amounts of the put and call options were $32.0 million and $46.0 million, respectively. At December 31, 1997, the notional amounts of the put and call options were $33.7 million and $50.1 million, respectively.

Financial Instruments Held for Trading Purposes: As part of its 1998 overall investment strategy, the Company has contracted with two external money managers to manage part of its investment portfolio. This portfolio at December 31, 1998, consisted of U.S. and nondollar denominated investments. To hedge the nondollar denominated investments, the money managers enter into forward contracts. The notional amounts of the forward contracts at December 31, 1998 and 1997, were $211.6 million and $209.3 million, respectively. The fair value at December 31, 1998 and 1997, of the forward contracts, totaled $0.4 million and $3.3 million, respectively. The average fair value during 1998 and 1997 totaled ($0.9) million and $2.1 million, respectively. Net realized and unrealized trading gains on the portfolio totaled approximately $16.2 million in 1998 and $9.1 million in 1997, respectively, and are included in interest income. Counterparties have strong credit ratings which minimize the risk of non-performance from the counterparties.

Summary of Fair Values: The table below summarizes the carrying value and fair value at December 31, 1998 and 1997, of the Company's financial instruments. The fair value of the long-term debt was estimated based on the quoted market price at year end (in thousands):

	1998		1997	
Financial Instruments	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets:				
Investment securities	$ 1,323,432	$ 1,323,353	$ 1,042,041	$ 1,042,060
Convertible equity loans	55,800	55,800	55,248	55,248
Purchased foreign exchange put options	1,441	5,741	3,891	14,468
Outstanding interest rate swaps	5,742	167,535	5,742	165,559
Liabilities:				
Long-term debt	149,990	148,000	150,000	139,500
Equity collars	4,857	11,600	12,161	15,533
Outstanding interest rate swaps	3,587	153,587	3,732	153,732

Other Accrued Liabilities

Other accrued liabilities at December 31 are as follows (in thousands):

	1998	1997
Accrued compensation	$ 47,057	$ 44,624
Accrued clinical and other studies	35,535	47,269
Accrued royalties	23,392	23,905
Accrued marketing and promotion costs	9,417	13,369
Other	77,639	55,678
Total other accrued liabilities	$ 193,040	$ 184,845

Long-term Debt

The Company's long-term debt as of December 31, 1998 and 1997, consisted of $150.0 million of convertible subordinated debentures, with interest payable at 5%, due in 2002. The debentures are convertible, at the option of the holder, into shares of the Company's Special Common Stock. Upon conversion, the holder receives, for each $74 in principal amount of debenture converted, one-half share of the Company's Special Common Stock and $18 in cash. The $18 in cash is reimbursed by Roche to the Company. Generally, the Company may redeem the debentures until maturity.

Leases, Commitments and Contingencies

Leases: Future minimum lease payments under operating leases, net of sublease income, at December 31, 1998, are as follows (in thousands):

1999	2000	2001	2002	2003	Thereafter	Total
$ 25,855	23,591	22,470	19,627	18,637	36,707	$ 146,887

The Company leases various real property under operating leases that generally require the Company to pay taxes, insurance and maintenance. Rent expense was approximately $12.7 million, $11.7 million and $11.7 million for the years 1998, 1997 and 1996, respectively. Sublease income was not material in any of the three years presented.

Under four of the lease agreements, the Company has an option to purchase the properties at an amount that does not constitute a bargain. Alternatively, the Company can cause the property to be sold to a third party. The Company is contingently liable, under residual value guarantees, for approximately $377.0 million. The Company also is required to maintain certain financial ratios and is limited to the amount of additional debt it can assume.

Commitments: The Company and CuraGen Corporation (CuraGen) entered into a research collaborative agreement in November 1997, whereby the Company invested $5.0 million in equity of CuraGen and has agreed to provide a convertible equity loan to CuraGen of up to $26.0 million. As of December 31, 1998, no loan amounts have been funded to CuraGen.

Also, in December 1997, the Company and LeukoSite, Inc. (LeukoSite) entered into a collaboration agreement to develop and commercialize LeukoSite's LDP-02, a humanized monoclonal antibody for the potential treatment of inflammatory bowel diseases. Under the terms of the agreement, the Company made a $4.0 million equity investment in LeukoSite and has agreed to provide a convertible equity loan for approximately $15.0 million to fund Phase II development costs. Upon successful completion of Phase II, if LeukoSite agrees to fund 25% of Phase III development costs, the Company has agreed to provide a second loan to LeukoSite for such funding. As of December 31, 1998, no loan amounts have been funded to LeukoSite.

In addition, the Company has entered into research collaborations with companies whereby potential future payments may be due to selective collaborative partners achieving certain benchmarks as defined in the collaborative agreements. The Company may also, from time to time, lend additional funds to these companies, subject to approval.

The Company is a limited partner in the Vector Later-Stage Equity Fund II, LP (Vector Fund). The General Partner is Vector Fund Management II, LLC, a Delaware limited liability company. The purpose of the Vector Fund is to invest in biotech equity and equity-related securities. Under the terms of the Vector Fund agreement, the Company makes contributions to the capital of the Vector Fund through installments in cash as called by the General Partner. The Company's total commitment to the Vector Fund through September 2003 is $25.0 million, of which $7.2 million was contributed as of December 31, 1998. The Vector Fund will terminate and be dissolved in September 2007.

Contingencies: The Company is a party to various legal proceedings, including patent infringement cases involving human growth hormone products and Activase® and other matters.

In July 1997, an action was filed in the U.S. District Court for the Northern District of California alleging that the Company's manufacture, use and sale of its Nutropin® human growth hormone products infringed a patent (the Goodman Patent) owned by the Regents of the University of California (UC). This action is substantially the same as a previous action filed in 1990 against the Company by UC alleging that the Company's manufacture, use and sale of its Protropin® human growth hormone products infringed the Goodman

Patent. The 1997 case has been stayed pending the conclusion of the 1990 case, which is expected to commence trial in April 1999.

Based upon the nature of the claims made and the information available to date to the Company and its counsel through investigations and otherwise, the Company believes the outcome of these actions is not likely to have a material adverse effect on the financial position, results of operations or cash flows of the Company. However, were an unfavorable ruling to occur in any quarterly period, there exists the possibility of a material impact on the net income of that period.

In addition to the above, in 1995, the Company received and responded to grand jury document subpoenas from the U.S. District Court for the Northern District of California for documents relating to the Company's past clinical, sales and marketing activities associated with human growth hormone. In February 1997, February 1998 and October 1998, the Company received grand jury document subpoenas from the same court related to the same subject matter. The government is actively investigating this matter, and the Company is a target of that investigation. The Company expects further activity with respect to this matter in the near future. At this time, the Company cannot reasonably estimate a possible range of loss, if any, that may result from this investigation due to uncertainty regarding the outcome.

Relationship with Roche Holdings, Inc.

On October 25, 1995, the Company and Roche entered into the Agreement. Each share of the Company's Common Stock not held by Roche or its affiliates on that date automatically converted to one share of Special Common Stock. The Agreement extends until June 30, 1999 Roche's option to cause the Company to redeem (call) the outstanding Special Common Stock of the Company at predetermined prices. Should the call be exercised, Roche will concurrently purchase from the Company a like number of common shares for a price equal to the Company's cost to redeem the Special Common Stock. During the quarter beginning January 1, 1999, the call price is $81.00 per share and increases by $1.50 per share each quarter through the end of the option period on June 30, 1999, on which date the price will be $82.50 per share. If Roche does not cause the redemption as of June 30, 1999, the Company's stockholders will have the option (put) to cause the Company to redeem none, some or all of their shares of Special Common Stock at $60.00 per share (and Roche will concurrently provide the necessary redemption funds to the Company by purchasing a like number of shares of Common Stock at $60.00 per share) within thirty business days commencing July 1, 1999. Roche Holding Ltd, a Swiss corporation, has guaranteed Roche's obligation under the put.

In the event of the put, wherein sufficient shares of the Company's Special Common Stock are tendered to result in Roche owning at least 85% of the total outstanding shares of the Company's stock, the Company has in place an Incentive Units Program (Program) which could result in amounts payable to eligible employees. These amounts are based on specified performance benchmarks achieved by the Company during the term of the Program. In the event of the put, at December 31, 1998, $14.8 million is contingently payable under the Program.

In conjunction with the Agreement, HLR was granted an option for ten years for licenses to use and sell certain of the Company's products in non-U.S. markets (the License Agreement). In 1997, the Company and HLR agreed in principle to changes to the License Agreement. Key changes to the License Agreement are summarized as follows: (1) For future products, HLR may choose to exercise its option either when the Company determines to move a product into development, or at the end of Phase II clinical trials (as in the 1995 agreement). U.S. and European development costs will be shared (discontinuing the distinction regarding location or purpose of studies). (2) If HLR exercises its option at the development determination point, U.S. and European development costs will be shared 50/50. (3) If HLR exercises its option at the end of Phase II clinical trials, HLR will reimburse the Company for 50 percent of any development costs incurred, and subsequent U.S. and European development costs will be shared 75/25, HLR/Genentech. (4) For nerve growth factor, which HLR has already exercised its option to develop, prospective U.S. and European development costs will be shared 60/40, HLR/Genentech. (5) HLR has assumed development of Xubix™ (the oral IIb/IIIa antagonist) globally on its own. The Company may subsequently opt-in and join development at any time through the New Drug Application approval for the first indication. If the Company does not opt-in, it will receive from HLR a 6.0% royalty on worldwide sales of Xubix.

In general, with respect to the Company's products, HLR pays a royalty of 12.5% until a product reaches $100.0 million in aggregate sales outside of the U.S., at which time the royalty rate on all sales increases to 15%. In addition, HLR has rights to, and pays the Company 20% royalties on, Canadian sales of Activase, Protropin, Nutropin, Pulmozyme and Actimmune, sales of Pulmozyme outside of the U.S. and sales of Rituxan® outside of the U.S., excluding Japan. HLR currently has the right to sell Pulmozyme exclusively in Canada and Europe and pays royalties to the Company on such sales. The Company supplies its products to HLR, and has agreed to supply its products for which HLR has exercised its option, for sales outside of the U.S. at cost plus 20%.

Under the Agreement, independent of its right to cause the Company to redeem the Special Common Stock, Roche may increase its ownership of the Company up to 79.9% by making purchases on the open market. Roche holds approximately 65.3% of the outstanding common equity of the Company as of December 31, 1998.

Related Party Transactions

The Company has transactions with Roche, HLR (a wholly owned subsidiary of Roche, with two officers on the Company's Board of Directors) and its affiliates in the ordinary course of business. The Company recorded nonrecurring contract revenues from HLR of $40.0 million for Herceptin® (trastuzumab) marketing rights outside of the U.S. in 1998 (see below) and $44.7 million for the exercise of their options under the License Agreement with respect to three development projects [Rituxan, insulin-like growth factor (IGF-I) which was subsequently terminated, and nerve growth factor] in 1996. All other contract revenue from HLR, including reimbursement for ongoing development expenses after the option exercise date, totaled $21.6 million in 1998, $67.6 million in 1997, $50.6 million in 1996. All other revenue from Roche, HLR and their affiliates, principally royalties under previous product licensing agreements, and royalties and product sales under the License Agreement, totaled $63.8 million in 1998, $42.8 million in 1997 and $39.5 million in 1996.

In July 1998, the Company entered into an agreement with HLR to provide HLR exclusive marketing rights outside of the U.S. for Herceptin. Under the agreement, HLR paid $40.0 million and has agreed to pay cash milestones tied to future product development activities, to contribute equally with the Company up to a maximum of $40.0 million on global development costs and to make royalty payments on product sales. As of December 31, 1998, no additional amounts have been paid.

The Company has a contractual relationship with Novation, LLC (Novation), a group purchasing organization that is a joint venture of VHA, Inc. and University HealthSystem Consortium. One officer of VHA, Inc. is on the Company's Board of Directors. Under the contractual relationship, the Company pays to Novation an administrative fee, and pays to Novation member hospitals a rebate, based on a percentage of the purchases of Activase by such member hospitals. In 1998, administrative fees and rebates paid to Novation and its member hospitals, respectively, were not material.

The Company has contracted with Jacobs Engineering Group, Inc. (Jacobs) to provide design and engineering services for various projects of the Company. One of the members of the Board of Directors of Jacobs is also a member of the Board of Directors of the Company. In 1998, the amounts the Company paid to Jacobs were not material.

Capital Stock

Common Stock, Special Common Stock and Redeemable Common Stock: After the close of business on June 30, 1995, each share of the Company's redeemable Common Stock automatically converted to one share of Genentech Common Stock, in accordance with the terms of the redeemable Common Stock put in place at the time of its issuance in 1990 and as described in Genentech's Certificate of Incorporation. On October 25, 1995, pursuant to the Agreement with Roche, each share of the Company's Common Stock not held by Roche or its affiliates automatically converted to one share of Special Common Stock. See the *Relationship with Roche Holdings, Inc.* note above for a discussion of these transactions.

Stock Award Plans: The Company has stock option plans adopted in 1996, 1994, 1990 and 1984, which variously allow for the granting of non-qualified stock options, stock awards and stock appreciation rights to employees, non-employee directors and consultants of the Company. Incentive stock options may only be granted to employees under these plans. Generally, non-qualified options have a maximum term of 20 years, except those granted under the 1996 Plan and options granted prior to 1992 under the 1984 Plan, which have a term of 10 years. Incentive options have a maximum term of 10 years. In general, options vest in increments over four years from the date of grant, although the Company may grant options with different vesting terms from time-to-time. No stock appreciation rights have been granted to date.

The Company adopted the 1991 Employee Stock Plan (1991 Plan) on December 4, 1990, and amended it during 1993, 1995

and 1997. The 1991 Plan allows eligible employees to purchase Special Common Stock at 85% of the lower of the fair market value of the Special Common Stock on the grant date or the fair market value on the first business day of each calendar quarter. Purchases are limited to 15% of each employee's eligible compensation. All full-time employees of the Company are eligible to participate in the 1991 Plan. Of the 4,500,000 shares of Special Common Stock reserved for issuance under the 1991 Plan, 3,743,789 shares have been issued as of December 31, 1998. During 1998, 2,818 of the eligible employees participated in the 1991 Plan.

The Company has elected to continue to follow Accounting Principles Board (APB) 25 for accounting for its employee stock options because the alternative fair value method of accounting prescribed by FAS 123, "Accounting for Stock-Based Compensation," requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, "Accounting for Stock Issued to Employees," no compensation expense is recognized because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant.

Pro forma information regarding net income and earnings per share has been determined as if the Company had accounted for its employee stock options and employee stock plan under the fair value method prescribed by FAS 123 and the earnings per share method under FAS 128. The resulting effect on pro forma net income and earnings per share disclosed is not likely to be representative of the effects on net income and earnings per share on a pro forma basis in future years, due to subsequent years including additional grants and years of vesting. The fair value of options was estimated at the date of grant using a Black-Scholes option valuation model with the following weighted average assumptions for 1998, 1997 and 1996, respectively: risk-free interest rates of 5.5%, 6.2% and 5.8%; dividend yields of 0%; volatility factors of the expected market price of the Company's Common Stock of 11.9%, 9.2% and 6.2%; and a weighted-average expected life of the option of five years.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's 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 its employee stock options.

For purposes of pro forma disclosures, the estimated fair value of options is amortized to pro forma expense over the options' vesting period. Pro forma information for the years ending December 31 follows (in thousands, except per share amounts):

	1998	1997	1996
Net income – as reported	$ 181,909	$ 129,044	$ 118,348
Net income – pro forma	140,995	111,441	104,358
Earnings per share – as reported:			
Basic	1.45	1.05	0.98
Diluted	1.40	1.02	0.95
Earnings per share – pro forma:			
Basic	1.12	0.91	0.87
Diluted	1.10	0.89	0.84

A summary of the Company's stock option activity and related information were as follows:

	Shares	Weighted Average Price
Options outstanding at December 31, 1995	15,209,074	$ 36.80
Grants	6,761,545	53.99
Exercises	(1,624,541)	29.39
Cancellations	(743,569)	48.93
Options outstanding at December 31, 1996	19,602,509	42.89
Grants	329,505	58.21
Exercises	(2,443,696)	30.07
Cancellations	(1,248,709)	52.35
Options outstanding at December 31, 1997	16,239,609	44.41
Grants	4,594,925	67.82
Exercises	(2,460,907)	35.32
Cancellations	(1,248,021)	54.64
Options outstanding at December 31, 1998	17,125,606	$ 51.27

The following table summarizes information concerning currently outstanding and exercisable options.

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Years Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$ 15.990 - $ 21.375	214,951	0.58	$ 19.87	214,951	$ 19.87
$ 25.500 - $ 38.125	3,196,155	11.08	28.18	3,155,655	28.20
$ 41.750 - $ 59.000	9,306,775	11.98	52.09	4,937,820	51.35
$ 67.063 - $ 71.125	4,407,725	9.68	67.82	1,525	67.31
	17,125,606			8,309,951	

Using the Black-Scholes option valuation model, the weighted average fair value of options granted in 1998, 1997 and 1996, respectively was $17.23, $15.37 and $13.36. Shares of Special Common Stock available for future grants under all stock option plans were 2,041,218 at December 31, 1998.

Report of Independent Auditors

Report of Ernst & Young LLP, Independent Auditors

The Board of Directors and Stockholders of Genentech, Inc.

We have audited the accompanying consolidated balance sheets of Genentech, Inc. as of December 31, 1998 and 1997, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 Genentech, Inc. at December 31, 1998 and 1997, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

San Jose, California
January 20, 1999

Ernst + Young LLP

Quarterly Financial Data (Unaudited)

(thousands, except per share amounts)

	1998 Quarter Ended			
	December 31	September 30	June 30	March 31
Total revenues	$ 304,301	$ 313,930	$ 268,012	$ 264,700
Product sales	213,713	163,100	176,263	164,719
Gross margin from product sales	181,212	127,749	139,113	131,098
Net income	37,140	63,378	40,374	41,017
Earnings per share:				
Basic	0.29	0.50	0.32	0.33
Diluted	0.28	0.49	0.31	0.32

	1997 Quarter Ended			
	December 31	September 30	June 30	March 31
Total revenues	$ 277,053	$ 248,917	$ 233,493	$ 257,285
Product sales	143,352	142,306	145,018	154,213
Gross margin from product sales	120,633	115,741	119,451	126,528
Net income	41,529	32,122	23,794	31,599
Earnings per share:				
Basic	0.34	0.26	0.19	0.26
Diluted	0.33	0.25	0.19	0.25

11-Year Financial Summary (Unaudited)

(millions, except per share and employee data)

	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989	1988
Total revenues	**$ 1,150.9**	$ 1,016.7	$ 968.7	$ 917.8	$ 795.4	$ 649.7	$ 544.3	$ 515.9	$ 476.1	$ 400.5	$ 334.8
Product sales	**717.8**	584.9	582.8	635.3	601.0	457.4	391.0	383.3	367.2	319.1	262.5
Royalties	**229.6**	241.1	214.7	190.8	126.0	112.9	91.7	63.4	47.6	36.7	26.7
Contract & other	**114.8**	121.6	107.0	31.2	25.6	37.9	16.7	20.4	31.9	27.5	33.5
Interest	**88.7**	69.1	64.2	60.5	42.8	41.5	44.9	48.8	29.4	17.2	12.1
Total costs and expenses	**$ 898.3**	$ 846.9	$ 820.8	$ 745.6	$ 665.8	$ 590.8	$ 522.3	$ 469.8	$ 572.7	$ 352.9	$ 311.7
Cost of sales	**138.6**	102.5	104.5	97.9	95.8	70.5	66.8	68.4	68.3	60.6	46.9
Research & development	**396.2**	470.9	471.1	363.0	314.3	299.4	278.6	221.3	173.1	156.9	132.7
Marketing, general & administrative	**358.9**	269.9	240.1	251.7	248.6	214.4	172.5	175.3	158.1	127.9	101.9
Special charge	**–**	–	–	25.0[1]	–	–	–	–	167.7[2]	–	23.3[3]
Interest	**4.6**	3.6	5.1	8.0	7.1	6.5	4.4	4.8	5.5	7.5	6.9
Income data											
Income (loss) before taxes	**$ 252.6**	$ 169.8	$ 147.9	$ 172.2	$ 129.6	$ 58.9	$ 22.0	$ 46.1	$ (96.6)	$ 47.6	$ 23.1
Income tax provision	**70.7**	40.8	29.6	25.8	5.2	–	1.1	1.8	1.5	3.6	2.5
Net income (loss)	**181.9**	129.0	118.3	146.4	124.4	58.9	20.9	44.3	(98.0)	44.0	20.6
Tax rate	**28%**	24%	20%	15%	4%	–	5%	4%	–	8%	11%
Earnings (loss) per share:											
Basic	**$ 1.45**	$ 1.05	$ 0.98	$ 1.24	$ 1.07	$ 0.52	$ 0.19	$ 0.40	–[4]	–[4]	$ 0.25
Diluted	**1.40**	1.02	0.95	1.20	1.03	0.50	0.18	0.39	$ (1.05)[4]	$ 0.51[4]	0.24
Selected balance sheet data											
Cash, short-term investments & long-term marketable securities	**$ 1,604.6**	$ 1,286.5	$ 1,159.1	$ 1,096.8	$ 920.9	$ 719.8	$ 646.9	$ 711.4	$ 691.3	$ 205.0	$ 152.5
Accounts receivable	**149.7**	189.2	197.6	172.2	146.3	130.5	93.9	69.0	58.8	66.8	63.9
Inventories	**148.6**	116.0	91.9	93.6	103.2	84.7	65.3	56.2	39.6	49.3	63.4
Property, plant & equipment, net	**700.2**	683.3	586.2	503.7	485.3	456.7	432.5	342.5	300.2	299.1	289.4
Other long-term assets	**196.3**	177.2	149.2	105.5	61.0	64.1	37.1	42.7	61.7	85.0	89.7
Total assets	**2,855.4**	2,507.6	2,226.4	2,011.0	1,745.1	1,468.8	1,305.1	1,231.4	1,157.7	711.2	662.9
Total current liabilities	**291.3**	289.6	250.0	233.4	220.5	190.7	133.5	118.6	101.4	75.9	95.4
Long-term debt	**150.0**	150.0	150.0	150.0	150.4	151.2	152.0	152.9	153.5	154.4	155.3
Total liabilities	**511.6**	476.4	425.3	408.9	396.3	352.0	297.8	281.7	264.5	242.2	263.6
Total stockholders' equity	**2,343.8**	2,031.2	1,801.1	1,602.0	1,348.8	1,116.8	1,007.3	949.7	893.2	469.0	399.3
Other data											
Depreciation and amortization expense	**$ 78.1**	$ 65.5	$ 62.1	$ 58.4	$ 53.5	$ 44.0	$ 52.2	$ 46.9	$ 47.6	$ 44.6	$ 38.3
Capital expenditures	**88.1**	154.9	141.8	70.2	82.8	87.5	126.0	71.3	36.0	37.2	110.9
Share information											
Shares used to compute EPS:											
Basic	**125.8**	123.0	120.6	118.3	116.0	113.9	111.9	111.0	–[4]	–[4]	82.2
Diluted	**129.9**	126.4	124.0	121.7	120.2	118.7	115.0	113.2	93.0[4]	86.0[4]	85.0
Actual year-end	**127.1**	124.2	121.4	119.3	117.2	114.8	112.9	111.3	110.6	84.3	82.9
Per share data											
Market price: High	**$ 79.75**	$ 60.63	$ 55.38	$ 53.00*	$ 53.50	$ 50.50	$ 39.50	$ 36.25	$ 30.88 $ 27.50**	$ 23.38	$ 47.50
Low	**$ 59.25**	$ 53.25	$ 51.38	$ 44.50*	$ 41.75	$ 31.25	$ 25.88	$ 20.75	$ 20.13 $ 21.75**	$ 16.00	$ 14.38
Book value	**$ 18.44**	$ 16.35	$ 14.84	$ 13.43	$ 11.50	$ 9.73	$ 8.92	$ 8.53	$ 8.08	$ 5.56	$ 4.82
Number of employees	**3,389**	3,242	3,071	2,842	2,738	2,510	2,331	2,202	1,923	1,790	1,744

The Company has paid no dividends.

The Financial Summary above reflects adoption of FAS 130 and 131 in 1998, FAS 128 and 129 in 1997, FAS 121 in 1996, FAS 115 in 1994, FAS 109 in 1992 and FAS 96 in 1988.

*Special Common Stock began trading October 26, 1995. On October 25, 1995, pursuant to the new Agreement with Roche, each share of the Company's Common Stock not held by Roche or its affiliates automatically converted to one share of Special Common Stock.

**Redeemable Common Stock began trading September 10, 1990; prior to that date all shares were Common Stock. Pursuant to the merger agreement with Roche, all shareholders as of effective date September 7, 1990, received for each common share owned, $18 in cash from Roche and one-half share of newly issued Redeemable Common Stock from the Company.

(1) Charges related to 1995 merger and new Agreement with Roche ($21 million) and resignation of the Company's former CEO ($4 million).

(2) Charges primarily related to 1990 Roche merger.

(3) Primarily inventory-related charge.

(4) Reflect amounts previously reported. Information was not available to restate these amounts pursuant to FAS 128.

Common Stock, Special Common Stock and Redeemable Common Stock Information

Stock Trading Symbol GNE

Stock Exchange Listings

The Company's callable putable Common Stock (Special Common Stock) has traded on the New York Stock Exchange and the Pacific Exchange under the symbol GNE since October 26, 1995. On October 25, 1995, the Company's non-Roche stockholders approved an agreement (the Agreement) with Roche Holdings, Inc. (Roche). Pursuant to the Agreement, each share of the Company's Common Stock not held by Roche or its affiliates automatically converted to one share of Special Common Stock. From July 3, 1995 through October 25, 1995, the Company's Common Stock was traded under the symbol GNE. After the close of business on June 30, 1995, each share of the Company's Redeemable Common Stock automatically converted to one share of the Company's Common Stock. The conversion was in accordance with the terms of the Redeemable Common Stock put in place at the time of its issuance on September 7, 1990, when the Company's merger with a wholly owned subsidiary of Roche was consummated. The Redeemable Common Stock of the Company traded under the symbol GNE from September 10, 1990 to June 30, 1995. The Company's Common Stock was traded on the New York Stock Exchange under the symbol GNE from March 2, 1988, until September 7, 1990, and on the Pacific Exchange under the symbol GNE from April 12, 1988, until September 7, 1990. The Company's Common Stock was previously traded in the NASDAQ National Market System under the symbol GENE. No dividends have been paid on the Common Stock, Special Common Stock or Redeemable Common Stock. The Company currently intends to retain all future income for use in the operation of its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future. See the *Relationship with Roche Holdings, Inc.* note in the *Notes to Consolidated Financial Statements* for a further description of the Agreement with Roche.

Special Common Stockholders

As of December 31, 1998, there were approximately 13,374 stockholders of record of the Company's Special Common Stock.

Stock Prices — Special Common/Redeemable Common/Common Stock

	1998 High	1998 Low	1997 High	1997 Low
4th Quarter	$ 79 3/4	$ 68 1/8	$ 60 5/8	$ 57 1/2
3rd Quarter	72 11/16	63 9/16	58 15/16	56 1/2
2nd Quarter	73 3/4	65 3/4	59 1/4	56 1/2
1st Quarter	72 1/2	59 1/4	58	53 1/4

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STOCK LISTINGS
Genentech, Inc. is listed on the New York Stock Exchange and the Pacific Exchange under the symbol GNE.

TRANSFER AGENT
Communications concerning transfer requirements, lost certificates and change of address should be directed to Genentech's transfer agent:

EquiServe
Boston EquiServe Division
Stockholder Services
Post Office Box 8040
Boston, MA 02266-8040
Telephone: (781) 575-3400
Fax: (781) 828-8813
http://www.equiserve.com

ANNUAL MEETING
The annual meeting of stockholders will be held at 10:00 a.m. Pacific time on April 13, 1999, at The Westin Hotel, 1 Old Bayshore Highway, Millbrae, California. Detailed information about the meeting is contained in the Notice of Annual Meeting and Proxy Statement sent with a copy of the Annual Report to each stockholder of record as of February 16, 1999.

INVESTOR RELATIONS
Genentech invites stockholders, security analysts, representatives of portfolio management firms and other interested parties to contact:

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ADDITIONAL INFORMATION
If you need additional assistance or information regarding the company, or would like to receive a free copy of Genentech's Form 10-K and 10-Q reports filed with the Securities and Exchange Commission, contact the Investor Relations Department at Genentech's corporate offices at (650) 225-8679 or send an e-mail message to investor.relations@gene.com. Or direct requests for literature to Genentech's literature request line at (800) 488-6519. You may also visit Genentech's site on the World Wide Web at http://www.gene.com.

INDEPENDENT AUDITORS
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San Jose, California

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* Member of Executive Committee

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the power of

4 Leverage Our Assets

By investing in strategic partnerships and acquisitions, Genentech is putting its financial assets to work as it seeks to complement and to extract the full value of its own scientific efforts.

As a key component of its business strategy, Genentech plans to continue to leverage its assets by developing strategic alliances and by acquisitions. The goal is to provide access to novel products and technologies that will add incremental value and growth to the company's own internal research, development and marketing portfolios. As the company's current alliances do now, new partnerships will enhance Genentech's efforts at all stages of the process of bringing new medicines to market.

To complement the beginning stages of the process, Genentech looks to enter research collaborations on promising early-stage technologies being developed by other companies. Some such existing partnerships — such as an agreement with Incyte Pharmaceuticals, Inc. to access its proprietary genomic database — are important components of Genentech's discovery research initiative. A new relationship with Abgenix, Inc. provides access to that company's XenoMouse™ technology for generating fully human antibodies. Genentech expects that this technology may be useful to develop desired antibodies to some of the proteins identified through SPDI (see page 18).

Further in the process, Genentech looks for partners to aid in the development of internal programs that fall outside its strategic focus or that need important expertise or resources offered by other companies. These partnerships focus on Genentech products that the company believes are exciting and valuable assets worthy of development, but that could be more effectively developed by partners. An example of a strategic product-development collaboration is

partners

Genentech's agreement with XOMA Ltd., which is developing for Genentech through Phase II studies an anti-CD11a antibody (hu1124) for the potential treatment of psoriasis.

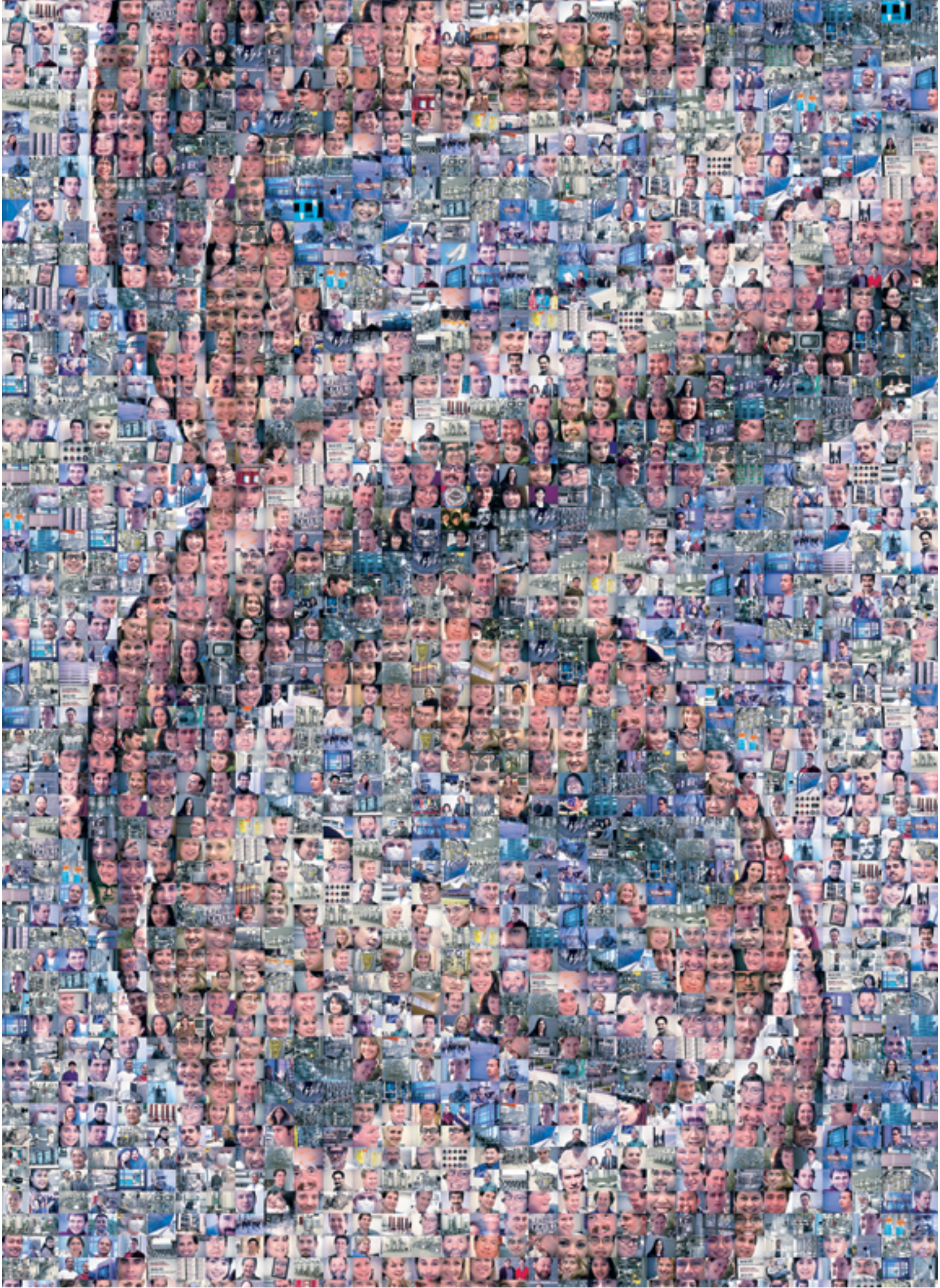
Genentech also seeks partnerships or acquisitions that will add complementary projects to its clinical development pipeline. Genentech's collaboration with LeukoSite, Inc. to develop LeukoSite's LDP-02 for the potential treatment of inflammatory bowel diseases is one example.

Strategic alliances also benefit Genentech's efforts once a product reaches the market. Genentech and its partner IDEC Pharmaceuticals Corporation continue to collaborate to expand the market for Rituxan in the United States. In 1998, Genentech entered an agreement with DAKO A/S to develop a laboratory diagnostic kit to detect HER2 overexpression in breast tumor specimens. This screening kit helps oncologists identify which of their patients can best benefit from treatment with Herceptin. As another example, in 1999 Genentech entered into an agreement with Schwarz Pharma AG, which, together with a previous arrangement with Sumitomo Pharmaceuticals Co., Ltd., will now make Genentech's growth hormone available worldwide.

Genentech assesses potential partnership opportunities on the basis of scientific merit, technical and regulatory feasibility, potential market size, competitive outlook, cost, means of financing, resource requirements and strategic fit with Genentech's existing portfolio. Genentech also licenses rights for certain Genentech intellectual property to partners that can maximize value for Genentech and make important technologies available for patient benefit.

Genentech brings to its partnerships not only financial resources but also its expertise in bringing products to market, which includes extensive experience in preclinical and clinical development, regulatory support, leading-edge process science and manufacturing capabilities, and a marketing/sales organization that recognizes the importance of demonstrating product value to customers and of responding quickly to customer needs.

By combining forces with its partners, Genentech enhances its power to achieve its strategy and its ambitious goals and to bring important new medicines to patients.



investing in the heart of our success: genentech people

3 Invest in Our People

By developing the talents, knowledge and growth of its people, Genentech is realizing the full value of its human assets, who are at the core of everything Genentech does.

From its inception in 1976, Genentech has prided itself in attracting and retaining only the best people in all areas of the company. The company's founders, Herbert W. Boyer, Ph.D., and Robert A. Swanson, laid the foundation for this reality by insisting that their new company break with industry tradition; while offering the benefits of a well-funded corporation, it would also offer significant scientific freedom. This approach worked and, in fact, was essential to attracting Genentech's current president and chief executive officer as one of the company's early research scientists.

Since then, Genentech has retained this founding philosophy and expanded on it so that it affects all areas of the company. Genentech seeks employees with an entrepreneurial drive and nurtures that drive through programs that encourage employees to become stockholders. Other programs reward individual initiative and ideas that identify scientific avenues, enhance productivity or reduce costs.

While individual drive spurs Genentech forward, day-to-day teamwork keeps the progress smooth and steady. Recognizing this, Genentech also has programs in place to reward interdisciplinary teams as they achieve important project milestones. The power of Genentech's teams stems in large part from the diversity of their players. Genentech seeks to attract and retain a diverse work force made up of individuals who bring their varied backgrounds and perspectives to their jobs.

Genentech's teams have strong individual players. Of the more than 3,300 Genentech employees, more than 80 percent have college degrees and more than 25 percent hold advanced degrees including Ph.D.s and M.D.s. Genentech expects the best from its employees and rewards them accordingly. The company's benefits plan includes industry-leading healthcare benefits, a company-matching retirement savings plan, domestic-partner benefits, a paid sabbatical program, a corporate-sponsored daycare center and health club membership.

In 1998, Genentech added "Invest in Our People" as a point to its strategy for growth. After all, it is the employees who make Genentech's success happen.

Genentech also ensures its employees remain up to date. Its scientific library rivals those of leading academic research centers. Company-sponsored, on-site scientific seminars and visiting scientist programs facilitate the free exchange of scientific ideas. Employee training funds and a tuition reimbursement program help employees throughout the company expand their skills and knowledge.

In 1998, as Genentech revised its strategy, it added as an additional point: "Invest in Our People." While Genentech has always done so, its strategy now explicitly recognizes that continuing this emphasis is essential to the company's continued success. After all, it is the employees who make Genentech's success happen.

pipeline

...and Development of Innovative Products

With 15 potential products in various stages of clinical development, all for treating serious medical conditions, Genentech's product pipeline offers hope to waiting patients.

- Cardiovascular
- Endocrinology
- Opportunistic
- BioOncology

Phase I

AMD Fab	Age-related Macular Degeneration*
LPD-02	Inflammatory Bowel Diseases

Phase II

Anti-CD11a Antibody (hu1124)	Psoriasis**
Anti-CD18 Antibody	Acute Myocardial Infarction
Anti-VEGF Antibody	Several Types of Solid-tumor Cancers
Herceptin	Non-breast Cancers***
Thrombopoietin†	Thrombocytopenia Related to Cancer Treatment
VEGF	Coronary Artery Disease**

as lifeline

PHASE III

Anti-IgE Antibody	Allergic Asthma, Allergic Rhinitis
Neuleze™	Diabetic Peripheral Neuropathy**
Pulmozyme	Cystic Fibrosis Early Intervention**
Rituxan	Intermediate- and High-grade Non-Hodgkin's Lymphoma
TNK	Acute Myocardial Infarction**
Xubix™ ††	Acute Coronary Syndrome

PREPARING REGULATORY FILING

Nutropin Depot™	Growth Hormone Deficiency in Children

* Currently preparing for Phase I clinical trial.

** Patient enrollment completed.

*** Currently preparing for Phase II clinical trial.

† Pharmacia & Upjohn (P&U) has exclusive worldwide rights for thrombopoietin (TPO). P&U and Genentech will jointly develop TPO.

†† Under clinical development by Roche. Genentech retains option rights.

Genentech's Product Development Pipeline

Through well-designed clinical trials, Genentech seeks to identify whether its projects meet certain key criteria early in the development process. This way the company can move only those candidates with the highest likelihood for success into more expensive and time-consuming late-stage clinical development. Genentech designs late-stage trials to provide answers needed by regulatory authorities to definitively determine safety and efficacy as needed for seeking marketing approval. At all stages, Genentech works closely with its development partners and with regulatory authorities to help ensure a smooth and expeditious development process. In all four of its areas of clinical focus, Genentech made significant progress in 1998.

BioOncology

Besides obtaining approval for Herceptin in 1998, Genentech progressed with continued studies of Rituxan and Herceptin and with other oncology products in its pipeline.

With partner IDEC Pharmaceuticals Corporation, Genentech announced results of a small Phase II pilot study combining Rituxan with standard chemotherapy in patients with previously untreated intermediate- or high-grade non-Hodgkin's lymphoma (NHL). The two companies continue to study this indication in Phase III trials. Rituxan is currently approved for a type of low-grade NHL. Genentech is also preparing to study Herceptin for additional cancer indications in Phase II clinical trials.

A Genentech antibody to the protein vascular endothelial growth factor (VEGF) began Phase II clinical trials. Designed to block the growth of new blood vessels to growing tumors, the anti-VEGF antibody may be useful for treating a variety of solid-tumor cancers, such as lung and colon cancer.

In collaboration with Pharmacia & Upjohn, Inc. (P&U), Genentech continued Phase II clinical trials of thrombopoietin (TPO). This blood growth factor induces the growth of platelets — cells that assist in blood clotting. Many cancer therapies lead to a side effect called thrombocytopenia, a platelet deficiency that can lead to uncontrolled bleeding. Genentech and P&U are investigating whether TPO can prevent or reduce the severity of thrombocytopenia related to cancer treatment.

Endocrinology

In 1998, Genentech completed Phase III clinical trials with Nutropin Depot, a sustained-release growth hormone product that may require an injection only once or twice monthly instead of daily. Based on positive results, with partner Alkermes, Inc., the company is preparing regulatory filings to seek approval to market Nutropin Depot for treating growth hormone deficiency in children.

Genentech is also investigating a potential medicine for the treatment of a common side effect of diabetes called peripheral neuropathy. This condition can cause pain and/or numbness of the hands and feet and can lead to severe complications, sometimes including amputation. Neuleze is in a Phase III clinical trial to determine if it can ameliorate peripheral neuropathy in diabetic patients. Enrollment in this trial is completed and patient evaluation is ongoing.

Cardiovascular Medicine

Four potential cardiovascular medicines developed by Genentech are in the clinic.

Genentech scientists selectively mutated the gene encoding tissue-plasminogen activator to develop TNK, a custom thrombolytic protein that may be easier to administer than Activase. Enrollment in the Phase III trial is complete and data analysis is under way. Genentech's development of TNK is designed to support the company's acute thrombolytic position, as is an ongoing Phase II trial of the anti-CD18 antibody used in combination with thrombolytic therapy. This trial is studying whether the anti-CD18 antibody can further improve blood flow in heart attack patients.

The other two projects in Genentech's cardiovascular development portfolio may offer a

more sustained approach to treating cardiovascular disease. They have the potential to prevent acute occurrences such as heart attacks.

Because the clumping of platelets is involved in the formation of blood clots that lead to heart attacks, Genentech's partner Roche is investigating Xubix, an oral drug that blocks a receptor on platelets involved in this clumping. Roche is conducting Phase III trials to determine if Xubix can reduce the risk of secondary heart attacks and death in patients with acute coronary syndrome (which includes unstable angina and heart attacks). Genentech retains certain U.S. option rights to Xubix.

Genentech completed enrollment in Phase II trials of VEGF as a potential treatment for ischemic cardiovascular disease. The trials are studying whether VEGF can enhance blood flow to the heart by growing new blood vessels to bypass blocked coronary arteries in patients with advanced cardiovascular disease.

Opportunistic

Genentech is developing several potential medicines that fall outside of its three defined areas of medicine and into its fourth, "opportunistic," area of focus.

In Phase III trials, an anti-IgE antibody is under clinical development for two related potential indications: allergic asthma and allergic rhinitis (hay fever). This antibody has the potential to interfere early in the complex, multistep process that leads to the symptoms of allergies and asthma. Genentech is investigating this potential medicine with its partners Novartis AG and Tanox Biosystems, Inc.

Also in Phase III trials, Genentech continues to investigate the potential benefits of managing cystic fibrosis patients with Pulmozyme early in the progression of their disease, before significant symptoms appear. Genentech has already gained approval for a label change to include safety data for the use of Pulmozyme in patients under the age of five. Results from this continuing trial may help physicians determine when best to begin their cystic fibrosis patients on Pulmozyme therapy.

With partner XOMA Ltd., Genentech completed enrollment in Phase II clinical trials of an anti-CD11a antibody as a potential treatment for psoriasis. This antibody may inhibit certain white blood cells of the immune system, which could lead to improvement in this autoimmune skin disorder.

With partner LeukoSite, Inc., Genentech is involved in investigating another antibody to receptors on certain white blood cells. Preclinical studies have indicated that these receptors may be involved in inflammatory bowel diseases. An antibody to these receptors, called LDP-02, is in Phase Ib/IIa trials as a potential treatment for these diseases.

Genentech is also currently planning Phase I clinical trials of AMD Fab, a fragment of an anti-VEGF antibody, for the potential treatment of age-related macular degeneration (AMD). In this condition, abnormal blood vessel growth in the retina of the eye can lead to blindness.

Besides conducting clinical trials of these potential medicines, Genentech also develops and refines the processes for their manufacture. The company seeks to produce extraordinarily complex medicines of the highest quality. It must do so economically and in a quantity and time frame appropriate to supply clinical trials and, upon approval, meet market demands. Depending on the processes involved, Genentech may develop production processes for its potential medicines in its manufacturing facilities in either South San Francisco or — newly opened in 1998 — Vacaville, California. Together, excellent clinical and manufacturing science will lead to new opportunities for patients and new products for Genentech's markets.

where discovery is delivered

1 Maximize Our Revenue Growth

Genentech has brought to market more biotechnology products than any other company, including a new oncology product introduced in 1998.

One component of Genentech's five-point strategy is to maximize its revenue growth. Genentech plans to do so by doing more of what it is good at: successfully introducing new products. The company intends to bolster the success of its products by maintaining market leadership in each of its therapeutic areas of focus, by continuing to deliver clinically focused resources to healthcare professionals and by continuing to provide unique patient services.

BioOncology

In 1998, Genentech successfully launched Herceptin for the treatment of certain patients with metastatic breast cancer. This followed, by about a year, the successful launch of Genentech's BioOncology Initiative and of Rituxan for treating a type of non-Hodgkin's lymphoma. These events firmly placed Genentech as a leader in certain oncology therapeutic areas. As such, Genentech has become increasingly involved in the patient- and medical-oncology community, supporting a variety of programs. For example, Genentech has established partnerships with various cancer associations to develop the Cancer Survival Toolbox™. This set of learning modules helps patients diagnosed with cancer learn skills to become better advocates for themselves as they manage their cancer.

Endocrinology

Despite significant competition in the growth hormone market, Genentech remains a market leader, with three growth hormone products that together target four indications. In 1998, Genentech recorded additional revenues from the latest indication, approved in late 1997: growth hormone deficiency in adults.

Genentech's commitment to the ongoing study of growth hormone treatment is evident in its observational clinical studies that investigate long-term safety and efficacy in patients receiving growth hormone for its various approved indications. Such studies provide physicians with important information that they can evaluate to ensure appropriate treatment of their patients.

Genentech also provides practical assistance to physicians. For example, it provides patient education materials to help the physician or nurse ease patients' concerns and help promote compliance.

Cardiovascular Medicine

During 1998, Activase continued to face pressure from a competitive thrombolytic agent and from a decline in the overall size of the thrombolytic therapy market as some heart attack patients received mechanical reperfusion rather than thrombolytic therapy. Despite these pressures, Activase continues to maintain market leadership in the thrombolytic therapy market.

In 1998 and early 1999, Genentech received three new patents related to variant forms of tissue-plasminogen activator (t-PA). The company filed patent infringement suits against Centocor, Inc., which allege that Centocor's sale, offer for sale, use and importation of Retavase® (Reteplase, recombinant) rPA in the United States infringe on these three new Genentech patents. Genentech is seeking a permanent injunction and damages.

Besides enforcing intellectual property rights, Genentech also supports its market through various programs for patients and the medical community. For example, Genentech supports the American Heart Association's Metro Stroke Task Force program. This effort has the potential to substantially reduce crucial delays in the treatment of stroke by educating and motivating professionals dedicated to emergency medicine and by raising public awareness of stroke symptoms.

Genentech is also committed to the continued study of, and improvements in care for, heart attack, known medically as acute myocardial infarction (AMI). Its National Registry of Myocardial Infarction (NRMI) — the world's largest observational study of AMI — collects, analyzes and publishes valuable data on practice patterns and outcomes. NRMI has demonstrated the importance of decreasing time to treatment and has served as a cornerstone for continued quality improvement in the treatment of AMI.

Opportunistic

In 1998, Genentech received approval to include safety data for the use of Pulmozyme in patients under age five. As a result, this medicine is now available to eligible cystic fibrosis (CF) patients of all age groups and at all levels of disease progression.

Genentech is committed to making the most of the medical benefit that Pulmozyme provides through the ongoing investigation of CF management. Its Epidemiologic Study of Cystic Fibrosis (ESCF) provides healthcare professionals valuable information on treatment trends and patient outcomes. Genentech also helps physicians by offering education and support materials for patients.

Orbin Anderson had an acute ischemic stroke in 1997. Because ten years earlier his wife had a stroke, she recognized his symptoms. Orbin was rushed to the hospital, where tests confirmed he was eligible for Activase. When he arrived, Orbin could not lift his left arm; within 20 minutes after Activase infusion, he could. Today he has no aftereffects from his stroke. Various programs that Genentech supports, such as the American Heart Association's Metro Stroke Task Force, seek to ensure that all stroke patients receive — as Orbin did — speedy medical care.

marketed products
and approved indications

Twelve of the approved products of biotechnology stem from Genentech science. Genentech manufactures and markets seven protein-based pharmaceuticals, listed below. Other products stemming from Genentech science are licensed to other companies.

Activase®
(Alteplase, recombinant)

A tissue-plasminogen activator

- Acute myocardial infarction
- Acute ischemic stroke within the first three hours of symptom onset
- Acute massive pulmonary embolism

Protropin®
(somatrem for injection)

Growth hormone

- Growth hormone deficiency (GHD) in children

Nutropin®
[somatropin (rDNA origin) for injection]

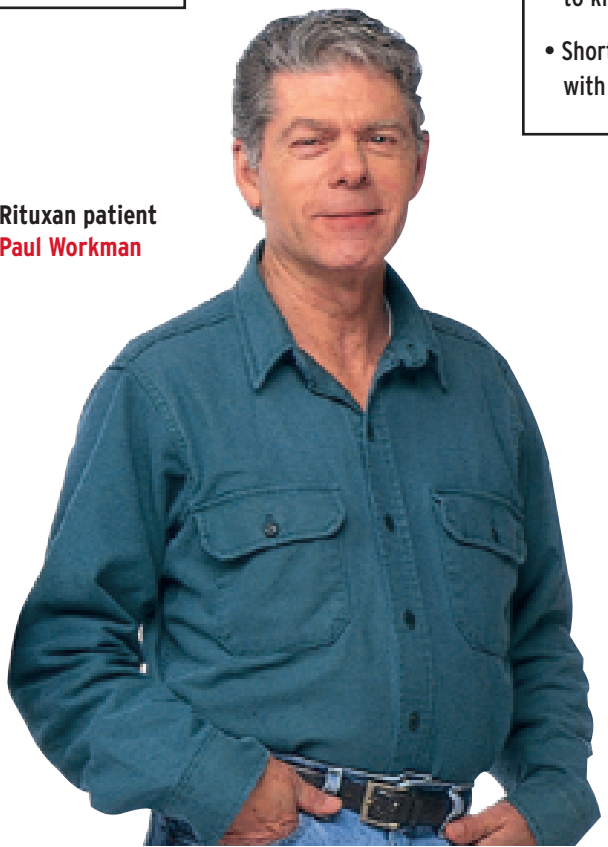
Growth hormone

- GHD in children
- GHD in adults
- Growth failure associated with chronic renal insufficiency (CRI) prior to kidney transplantation
- Short stature associated with Turner syndrome

Nutropin AQ®
[somatropin (rDNA origin) injection]

Liquid formulation growth hormone

- GHD in children
- GHD in adults
- Growth failure associated with CRI prior to kidney transplantation
- Short stature associated with Turner syndrome



Rituxan patient
Paul Workman

- CARDIOVASCULAR
- ENDOCRINOLOGY
- OPPORTUNISTIC
- BIOONCOLOGY

Pulmozyme®
(dornase alfa, recombinant)

Inhalation Solution

- Management of cystic fibrosis (including patients under the age of five*)

Rituxan®
(Rituximab)

- Relapsed or refractory low-grade or follicular, CD20 positive, B-cell non-Hodgkin's lymphoma

Herceptin®*
(Trastuzumab)

Anti-HER2 antibody

- Metastatic breast cancer in which HER2 is overexpressed

*New approval

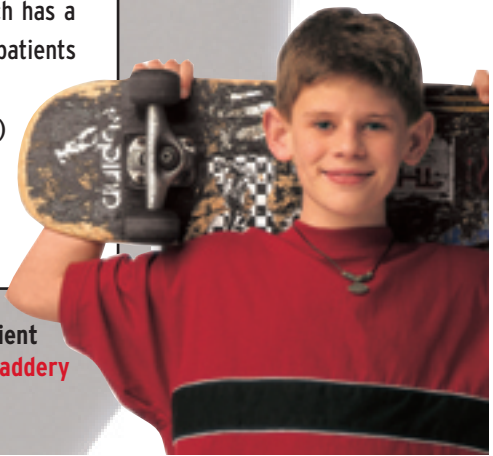
ENSURING ACCESS TO NEEDED MEDICINES

Since it launched its first product, Genentech has had programs in place to ensure that U.S. patients who need its medicines can receive them, regardless of their ability to pay.

An important service to growth hormone and BioOncology patients and their physicians is SPOC,℠ or Single Point of Contact, launched in 1997. SPOC provides customer-focused assistance to help patients and their physicians identify resources for reimbursement. One possible resource for uninsured U.S. patients is Genentech's Uninsured Patients Program (UPP). SPOC case support ensures that each patient is managed from the first call until appropriate coverage has been identified or, if the patient is eligible, Genentech provides medication under the UPP.

To help ensure that Activase is available to every patient who needs it, Genentech has a financial assistance program to provide support for uninsured and underinsured patients meeting the program's criteria.

Genentech is aware that the numerous expenses associated with cystic fibrosis (CF) treatment can, at times, limit patients' access to needed therapies. This concern led Genentech to create the Genentech Endowment for Cystic Fibrosis. The Endowment's purpose is to help financially needy CF patients with the cost of Pulmozyme therapy.



Nutropin patient
Andrew McGladdery

innovate to live,

2 Further Our Discovery...

Driven at first by innate curiosity and the never-ending "What ifs?," Genentech scientists' penchant to innovate is made more urgent by a sincere desire to benefit patients.

live to innovate

What is the key to discovery? For Genentech, as the company moves into the 21st century, it is focusing on its areas of expertise and asking the right questions. And, with the benefits of modern technology, asking — and getting answers to — the right questions very quickly. This is the essence of SPDI (pronounced *speedy*), Genentech's Secreted Protein Discovery Initiative.

SPDI builds on Genentech's world-class expertise in cloning and expressing genes that encode proteins. It also focuses on identifying the minority of proteins that are secreted by cells. These are the proteins most likely to be of therapeutic interest. SPDI uses computers and the new technologies of bioinformatics to search large databases of information to find secreted proteins. Genentech is cloning, expressing and purifying thousands of these secreted proteins using recombinant DNA technology.

SPDI next uses dozens of biological screens to sift through the purified proteins to find those of potential therapeutic interest. The biological screens were carefully selected by Genentech scientists with many different areas of expertise to identify

proteins with therapeutic potential. These screens very quickly ask the question of thousands of proteins, "Might this protein show activity in this area?" and very quickly give an answer, "Yes" or "No." The "Yeses" are then subjected to more thorough screening and testing to identify the most promising therapeutic candidates.

For example, some screens seek to identify proteins that may cause new blood vessels to grow — a process called angiogenesis. These screens have already identified some promising candidates for treating cardiovascular disease, where the growth of new blood vessels to bypass clogged arteries would be desirable. By creating antibodies to such proteins, Genentech has also identified promising potential cancer therapies, where blocking new blood supplies to growing tumors would be desirable.

Another set of screens, available to Genentech through a partnership with the National Cancer Institute, identifies proteins that cause a process called apoptosis — the biologically programmed death of cells. These screens have identified proteins that may be useful as cancer therapies, where programming the death of tumor cells would be desirable.

A third screen identifies genes rather than proteins — specifically genes that are amplified (exist in multiple copies) in certain cancers. Just as the HER2 gene's amplification in breast cancer led to the development of Herceptin to treat metastatic breast cancer, knowledge of genes amplified in other cancers could lead to specific antibodies to treat these cancers. One gene that has so far been identified, to which Genentech is now developing antibodies, is amplified in colon and lung cancers.

The beauty of SPDI is that, because of its speed, all the screens that Genentech employs can practically be applied to all the proteins to which it has access. Therefore, certain proteins may show activity in certain unexpected areas that might never have been identified with more traditional research techniques. And Genentech scientists with vastly different areas of focus and expertise are all finding uses for SPDI that expedite and enhance their research projects. As always, based on their experience and insight, Genentech scientists are deciding what questions to ask. With SPDI, they are getting useful answers faster than ever.

Genentech scientist William Wood, Ph.D., and computer specialist Kathryn Woods are involved in testing the hundreds of proteins being investigated through Genentech's Secreted Protein Discovery Initiative (SPDI).

STOCKHOLDER INFORMATION

HEADQUARTERS

Genentech, Inc.
1 DNA Way
South San Francisco, California
94080-4990
(650) 225-1000
http://www.gene.com

STOCK LISTINGS

Genentech, Inc. is listed on the New York Stock Exchange and the Pacific Exchange under the symbol GNE.

TRANSFER AGENT

Communications concerning transfer requirements, lost certificates and change of address should be directed to Genentech's transfer agent:

EquiServe
Boston EquiServe Division
Stockholder Services
Post Office Box 8040
Boston, MA 02266-8040
Telephone: (781) 575-3400
Fax: (781) 828-8813
http://www.equiserve.com

ANNUAL MEETING

The annual meeting of stockholders will be held at 10:00 a.m. Pacific time on April 13, 1999, at The Westin Hotel, 1 Old Bayshore Highway, Millbrae, California. Detailed information about the meeting is contained in the Notice of Annual Meeting and Proxy Statement sent with a copy of the Annual Report to each stockholder of record as of February 16, 1999.

INVESTOR RELATIONS

Genentech invites stockholders, security analysts, representatives of portfolio management firms and other interested parties to contact:

Susan Bentley
Senior Director, Investor Relations
Genentech, Inc.
1 DNA Way
South San Francisco, California 94080-4990
(650) 225-1260
e-mail: investor.relations@gene.com

ADDITIONAL INFORMATION

If you need additional assistance or information regarding the company, or would like to receive a free copy of Genentech's Form 10-K and 10-Q reports filed with the Securities and Exchange Commission, contact the Investor Relations Department at Genentech's corporate offices at (650) 225-8679 or send an e-mail message to investor.relations@gene.com. Or direct requests for literature to Genentech's literature request line at (800) 488-6519. You may also visit Genentech's site on the World Wide Web at http://www.gene.com.

INDEPENDENT AUDITORS

Ernst & Young LLP
San Jose, California

WANT TO LEARN MORE ABOUT GENENTECH?

Visit us on the World Wide Web:
http://www.gene.com

INTERESTED IN BIOLOGY?

Visit Access Excellence, Genentech's site on the World Wide Web for biology teachers, their students and everyone interested in the latest exciting advances in the life sciences:
http://www.gene.com/ae

letter

February 16, 1999

"We showed that excellent science can indeed serve as a foundation for solid operating results."

Arthur D. Levinson, Ph.D.
President and Chief Executive Officer

to stockholders

Since I assumed the leadership of Genentech in 1995, I have reported to you each year on the progress of our business plan. This year I do so with particular pleasure.

1998 was one of the most significant years in Genentech's history. We successfully launched Herceptin, the first monoclonal antibody for the treatment of certain types of metastatic breast cancer, offering enhanced survival time to some of the most seriously ill breast cancer patients. I give tremendous credit to Genentech employees, who discovered Herceptin, developed it, manufacture it, achieved its regulatory approval and launched the new medicine, with some records set for speed and efficiency along the way.

We also in 1998 recorded significant financial growth. In doing so we showed that excellent science can indeed serve as a foundation for solid operating results. Too often our industry has seen these two elements as representing incompatible goals. We, however, are taking a lead in demonstrating a new vision for business success in the industry. Solid business results are absolutely necessary for us to continue our scientific endeavors toward benefiting people's lives. I have gained great satisfaction, as I hope you have, from seeing our approach validated as our scientific efforts continue to drive important product introductions.

Key to our success in making a solid business of excellent science has been our strategy and Long-Range Plan (LRP). From the start, these were designed to be both flexible and disciplined. In 1998, we extended our specific goals into the middle of the first decade of the new millennium. We reassessed our strengths and challenges and developed a new five-point strategy for achieving our goals — a refinement of our earlier four-point strategy that has served us well. While we have always been an industry leader in terms of science and numbers of products developed, we now strive to have leading financial results as well. For details of our goals and the strategy for achieving them, please see page 10 of this report.

We have shown with our success to date that the discipline of our strategy and LRP has not forced scientific compromise. Rather, it has spurred further innovation, allowing us to make progress in all operating areas within the constraints of our budget.

And our progress has been significant. Besides the approval of Herceptin, we also received a second FDA approval, for a label change to include safety information in the management of cystic fibrosis patients younger than age five with Pulmozyme.

In its first full year on the market, Rituxan was used to treat more than 16,000 patients worldwide — one of the most successful introductions of any cancer therapy. In Europe, Roche received approval to market MabThera (marketed as Rituxan in the United States) for a specific non-Hodgkin's lymphoma indication. Our initial successes with Genentech's BioOncology initiative set the stage well for the launch of Herceptin in the United States. We also reached an agreement with Roche for the international development and marketing of Herceptin. This agreement provides significant revenues to Genentech and helps ensure that this medicine will reach patients worldwide.

"While we have always been an industry leader in terms of science and numbers of products developed, we now strive to have leading financial results as well."

For the remaining products in our portfolio — our growth hormone products and our thrombolytic medicine, Activase — we retained a significant market share even in the face of continued strong competition. These product lines continue to contribute significant revenues. For more information on our efforts related to our seven marketed products, please see page 14 of this report.

As we have since we launched our first product, we continue to support programs to help ensure that patients who need our medicines can receive them, regardless of their ability to pay. I believe that these programs — besides being of tremendous importance to thousands of people — are characteristic of the fundamental ethos of Genentech and its people.

Our product pipeline fuels both our hope for continued business success and patients' hopes for improved or extended lives. 1998 was a year of tremendous progress in our pipeline, and we are poised to learn key results for several of our potential products in coming months. In all, we now have 15 products in our development pipeline, including seven in Phase III or beyond.

Even with the best science, clinical research into new medicines occasionally identifies products that do not work significantly well for certain indications. This was the case with our and others' efforts investigating tissue-plasminogen activator, which we sell as Activase in the United States, for the treatment of acute ischemic stroke in patients arriving for treatment beyond three hours after symptoms began. Activase is currently approved and used successfully for treating acute ischemic stroke in patients within three hours of symptom onset, and we continue our efforts to educate the medical community and the public about the urgent need for emergency medical treatment of stroke.

Occasional disappointments are to be expected in this business, which is one reason a broad yet focused pipeline of products is necessary for our continued success. As you can see in the section beginning on page 20, the potential medicines in our pipeline represent all four of our areas of therapeutic focus: oncology, cardiovascular medicine, endocrinology and opportunistic (where we pursue exciting opportunities that fall outside of the other three defined areas). With this broad base, even with the inevitable, occasional disappointments, I believe we are well-poised to enhance our portfolio of marketed products in the coming years.

As pipeline products move onto the market, we must ensure that we have the capacity to manufacture them. In 1998, we opened a second manufacturing facility in Vacaville, California, to provide this needed capacity. This new facility defines state-of-the-science for biopharmaceutical manufacturing and is a result of excellent planning by Genentech employees, who are now readying the facility to manufacture future supplies of Herceptin, the first product to be manufactured there.

As projects move through our pipeline, we must continue to build for the future by adding new ones. For this, our discovery research efforts are essential. Two years ago we began implementing a powerful approach to discovering new proteins with pharmaceutical potential. I'm pleased to report that we are beginning to see exciting results. I believe that this approach, called the Secreted Protein Discovery Initiative (SPDI), will serve well to keep our pipeline primed for the years to come. I invite you to read about our discovery efforts on page 18 of this report.

Also important to keeping our pipeline filled are our partnerships with other companies. In fact, such partnerships complement our efforts through all stages of the drug development process. Whether we are working with Abgenix, Inc.'s technology to create new potential antibody medicines, XOMA Ltd. to move a potential psoriasis medicine through the clinical testing process, IDEC Pharmaceuticals Corporation to promote Rituxan, or Schwarz Pharma AG and Sumitomo Pharmaceuticals Co., Ltd. to make our growth hormone available worldwide, our partners' efforts complement our own and strengthen our business. As you can read on page 26, powerful partnerships remain an important component of our business strategy.

While four of the five elements of our new five-point strategy for success are refinements of the elements of our earlier four-point strategy, the fifth one is new. It concerns investing in our people. In fact, it is primarily the articulation of this point in our strategy that is new: we have long recognized the value of our employees and invested in attracting, retaining and training the best people for the job. The fact that *FORTUNE* magazine recently named Genentech to its annual list of the "100 Best Companies to Work for in America" is testimony to our efforts. I'm pleased that we have added this point to our strategy, as it will ensure that we continue to recognize and invest in this valuable asset, and it reaffirms to our employees that they are at the heart of our strategy for success.

On that note, I want to thank our more than 3,300 employees for your tremendous efforts in 1998. You made our success. I also want to thank all our stockholders for your continued support. You enabled us to pursue our goals. And finally I want to thank the medical community and the patients who use or are waiting for our medicines. In huge measure, you drive us to succeed. And we intend to continue to do so.

We face 1999 with a midyear deadline for Roche's call option followed by a stockholder put option on our stock. These will be important time points in defining our relationship with Roche. Our best approach to this challenge — and one that has moved our stock price beyond the specified put price of $60 a share — is to continue with our focus on and commitment to implementing our plan for continued growth. We are working hard to ensure that, whatever the outcome of our arrangement with Roche, the spirit, culture and potential of Genentech will continue to flourish. We are also working to achieve financial results that will make exercising the put option unattractive to shareholders.

In 1999 and into the next century, we remain
in business for hope,
in business for results,
in business for life.

Sincerely,

/s/ Arthur D. Levinson

Arthur D. Levinson, Ph.D.
President and Chief Executive Officer

Genentech's enhanced strategy aims to help Genentech reach its goal of becoming the world's leading biotechnology company by the year 2005. It does so by setting ambitious targets for five key measures (at right). As Genentech strives to reach these targets, the Long-Range Plan will help guide the company's decision-making, steering Genentech toward significant continued growth even if each of the five targets is not reached.*

- **$5 billion in revenues**
- **5 significant products in late-stage clinical trials**
- **5 new approved products/indications**
- **$500 million in revenues from strategic alliances or acquisitions**
- **25 percent net income as a percent of revenues**

*This table contains forward-looking statements, which involve risks and uncertainties, and actual results may differ materially. For a discussion of risk factors that may affect future revenues, including future revenues from strategic alliances and acquisitions, see "—Product Sales," "—Competition," "—Royalty and Contract Revenues," and "—Uncertainties Surrounding Proprietary Rights" on pages 37 and 38. For a discussion of risk factors that may affect future net income as a percent of revenues, see the foregoing risk factors plus "—R&D," "—Income Tax Provision," "—Year 2000," "—Market Risk," "—Credit Risk of Counterparties" and "—Legal Proceedings" on pages 37 to 40. For a discussion of risk factors that may affect the development and approval of products, see "—Uncertainties Surrounding Proprietary Rights" on page 38 and "—R&D" on pages 37 to 38.

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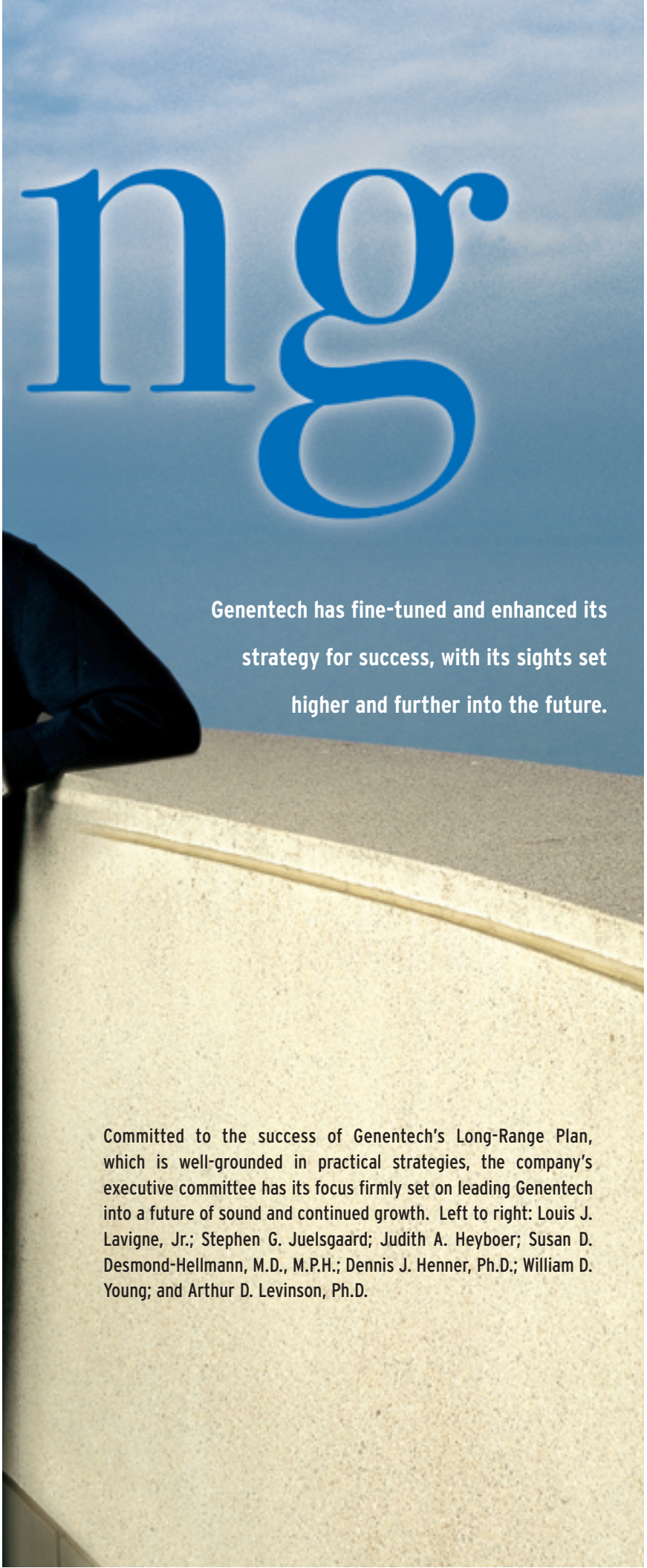
Genentech has fine-tuned and enhanced its strategy for success, with its sights set higher and further into the future.



Committed to the success of Genentech's Long-Range Plan, which is well-grounded in practical strategies, the company's executive committee has its focus firmly set on leading Genentech into a future of sound and continued growth. Left to right: Louis J. Lavigne, Jr.; Stephen G. Juelsgaard; Judith A. Heyboer; Susan D. Desmond-Hellmann, M.D., M.P.H.; Dennis J. Henner, Ph.D.; William D. Young; and Arthur D. Levinson, Ph.D.

Genentech's targets and strategies along with its Long-Range Plan set the course for Genentech's goal to become the world's leading biotechnology company.

Genentech has long been recognized as a leading biotechnology company in terms of scientific achievement and new-product development and introduction. By following its four-point strategy for success and its Long-Range Plan implemented in 1995, the company has affirmed that leadership position and has begun to show attractive financial returns as well. Now Genentech has fine-tuned and enhanced its strategy for success, with its sights set higher and further into the future. The company has set specific ambitious targets for the year 2005, with the goal of becoming the world's leading biotechnology company. These targets focus on five key measures: revenues, number of products in late-stage clinical testing, number of new approved products and indications, revenues resulting from alliances and acquisitions, and net income as a percent of revenues.

Essential to achieving these targets is a new five-point strategy, outlined on the following pages.

Genentech's Five-Point Strategy

1 Maximize Our Revenue Growth

- With successful new-product introductions and continued market leadership in our therapeutic areas of focus.
- By delivering clinically focused resources to healthcare professionals and by providing unique patient services.

2 Further Our Discovery and Development of Innovative Products

- By building on our scientific strengths, coupled with using industry-leading technology to discover and develop a steady stream of protein (including antibody) and small-molecule products.
- With well-designed preclinical and clinical trials, using products from highly efficient manufacturing and regulatory processes directed toward bringing new therapeutic products to patients quickly and safely.
- By initiating four new development projects each year (three from research, one from in-licensing).

3 Invest in Our People

- By fostering an exceptional environment that provides growth, recognition and continuous learning, to retain and attract committed people whose knowledge, efforts and creativity will enable our success.

4 Leverage Our Assets

- With aggressive pursuit of strategic alliances, acquisitions and other arrangements that add incremental value and growth to our discovery, development and marketed product portfolios.

5 Improve Our Financial Returns

- With profitable growth and productivity measured by net income as a percentage of revenues that is in the top quartile of the industry.

This five-point strategy serves both as a guide for Genentech's actions and as a measure for its success. It is geared toward enabling the company to continue its pursuit of excellent science directed toward addressing further unmet medical needs, while at the same time building value for stockholders and providing new opportunities for employees. Although these goals are ambitious, Genentech's management and its employees are committed to the five-point strategy to achieve Genentech's next goals. Guided by the Long-Range Plan, Genentech's management intends to lead the company into a new millennium of success for stockholders, for employees, for medical providers and, most important, for patients in need.

Having a clear plan in place allows Genentech to take calculated risks for its future. In 1995, with several potential medicines moving into late stages of clinical development, Genentech began building its new manufacturing facility in Vacaville, California. Opened in 1998, it is expected to be fully operational in the third quarter of 1999, with FDA licensure to follow. It is now being readied to manufacture the newly approved Herceptin (initially manufactured in South San Francisco) and will be available to provide needed capacity for other products moving through Genentech's pipeline.