



Minerva Boor  
Herceptin patient



Drew Williams  
Xolair trial patient

ONCE UPON A

# GENENTECH



Marge Harris  
Xanelim trial patient



Ronald Pearson, M.D.  
TNKase patient

# A CONSTELLATION OF ACHIEVEMENT

Significant scientific and industry milestones in biotechnology

**1663**  
Cells first described by Hooke.

**1830**  
Proteins are discovered.

**1855**  
*Escherichia coli* (*E. coli*) bacterium discovered (later becomes a major tool for biotechnology).

**1869**  
Miescher discovers DNA in the sperm of trout.

**1920**  
Human growth hormone discovered by Evans and Long.

**1940**  
Avery demonstrates that DNA is the "transforming factor" and material of genes.

**1953**  
"Double-helix" structure of DNA first described by Watson and Crick.

**1966**  
The genetic code is cracked, demonstrating that a sequence of three nucleotide bases determines each of 20 amino acids.

**1973**  
Cohen and Boyer develop genetic engineering techniques to "cut and paste" DNA and reproduce the new DNA in bacteria.

**1975**  
Milstein and Kohler develop the first monoclonal antibodies (MAbs).



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The following products were developed and are marketed by Genentech: Activase® (Alteplase, recombinant) tissue-plasminogen activator; Herceptin® (Trastuzumab) anti-HER2 antibody; Protropin® (somatrem for injection) growth hormone; and Pulmozyme® (dornase alfa, recombinant) inhalation solution indicated for the management of cystic fibrosis (including patients under age 5). Rituxan® (Rituximab) anti-CD20 antibody was developed jointly by Genentech and IDEC Pharmaceuticals Corporation and is marketed by Genentech in the U.S.; it is indicated for relapsed or refractory low-grade or follicular, CD20 positive, B-cell non-Hodgkin's lymphoma. Enbrel® (etanercept) was developed and is marketed by Immunex Corporation; Epogen® (Epoetin alfa) and Neupogen® (Filgrastim) were developed and are marketed by Amgen, Inc.; Recombinate™ (antihemophilic factor, recombinant) was developed and is marketed by Baxter Healthcare Corporation.

## TO OUR STOCKHOLDERS



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

*Twenty-five years ago, Herb Boyer and Bob Swanson had the incredible insight, bold genius and unwavering commitment to start a different kind of company — one based on the belief that recombinant DNA technology would produce commercially viable, breakthrough medicines within a relatively short period of time. On April 7, 1976, the two founded Genentech — and in doing so launched the biotechnology industry. The adventure began...*

As we enter the year 2001 and celebrate biotechnology's first quarter century, I continue to be amazed by the magnitude and pace of biotech discovery, and I marvel at the remarkable impact our "young" industry has already had on the world of human health. As Chairman and CEO of Genentech, I am particularly proud of the role our company has played in inciting the "revolution in biology" back in 1976 and in remaining at the forefront of the biotech industry ever since.

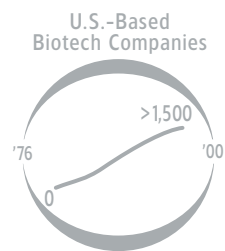
From its humble beginnings, this industry — founded on a vision and a promise — has grown today to include over 1,500 U.S.-based biotech companies. Nearly 100 biotech drugs and vaccines have been approved in the United States and around the world, enhancing or extending the lives of hundreds of millions of people. And, more than 350 new biotech drugs and vaccines are currently being evaluated in clinical trials, with hundreds more in development. Today, scientists worldwide are closer than ever to discovering new therapies and cures for our most serious and life-threatening diseases, including cancer, heart disease and neurodegenerative diseases such as Alzheimer's and Parkinson's. All this, while we are on the verge of a terrific expansion of the knowledge and understanding of the human genetic and biologic function. Never has there been a time when so much has converged to enable even more significant advances in the not-too-distant future.

This year's report documents not only Genentech's performance for the year 2000, but also reflects on how far we've come in 25 years in our ability to discover, develop, manufacture and market innovative biotech therapies that fill significant unmet medical needs, while delivering strong financial returns to our stockholders.

In 2000, our total revenues were \$1.73 billion — a 23 percent increase over 1999 revenues.<sup>12</sup> Our prime productivity measure of net income as a percent of revenues was 19 percent for 2000, up from 18 percent in 1999 and making progress toward *our 5 x 5 goal of 25 percent of revenues reaching the bottom line by 2005*.<sup>12</sup> Earnings-per-share growth in 2000 increased 28 percent over 1999, in line with *our goal for 2005 of an on-average annual*

## MISSION STATEMENT

Our mission is to be the leading biotechnology company, using human genetic information to develop, manufacture and market pharmaceuticals that address significant unmet medical needs. We commit ourselves to high standards of integrity in contributing to the best interests of patients, the medical profession, and our employees, and to seeking significant returns to our stockholders based on the continued pursuit of excellent science.



**25-percent earnings-per-share growth.**<sup>2-4</sup> Also, for the second year in a row, product sales exceeded \$1 billion, and in 2000 reflected a 23 percent increase over 1999 product sales.<sup>1,2</sup> A strong commercialization effort throughout the year drove sales growth, primarily through our biooncology products, Herceptin and Rituxan.

In June of 2000, we successfully introduced two new products, TNKase, the first thrombolytic agent able to be administered as a five-second injection, and Nutropin Depot, the first long-acting dosage form of recombinant growth hormone (indicated for the treatment of growth failure due to inadequate endogenous growth hormone secretion in children). Together with Novartis Pharmaceuticals Corporation and Tanox, Inc., we also submitted a Biologics License Application to the U.S. Food and Drug Administration (FDA) for anti-IgE, or Xolair, the first humanized monoclonal antibody for the potential treatment of asthma and seasonal allergic rhinitis.

Going forward, the majority of our research and development efforts will remain focused on the areas of oncology and cardiovascular medicine — areas that today represent the top two leading causes of death by disease in the United States — as well as other areas where we see opportunities and possess strong biological insights and a deep understanding of the basis of disease. We will continue to maximize our strategic advantage in cancer as the primary driver of growth for the company. This strategy is reflected in our current development pipeline, which has grown to include 20 active projects — many of which are monoclonal antibodies being evaluated in oncology indications or in opportunistic areas such as respiratory disease, inflammation and immunology. The progress we are making in the development area puts us on course to meet **another of our 5 x 5 goals — to gain approval of five new products or indications by 2005.**

Our capacity and expertise in large-scale manufacturing of complex proteins are unmatched in the industry and provide us with a unique and powerful competitive advantage. In 2000, we received FDA licensure for our Vacaville, Calif., facility, one of the world's largest biotechnology manufacturing plants for the production of pharmaceutical proteins, and acquired a third facility in Porriño, Spain.

During a year of growth and progress in manufacturing, we have also had to address several observations resulting from an FDA-sponsored Team Biologics inspection of our South San Francisco facility. At no time did these observations cause any safety issues for patients nor did they have any negative impact on product quality or on the availability of products to patients. We communicated our plans for improvements in our quality and manufacturing processes to the FDA and, in February 2001, we were officially informed by the FDA that our responses to their observations were acceptable.

Last year's sequencing of the human genome began a whole new era in medicine — one that holds unprecedented potential for improving and saving millions of lives. Genentech's 25 years of experience in genetic engineering, expertise in molecular biology, and integrated multidisciplinary research foundation uniquely position us to capitalize on the tools of genomics to accelerate the drug discovery process. Over the past several years, we have filed more than 1,000 patent applications on full-length DNA sequences that encode novel human proteins with therapeutic potential — many the result of our own highly successful Secreted Protein Discovery Initiative (SPDI). From the start, our strategy has been to include in our patent applications data from actual biologic assays that disclose the function and utility of these sequences. We believe that this is a responsible approach, which is consistent with the U.S. Patent and Trademark Office's new guidelines on utility, and places us in an excellent position to have new patents granted in the United States and internationally. To date, we hold more than 3,600 patents worldwide, with more than 2,600 patent applications pending. Our strong research and development organization and advantage in genomics-enabled discovery continue to fuel our pipeline and will help us meet **our 5 x 5 goal of having five significant products in late-stage clinical trials by 2005.** Toward this end, we established an internal goal last year of adding four new projects per year to our pipeline starting in the year 2000, and I am pleased to report that we have exceeded that goal.

As we continue to mine the information from the sequencing of the human genome for potential therapies, we must also work to preserve the potential market for those therapies. Therefore, this year, we have begun devel-

oping a set of principles for the Medicare Outpatient Drug benefit legislation currently before Congress. We feel strongly that the benefit must be market-based to ensure that beneficiaries have a choice of drug service providers. As such, we also recommend that the program be run by an entity with prior experience in administering market-based systems. We support a stop-loss benefit and a low-income subsidy, which will protect individuals with high drug spending from impoverishment and provide proportionately greater assistance to those who cannot afford to buy their drugs. Finally, it is our recommendation that the program be voluntary and open to all who wish to participate. By taking this position, we hope to ensure that the benefits of our continuing discoveries will be translated into therapies that can be used by all Americans.

Strategic alliances, partnerships and acquisitions have become an increasingly important priority for Genentech over the past several years — and a key factor in our future growth. We are currently involved in 27 such collaborative arrangements — several of which represent innovative new business models. We have had much success recently in forming alliances that solidify or strengthen our biooncology and cardiovascular businesses. Our ongoing progress in these areas should help us achieve **our 5 x 5 goal of generating \$500 million in new revenues from alliances and acquisitions by the year 2005.**

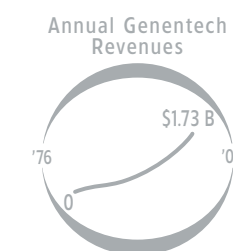
I invite you to read through this year's annual report and share in our very special anniversary celebration. The pages that follow highlight key areas of achievement that reflect Genentech's growth, strength and commitment: marketed products, partnerships, development pipeline, monoclonal antibodies, product operations, genomics, research and corporate responsibility. We enter the new millennium more capable than ever before of delivering consistently strong commercial, scientific and financial results. "Firing on all cylinders" — from basic research to commercialization — Genentech has the resources, talent and strategies in place to propel us to new levels of accomplishment in providing valuable therapies to an expanding patient base and increasingly strong financial returns to our stockholders.

In closing, I'd like to thank the thousands of employees and the stockholders who have contributed to our success, growth and ability to save or improve lives over the past 25 years. We have accomplished great things, but this is truly only the beginning. I would also like to pay tribute to the millions of patients who have put their trust in the power of biotechnology products, participated in clinical studies and shared their experiences with us — for they are truly the heroes and heroines of this story.

I look forward to your continued support.

Sincerely,

**Arthur D. Levinson, Ph.D.**  
Chairman and Chief Executive Officer



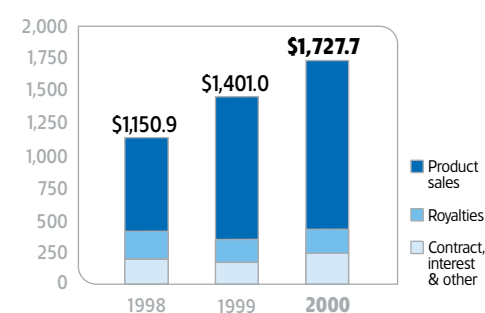
1. Based on Pro Forma amounts, which exclude the special charges in 1999 related to the Redemption and legal settlements, recurring charges related to the Redemption in 2000 and 1999, costs in 2000 and 1999 related to the sale of inventory that was written up at the Redemption, and their related tax effects. In addition, Pro Forma excludes the cumulative effect of a change in accounting principle, net of tax, in 2000. See the "Special Charges," "Recurring Charges Related to Redemption," "Cost of Sales," "Income Tax," and "Staff Accounting Bulletin No. 101" discussions on pages 29-31 in the Financial Review section of this annual report for further information on these charges. 2. Percent change was calculated based on Pro Forma amounts and shares where applicable. 3. All share, price per share and per share amounts of Common Stock and Special Common Stock reflect the two-for-one splits of our Common Stock that were effected in October 2000 and November 1999. 4. The goals for 2005 in this letter are forward-looking statements. The Company's actual results may differ materially. For a discussion of the factors that may affect future revenues, see "Forward-Looking Information and Cautionary Factors That May Affect Future Results—Fluctuations in Our Operating Results Could Affect the Price of Our Common Stock," "Our Affiliation Agreement With Roche Could Limit Our Ability to Make Acquisitions and Could Have a Material Negative Impact on Our Liquidity," "We Face Growing and New Competition," "Other Competitive Factors Could Affect Our Product Sales," "Our Royalty and Contract Revenues Could Decline," "Difficulties or Delays in Product Manufacturing Could Harm Our Business," "We Are Exposed to Market Risk," and the factors discussed below that could affect the development and approval of products, on pages 37-44; future earnings per share and net income as a percent of revenues, see the foregoing factors, plus "In Connection With the Redemption of Our Special Common Stock, We Recorded Substantial Goodwill and Other Intangibles, the Amortization of Which May Adversely Affect Our Earnings," "Protecting Our Proprietary Rights Is Difficult and Costly," "We May Incur Material Litigation Costs," "We May Incur Material Product Liability Costs," "We Are Exposed to Market Risk," "Our Interest Income Is Subject to Fluctuations in Interest Rates," "Our Investments in Equity Securities Are Subject to Market Risks," "Recent Accounting Pronouncements Could Impact Our Financial Position and Results of Operations," and "We Are Exposed to Credit Risk of Counterparties," on pages 40-44; the development and approval of products, see "The Successful Development of Pharmaceutical Products Is Highly Uncertain," "We May Be Unable to Retain Skilled Personnel and Maintain Key Relationships," and "We May Be Unable to Obtain Regulatory Approvals for Our Products," on pages 37-41.

# FINANCIAL HIGHLIGHTS

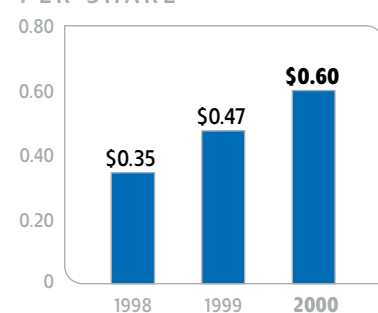
(dollars in millions, except per share data)

Years ended December 31	2000		1999		% Change from Preceding Year <sup>(1)</sup>		
	Actual	Pro Forma <sup>(1)</sup>	Actual <sup>(2)</sup>	Pro Forma <sup>(1)</sup>	1998	00/99	99/98
Total revenues	\$ 1,736.4	\$ 1,727.7	\$ 1,401.0	\$ 1,401.0	\$ 1,150.9	23%	22%
Product sales	1,278.3	1,278.3	1,039.1	1,039.1	717.8	23	45
Cost of sales	364.9	272.1	285.6	192.2	138.6	42	39
Research and development (R&D) expenses	489.9	489.9	367.3	367.3	396.2	33	(7)
Marketing, general and administrative expenses	497.0	497.0	467.9	467.9	358.9	6	30
Special charges <sup>(4)</sup>	—	—	1,437.7	—	—	—	—
Recurring charges related to redemption <sup>(5)</sup>	375.3	—	197.7	—	—	—	—
Cumulative effect of accounting change, net of tax <sup>(6)</sup>	(57.8)	—	—	—	—	—	—
Net income (loss)	(74.2)	319.8	(1,157.5)	246.7	181.9	30	36
Diluted earnings (loss) per share <sup>(7)</sup>	(0.14)	0.60	(2.26)	0.47	0.35	28	34
R&D expense as a % of revenues	—	28%	—	26%	34%	—	—
Net income as a % of revenues	—	19%	—	18%	16%	—	—
Shares used to compute diluted earnings (loss) per share (millions) <sup>(7)</sup>	522.2	536.1	512.9	529.5	519.5	1	2
Actual shares at year-end (millions) <sup>(7)</sup>	525.5	525.5	516.2	516.2	508.5	2	2
Stock price at year-end <sup>(7)</sup>	\$ 81.50	—	\$ 67.25	—	\$ 19.93	21	237
<i>No cash dividends were paid.</i>							
Cash, short-term investments and long-term marketable securities	\$ 2,459.4	—	\$ 1,957.4	—	\$ 1,604.6	26	22
Property, plant and equipment, net	752.9	—	730.1	—	700.2	3	4
Total assets	6,711.8	—	6,534.8	—	2,855.4	3	129
Total stockholders' equity	5,674.2	—	5,269.9	—	2,343.8	8	125
Capital expenditures	112.7	—	95.0	—	88.1	19	8
Number of employees	4,459	—	3,883	—	3,389	15	15

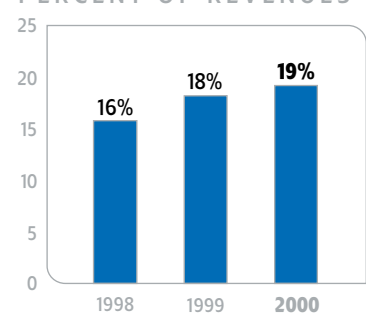
## REVENUES<sup>(8)</sup>



## DILUTED EARNINGS PER SHARE<sup>(8)</sup>



## NET INCOME AS A PERCENT OF REVENUES<sup>(8)</sup>



(1) Pro Forma amounts exclude the special charges in 1999 related to the Redemption and legal settlements, recurring charges related to the Redemption in 2000 and 1999, costs in 2000 and 1999 related to the sale of inventory that was written up at the Redemption, and their related tax effects. In addition, Pro Forma excludes the cumulative effect of a change in accounting principle, net of tax, in 2000. See the "Special Charges," "Recurring Charges Related to Redemption," "Cost of Sales," "Income Tax," and "Staff Accounting Bulletin No. 101" discussions in the Financial Review section of this annual report for further information on these charges. (2) Actual 1999 results include the combined New Basis and Old Basis presentation from the Consolidated Statements of Operations and the Consolidated Statements of Cash Flows. In addition, we corrected the accounting related to the write up of the valuation allowance pertaining to unrealized gains on certain marketable securities. Refer to "Basis of Presentation and Restatement" in the Notes to Consolidated Financial Statements. (3) Percent change was calculated based on Pro Forma amounts and shares where applicable. (4) Amount includes \$1,207.7 million related to the Redemption of our Special Common Stock and \$230.0 million related to legal settlements. (5) Amounts primarily relate to the amortization of goodwill and other intangible assets due to the Redemption of our Special Common Stock. (6) We adopted the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 on revenue recognition effective January 1, 2000, and recorded a cumulative effect of a change in accounting principle, net of tax. (7) All share, price per share and per share amounts of Common Stock and Special Common Stock reflect the two-for-one splits of our Common Stock that were effected in October 2000 and November 1999. (8) Graphs are based on Pro Forma amounts.

# BUSINESS MILESTONES

Highlighted below are major events that occurred in 2000 and early 2001.

## MARKETED AND PIPELINE PRODUCT EVENTS

### Oncology

- With partners Roche and IDEC Pharmaceuticals Corporation, announced positive interim results from a Phase III study of Rituximab (Rituxan/MabThera) in combination with CHOP (cyclophosphamide, doxorubicin, vincristine and prednisone) chemotherapy in previously untreated patients with aggressive non-Hodgkin's lymphoma.
- In conjunction with F. Hoffmann-La Roche and leading cancer cooperative groups, initiated large randomized Phase III clinical trials to evaluate Herceptin in the adjuvant setting for early-stage breast cancer.
- Announced at the American Society of Clinical Oncology (ASCO) annual meeting, positive results from a Phase II study investigating Herceptin as a single agent for patients with previously untreated HER2-positive metastatic breast cancer.
- Announced, also at ASCO, preliminary positive results from Phase II trials evaluating anti-VEGF in combination with chemotherapy in patients with advanced metastatic colorectal and non-small cell lung cancers, as well as positive interim Phase II results of trials evaluating anti-VEGF as a single agent in patients with relapsed metastatic breast cancer.
- Initiated Phase III clinical trials of anti-VEGF in colorectal and breast cancers.
- Moved 2C4, a monoclonal antibody, into development for the potential treatment of a variety of solid-tumor cancers.
- With OSI Pharmaceuticals, Inc. and Roche, announced agreements for the global codevelopment and commercialization of OSI's lead anti-cancer drug, OSI-774.

### Cardiovascular Medicine

- Received U.S. Food and Drug Administration (FDA) approval of and launched TNKase (Tenecteplase), the first five-second, single-dose thrombolytic for the treatment of acute myocardial infarction (AMI), or heart attack.
- Submitted to the FDA and had accepted for review a supplemental Biologics License Application (sBLA) for Activase for use in catheter clearance.

- Initiated Phase III clinical trials in collaboration with other major pharmaceutical manufacturers to test TNKase in combination with various leading anti-thrombotic agents in the treatment of AMI.
- Signed a licensing agreement with Actelion Ltd. for the development and copromotion in the United States of tezosentan, which is in Phase III trials for the potential treatment of acute heart failure.
- Signed a second licensing agreement with Actelion for the development and copromotion in the United States of Tracleer, also in Phase III trials, for the potential treatment of pulmonary hypertension and acute and chronic heart failure.
- Announced results indicating that the Phase II clinical trial of anti-CD18 for the treatment of heart attack did not meet its primary objectives.
- Announced a collaborative agreement with COR Therapeutics, Inc. and Schering-Plough Corporation to copromote INTEGRILIN for non-ST-segment acute coronary syndrome, and TNKase and Activase for acute ST-segment-elevation AMI.

### Opportunistic

- With partners Novartis Pharmaceuticals Corporation and Tanox, Inc., filed a Biologics License Application (BLA) with the FDA for Xolair for the potential treatment of asthma and seasonal allergic rhinitis.
- Completed patient enrollment in two pivotal Phase III clinical trials evaluating Xanelim anti-CD11a antibody in patients with moderate to severe psoriasis, and completed enrollment in a Phase I/II clinical study of Xanelim in the prevention of kidney transplant rejection. Genentech is developing Xanelim with XOMA Ltd.
- Launched Nutropin Depot, the first long-acting dosage form of recombinant growth hormone, indicated for the treatment of growth failure due to inadequate endogenous growth hormone secretion in children, and developed with partner Alkermes, Inc.
- Completed a Phase III clinical trial of Pulmozyme in early-stage cystic fibrosis and presented positive results at the North American Cystic Fibrosis Conference.

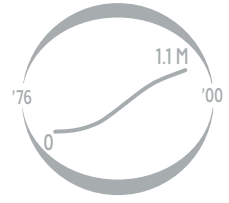
- With Alkermes, Inc., announced a decision to proceed with a Phase II/III clinical trial of Nutropin Depot in growth-hormone-deficient adults.
- In collaboration with Genentech, Millennium Pharmaceuticals, Inc. initiated Phase II clinical trials of LDP-02 for inflammatory bowel disease.
- In collaboration with Genentech, Inspire Pharmaceuticals, Inc. initiated Phase II clinical trials of INS365 for patients with chronic bronchitis, and filed a new drug application for INS37217 Respiratory for the treatment of cystic fibrosis.

## CORPORATE AND EMPLOYEE EVENTS

- Was named in 2001 for the third consecutive year to *Fortune* magazine's annual list of "100 Best Companies to Work for in America."
- Appointed Myrtle S. Potter as executive vice president, commercial operations, and chief operating officer.
- Named as senior vice presidents: Richard H. Scheller, Ph.D., research; Robert L. Garnick, Ph.D., regulatory, quality and compliance; and Kimberly J. Popovits, marketing and sales.
- Named as vice presidents: Claudia Estrin, decision support and commercial innovation; Roy Hardiman, corporate law, and assistant secretary; R. Guy Kraines, finance; Joseph S. McCracken, business and commercial development; David Nagler, human resources; Andrew Scherer, engineering, facilities, strategic planning and support; and John M. Whiting, controller and chief accounting officer.
- Received multiproduct FDA licensure for the new, state-of-the-art manufacturing facility in Vacaville, Calif. Also, purchased a cell culture manufacturing facility in Porriño, Spain, that will supplement Genentech's existing bulk cell culture production capacity.
- Roche completed the public offering of 34.6 million Genentech shares.\*
- In October, announced a two-for-one stock split that was effective October 24, 2000 in the form of a stock dividend.

\*All share information reflects the two-for-one stock split in October 2000.

Genentech has or owns rights to various copyrights, trademarks and trade names used in our business, including the following: Activase® (Alteplase, recombinant) tissue-plasminogen activator; Herceptin® (Trastuzumab) anti-HER2 antibody; Nutropin® [somatotropin (rDNA origin) for injection] growth hormone; Nutropin AQ® [somatotropin (rDNA origin) injection] liquid formulation growth hormone; Nutropin Depot® [somatotropin (rDNA origin) for injectable suspension] growth hormone; Protropin® (somatrem for injection) growth hormone; Pulmozyme® (dornase alfa, recombinant) inhalation solution; TNKase® (Tenecteplase) single-bolus thrombolytic agent; Xanelim® (efalizumab) anti-CD11a antibody; and Xolair® (Omalizumab) anti-IgE antibody. Enbrel® (etanercept) is a registered trademark of Immunex Corporation; Epogen® (Epoetin alfa) and Neupogen® (Filgrastim) are registered trademarks of Amgen, Inc.; INTEGRILIN® (eptifibatid) injection is a registered trademark of COR Therapeutics, Inc.; MabThera® (Rituximab) antibody is a registered trademark of Roche; Recombinate® (antihemophilic factor, recombinant) is a trademark of Baxter Healthcare Corporation; Rituxan® (Rituximab) antibody is a registered trademark of IDEC Pharmaceuticals Corporation; Tracleer® (bosentan) is a trademark of Actelion Ltd.



A STORY OF LIVES  
ENHANCED

*Minerva Boor was diagnosed with breast cancer in 1994 at age 33. After failing to respond to chemotherapy, radiation and a bone marrow transplant, Minerva started Herceptin treatment in late 1998. She's been on Herceptin since, with no recurrence of cancer and no significant side effects. Today, Minerva enjoys good health and an active life with her husband and two young boys.*



Delivering innovative medicines to patients with serious or life-threatening medical conditions is what Genentech is all about. Since its beginning in 1976, the company has focused its drug discovery efforts solely on therapies that would fill unmet needs. Today, Genentech markets and manufactures nine protein-based products for 10 serious or life-threatening medical conditions — giving Genentech one of the leading product portfolios in the biotech industry.

During the last two decades, these medicines have been used to successfully treat over 1 million cardiovascular, oncology, respiratory and growth hormone patients worldwide — and this number continues to rise. The positive impact of Genentech's therapies on the lives of patients and their families is a constant inspiration to Genentech's employees.

Because many Genentech products are unique, first-ever therapies, they have actually changed the way healthcare professionals treat certain diseases and disorders — while providing new hope to patients. Two prime examples of this innovation at work are the biooncology drugs Herceptin and Rituxan, both of which are monoclonal antibodies — precisely targeted therapeutics that can destroy cancer cells without subjecting patients to many of the toxic side effects seen with chemotherapy and radiation treatment.

Developed with partner IDEC Pharmaceuticals Corporation, and approved for non-Hodgkin's lymphoma in 1997, Rituxan became the first monoclonal antibody approved for the treatment of

THE DREAM OF BIOTECHNOLOGY COMES TRUE...  
MARKETED PRODUCTS

**HERCEPTIN<sup>®</sup>** (Trastuzumab)

Anti-HER2 antibody

- Metastatic breast cancer in HER2 overexpressed tumors

**RITUXAN<sup>®</sup>** (Rituximab)

Anti-CD20 antibody

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

**TNKase<sup>™</sup>** (Tenecteplase)

Single-bolus thrombolytic agent

- For the treatment of acute myocardial infarction (AMI)

**ACTIVASE<sup>®</sup>** (Alteplase, recombinant)

A tissue-plasminogen activator

- AMI
- Acute ischemic stroke
- Acute massive pulmonary embolism

**PULMOZYME<sup>®</sup>** (dornase alfa, recombinant)

Inhalation solution

- For the management of cystic fibrosis (including patients under age 5)

**NUTROPIN DEPOT<sup>™</sup>** [somatropin (rDNA origin) for injectable suspension]

Growth hormone

- For the treatment of growth failure due to inadequate endogenous growth hormone secretion in children

**NUTROPIN AQ<sup>®</sup>** [somatropin (rDNA origin) injection]

Liquid formulation growth hormone

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

**NUTROPIN<sup>®</sup>** [somatropin (rDNA origin) for injection]

Growth hormone

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

**PROTROPIN<sup>®</sup>** (somatrem for injection)

Growth hormone

- GHD in children

Genentech also copromotes the GP IIb/IIIa inhibitor **INTEGRILIN<sup>®</sup>** (eptifibatide) Injection, which was developed by COR Therapeutics, Inc. and Schering-Plough Corporation. **INTEGRILIN** is indicated for the treatment of patients with acute coronary syndrome (unstable angina and non-Q-wave MI), including those who are to be managed medically and those undergoing percutaneous coronary intervention (PCI); and for the treatment of patients undergoing PCI at the time of procedure.

AN AMAZING TALE  
OF SURVIVAL

*While on duty, emergency room (ER) physician Dr. Ronald Pearson realized he was having a heart attack of his own. Springing into action, Dr. Pearson chose to be treated with the newly approved thrombolytic, TNKase. Twenty minutes after receiving this single-injection clot-buster, Dr. Pearson felt his chest pain subside. Two weeks later, he was back at work in the ER.*



cancer and has since been used to treat more than 40,000 patients worldwide. Today, Rituxan remains the only monoclonal antibody therapy approved for non-Hodgkin's lymphoma, a disease affecting some 300,000 Americans.

First approved in 1998, Herceptin has proved to be one of a very few drugs on the market to show a significant survival benefit in women with HER2-positive metastatic breast cancer. More than 25,000 women have been treated with Herceptin to date. Clinical studies under way are evaluating Herceptin in the adjuvant setting for early-stage breast cancer.

In the cardiovascular arena, Genentech launched the new thrombolytic agent, TNKase, for the treatment of acute myocardial infarction (AMI), or heart attack, in mid-2000. The first "clot-buster" able to be administered in a single five-second injection,

TNKase represents an important advance in the speed with which heart attack treatment can be delivered. A bioengineered plasminogen activator, TNKase is similar to Genentech's Activase, the recombinant DNA-derived version of naturally occurring tissue-plasminogen activator (t-PA) that revolutionized AMI treatment more than 13 years ago. TNKase's unique features have been specifically designed to prolong its half-life, enabling it to be given as a single injection. It also has been engineered with increased specificity for fibrin, a key component of intra-coronary clots, potentially resulting in less disturbance of the body's natural clotting system.

Starting in early 2001, Genentech will copromote the glycoprotein (GP) IIb/IIIa inhibitor INTEGRILIN, developed by COR Therapeutics, Inc. and Schering-Plough Corporation. The most widely used GP IIb/IIIa inhibitor in the United States, INTEGRILIN helps prevent the development of blood clots that can occlude arteries in the heart, causing heart attack and death. Through this collaboration, COR and Schering-Plough will copromote the Genentech cardiovascular products, TNKase and Activase.

Four growth hormone products — including newcomer Nutropin Depot, a long-acting formulation of growth hormone that offers once- or twice-monthly dosing (and may require more than one injection per dose) — and the unique cystic fibrosis medicine, Pulmozyme, comprise Genentech's "opportunistic" area of therapeutic products.

COMMERCIAL  
TAKES OFF...

Staying ahead of a prolific pipeline and a successful development arm has been a major focus of Genentech. As the company has grown and the complexities of the healthcare industry have increased, so have the skills and capabilities of Genentech's commercial organization.

Introducing and marketing multiple products into new and different markets, directing prelaunch commercial development activities and utilizing cutting-edge sales approaches — Genentech brings the same level of excellence and innovation to its commercial organization as it does to research and development. In recent years, Genentech's commercial organization has experienced a period of expansion and maturation that has helped ensure that the company's products get to all patients who need them and has brought added stockholder value to the company.

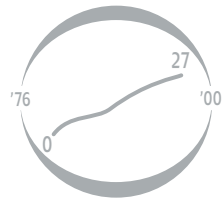
The strength of this commercial organization is perhaps best evidenced by Genentech's rapidly established presence in the oncology market within the last three years, with the drugs Herceptin and Rituxan — both of which produced first-year sales that surpassed any previous cancer drug. In partnership with professional societies and advocacy groups, Genentech has ensured that physicians and patients are kept informed and educated about these novel therapies.

The commercialization team is also involved with development activities that bring forward products in the pipeline in the most efficient way to meet the demands of the market and the healthcare community — directing market research, sponsoring medical education efforts and developing a leading patient

reimbursement assistance program. In an age in which strategic partnerships are an increasingly important part of development, Genentech is continually forming new alliances and collaborations to maximize the value of its portfolio, leverage its assets and garner additional value for patients and stockholders. The company's expertise in commercialization has made it a valuable and sought-after partner.



*Left to right: Kim Popovits, senior vice president, marketing and sales; Joe McCracken, vice president, business and commercial development; Myrtle Potter, executive vice president, commercial operations, and chief operating officer; Diane Parks, vice president, managed healthcare and commercial support; and Claudia Estrin, vice president, decision support and commercial innovation, bring a unique blend of experience, strength and innovation to Genentech's commercial organization.*



From the beginning of its existence, Genentech has recognized the value of strategic partnerships. The company joined forces with Eli Lilly and Company in 1978 (licensing to Lilly the rights to market recombinant human insulin), and since then has formed hundreds of alliances that span all areas of the business — from basic research and clinical development to manufacturing and commercialization. Partnerships, alliances and acquisitions have been identified as key strategies and drivers of future growth.

collaborations with other companies. One exciting product poised to emerge from the pipeline is Xolair, an anti-IgE monoclonal antibody therapy with the potential to reduce asthma exacerbations and control the symptoms of seasonal allergic rhinitis, reducing the need for corticosteroids and improving the patient's quality of life. Genentech is developing this product with partners Novartis Pharmaceuticals Corporation and Tanox, Inc. and will commercialize the product in the United States with Novartis.

## A NEW WORLD OF OPPORTUNITY EMERGES... PARTNERSHIPS

### A NEW BEGINNING

*Severe asthma has kept Drew Williams from participating in most school outings and physical activities since early childhood. For the past 2 1/2 years, Drew has received the monoclonal antibody Xolair as part of a clinical study. Healthier and more active than ever, Drew has been able to stop all his other medications, except for the occasional use of an inhaler.*



*Xolair is being developed by Genentech and partners Novartis Pharmaceuticals Corporation and Tanox, Inc.*

Genentech's considerable assets make it a valuable ally, as does the ability to design and implement collaborations that fit the situation rather than adhere to a single, rigid business model. Over the years, Genentech has also become more adept at identifying unique opportunities offered by teaming up with partners whose strengths complement its own. A successful partnership with IDEC Pharmaceuticals Corporation, which resulted in the 1997 launch of the breakthrough biooncology drug Rituxan, is representative of a true collaborative effort — one that benefited both companies and facilitated the delivery of a much-needed therapy to patients.

When it comes to partnerships in the area of development, Genentech's pipeline says it all: of the 20 projects in its pipeline, 15 are evolving through

A number of other collaborative efforts moved forward in 2000. XOMA Ltd. initiated and completed enrollment in a Phase I/II clinical study of Xanelim anti-CD11a antibody in the prevention of kidney transplant rejection, and completed enrollment in two Phase III studies of Xanelim in psoriasis. Under an innovative deal structure, Genentech and XOMA are working together to develop this antibody. Also, partner Millennium Pharmaceuticals, Inc. announced encouraging Phase I/II clinical trial results for LDP-02 in treating inflammatory bowel disease.

Genentech entered into several new strategic alliances in 2000 and early 2001 that augment its focus areas of cardiovascular medicine and oncology. The company entered into two separate agreements with Actelion Ltd. for the development and copromotion of tezosentan, for the potential treatment of acute heart failure, and Tracleer (bosentan), for the potential treatment of pulmonary hypertension and acute and chronic heart failure. Genentech and Roche entered into agreements for the global codevelopment and commercialization of OSI Pharmaceuticals' lead anti-cancer drug, OSI-774, which is now in Phase II clinical studies for non-small cell lung, head and neck, and ovarian cancers.

More collaborations are on the horizon. Recent success in sequencing the human genome is changing the landscape of drug discovery and development, and Genentech is cultivating key partnerships in this area to enhance its already strong position.



Abgenix, Inc. -- Actelion Ltd. -- Alkermes, Inc. -- Aventis S.A. -- Boehringer Ingelheim International GmbH  
Cambridge Antibody Technology Ltd. -- COR Therapeutics, Inc. & Schering-Plough Corporation -- CuraGen Corporation -- DAKO  
IDEC Pharmaceuticals Corporation -- Immunex Corporation -- ImmunoGen, Inc. -- Incyte Genomics, Inc. -- Inspire Pharmaceuticals, Inc.  
InterMune Pharmaceuticals, Inc. -- Millennium Pharmaceuticals, Inc. -- Novartis Pharmaceuticals Corporation & Tanox, Inc.  
OSI Pharmaceuticals, Inc. -- Pharmacia Corporation -- Roche -- Schwarz Pharma AG -- Seattle Genetics, Inc.  
Sumitomo Pharmaceuticals Corporation -- UroGenesys, Inc. -- XOMA Ltd.



# DISCOVERIES ADVANCE AND PROMISE LEADS TO PROGRESS... DEVELOPMENT PIPELINE

As a biotechnology leader, Genentech has a long-standing tradition of reinvesting a significant percentage of revenues back into research and development — a practice that has proved successful in transforming promising drug candidates into important new products. In the year 2000, this figure was 28 percent.

With 20 projects under way, Genentech's development pipeline has never been more productive and promising — thanks to a strong development organization and collaborative efforts with strategic partners. While the pipeline reflects the company's commitment to oncology and cardiovascular medicine, Genentech is also developing other "opportunistic" projects that utilize the company's expertise and fill a therapeutic void in important areas of medicine. In addition, a commitment to furthering the utility and effectiveness of current products is evident. This year, approximately half of Genentech's pipeline is composed of monoclonal antibody therapies — an area in which Genentech continues to lead the industry.

## PHASE I

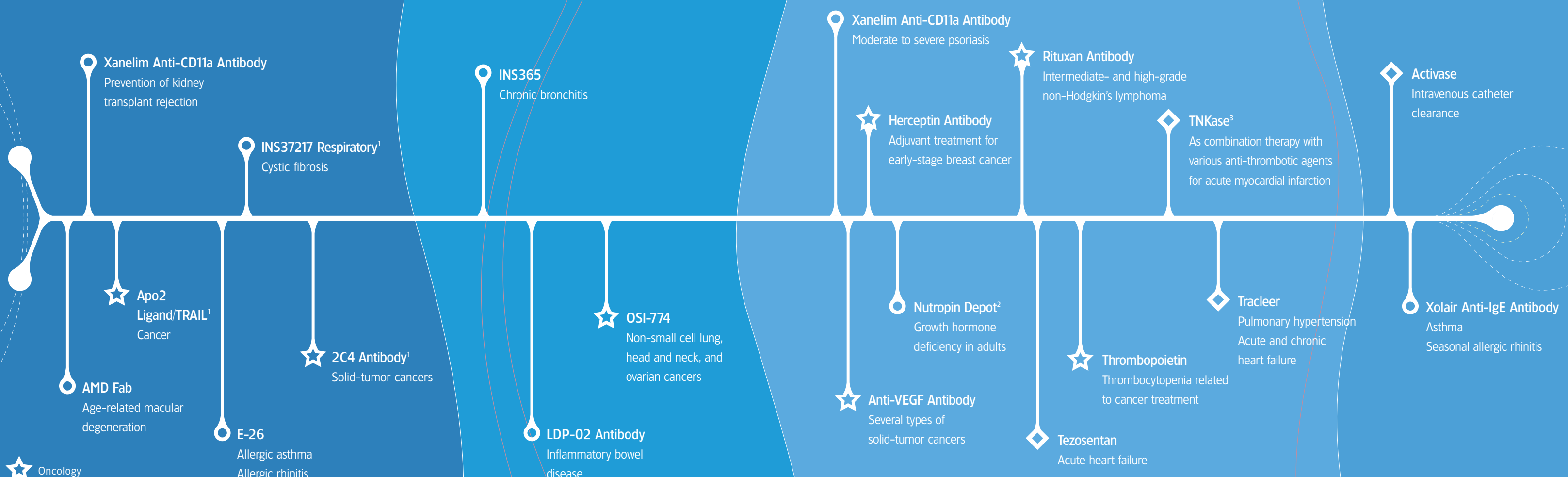
## PHASE II

## PHASE III

## PENDING FDA APPROVAL

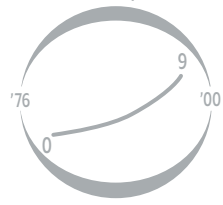
Research

Product



1. Phase I trials currently under preparation. 2. Phase III trial currently under preparation. 3. ASSENT III is a Phase III trial. INTEGRITI, ENTIRE and FASTER are Phase II trials.  
Xanelim anti-CD11a antibody developed with XOMA Ltd.; Apo2 Ligand/TRAIL developed with Immunex Corporation; E-26 developed with Novartis Pharmaceuticals Corporation and Tanox, Inc.; INS37217 and INS365 developed with Inspire Pharmaceuticals; LDP-02 antibody developed with Millennium Pharmaceuticals, Inc.; OSI-774 developed with OSI Pharmaceuticals, Inc. and Roche; Herceptin adjuvant studies in early-stage breast cancer being conducted with F. Hoffmann-La Roche and U.S. national cooperative groups; Nutropin Depot developed with Alkermes, Inc.; Rituxan antibody developed with IDEC Pharmaceuticals Corporation in the United States; tezosentan developed with Actelion Ltd.; exclusive worldwide rights for thrombopoietin belong to Pharmacia Corporation; TNKase in combination with various anti-thrombotic agents studies being conducted with COR Therapeutics, Inc. and Schering-Plough Corporation; Tracleer developed with Actelion Ltd.; Xolair anti-IgE antibody developed with Novartis Pharmaceuticals Corporation and Tanox, Inc.

Note: Projects are positioned in alphabetical order within each phase of development.



Humanized monoclonal antibodies (MAbs) have become a major focus of Genentech's development efforts in recent years. Spurred by the success of Rituxan and Herceptin, the first monoclonal antibodies marketed in the United States for non-Hodgkin's lymphoma and breast cancer, respectively, Genentech now leads the industry in the research and development of this important new drug category, whose promise extends well beyond oncology.

Monoclonal antibodies were first discovered in 1975, when British scientists Milstein and Kohler invented a process for generating large quantities of uniform mouse antibodies designed to target specific proteins — work that earned them a Nobel Prize in medicine in 1984. However, early mouse MAbs were of limited therapeutic value, predominantly due to the patient's allergic response to mouse-derived antibodies. Over the years, researchers have used recombinant DNA technology to create "humanized" antibodies, thereby lowering the risk of allergic responses and making the drugs safer and more effective.

## THE POWER OF TARGETED THERAPY EMERGES... MONOCLONAL ANTIBODIES

### A LONG JOURNEY TOWARD HEALTH

*Diagnosed with psoriasis as an infant, Marge Harris has been plagued with flare-ups and skin lesions over much of her body surface throughout her life. She's tried virtually every treatment available, with little or no relief. Today, Marge is participating in a clinical trial of the monoclonal antibody Xanelim, which is being developed by Genentech and XOMA Ltd. Her flare-ups are down to a minimum, and she's never felt or looked better.*

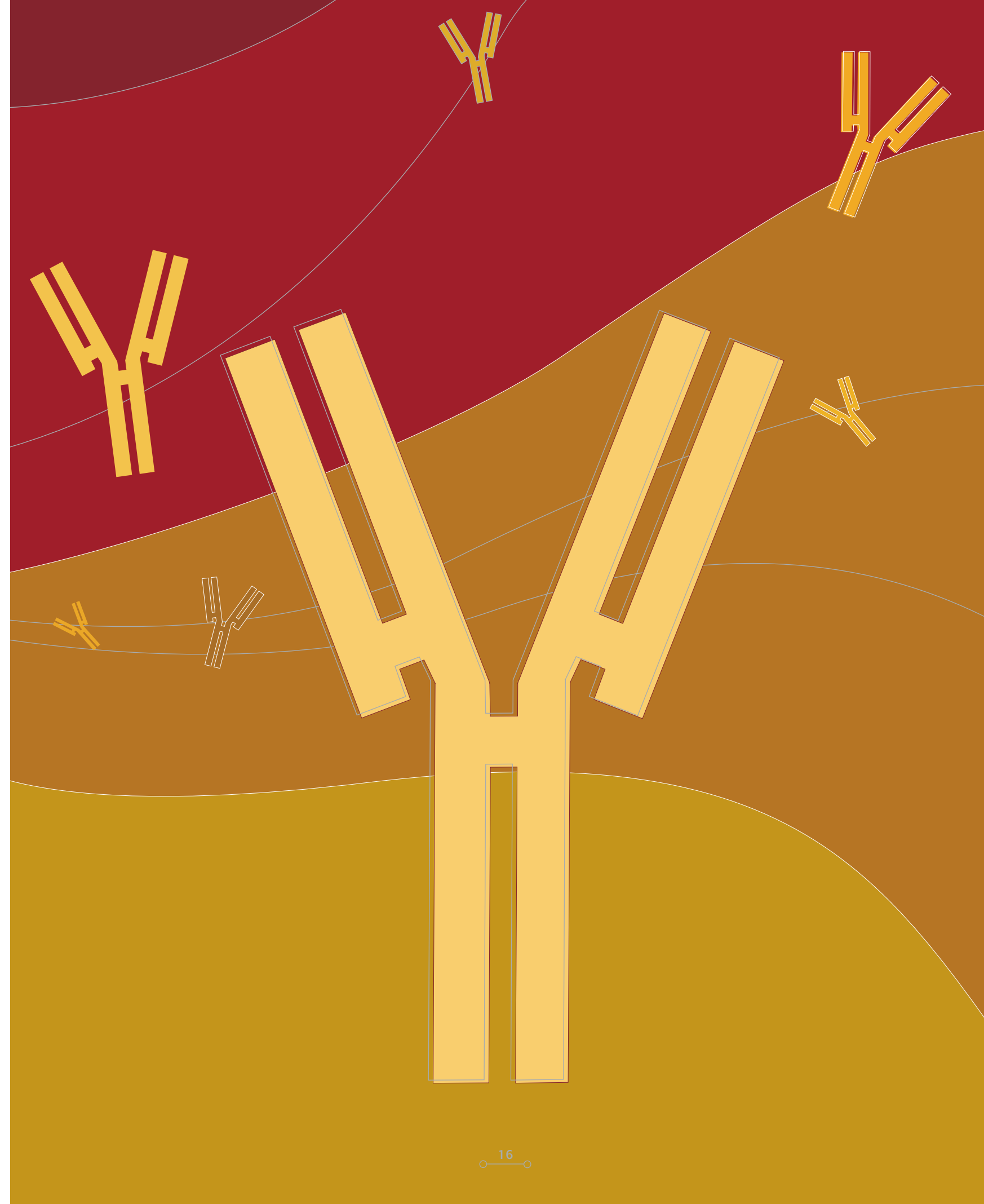


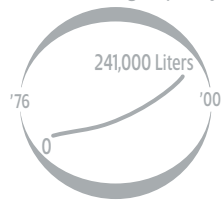
Specially engineered versions of the body's own antibodies, humanized monoclonal antibodies are highly targeted therapeutics. Some MAbs are capable of tracking down specific cells, such as cancer cells, and destroying them — without many of the debilitating, toxic side effects of chemotherapy and radiation.

With seven new humanized monoclonal antibody projects in development, and an additional two studies evaluating the further utility of Herceptin and Rituxan, monoclonal antibodies account for approximately half of Genentech's pipeline projects. Each of these studies holds the promise of offering patients a much-needed therapy by filling a gap or deficiency in the existing treatment options.

In addition to oncology, Genentech's current monoclonal antibody projects include potential therapies for asthma and seasonal allergic rhinitis, psoriasis, organ transplant rejection and inflammatory bowel disease.

Xanelim, a monoclonal antibody developed by Genentech and partner XOMA Ltd., is currently in Phase III investigation for the treatment of moderate to severe psoriasis — an autoimmune disease that affects millions of people worldwide. Xanelim anti-CD11a antibody works by preventing the activation of T cells and their migration to sites of inflammation on the skin. This ability of Xanelim to inhibit T cells may prove useful in other autoimmune or T-cell-mediated diseases. Phase I/II studies of Xanelim in kidney transplant patients began in early 2000.





Biotech's rich promise is truly fulfilled only when its scientific breakthroughs are transformed into safe, effective therapies, made available in quantities sufficient to treat all those in need. This extremely complex and demanding task is the responsibility of Genentech's Product Operations (PROP) organization, which is composed of process science, quality, facilities/engineering, regulatory and manufacturing services. Each area performs specific tasks on which the other areas depend — so making quality medicines becomes a highly synchronized collaborative effort — right down to the final manufacturing process. The success of PROP is not only critical to the overall success of the company, but is essential to meeting the needs of patients. For this reason, Genentech is continually evaluating, strengthening and expanding its Product Operations organization to meet the highest standards of quality and excellence.

Following the plant's completion in 1998, the staff conducted trial production runs, produced qualification lots of Herceptin and demonstrated the ability to produce bulk quantities. This cutting-edge facility occupies 310,000 square feet on a 100-acre site, and is the world's largest biotechnology manufacturing plant for the large-scale production of pharmaceutical proteins from mammalian cells. In addition to Herceptin, Vacaville currently manufactures Xolair, a unique anti-IgE monoclonal antibody awaiting FDA approval for the potential treatment of asthma and seasonal allergic rhinitis.

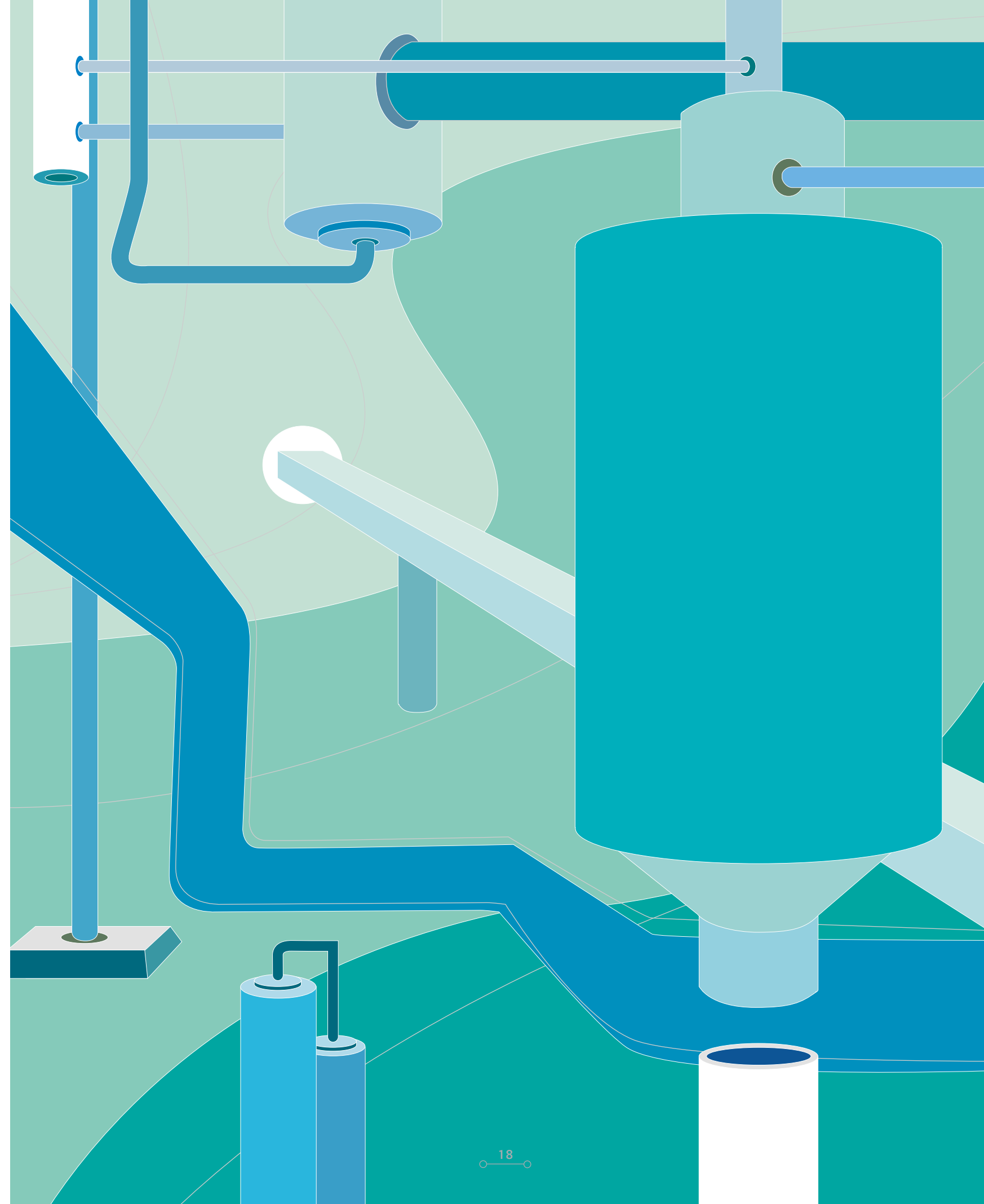
In the year 2000, Genentech also acquired a cell culture manufacturing facility in Porriño, Spain. Built in 1976, the 40,000-square-foot plant formerly manufactured interferon. The facility now operates as a wholly owned subsidiary company, Genentech España S.L., and will supplement Genentech's existing bulk cell culture production capacity.

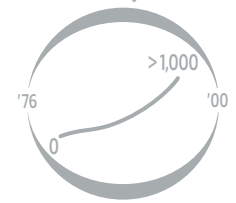
## MEETING DEMANDS AND ANTICIPATING NEEDS BECAME OUR MANDATE... PRODUCT OPERATIONS

In just 25 years, Genentech has built the quality and capacity of its production systems to include one of the largest, most advanced biologics manufacturing operations in the world. From its South San Francisco campus to new facilities in Vacaville, Calif., and overseas, Genentech has aggressively grown its product operations capabilities — and staffed them with highly skilled, experienced people — to anticipate the demands of an ever-growing pipeline.

2000 was an important year for Genentech Product Operations. At the South San Francisco campus, the company augmented its state-of-the-art capabilities to begin commercial production of two newly approved medications: TNKase and Nutropin Depot. The Vacaville facility received FDA licensure, marking the culmination of a major gearing-up effort.

Genentech is ready to continue evolving its product operations at all three sites to meet the demands of the next quarter century. The Vacaville facility has room to expand capacity another twofold, and current plans call for increasing output there by some 50 percent. The company is also expanding its expert workforce — the solid manufacturing experience of its new employees in Spain goes back nearly three decades, and in South San Francisco and Vacaville, Genentech continues to hire and retain the best and brightest talent in biotech.





For the past quarter century, Genentech scientists have been utilizing human genetic information and new technologies to identify genes and proteins with therapeutic value — with much success. The completion in mid-2000 of the first draft of the human genome is something Genentech is uniquely positioned to utilize to its advantage. The company's strong competitive edge in genomics-enabled discovery stems from a solid, integrated foundation that provides its researchers access to the most advanced technologies as well as the biologic expertise necessary to identify and validate novel drug targets.

“expressed sequence tags.” Genentech’s own proprietary algorithms are also used to identify sequence homologies and detect novel secreted and transmembrane proteins.

The company’s expertise is fully realized downstream from bioinformatics when biologists like Drs. Austin Gurney and John Stults develop physical clones of the genes identified to hold therapeutic potential, conduct the difficult process of expressing and purifying the proteins encoded by them and then identify the function of these proteins.

## OUR ADVANTAGE INTENSIFIES... GENOMICS

Molecular biologist Austin Gurney, Ph.D.; proteomics scientist John Stults, Ph.D.; and bioinformatics scientist Thomas Wu, M.D., Ph.D., exemplify Genentech’s integrated multidisciplinary approach to genomics-enabled drug discovery.



Molecular biologist Austin Gurney is working to find new receptor-hormone interactions. His group is hoping to catalog the genome by matching up all the molecular keys to the receptor locks expressed on the surface of cells in an effort to understand and control each of the chemical pathways in the body. Working with a lead from bioinformatics, Dr. Gurney’s group recently discovered that a certain protein was the key that binds to and turns on a new receptor. Concurrently, another research lab at Genentech found that this same receptor was a protein highly expressed in colon cancer.

A specialist in proteomics, John Stults studies the concentration levels of proteins and how they are modified in their functional states. His group recently developed an advanced methodology for the differential analysis of normal versus tumor proteins that is more automated and far more sensitive to cell membrane proteins than traditional methods. The increased sensitivity is also important because tumors for study are becoming smaller in size.

No doubt, genomics has had a significant impact on the drug discovery process at Genentech — not only by accelerating the identification of genes and proteins with potential, but also by enabling the company to take full advantage of its core strength — biology.

Drug discovery at Genentech starts with information. An in-house bioinformatics department is staffed by scientists like Dr. Thomas Wu, who possess a deep understanding of molecular biology and are skilled in computational methods for mining genomic data. A centralized database that stores experimental data on genes and proteins is accessible to researchers throughout the company. Through a powerful computing infrastructure, the bioinformatics department processes large amounts of sequence data from the Human Genome Project (HGP) around the clock. And, a collaboration with Incyte Genomics, Inc. provides Genentech with genomic data known as



Perhaps nowhere in Genentech are the intensity and drive to succeed more apparent than in the research labs. Science has been the foundation of Genentech, and the company's commitment to the pursuit of excellent science remains foremost. Its 400 scientists are among the top in their fields, publishing 250 to 275 papers annually — a rate unmatched in the biotech and pharmaceutical industries. As one scientist put it, "At Genentech, we're encouraged to act on promising leads, follow our intuition and test our hypotheses. This enables great science versus formula."

## TOMORROW'S THERAPIES TAKE SHAPE... RESEARCH

Staff scientist Avi Ashkenazi and director of molecular oncology Vishva Dixit are discovering ways to harness the biological mechanism of apoptosis, or programmed cell death, in their fight against cancer.



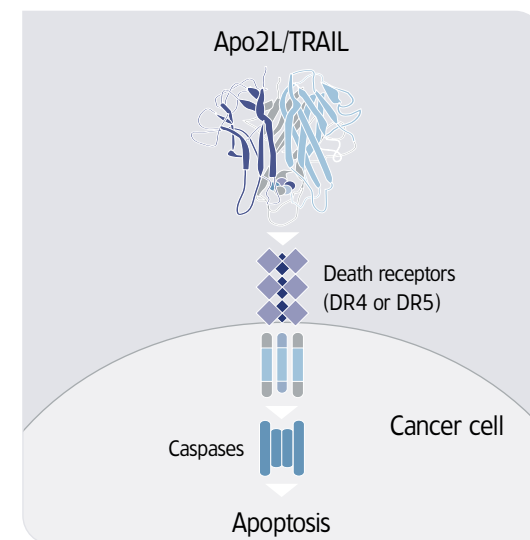
### APOPTOSIS Basic Science as a Powerful and Practical Tool

Scientists Vishva Dixit and Avi Ashkenazi of Genentech's molecular oncology department are world-renowned leaders in the study of apoptosis, the mechanism by which cells self-destruct. Both researchers are intent on uncovering ways to use this built-in regulatory process to fight cancer. "Essentially, our philosophy is to discover biological pathways, understand how they operate and then put them to work for us," says Ashkenazi. This strategy has proved quite productive — with one molecule in

development and several other promising genes in earlier stages of research.

Apoptosis is a natural regulatory program for suicide that exists in all cells, including cancer cells. Its purpose is to eliminate damaged or unneeded cells from the organism; however, in cancer cells this self-regulation program is silenced, allowing tumors to survive and grow. Dixit and Ashkenazi are finding new ways to activate the apoptosis machinery in cancer cells as a means of attacking tumors.

A major breakthrough for Ashkenazi's team came several years ago when they discovered the Apo2L/TRAIL gene, which encodes for a protein that can trigger the apoptosis machinery in certain cells. They found that their recombinant version of this protein could effectively kill tumor cells, while sparing normal ones. Further investigation led to the identification of the protein's receptors and the revelation that these "death receptors" can activate the dormant suicide machinery of cancer cells. Concurrent with Genentech's work in this area, scientists at Immunex Corporation had identified



Death receptors on the Apo2L/TRAIL gene activate the caspases, or suicide machinery, of cancer cells and trigger apoptosis.

and were studying the same gene. To facilitate rapid development and maximize the complementary strengths of both companies, a collaborative agreement was formed in 1999. Today, Apo2L/TRAIL is in Genentech's development pipeline, where it will be evaluated for efficacy in a number of solid-tumor cancers.

Having a research focus on apoptosis has helped keep Genentech's molecular oncology researchers out front and ahead of the competition. As Dr. Dixit puts it, "The pace of our apoptosis research has accelerated dramatically over the past two years. Every day we learn something new about this process and how to take best advantage of it therapeutically."

### OSTEOARTHRITIS A Novel Approach to an Age-Old Disease

In addition to oncology and cardiovascular medicine, Genentech scientists conduct research in a range of "opportunistic" areas with significant unmet medical needs. Cell biologist Ellen Filvaroff, Ph.D., is currently leading efforts to address an unmet need of monumental proportions: osteoarthritis (OA). Filvaroff is tackling the problem on a number of fronts, working to unravel the biology of human joints while also investigating proteins that may have beneficial effects on diseased joints.

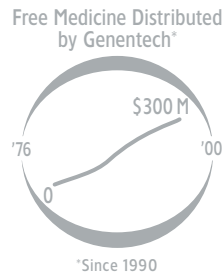
Osteoarthritis affects up to 13 percent of the U.S. adult population — costing the country over \$50 billion each year in lost earnings and medical care. Current treatments include physical therapy, analgesics, intra-articular steroid injections and, in the most severe cases, surgery. To date, no drug has been shown to slow or reverse the progression of the disease. The need (and the market) for such a therapy is both vast and growing. OA is one of the most prevalent chronic conditions in people over 65 (a group poised to expand as baby boomers age) and is among the leading causes of disability in adults.

"My work," says Filvaroff, "is focused on the structural aspects of OA." To this end, she is investigating a protein that appears to have a positive impact on articular cartilage, because degeneration of this tissue is a central feature of OA. Says Filvaroff, "We think that a factor that can delay or reverse cartilage breakdown will likely slow or halt progression of disease." So far, various formulations of this protein have been tested *in vitro* and *in vivo*, and Filvaroff has forwarded her findings to Genentech's marketing department to gauge interest in such a therapy among orthopedic surgeons.



Scientist Ellen Filvaroff (center), along with research associates Min Bao and Liping Cai, is searching for new ways to slow down osteoarthritis.

Filvaroff's experiences typify Genentech's uniquely nurturing, integrated approach to scientific discovery. When she arrived three years ago, she brought an expertise in the musculoskeletal system and was offered the opportunity to choose an area of focus to pursue. She thought immediately of OA. "I know a number of people with this debilitating disease," she says. "I thought, 'This is a disease that Genentech should be studying — with its advanced technology and collection of cloned genes.'" As Filvaroff began her research, colleagues offered to share their expertise, as well as pertinent findings from their own studies. This, along with access to Genentech's integrated network of databases and resources, may help Filvaroff find the answers she's looking for and provide osteoarthritis patients with a much-needed therapy.



The same passion, drive and initiative that have made Genentech the dynamic growth business it is today spill over into its commitment to community. In the year 2000, Genentech, as a company, and Genentech employees donated time, money, resources and products to a wide range of causes and nonprofit organizations.

Genentech provided nearly \$2 million in support of nonprofit organizations in 2000 through its ongoing charitable contributions program. Consistent with the company's mission to address unmet medical needs, the majority of these funds went to national and local nonprofit groups working in areas of science and healthcare of strategic interest to the company. In addition, in its good-neighbor capacity, Genentech supported key nonprofit educational, civic, cultural and social service organizations in its own South San Francisco and Vacaville, Calif., communities.

who share this passion. The company proactively and regularly works with advocacy groups to disseminate information and gain their insight and involvement in major development efforts, such as clinical trials enrollment and oversight, investigator meetings and safety boards.

Genentech's commitment to patients is further evident in its support of programs designed to help people better live and cope with their disease. The Cancer Survival Toolbox™ — developed by the National Coalition for Cancer Survivorship, the Oncology Nursing Society and the Association of Oncology Social Work through an educational grant from Genentech BioOncology — is successfully helping individuals with cancer develop practical skills for dealing with their diagnosis and treatment.

## OUR COMMITMENT SHINES THROUGH... CORPORATE RESPONSIBILITY

Genentech employees also play a critical role in community work. In 2000, employees contributed to hundreds of nonprofits, with Genentech matching these funds dollar for dollar. On top of this, committed employees donated time and energy to dozens of local events that raised awareness and funds for causes such as cancer, cystic fibrosis, heart disease and HIV/AIDS.

Investing in the future of science is a key priority for Genentech, and the company has established several science education initiatives to do just that. Among them are the Genentech Foundation for Biomedical Sciences, the Genentech Center for Clinical Research and Education, and Access Excellence®, a Web-based educational resource for teachers that will soon form the core educational component of the National Health Museum Web site.

Genentech strives to push the boundaries of disease treatment through innovative therapies and makes a practice of partnering with patient advocacy groups

Beginning with its very first marketed product, Genentech has believed that any patient who needs one of its medicines should get it — regardless of economic or insurance status. To this end, the company offers the Genentech Assistance Program and the Genentech Endowment for Cystic Fibrosis. During the past 10 years alone, over \$300 million worth of free medicine has been provided to uninsured or underinsured patients through these efforts.

Genentech's accomplishments in the areas of corporate responsibility and scientific leadership have not gone unnoticed. The company and its founders have been the recent recipients of several prestigious awards, including the National Breast Cancer Coalition Corporate Leadership Award and the National Medal of Technology, as well as two of the top biotech industry awards, the 5th Annual Helix Award and the Biotechnology Heritage Award. In addition, the company has been named to *Fortune* magazine's "100 Best Companies to Work for in America."

## THE PEOPLE WHO ARE GENENTECH'S FUTURE

At over 4,400 strong, employees are Genentech's most valued asset and perhaps the best predictor of its future growth. Three of the company's current high-priority initiatives in line with its overall strategy to "invest in its people" are:

- **Employee Involvement in 5 x 5** — Designed to further strengthen Genentech's cohesive, empowered and enthusiastic employee base, this initiative encourages every employee to personally invest in Genentech's 5 x 5 plan (that is, 5 goals for the year 2005).
- **Flexible Work Arrangement** — To meet the needs of employees balancing work and home life and to remain competitive in today's employee market, Genentech offers this opportunity, which focuses on *what* versus *how* employees contribute.

- **Diversity** — Genentech will continue to build on its commitment to diversity — that aspect of its community that represents different thought processes, backgrounds, characteristics and skill sets that each individual brings to the pursuit of the company's common mission — as an essential part of its plan for growth.





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# FINANCIAL REVIEW

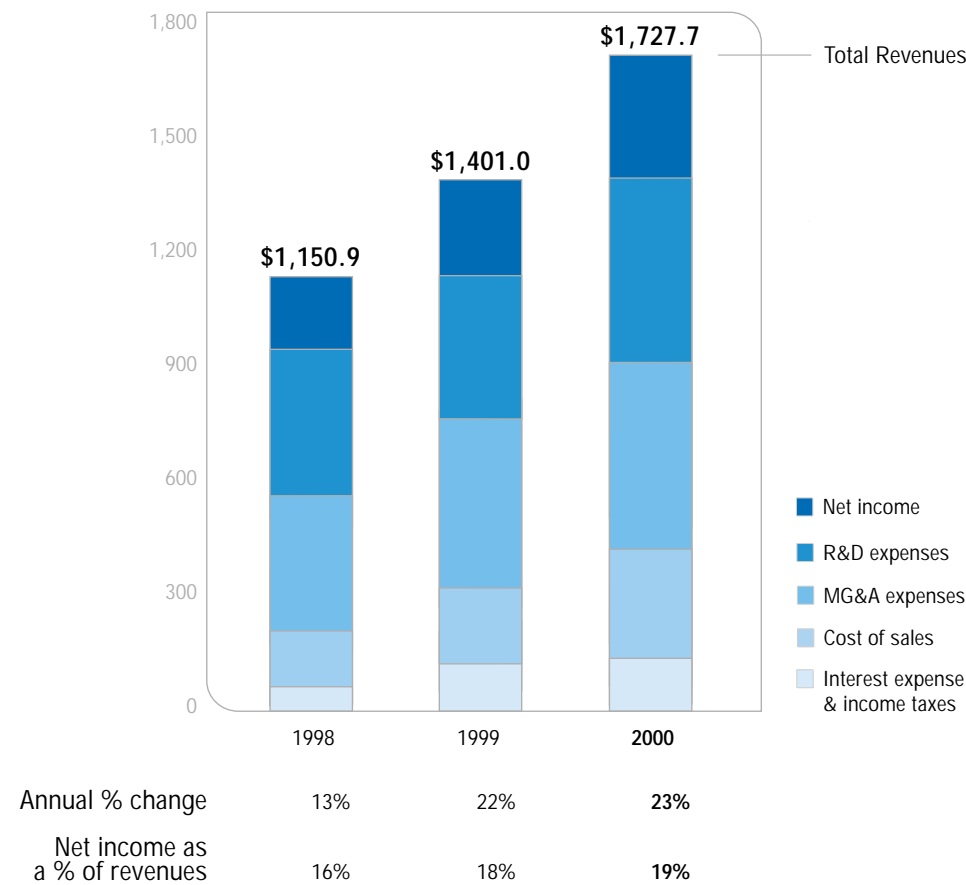
(dollars in millions, except per share amounts)

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In this Annual Report, "Genentech," "we," "us" and "our" refer to Genentech, Inc. "Common Stock" refers to Genentech's common stock, par value \$0.02 per share, "Special Common Stock" refers to Genentech's callable puttable common stock, par value \$0.02 per share and "Redeemable Common Stock" refers to Genentech's redeemable common stock, par value \$0.02 per share. All numbers related to the number of shares, price per share and per share amounts of Common Stock, Special Common Stock and Redeemable Common Stock give effect to the two-for-one splits of our Common Stock that were effected in October 2000 and November 1999.

### DISTRIBUTION OF REVENUE DOLLARS<sup>(1)</sup>



(1) Based on Pro Forma amounts, which exclude the special charges in 1999 related to the Redemption and legal settlements, recurring charges related to the Redemption in 2000 and 1999, costs in 2000 and 1999 related to the sale of inventory that was written up at the Redemption, and their related tax effects. In addition, Pro Forma excludes the cumulative effect of an accounting change, net of tax, in 2000. See the *Special Charges, Recurring Charges Related to Redemption, Cost of Sales, Income Tax and Staff Accounting Bulletin No. 101* discussions in the *Financial Review* section of this annual report for further information on these charges.

### OVERVIEW OF OUR BUSINESS

Genentech is a leading biotechnology company using human genetic information to discover, develop, manufacture and market human pharmaceuticals that address significant unmet medical needs. Fourteen of the approved products of biotechnology stem from our science. We manufacture and market nine protein-based pharmaceuticals listed below, and license several additional products to other companies.

- Herceptin (trastuzumab) antibody for the treatment of certain patients with metastatic breast cancer whose tumors overexpress the human epidermal growth factor receptor2, or HER2, protein;
- Rituxan (rituximab) antibody which we market together with IDEC Pharmaceuticals Corporation, commonly known as IDEC, for the treatment of patients with relapsed or refractory low-grade or follicular, CD20-positive B-cell non-Hodgkin's Lymphoma;
- TNKase (tenecteplase) single-bolus thrombolytic agent for the treatment of acute myocardial infarction;
- Activase (alteplase, recombinant) tissue plasminogen activator, or t-PA, for the treatment of acute myocardial infarction, acute ischemic stroke within three hours of the onset of symptoms and acute massive pulmonary embolism;
- Nutropin Depot [somatotropin (rDNA origin) for injectable suspension] long-acting growth hormone for the treatment of growth failure associated with pediatric growth hormone deficiency;
- Nutropin AQ [somatotropin (rDNA origin) injection] liquid formulation growth hormone for the same indications as Nutropin;
- Nutropin [somatotropin (rDNA origin) for injection] growth hormone for the treatment of growth hormone deficiency in children and adults, growth failure associated with chronic renal insufficiency prior to kidney transplantation and short stature associated with Turner syndrome;
- Protropin (somatrem for injection) growth hormone for the treatment of inadequate endogenous growth hormone secretion, or growth hormone deficiency, in children; and
- Pulmozyme (dornase alfa, recombinant) inhalation solution for the treatment of cystic fibrosis.

We receive royalties on sales of rituximab outside of the United States (excluding Japan), on sales of Pulmozyme and Herceptin outside of the United States and on sales of certain products in Canada from F. Hoffmann-La Roche Ltd, an affiliate of Roche Holdings, Inc., that is commonly known as Hoffmann-La Roche. We receive royalties on sales of growth hormone products and t-PA outside of the United States and Canada, and we will receive royalties on sales of rituximab

in Japan through other licensees. We also receive worldwide royalties on seven additional licensed products that are marketed by other companies. Six of these products originated from our technology.

### REDEMPTION OF OUR SPECIAL COMMON STOCK

On June 30, 1999, we redeemed all of our outstanding Special Common Stock held by stockholders other than Roche Holdings, Inc., commonly known as Roche, at a price of \$20.63 per share in cash with funds deposited by Roche for that purpose. We refer to this event as the "Redemption." As a result, on that date, Roche's percentage ownership of our outstanding Common Stock increased from 65% to 100%. Consequently, under U.S. generally accepted accounting principles, we were required to use push-down accounting to reflect in our financial statements the amounts paid for our stock in excess of our net book value. Push-down accounting required us to record \$1,685.7 million of goodwill and \$1,499.0 million of other intangible assets onto our balance sheet on June 30, 1999. Also, as a result of push-down accounting, we recorded special charges related to the Redemption of \$1,207.7 million on June 30, 1999. For more information about special charges and push-down accounting, you should read "Special Charges" below and the "Redemption of Our Special Common Stock" note in the *Notes to Consolidated Financial Statements*. Roche subsequently made public offerings of our Common Stock as described below.

### STOCK SPLITS

On October 24, 2000, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech Common Stock for each share held at the close of business on October 17, 2000. Our stock began trading on a split-adjusted basis on October 25, 2000. On November 2, 1999, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech Common Stock for each share held at the close of business on October 29, 1999. Our stock began trading on a split-adjusted basis on November 3, 1999. All information in this annual report relating to the number of shares, price per share and per share amounts of Common Stock, Special Common Stock and Redeemable Common Stock give effect to these splits.

### PUBLIC OFFERINGS

On July 23, 1999, October 26, 1999, and March 29, 2000, Roche completed public offerings of our Common Stock. We did not receive any of the net proceeds from these offerings. On January 19, 2000, Roche completed an offering of zero-coupon notes that are exchangeable for an aggregate of 13,034,618 shares of our Common Stock held by Roche. Roche's percentage ownership of our outstanding Common Stock is approximately 58.4% at December 31, 2000.



# FINANCIAL REVIEW

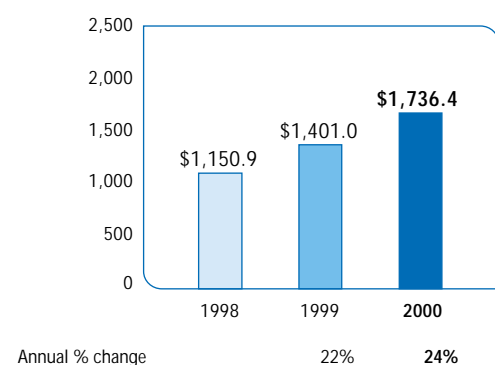
(continued)

## RESULTS OF OPERATIONS

(dollars in millions, except per share amounts)

As discussed in the "Basis of Presentation and Restatement" note in the Notes to Consolidated Financial Statements, our 1999 financial statements have been restated to reflect: (a) our results of operations prior to the Redemption (Old Basis) separately from our results of operations subsequent to the Redemption (New Basis) and (b) revised accounting related to the write up of the valuation allowance pertaining to unrealized gains on certain marketable equity securities resulting from the Redemption. Information for 1999 in this Financial Review for 1999 reflects the combined Old Basis and New Basis presentation from the Consolidated Financial Statements.

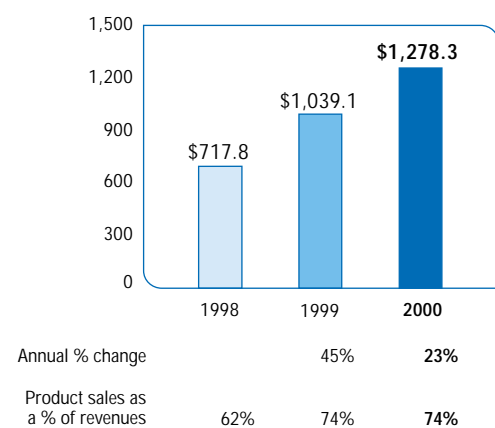
### Total Revenues



### Total Revenues

Total revenues for 2000 reached \$1,736.4 million, a 24% increase from 1999. Revenues for 1999 increased 22% from 1998 primarily due to higher product sales. These increases are further discussed below.

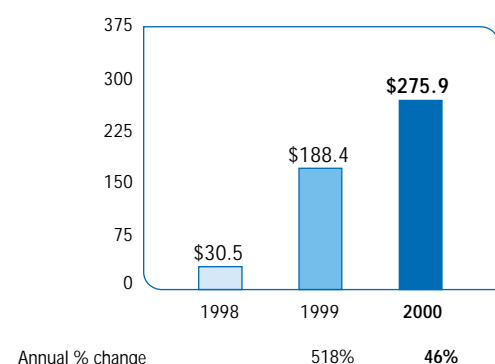
### Total Product Sales



### Total Product Sales

Total product sales were \$1,278.3 million in 2000, an increase of 23% from 1999 reflecting the effect of strong Rituxan and Herceptin sales. Total product sales were \$1,039.1 million in 1999, an increase of 45% from 1998 also reflecting the effect of strong Rituxan sales, a full year of Herceptin sales and higher Activase sales. Product sales in connection with our licensing agreement with Hoffmann-La Roche were \$67.4 million in 2000, \$41.3 million in 1999 and \$28.7 million in 1998. See "Relationship With Roche" below for further information about our licensing agreement with Hoffmann-La Roche.

### Herceptin



### Herceptin

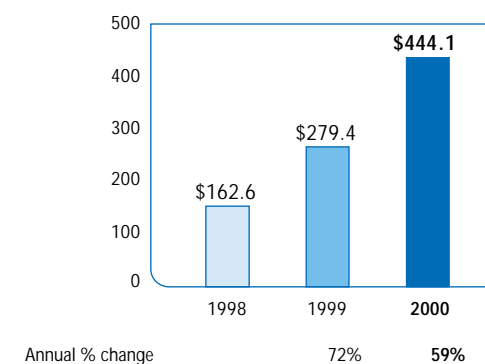
Sales of Herceptin were \$275.9 million, a 46% increase from 1999. In 1999 sales of Herceptin were \$188.4 million. We recorded \$30.5 million of initial sales of Herceptin in the fourth quarter of 1998. Herceptin was first marketed in September 1998 and is the first humanized monoclonal antibody for the treatment of HER2 overexpressing metastatic breast cancer. Since the launch of Herceptin, an increase in penetration into the breast cancer market has contributed to a positive sales trend. We have granted Hoffmann-La Roche exclusive marketing rights to Herceptin outside of the United States.

During the third quarter of 2000, Hoffmann-La Roche received approval from the European Commission to market Herceptin for the treatment of HER2-positive metastatic breast cancer in Europe. We receive royalties from Hoffmann-La Roche for these European Herceptin product sales.

On May 3, 2000, we sent a letter to physicians advising them of some serious adverse events that have been reported related to the use of Herceptin in certain patients and that have occurred subsequent to its approval. In 15 patients who experienced such serious adverse events following Herceptin therapy, death ensued. Nine of these patients died within 24 hours after Herceptin administration. Most of these patients had significant pre-existing pulmonary

compromise as a consequence of lung disease or malignancies that had spread to the lung. On October 6, 2000, we issued a follow-up letter to physicians which included an amended package insert for Herceptin including this information.

### Rituxan

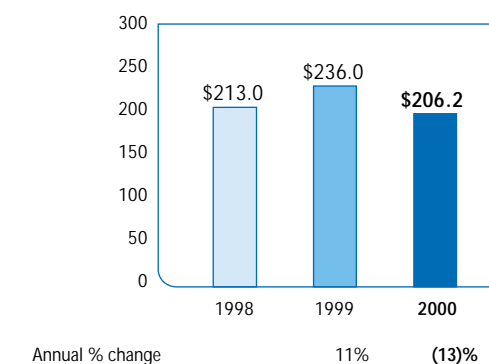


### Rituxan

Sales of Rituxan were \$444.1 million in 2000, an increase of 59% from 1999. Sales of Rituxan were \$279.4 million in 1999, an increase of 72% from 1998. These increases were primarily due to increased market penetration for the treatment of B-cell non-Hodgkin's lymphoma. Sales of Rituxan were \$162.6 million in 1998, the first full year of sales. Rituxan was approved for marketing by the Food and Drug Administration, or FDA, in late November 1997 and we launched Rituxan in December 1997. We co-developed Rituxan with IDEC, from which we license Rituxan. IDEC and Genentech jointly promote Rituxan in the U.S. We shared responsibility with IDEC for manufacturing the product until the end of the third quarter of 1999, when IDEC finished transferring all bulk manufacturing responsibilities for Rituxan to us. Our partner Hoffmann-La Roche received permission from the European Commission in 1997 to market rituximab under the tradename MabThera® in the European Union. Hoffmann-La Roche holds marketing rights for MabThera outside of the U.S., excluding Japan, and has agreed to pay us royalties and a mark-up on the supply of MabThera.

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

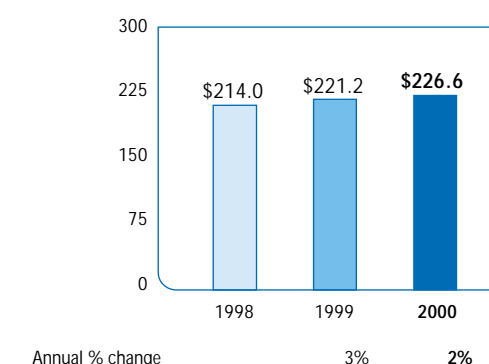
### Activase/TNKase



### Activase/TNKase

Sales of our two cardiovascular products, Activase and TNKase, were \$206.2 million in 2000, a decrease of 13% from 1999. TNKase received FDA approval in early June 2000 and was launched in late June 2000. The decrease from the prior year was due primarily to increased competition from Centocor, Inc.'s Retavase® (reteplase), and a decline in the overall size of the thrombolytic market as a result of increasing use of mechanical reperfusion as well as early intervention with other therapies in the treatment of acute myocardial infarction. In 1999, sales of Activase were \$236.0 million, an increase of 11% from 1998. This increase was largely due to the usage of Activase in peripheral vascular occlusive disease in lieu of another company's thrombolytic that was unavailable. This increase was offset in part by a continued decline in the overall size of the thrombolytic therapy market due to increasing use of mechanical reperfusion and competition from Centocor's Retavase.

### Growth Hormone



### Growth Hormone

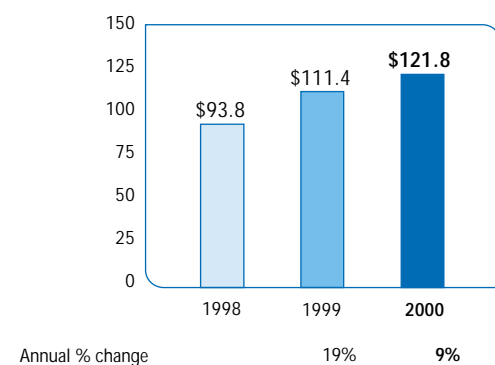
Sales of our four growth hormone products, Nutropin Depot, Nutropin AQ, Nutropin and Protropin, increased slightly in 2000 compared to 1999. This increase was largely due to fluctuations in customer ordering patterns and the introduction of Nutropin Depot.

# FINANCIAL REVIEW

(continued)

In December 1999, we received FDA approval for Nutropin Depot, a long-acting dosage form of recombinant growth hormone for pediatric growth hormone deficiency. Nutropin Depot was launched in late June 2000. In 1999, Protropin, Nutropin and Nutropin AQ sales were \$221.2 million, a slight increase from 1998. This increase primarily reflects fluctuations in customer ordering patterns.

## Pulmozyme



## Pulmozyme

Pulmozyme sales were \$121.8 million in 2000, a 9% increase from 1999. This increase was attributable to increased market penetration in the early and mild patient populations for the treatment of cystic fibrosis. Sales of Pulmozyme were \$111.4 million in 1999, an increase of 19% over 1998. This increase was due to our continued market penetration for the treatment of cystic fibrosis in the early and mild patient populations.

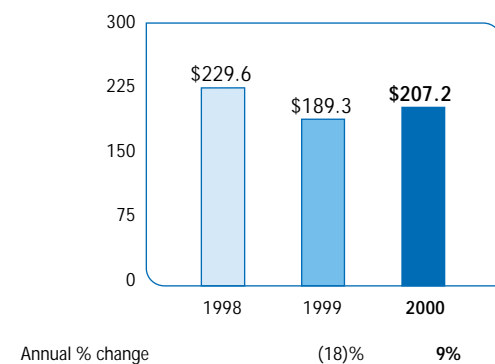
## Actimmune® (interferon gamma-1b)

	2000	1999	1998	Annual % Change	
				00/99	99/98
Actimmune	\$ 3.7	\$ 2.7	\$ 3.9	37%	(31)%

## Actimmune

In the second quarter of 1998, in return for a royalty on net sales, we licensed U.S. marketing and development rights to interferon gamma, including Actimmune, to Connetics Corporation. Thereafter, Connetics sublicensed all of its rights to InterMune Pharmaceuticals, Inc., or InterMune. As of January 1999, we no longer sell Actimmune directly in the United States. We have agreed to sell packaged drug product to InterMune at cost plus a mark-up.

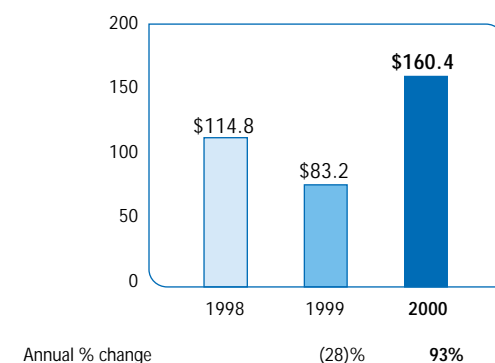
## Royalties



## Royalties

Royalty income was \$207.2 million, an increase of 9% from 1999. This increase was due to higher third-party sales from various licensees. Royalty income was \$189.3 million in 1999, a decrease of 18% from 1998. This decrease was primarily related to the expiration of royalties from Eli Lilly and Company for sales of Humulin® (human insulin) which expired in August 1998. The decrease in 1999 was partly offset by higher royalties from various licensees, and new royalties from Immunex Corporation under a licensing agreement for Enbrel® (etanercept) biologic response modifier. Cash flows from royalty income include revenues denominated in foreign currency. We currently purchase simple foreign currency put option contracts (options) to hedge these royalty cash flows. All options expire within the next two years. See "Forward-Looking Information and Cautionary Factors That May Affect Future Results" below for a discussion of market risks related to these financial instruments.

## Contract and Other Revenues



## Contract and Other Revenues

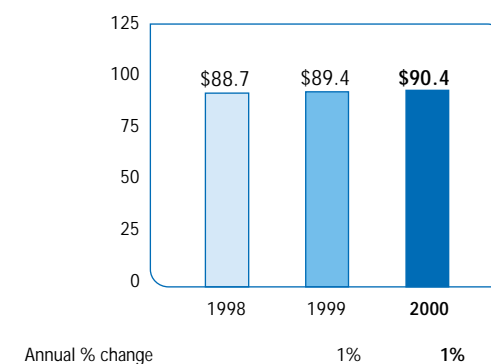
Contract and other revenues were \$160.4 million in 2000, an increase of 93% over 1999. This increase was primarily due to higher gains from the sale of biotechnology equity securities and the recognition of

\$8.6 million of deferred revenues (see "Staff Accounting Bulletin No. 101" below for further discussion), offset in part by lower contract revenues from our strategic alliances with third-party collaborators. Contract and other revenues were \$83.2 million in 1999, a decrease of 28% from 1998. This decrease resulted primarily from higher revenues in 1998 related to payments from Hoffmann-La Roche for Herceptin marketing rights and from Novo Nordisk A/S, commonly known as Novo, for the patent infringement litigation settlement, as discussed below. These decreases were partially offset by higher revenues in 1999 from our strategic alliances, including initial license fees from Immunex for Enbrel and from Schwarz Pharma AG for Nutropin AQ and Nutropin Depot and by higher gains from the sale of biotechnology equity securities.

In July 1998, we settled a lawsuit brought by us against Novo relating to our patents for human growth hormone and insulin and a lawsuit brought by Novo alleging infringement of a patent held by Novo relating to our manufacture, use and sale of our Nutropin human growth hormone products. Under the settlement agreement, we agreed with Novo to cross-license worldwide certain patents relating to human growth hormone. In August 1998, Novo received a worldwide license under our patents relating to insulin, and we received certain payments from Novo that were recorded in contract revenues.

We recorded contract revenues from Hoffmann-La Roche of \$40.0 million in 1998 for Herceptin marketing rights outside of the U.S. All other contract revenue from Hoffmann-La Roche, including reimbursement for ongoing development expenses after the option exercise date, totaled \$3.5 million in 2000, \$17.2 million in 1999 and \$21.6 million in 1998.

## Interest Income



## Interest Income

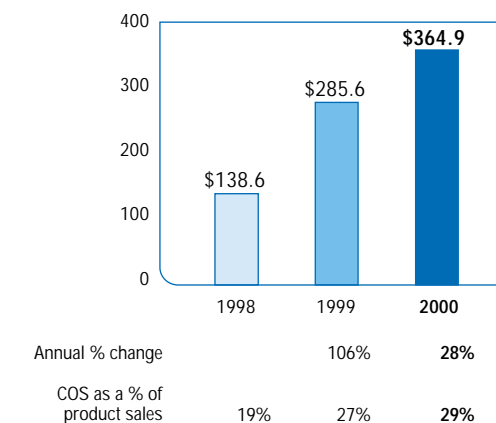
Interest income in 2000 and 1999 were comparable to previous years. In our fixed income portfolio (cash, short-term and long-term investment portfolio, excluding marketable equity securities), at

December 31, 2000, lower portfolio returns were offset by higher average balances. Year end balances were also higher in 2000 compared to 1999.

## Total Costs and Expenses

	2000	1999	1998	Annual % Change	
				00/99	99/98
Total costs and expenses	\$ 1,732.4	\$ 2,761.6	\$ 898.3	(37)%	207%
% of revenues	100%	197%	78%		

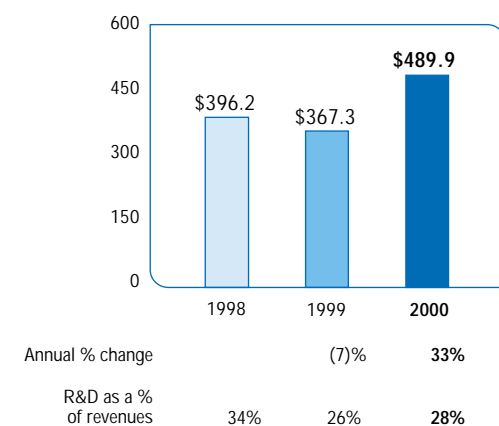
## Cost of Sales



## Cost of Sales

Cost of sales, or COS, was \$364.9 million in 2000, an increase of 28% from 1999. COS as a percent of product sales was 29%, an increase from 1999. This increase primarily reflects a change in the product mix, an increase in provisions established for nonuseable inventory and higher sales to Hoffmann-La Roche. COS was \$285.6 million in 1999, an increase of 106% from 1998. COS as a percent of net sales increased to 27% in 1999. This increase reflects the six months of costs related to the sale of inventory that was written up at the Redemption due to push-down accounting, offset in part by efficiencies in production and a more favorable product mix. As a result of push-down accounting, \$92.8 million and \$93.4 million of expense was recognized in 2000 and 1999, respectively, through the sale of inventory that was written up as a result of the Redemption. All inventory written up as a result of the Redemption has been sold as of December 31, 2000.

Research and Development

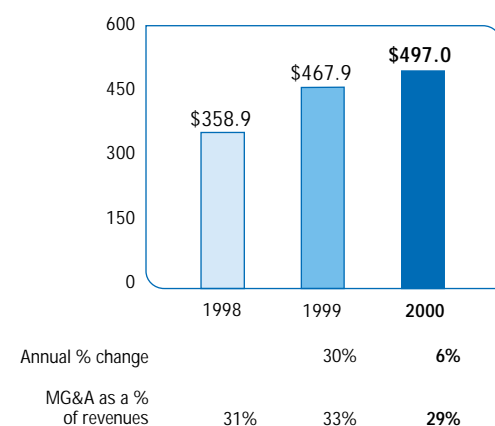


Research and Development

Research and development, or R&D, expenses in 2000 were \$489.9 million, up 33% from 1999. This increase was due to higher clinical costs related to later-stage clinical trials and higher in-licensing and collaboration expenses. In-licensing expenses in 2000 included a \$15.0 million payment for the purchase of in-process research and development, or IPR&D, during the first quarter of 2000 under an agreement with Actelion Ltd., for the rights to develop and co-promote tezosentan in the United States for the potential treatment of acute heart failure. Actelion is leading the development effort of tezosentan and the project is currently in Phase III clinical trials. In addition, we made a \$35.0 million payment to Actelion for the purchase of IPR&D for the rights to develop and co-promote Actelion's endothelin receptor antagonist Tracleer™ (bosentan) in the United States for the potential treatment of acute and chronic heart failure. Actelion is leading the development efforts and commercialization of Tracleer. We determined that the above acquired IPR&D was not yet technologically feasible and that the acquired IPR&D had no future alternative uses. R&D expenses were \$367.3 million in 1999, down 7% from 1998 as a result of reduced spending as products progressed through late-stage clinical trials. R&D as a percentage of revenues was 28% in 2000, 26% in 1999 and 34% in 1998.

To gain additional access to potential new products and technologies, and to utilize other companies to help develop potential new products, we establish strategic alliances with various companies. These companies are developing technologies that may fall outside our research focus and through technology exchanges and investments with these companies we may have the potential to generate new products. As part of these strategic alliances, we have acquired equity and convertible debt securities of such companies. We have also entered into product-specific collaborations to acquire development and marketing rights for products.

Marketing, General and Administrative



Marketing, General and Administrative

Marketing, general and administrative, or MG&A, expenses in 2000 increased 6% from 1999. This increase resulted from higher marketing and sales expenses while general and administrative expenses decreased. The marketing and sales increase was driven by the continued support of our growing bio-oncology business, including the Rituxan profit-sharing expense with IDEC, the launch of TNKase, and the prelaunch support of Xolair for the potential treatment of allergic asthma and seasonal allergic rhinitis. The decrease in general and administrative expenses was mostly due to the write down of certain biotechnology investments as a result of other than temporary impairment and higher legal expenses in 1999. In 1999, MG&A expenses increased 30% from 1998. The increase was primarily in support of the growth of our bio-oncology products including the Rituxan profit-sharing with IDEC, and competitive conditions with other marketed products. Additional increases came from higher royalty, legal and corporate expenses.

Special Charges

	2000	1999	1998
Special charges:			
Related to redemption	—	\$ 1,207.7	—
Legal settlements	—	230.0	—

Special Charges

During 1999, we had special charges of \$1,437.7 million related to the Redemption and the application of push-down accounting, and legal settlements. The Redemption related charge of \$1,207.7 million primarily included: (1) a non-cash charge of \$752.5 million for IPR&D, (2) \$284.5 million of compensation expense related to early

cash settlement of certain employee stock options and (3) an aggregate of approximately \$160.1 million as a non-cash charge for the remeasurement of the value of continuing employee stock options. See "In-Process Research and Development" below and the "Redemption of Our Special Common Stock" note in the Notes to Consolidated Financial Statements for further information regarding these special charges.

The legal settlements charge included: (1) a \$50.0 million settlement related to a federal investigation of our past clinical, sales and marketing activities associated with human growth hormone; and (2) a \$180.0 million charge for the settlement of the patent infringement lawsuits brought by the University of California relating to our human growth hormone products. See the "Leases, Commitments and Contingencies" note in the Notes to Consolidated Financial Statements for further information regarding these special charges.

Recurring Charges Related to Redemption

	2000	1999	1998	Annual % Change	
				00/99	99/98
Recurring charges related to redemption	\$ 375.3	\$ 197.7	—	90%	—

Recurring Charges Related to Redemption

We began recording recurring charges related to the Redemption and push-down accounting in the third quarter of 1999. These charges were \$375.3 million in 2000 and \$197.7 million in 1999. These charges were comprised of \$364.2 million in 2000 and \$190.4 million in 1999 related to the amortization of other intangible assets and goodwill, and \$11.1 million in 2000 and \$7.3 million in 1999 of compensation expense related to alternative arrangements provided at the time of the Redemption for certain holders of some of the unvested options.

Interest Expense

	2000	1999	1998	Annual % Change	
				00/99	99/98
Interest expense	\$ 5.3	\$ 5.4	\$ 4.6	(2)%	17%

Interest Expense

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 our 5% convertible subordinated debentures.

Income (Loss) Before Taxes and Cumulative Effect of Accounting Change, Income Taxes and Cumulative Effect of Accounting Change

	2000	1999	1998
Income (loss) before taxes and cumulative effect of accounting change	\$ 4.0	\$ (1,360.6)	\$ 252.6
Income tax provision (benefit)	20.4	(203.1)	70.7
Income (loss) before cumulative effect of accounting change	(16.4)	(1,157.5)	181.9
Cumulative effect of accounting change, net of tax	(57.8)	—	—

Staff Accounting Bulletin No. 101

In the fourth quarter of 2000, we adopted the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 on revenue recognition effective January 1, 2000 and recorded a \$57.8 million charge, net of tax, as a cumulative effect of a change in accounting principle related to contract revenues recognized in prior periods. The related deferred revenue is being recognized over the term of the agreements. In 2000, we recognized \$8.6 million of this deferred revenue in contract and other income. (See the "Change in Accounting Principle" section of the "Description of Business and Significant Accounting Policies" note in the Notes to Consolidated Financial Statements for further information on our adoption of Staff Accounting Bulletin No. 101.)

Income Tax

The tax provision of \$20.4 million for 2000 increased over the 1999 tax benefit of \$203.1 million primarily due to increased pretax income and non-deductible goodwill amortization related to the Redemption. The increase was partially offset by the increased benefit of R&D tax credits. The 1999 tax benefit differed from the 1998 tax provision primarily because of the charges related to the Redemption and legal settlements. The tax provision and tax benefit in 2000 and 1999, respectively, reflect the adverse impact of non-deductible in-process R&D charges and amortization of goodwill.

The tax rate of 31% in 2000 on pretax income excluding charges related to the Redemption and cumulative effect of accounting change is lower than the comparable tax rate of 33% in 1999 primarily due to increased R&D tax credits. The 1999 tax rate increased from 28% in 1998 primarily due to reduced research credits and realization of foreign losses.

# FINANCIAL REVIEW

(continued)

## Net Income (Loss)

	2000	1999	1998
<b>Net income (loss)</b>	<b>\$ (74.2)</b>	<b>\$ (1,157.5)</b>	<b>\$ 181.9</b>
Earnings (loss) per share:			
Basic:			
Earnings (loss) before cumulative effect of accounting change	\$ (0.03)	\$ (2.26)	\$ 0.36
Cumulative effect of accounting change, net of tax	(0.11)	—	—
<b>Net earnings (loss) per share</b>	<b>\$ (0.14)</b>	<b>\$ (2.26)</b>	<b>\$ 0.36</b>
Diluted:			
Earnings (loss) before cumulative effect of accounting change	\$ (0.03)	\$ (2.26)	\$ 0.35
Cumulative effect of accounting change, net of tax	(0.11)	—	—
<b>Net earnings (loss) per share</b>	<b>\$ (0.14)</b>	<b>\$ (2.26)</b>	<b>\$ 0.35</b>

## Net Income (Loss)

The net loss of \$74.2 million, or a loss of \$0.14 per share in 2000 primarily reflects a full year of recurring charges for the amortization of goodwill and other intangible assets related to the Redemption and push-down accounting, the cumulative effect of a change in accounting principle, costs related to the sale of inventory that was written up at the Redemption and higher R&D expenses; offset in part by higher product sales. The net loss in 1999 of \$1,157.5 million, or a loss of \$2.26 per share, is attributable to the Redemption and related push-down accounting, and legal settlements, net of their related tax effects. To a lesser extent, the loss in 1999 was also due to higher MG&A expenses, COS and income taxes, and lower royalty and contract and other revenues, partly offset by higher product sales and lower R&D spending.

## In-Process Research and Development

At June 30, 1999, the Redemption date, we determined that the acquired in-process technology was not technologically feasible and that the in-process technology had no future alternative uses. In 1990 and 1991 through 1997, Roche purchased 60% and 5%, respectively, of our outstanding common stock. The push-down effect of Roche's aggregate purchase price is allocated based on Roche's ownership percentages as if the purchases had occurred at the original purchase dates for the 1990 and 1991 through 1997 purchases. Therefore, 65% of the purchase price allocated to IPR&D as of September 7, 1990, or 65% of \$770.0 million (\$500.5 million) was recorded as an adjustment to additional paid-in capital related to the 1990-1997 acquisitions. The remaining 35% of our outstanding

common stock not owned by Roche was purchased in 1999. Accordingly, 35% of \$2,150.0 million of total fair value at the Redemption date, or \$752.5 million, was expensed on June 30, 1999.

The amounts of IPR&D were determined based on an analysis using the risk-adjusted cash flows expected to be generated by the products that result from the in-process projects. The analysis included forecasted future cash flows that were expected to result from the progress made on each of the in-process projects prior to the purchase dates. These cash flows were estimated by first forecasting, on a product-by-product basis, total revenues expected from sales of the first generation of each in-process product. A portion of the gross in-process product revenues was then removed to account for the contribution provided by any core technology, which was considered to benefit the in-process products. The net in-process revenue was then multiplied by the project's estimated percentage of completion as of the purchase dates to determine a forecast of net IPR&D revenues attributable to projects completed prior to the purchase dates. Appropriate operating expenses, cash flow adjustments and contributory asset returns were deducted from the forecast to establish a forecast of net returns on the completed portion of the in-process technology. Finally, these net returns were discounted to a present value at discount rates that incorporate both the weighted-average cost of capital (relative to the biotech industry and us) as well as the product-specific risk associated with the purchased IPR&D products. The product-specific risk factors included each product in each phase of development, type of molecule under development, likelihood of regulatory approval, manufacturing process capability, scientific rationale, pre-clinical safety and efficacy data, target product profile and development plan. The discount rates ranged from 16% to 19% for the 1999 valuation and 20% to 28% for the 1990 purchase valuation, all of which represent a significant risk premium to our weighted-average cost of capital.

The forecast data in the analysis was based on internal product level forecast information maintained by our management in the ordinary course of managing the business. The inputs used by us in analyzing IPR&D were based on assumptions, which we believed to be reasonable but which were inherently uncertain and unpredictable. These assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur.

A brief description of projects that were included in the IPR&D charge is set forth below, including an estimated percentage of completion as of the Redemption date. Projects subsequently added to the research and development pipeline are not included. Except as otherwise noted below, since the Redemption date there have been no significant changes to the phase of development for the projects listed. We do not track all costs associated with research and devel-

opment on a project-by-project basis. Therefore, we believe a calculation of cost incurred as a percentage of total incurred project cost as of FDA approval is not possible. We estimated, however, that the R&D expenditures that will be required to complete the in-process projects will total at least \$640.0 million as of December 31, 2000, as compared to \$700.0 million as of the Redemption date. This estimate reflects costs incurred since the Redemption date, discontinued projects and decreases in cost to complete estimates for other projects, partially offset by an increase in certain cost estimates related to early stage projects and changes in expected completion dates.

The foregoing discussion of our IPR&D projects, and in particular the following table and subsequent paragraphs regarding the future of these projects, our additional product programs and our process technology program include forward-looking statements that involve risks and uncertainties, and actual results may vary materially. For a discussion of risk factors that may affect projected completion dates and the progress of research and development, see "Forward-Looking Information and Cautionary Factors That May Affect Future Results."

At the Redemption date, we estimated percentage complete data for each project based on weighting of three indicators, as follows:

*PTS*: Probability of technical success, or PTS, is a project level statistic maintained by us on an ongoing basis, which is intended to represent the current likelihood of project success, i.e., FDA approval. This is a quantitative calculation based on the stage of development

and the complexity of the project, and it is highly correlated with the project's phase of development. PTS is periodically adjusted to reflect actual experiences over a reasonable period of time.

*Status Compared to Baseline Model*: We developed a baseline model which allocated percentages of a standard development project to each major phase of the project based on our experience. We then overlaid the time-based status of each project to this baseline model, in order to calculate a percentage complete for each project.

*Management's Estimate of Percentage Complete*: Below is a list of the projects and their estimated percentage complete included in the IPR&D charge related to the Redemption.

We also identified five additional product programs that were at different stages of IPR&D. As of June 30, 1999, the Redemption date, we estimated that these projects would be substantially complete in years 1999 through 2004. The percent completion for each of these additional programs ranged from an estimated 35% to 90%. These projects did not receive material allocations of the purchase price.

In addition, our IPR&D at the Redemption date included a process technology program. The process technology program included the research and development of ideas and techniques that could improve the bulk production of antibodies, including cell culture productivity, and streamlined and improved recovery processes, and improvements in various areas of pharmaceutical manufacturing. We

Project	Description/Indication	Phase of Development	As of the Redemption Date June 30, 1999	
			Substantial Completion Date	% Complete
Nutropin Depot	long-acting dosage form of recombinant growth hormone	Awaiting Regulatory Approval	2000	85%
TNKase, second generation t-PA	acute myocardial infarction	Awaiting Regulatory Approval	2000	90%
Anti-IgE antibody	allergic asthma, seasonal allergic rhinitis	Phase III	2001	75%
Pulmozyme	early-stage cystic fibrosis	Phase III	2003	75%
Dornase alfa AERx™ Delivery System	cystic fibrosis	Preparing for Clinical Testing	2003	45%
Rituxan antibody	intermediate- and high-grade non-Hodgkin's lymphoma	Phase III	2004	60%
Xubix (sibrafiban) oral IIb/IIIa antagonist	orally administered inhibitor of platelet aggregation	Phase III	2000	65%
Activase t-PA	intravenous catheter clearance	Preparing for Phase III	1999	90%
Anti-CD11a antibody (hu1124)	psoriasis	Preparing for Phase III	2003	50%
Herceptin antibody	adjuvant therapy for breast cancer	Preparing for Phase III	2007	45%
Thrombopoietin (TPO)	thrombocytopenia related to cancer treatment	Preparing for Phase III	2002	55%
Anti-CD18 antibody	acute myocardial infarction	Phase II	2004	55%
Anti-VEGF antibody	colorectal and lung cancer	Phase II	2003	35-40%
Herceptin antibody	other tumors	Phase II	2004	40-45%
AMD Fab	age-related macular degeneration	Preparing for Phase I	2004	20%
LDP-02	inflammatory bowel disease	Phase Ib/IIa	2005	30%

estimated that the process technology program was approximately 50% complete at the Redemption date. Material cash inflows from significant projects are generally expected to commence within one to two years after the substantial completion date has been reached.

The significant changes to the projects in the IPR&D charge since the Redemption date through December 31, 2000, include:

- Nutropin Depot long-acting growth hormone — project received FDA approval in December 1999.
- TNKase second generation t-PA — project received FDA approval in June 2000.
- Anti-IgE antibody — project has moved from Phase III studies to awaiting regulatory approval.
- Xubix (sibrafiban) oral IIb/IIIa antagonist — project has been discontinued.
- Anti-CD18 antibody — project has been discontinued.
- Anti-VEGF antibody — project has moved from Phase II studies to Phase III studies.
- Dornase alfa AERx — project discontinued in January 2001.
- Activase t-PA — project has completed one Phase III trial and is awaiting regulatory approval.
- Anti-CD11a antibody — project has moved to Phase III.
- Herceptin antibody for adjuvant therapy for breast cancer — project has moved to Phase III.
- Thrombopoietin (TPO) — project has moved to Phase III.
- AMD Fab — project has moved to Phase I trials.
- LDP-02 — project has moved to Phase II studies.
- Pulmozyme — project has completed Phase III trials.

## STOCK OPTION CHANGES

In connection with the Redemption of our Special Common Stock, the following changes occurred with respect to our stock options that were outstanding as of June 30, 1999:

- Options for the purchase of approximately 27.2 million shares of Special Common Stock were canceled in accordance with the terms of the applicable stock option plans, and the holders received cash payments in the amount of \$20.63 per share, less the exercise price;
- Options for the purchase of approximately 16.0 million shares of Special Common Stock were converted into options to purchase a like

number of shares of Common Stock at the same exercise price; and

- Options for the purchase of approximately 19.6 million shares of Special Common Stock were canceled in accordance with the terms of our 1996 Stock Option/Stock Incentive Plan, or the 1996 Plan. With certain exceptions, we granted new options for the purchase of 1.333 times the number of shares under the previous options with an exercise price of \$24.25 per share, which was the July 23, 1999, public offering price of the Common Stock. The number of shares that were the subject of these new options, which were issued under our 1999 Stock Plan, or the 1999 Plan, was approximately 20.0 million. Alternative arrangements were provided for certain holders of some of the unvested options under the 1996 Plan.

Of the approximately 16.0 million shares of converted options, options with respect to approximately 4.0 million shares were outstanding at December 31, 2000, all of which are currently exercisable except for options with respect to approximately 320,507 shares. These outstanding options are held by 1,420 employees; no non-employee directors hold these options.

Our board of directors and Roche, then our sole stockholder, approved the 1999 Plan on July 16, 1999. Under the 1999 Plan, we granted new options to purchase approximately 26.0 million shares (including the 20.0 million shares referred to above) of Common Stock to approximately 2,400 employees at an exercise price of \$24.25 per share, with the grant of such options made effective as of July 16, 1999. Of the options to purchase these 26.0 million shares, options to purchase approximately 19.8 million shares were outstanding at December 31, 2000, of which options to purchase approximately 7.7 million shares are currently exercisable.

In connection with these stock option transactions, we recorded:

- (1) cash compensation expense of approximately \$284.5 million associated with the cash-out of such stock options and (2) non-cash compensation expense of approximately \$160.1 million associated with the remeasurement, for accounting purposes, of the converted options, which non-cash amount represents the difference between each applicable option exercise price and the redemption price of the Special Common Stock; and
- Over a two-year period beginning July 1, 1999, an aggregate of approximately \$27.4 million of deferred cash compensation available to be earned by a limited number of employees who elected the alternative arrangements described above. As of December 31, 2000, \$11.1 million and as of December 31, 1999, \$7.3 million of compensation expense has been recorded related to these alternative arrangements.

## RELATIONSHIP WITH ROCHE

As a result of the Redemption of our Special Common Stock, the then-existing governance agreement between us and Roche terminated, except for provisions relating to indemnification and stock options, warrants and convertible securities. In July 1999, we entered into certain affiliation arrangements with Roche, amended our licensing and marketing agreement with Hoffmann-La Roche, and entered into a tax sharing agreement with Roche as follows:

### Affiliation Arrangements

Our board of directors consists of two Roche directors, three independent directors nominated by a nominating committee currently controlled by Roche, and one Genentech employee. However, under the affiliation agreement, Roche has the right to obtain proportional representation on our board at any time. Roche intends to continue to allow our current management to conduct our business and operations as we have done in the past. However, we cannot ensure that Roche will not implement a new business plan in the future.

Except as follows, the affiliation arrangements do not limit Roche's ability to buy or sell our Common Stock. If Roche and its affiliates sell their majority ownership of shares of our Common Stock to a successor, Roche has agreed that it will cause the successor to purchase all shares of our Common Stock not held by Roche as follows:

- with consideration, if that consideration is composed entirely of either cash or equity traded on a U.S. national securities exchange, in the same form and amounts per share as received by Roche and its affiliates; and
- in all other cases, with consideration that has a value per share not less than the weighted-average value per share received by Roche and its affiliates as determined by a nationally recognized investment bank.

If Roche owns more than 90% of our Common Stock for more than two months, Roche has agreed that it will, as soon as reasonably practicable, effect a merger of Genentech with Roche or an affiliate of Roche.

Roche has agreed, as a condition to any merger of Genentech with Roche or the sale of our assets to Roche, that either:

- the merger or sale must be authorized by the favorable vote of a majority of non-Roche stockholders, provided no person will be entitled to cast more than 5% of the votes at the meeting; or
- in the event such a favorable vote is not obtained, the value of the consideration to be received by non-Roche stockholders would be equal to or greater than the average of the means of the ranges of fair values for the Common Stock as determined by two nationally recognized investment banks.

We have agreed not to approve, without the prior approval of the directors designated by Roche:

- any acquisition, sale or other disposal of all or a portion of our business representing 10% or more of our assets, net income or revenues;
- any issuance of capital stock except under certain circumstances; or
- any repurchase or redemption of our capital stock other than a redemption required by the terms of any security and purchases made at fair market value in connection with any of our deferred compensation plans.

### Licensing Agreement

In 1995, we entered into a licensing and marketing agreement with Hoffmann-La Roche and its affiliates granting it a ten-year option to license to use and sell our products in non-U.S. markets. In July 1999, we amended that agreement, the major provisions of which include:

- extending Hoffmann-La Roche's option until at least 2015;
- Hoffmann-La Roche may exercise its option to license our products upon the occurrence of any of the following: (1) our decision to file an Investigational New Drug exemption application, or IND, for a product, (2) completion of a Phase II trial for a product or (3) if Hoffmann-La Roche previously paid us a fee of \$10.0 million to extend its option on a product, completion of a Phase III trial for that product;
- we agreed, in general, to manufacture for and supply to Hoffmann-La Roche its clinical requirements of our products at cost, and its commercial requirements at cost plus a margin of 20%; however, Hoffmann-La Roche will have the right to manufacture our products under certain circumstances;
- Hoffmann-La Roche has agreed to pay, for each product for which Hoffmann-La Roche exercises its option upon either a decision to file an IND with the FDA or completion of the Phase II trials, a royalty of 12.5% on the first \$100.0 million on its aggregate sales of that product and thereafter a royalty of 15% on its aggregate sales of that product in excess of \$100.0 million until the later in each country of the expiration of our last relevant patent or 25 years from the first commercial introduction of that product; and
- Hoffmann-La Roche will pay, for each product for which Hoffmann-La Roche exercises its option after completion of the Phase III trials, a royalty of 15% on its sales of that product until the later in each country of the expiration of our relevant patent or 25 years from the first commercial introduction of that product; however, \$5.0 million of any option extension fee paid by Hoffmann-La Roche will be credited against royalties payable to us in the first calendar year of sales by Hoffmann-La Roche in which aggregate sales of that product exceed \$100.0 million.

**Tax Sharing Agreement**

Since the redemption of our Special Common Stock, and until Roche completed its second public offering of our Common Stock in October 1999, we were included in Roche's U.S. federal consolidated income tax group. Accordingly, we entered into a tax sharing agreement with Roche. Pursuant to the tax sharing agreement, we and Roche are to make payments such that the net amount paid by us on account of consolidated or combined income taxes is determined as if we had filed separate, stand-alone federal, state and local income tax returns as the common parent of an affiliated group of corporations filing consolidated or combined federal, state and local returns.

Effective with the consummation of the second public offering on October 26, 1999, we ceased to be a member of the consolidated federal income tax group (and certain consolidated or combined state and local income tax groups) of which Roche is the common parent. Accordingly, our tax sharing agreement with Roche now pertains only to the state and local tax returns in which we will be consolidated or combined with Roche. We will continue to calculate our tax liability or refund with Roche for these state and local jurisdictions as if we were a stand-alone entity.

**Roche's Right to Maintain Its Percentage Ownership Interest in Our Stock**

We expect from time to time to issue additional shares of common stock in connection with our stock option and stock purchase plans, and we may issue additional shares for other purposes. The affiliation agreement provides that we will, among other things, establish a stock repurchase program designed to maintain Roche's percentage ownership interest in our common stock. In addition, Roche has a continuing option to buy stock from us at prevailing market prices to maintain its percentage ownership interest. In connection with that provision, with respect to any issuance of common stock by Genentech in the future, the percentage of Genentech common stock owned by Roche immediately after such issuance is to be no lower than Roche's lowest percentage ownership of Genentech common stock at any time after the offering of common stock occurring in July 1999 and prior to the time of such issuance, except that Genentech may issue shares up to an amount that would cause Roche's lowest percentage ownership to be no more than 2% below the "Minimum Percentage." The Minimum Percentage equals the lowest number of shares of Genentech common stock owned by Roche since the July 1999 offering (to be adjusted in the future for dispositions of shares of Genentech common stock by Roche) divided by 509,194,352 (to be adjusted in the future for stock splits or stock combinations), which is the number of shares of Genentech common stock outstanding at the time of the July 1999 offering adjusted for the two-for-one splits of our common stock in October 2000 and

November 1999. As long as Roche's percentage ownership is greater than 50%, prior to issuing any shares, Genentech has agreed to repurchase a sufficient number of shares of its common stock to provide that, immediately after its issuance of shares, Roche's percentage ownership will be greater than 50%. We have also agreed, upon request, to repurchase shares of our common stock to increase Roche's ownership to the Minimum Percentage.

**LIQUIDITY AND CAPITAL RESOURCES**

	2000	1999	1998
<b>December 31:</b>			
Cash, cash equivalents, short-term investments and long-term marketable debt and equity securities	\$ 2,459.4	\$ 1,957.4	\$ 1,604.6
Working capital	1,340.1	849.1	950.6
Current ratio	4.0:1	2.8:1	4.3:1
<b>Year Ended December 31:</b>			
Cash provided by (used in):			
Operating activities	193.5	(7.4)	349.9
Investing activities	(160.2)	(96.2)	(421.1)
Financing activities	180.4	160.2	107.9
Capital expenditures (included in investing activities above)	(112.7)	(95.0)	(88.1)

We used cash generated from operations, income from investments and proceeds from stock issuances to fund operations, purchase marketable securities and make capital and equity investments during 2000. In 1999, cash generated from operations, income from investments and proceeds from stock issuances were used to pay for the cash-out of stock options related to the Redemption in 1999, to purchase marketable securities and to make capital and equity investments.

Capital expenditures in 2000 and 1999 primarily consisted of equipment purchases and improvements to existing manufacturing and service facilities. Capital expenditures in 1998 included improvements to existing office and laboratory facilities and equipment purchases.

We believe that our cash, cash equivalents and short-term investments, together with funds provided by operations and leasing arrangements, will be sufficient to meet our foreseeable operating cash requirements. In addition, we believe we could access additional funds from the debt and, under certain circumstances, capital markets. See also "Our Affiliation Agreement With Roche Could Adversely Affect Our Cash Position" below for factors that could negatively affect our cash position.

Our long-term debt consists of \$149.7 million of convertible subordinated debentures, with interest payable at 5%, due in March 2002. As a result of the redemption of our Special Common Stock, upon conversion, the holder receives, for each \$74 in principal amount of debenture converted, \$59.25 in cash, of which \$18 will be reimbursed to us by Roche. Generally, we may redeem the debentures until maturity.

**FORWARD-LOOKING INFORMATION AND CAUTIONARY FACTORS THAT MAY AFFECT FUTURE RESULTS**

The following section contains forward-looking information based on our current expectations. Because our actual results may differ materially from this and any other forward-looking statements made by or on behalf of Genentech, this section also includes a discussion of important factors that could affect our actual future results, including, but not limited to, our product sales, royalties, contract revenues, expenses and net income.

**Fluctuations in Our Operating Results Could Affect the Price of Our Common Stock**

Our operating results may vary from period to period for several reasons including:

- The overall competitive environment for our products. For example, sales of our Activase product decreased in 2000, 1999 and 1998 primarily due to competition from Centocor Inc.'s Retavase and more recently to a decreasing size of the thrombolytic marketplace as other forms of acute myocardial infarction treatment gain acceptance.
- The amount and timing of sales to customers in the United States. For example, sales of our Growth Hormone products increased in 2000 and 1999 due to fluctuations in distributor ordering patterns.
- The amount and timing of our sales to Hoffmann-La Roche of products for sale outside of the United States and the amount and timing of its sales to its customers, which directly impact both our product sales and royalty revenues. For example, in the third quarter of 2000, Hoffmann-La Roche's approval of Herceptin in Europe increased our sales of Herceptin product.
- 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 our various products as determined both in clinical testing and by the accumulation of additional information on each product after it is approved by the FDA for sale.
- The rate of adoption and use of our products for approved indications and additional indications.

For example, sales of Pulmozyme increased in 1998 due, in part, to new patients who were attracted to our product as a result of an FDA approval for a label extension to include cystic fibrosis patients under the age of five.

- The potential introduction of new products and additional indications for existing products in 2001 and beyond.
- The ability to successfully manufacture sufficient quantities of any particular marketed product.
- The number and size of any product price increases we may issue.

**The Successful Development of Pharmaceutical Products Is Highly Uncertain**

Successful pharmaceutical product development is highly uncertain and is dependent on numerous factors, many of which are beyond our control. Products that appear promising in the early phases of development may fail to reach the market for several reasons including:

- Preclinical and clinical trial results that may show the product to be less effective than desired or to have harmful problematic side effects;

For example:

- In June 2000, we announced that the preliminary results from our 415-patient Phase II clinical trial of our recombinant humanized anti-CD18 monoclonal antibody fragment, which is known as rhuMab CD18, for the treatment of myocardial infarction, more commonly known as a heart attack, did not meet its primary objectives.
- In 1999, our Phase III clinical trial of recombinant human nerve growth factor, which is known as rhNGF, for use in diabetic peripheral neuropathy did not meet its objectives and we decided not to file for product approval with the FDA.
- In 1999, our Phase II clinical study of recombinant human vascular endothelial growth factor, which is known as VEGF, protein failed to meet the primary endpoints of the study.

- Failure to receive the necessary regulatory approvals or delay in receiving such approvals;
- Manufacturing costs or other factors that make the product uneconomical; or
- The proprietary rights of others and their competing products and technologies that may prevent the product from being commercialized.

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 our research and development expenses include, but are not limited to:

- The number of and the outcome of clinical trials currently being conducted by us and/or our collaborators.
- The number of products entering into development from late-stage research.

For example, there is no guarantee that internal research efforts will succeed in generating sufficient data for us to make a positive development decision or that an external candidate will be available on terms acceptable to us. In the past, promising candidates have not yielded sufficiently positive preclinical results to meet our stringent development criteria.

- Hoffmann-La Roche's decisions whether to exercise its options to develop and sell our future products in non-U.S. markets and the timing and amount of any related development cost reimbursements.
- In-licensing activities, including the timing and amount of related development funding or milestone payments.

For example, in February 2000, we entered into an agreement with Actelion Ltd. for the purchase of rights for the development and co-promotion in the United States of tezosentan, and paid Actelion an upfront fee of \$15.0 million which was recorded as a research and development expense.

- As part of our strategy, we invest in R&D. R&D as a percent of revenues can fluctuate with the changes in future levels of revenue. Lower revenues can lead to more disciplined spending of R&D efforts.
- Future levels of revenue.

**Roche, Our Controlling Stockholder, May Have Interests That Are Adverse to Other Stockholders**

Roche, as our majority stockholder, controls the outcome of actions requiring the approval of our stockholders. Our bylaws provide, among other things, that the composition of our board of directors shall consist of two Roche directors, three independent directors nominated by a nominating committee and one Genentech employee nominated by the nominating committee. As long as Roche owns in excess of 50% of our common stock, Roche directors will comprise two of the three members of the nominating committee. However, at any time until Roche owns less than 5% of our stock,

Roche will have the right to obtain proportional representation on our board. Roche intends to continue to allow our current management to conduct our business and operations as we have done in the past. However, we cannot assure stockholders that Roche will not institute a new business plan in the future. Roche's interests may conflict with your interests.

**Our Affiliation Agreement With Roche Could Limit Our Ability to Make Acquisitions and Could Have a Material Negative Impact on Our Liquidity**

The affiliation agreement between us and Roche contains provisions that:

- Require the approval of the directors designated by Roche to make any acquisition or any sale or disposal of all or a portion of our business representing 10% or more of our assets, net income or revenues;
- Enable Roche to maintain its percentage ownership interest in our common stock; and
- Establish a stock repurchase program designed to maintain Roche's percentage ownership interest in our common stock.

These provisions may have the effect of limiting our ability to make acquisitions and while the dollar amounts associated with the stock repurchase program cannot currently be estimated, these stock repurchases could have a material adverse impact on our liquidity, credit rating and ability to access capital in the financial markets.

**Our Stockholders May Be Unable to Prevent Transactions That Are Favorable to Roche but Adverse to Us**

Our certificate of incorporation includes provisions relating to:

- Competition by Roche with us;
- Offering of corporate opportunities;
- Transactions with interested parties;
- Intercompany agreements; and
- Provisions limiting the liability of specified employees.

Our certificate of incorporation provides that any person purchasing or acquiring an interest in shares of our capital stock shall be deemed to have consented to the provisions in the certificate of incorporation relating to competition with Roche, conflicts of interest with Roche, the offer of corporate opportunities to Roche and intercompany agreements with Roche. This deemed consent may restrict your ability to challenge transactions carried out in compliance with these provisions.

**Potential Conflicts of Interest Could Limit Our Ability to Act on Opportunities That Are Adverse to Roche**

Persons who are directors and/or officers of Genentech and who are also directors and/or officers of Roche may decline to take action in

a manner that might be favorable to us but adverse to Roche. Two of our directors, Dr. Franz B. Humer and Dr. Jonathan K.C. Knowles, currently serve as directors, officers and employees of Roche Holding Ltd and its affiliates.

**We May Be Unable to Retain Skilled Personnel and Maintain Key Relationships**

The success of our business depends, in large part, on our continued ability to attract and retain highly qualified management, scientific, manufacturing and sales and marketing personnel, and on our ability to develop and maintain important relationships with leading research institutions and key distributors. Competition for these types of personnel and relationships is intense.

Roche has the right to maintain its percentage ownership interest in our common stock. Our affiliation agreement with Roche provides that, among other things, we will establish a stock repurchase program designed to maintain Roche's percentage ownership in our common stock if we issue or sell any shares. This right of Roche may limit our flexibility as to the number of shares we are able to grant under our stock option plans. We therefore cannot assure you that we will be able to attract or retain skilled personnel or maintain key relationships.

**We Face Growing and New Competition**

We face growing competition in two of our therapeutic markets and expect new competition in a third market. First, in the thrombolytic market, Activase has lost market share and could lose additional market share to Centocor's Retavase, either alone or in combination with the use of another Centocor product, ReoPro® (abciximab) and to the use of other mechanical therapies to treat acute myocardial infarction; the resulting adverse effect on sales has been and could continue to be material. Retavase received approval from the FDA in October 1996 for the treatment of acute myocardial infarction. We expect that the use of mechanical reperfusion in lieu of thrombolytic therapy for the treatment of acute myocardial infarction will continue to grow.

Second, in the growth hormone market, we continue to face increased competition from four other companies currently selling growth hormone and an additional company which may enter the market in the near future. As a result of that competition, we have experienced a loss in market share. The four competitors have also received approval to market their existing human growth hormone products for additional indications. As a result of this competition, sales of our Growth Hormone products may decline, perhaps significantly.

Third, in the non-Hodgkin's lymphoma market, Corixa Corporation, formerly Coulter Pharmaceutical, Inc., has filed and received an expedited review of a revised Biologics License

Application, or BLA, in 2000 for Bexxar™ (tositumomab and iodine I 131 tositumomab), which may potentially compete with our product Rituxan and IDEC has filed a BLA for Zevalin™ (ibrutinomab tiuxetan), a product which could also potentially compete with Rituxan. Both Bexxar and Zevalin are radiolabeled molecules while Rituxan is not. We are also aware of other potentially competitive biologic therapies for non-Hodgkin's lymphoma in development.

**Other Competitive Factors Could Affect Our Product Sales**

Other competitive factors that could affect our product sales include, but are not limited to:

- The timing of FDA approval, if any, of competitive products. For example, in June 2000 one of our competitors, Novo, received FDA approval for a liquid formulation of its growth hormone product that will directly compete with our liquid formulation, Nutropin AQ. Also in June 2000, another of our competitors, Serono S.A., received FDA approval to deliver its competitive growth hormone product in a needle-free device.
- Our pricing decisions and the pricing decisions of our competitors. For example, we raised the prices of Rituxan in May 2000 and Pulmozyme in June 2000 by approximately 5%.
- The degree of patent protection afforded our products by patents granted to us and by the outcome of litigation involving our patents. For example, in January 2000, a federal court judge lifted a preliminary injunction that had been in effect since 1995 against Bio-Technology General Corporation, or BTG. Although an appeal of the judge's decision is pending, BTG is now permitted to sell its competitive growth hormone product in the United States.
- The outcome of litigation involving patents of other companies concerning our products or processes related to production and formulation of those products or uses of those products. For example, as further described in "Protecting Our Proprietary Rights Is Difficult and Costly," in May 1999, June 2000 and September 2000, several companies filed patent infringement lawsuits against us alleging that we are infringing certain of their patents.
- The increasing use and development of alternate therapies. For example, the overall size of the market for thrombolytic therapies, such as our Activase product, continues to decline as a result of the increasing use of mechanical reperfusion.
- The rate of market penetration by competing products. For example, in the past, we have lost market share to new competitors in the thrombolytic and growth hormone markets.

***In Connection With the Redemption of Our Special Common Stock, We Recorded Substantial Goodwill and Other Intangibles, the Amortization of Which May Adversely Affect Our Earnings***

As a result of the redemption of our special common stock, Roche owned all of our outstanding common stock. Consequently, push-down accounting under generally accepted accounting principles was required. Push-down accounting required us to establish a new accounting basis for our assets and liabilities, based on Roche's cost in acquiring all of our stock. In other words, Roche's cost of acquiring Genentech was "pushed down" to us and reflected on our financial statements. Push-down accounting required us to record goodwill and other intangible assets of approximately \$1,685.7 million and \$1,499.0 million, respectively, on June 30, 1999. The amortization of this goodwill and other intangible assets will have a significant negative impact on our financial results in future years. In addition, we will continuously evaluate whether events and circumstances have occurred that indicate the remaining balance of this and other intangible assets may not be recoverable. If our assets need to be evaluated for possible impairment, we may have to reduce the carrying value of our intangible assets. This could have a material adverse effect on our financial condition and results of operations during the periods in which we recognize a reduction. We may have to write down intangible assets in future periods. For more information about push-down accounting, see the "Redemption of Our Special Common Stock" note in the *Notes to Consolidated Financial Statements*.

***Our Royalty and Contract Revenues Could Decline***

Royalty and contract revenues in future periods could vary significantly. Major factors affecting these revenues include, but are not limited to:

- Hoffmann-La Roche's decisions whether to exercise its options and option extensions to develop and sell our future products in non-U.S. markets and the timing and amount of any related development cost reimbursements.
- Variations in Hoffmann-La Roche's sales and other licensees' sales of licensed products.

For example, we began receiving royalty revenues from Immunex's sale of Enbrel in 1999.

- The conclusion of existing arrangements with other companies and Hoffmann-La Roche.

For example, royalty revenues decreased in 1999 from 1998 due to the expiration of royalty payments primarily on sales of human insulin, from Eli Lilly and Company in August 1998.

- The timing of non-U.S. approvals, if any, for products licensed to Hoffmann-La Roche and other licensees.

For example, we expect the approval of Herceptin outside the United States which occurred in third quarter of 2000 to have a continuing positive impact on royalties.

- Fluctuations in foreign currency exchange rates.
- The initiation of new contractual arrangements with other companies. For example, license fees from Immunex and Schwarz Pharma increased contract revenues in 1999.

- Whether and when contract benchmarks are achieved. For example, milestone payments from Pharmacia increased contract revenue in 1997.

- The failure of or refusal of a licensee to pay royalties.
- The expiration or invalidation of patents or licensed intellectual property.

***Protecting Our Proprietary Rights Is Difficult and Costly***

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. Accordingly, we cannot predict the breadth of claims allowed in these companies' patents. Patent disputes are frequent and can preclude the commercialization of products. We have in the past been, are currently, and may in the future be involved in material patent litigation. Patent litigation is costly in its own right and could subject us to significant liabilities to third parties. In addition, an adverse decision could force us to either obtain third-party licenses at a material cost or cease using the technology or product in dispute. For example, in late 1999 we settled a patent infringement lawsuit brought against us by the Regents of the University of California in which the University alleged that the manufacture and sale of our Protopin and Nutropin growth hormone products infringed a patent owned by the University. In connection with that settlement we paid the University of California \$150.0 million and donated \$50.0 million for the construction of a new life sciences building on the University of California, San Francisco campus.

The presence of patents or other proprietary rights belonging to other parties may lead to our termination of the research and development of a particular product.

We believe that we have strong patent protection or the potential for strong patent protection for a number of our products that generate sales and royalty revenue or that we are developing. However, the courts will determine the ultimate strength of patent protection of our products and those on which we earn royalties.

Three lawsuits have been filed against us in which the companies involved allege that we have infringed their patents by the manufacture and sale of certain of our products:

- In May 1999, GlaxoSmithKline plc, or Glaxo, filed a complaint in which it appears to claim that our manufacture, use and sale of Rituxan and Herceptin antibody products infringe four Glaxo patents that relate to certain uses and preparations of antibodies.
- In June 2000, Chiron Corporation filed a complaint in which it claims that our manufacture and sale of Herceptin infringe a patent it owns.
- In September 2000, Glaxo filed another complaint in which it appears to claim that our manufacture, use and sale of Rituxan and Herceptin antibody products infringe a Glaxo patent that relates to certain cell culture methods.

***We May Incur Material Litigation Costs***

Litigation to which we are currently or have been subjected relates to, among other things, our patent and intellectual property rights, licensing arrangements with other persons, product liability and financing activities. We cannot predict with certainty the eventual outcome of pending litigation, and we might have to incur substantial expense in defending these lawsuits. We have in the past taken substantial special charges relating to litigation, including \$230.0 million in 1999.

***We May Incur Material Product Liability Costs***

The testing and marketing of medical products entail an inherent risk of product liability. Pharmaceutical product liability exposures could be extremely large and pose a material risk. Our business may be materially and adversely affected by a successful product liability claim in excess of any insurance coverage that we may have.

***We May Be Unable to Obtain Regulatory Approvals for Our Products***

The pharmaceutical industry is subject to stringent regulation with respect to product safety and efficacy by various federal, state and local authorities. Of particular significance are the FDA's requirements covering research and development, testing, manufacturing, quality control, labeling and promotion of drugs for human use. A pharmaceutical product cannot be marketed in the United States until it has been approved by the FDA, and then can only be marketed for the indications and claims approved by the FDA. As a result of these requirements, the length of time, the level of expenditures and the laboratory and clinical information required for approval of a New Drug Application, or NDA, or a BLA, are substantial and can require a number of years. In addition, after any of our products receive regulatory approval, they remain subject to ongoing FDA regulation,

including, for example, changes to their label, written advisements to physicians and product recall.

We cannot be sure that we can obtain necessary regulatory approvals on a timely basis, if at all, for any of the products we are developing or that we can maintain necessary regulatory approvals for our existing products, and all of the following could have a material adverse effect on our business:

- Significant delays in obtaining or failing to obtain required approvals.
- Loss of or changes to previously obtained approvals.

For example, in May 2000, we issued letters to physicians advising them of some serious adverse events associated with the administration of Herceptin. In October 2000, we issued a new package insert for Herceptin including this information.

- Failure to comply with existing or future regulatory requirements. For example, in 1999, we paid a \$50.0 million settlement to the federal government in connection with a federal investigation of our former clinical, sales and marketing activities associated with our human growth hormone products.

Moreover, it is possible that the current regulatory framework could change or additional regulations could arise at any stage during our product development, which may affect our ability to obtain approval of our products.

***Difficulties or Delays in Product Manufacturing Could Harm Our Business***

We currently produce all of our products at our manufacturing facilities located in South San Francisco, California and Vacaville, California or through various contract manufacturing arrangements. Problems with any of our or our contractors' manufacturing processes could result in product defects, which could require us to delay shipment of products, recall products previously shipped or be unable to supply products at all.

For example, in March 2000, we issued an important drug notification regarding a defect in the packaging of our Pulmozyme product. During a quality assurance inspection, we had discovered that there was a defect in the packaging of Pulmozyme which occasionally caused a small puncture in ampules of that product. We suspended shipping the product while we determined the source and extent of the defect. We ultimately recalled some of the product.

On December 27, 2000, we received a Warning Letter from the FDA regarding our quality control at our South San Francisco manufacturing plant. The products cited were for cystic fibrosis, breast cancer and acute myocardial infarction. On February 7, 2001, we received a



letter from the FDA accepting our responses and corrective actions with respect to the Warning Letter.

In addition, any prolonged interruption in the operations of our or our contractors' manufacturing facilities could result in cancellations of shipments. A number of factors could cause interruptions, including equipment malfunctions or failures, or damage to a facility due to natural disasters or otherwise. Because our manufacturing processes and those of our contractors are highly complex and are subject to a lengthy FDA approval process, alternative qualified production capacity may not be available on a timely basis or at all. Difficulties or delays in our and our contractors' manufacturing of existing or new products could increase our costs, cause us to lose revenue or market share and damage our reputation.

### ***Our Stock Price, Like That of Many Biotechnology Companies, Is Highly Volatile***

The market prices for securities of biotechnology companies in general have been highly volatile and may continue to be highly volatile in the future. In addition, due to the absence of the put and call that were associated with our special common stock, the market price of our common stock has been and may continue to be more volatile than our special common stock was in the past.

In addition, the following factors may have a significant impact on the market price of our common stock:

- Announcements of technological innovations or new commercial products by us or our competitors.

For example, our stock increased by approximately 4% on the day we announced FDA approval for our Nutropin Depot product.

- Developments concerning proprietary rights, including patents.

For example, our stock price decreased by approximately 4% on the day one of our competitors, Chiron, announced a patent infringement suit against us.

- Publicity regarding actual or potential medical results relating to products under development by us or our competitors.

For example, our stock price increased by approximately 9% on the day we announced positive preliminary Phase III results from the Anti-IgE asthma clinic.

- Regulatory developments in the United States and foreign countries.

- Public concern as to the safety of biotechnology products.

For example, on May 8, 2000, we issued a warning concerning our Herceptin drug after 15 deaths resulted from the administration of Herceptin. Our stock price decreased by approximately 2% at that time.

- Economic and other external factors or other disaster or crisis.

For example, our stock reached a high of \$122.50 per share in March 2000 and decreased, as the biotech sector and stock market in general decreased, to a low of \$42.25 per share in late May 2000.

- Period-to-period fluctuations in financial results.

For example, our stock price has historically been affected by whether we met or exceeded analyst expectations.

### ***Our Affiliation Agreement With Roche Could Adversely Affect Our Cash Position***

Our affiliation agreement with Roche provides that we will establish a stock repurchase program designed to maintain Roche's percentage ownership interest in our common stock. While the dollar amounts associated with these future purchases cannot currently be estimated, these stock repurchases could have a material adverse effect on our cash position and may have the effect of limiting our ability to use our capital stock as consideration for acquisitions.

These provisions may have the effect of limiting our ability to make acquisitions and while the dollar amounts associated with the stock repurchase program cannot currently be estimated, these stock repurchases could have a material adverse impact on our liquidity, credit rating and ability to access capital in the financial markets.

### ***Future Sales by Roche Could Cause the Price of Our Common Stock to Decline***

As of December 31, 2000, Roche owned 306,594,352 shares of our common stock or approximately 58.4% of our outstanding shares. All of our shares owned by Roche are eligible for sale in the public market subject to compliance with the applicable securities laws. We have agreed that, upon Roche's request, we will file one or more registration statements under the Securities Act in order to permit Roche to offer and sell shares of our common stock. We have agreed to use our best efforts to facilitate the registration and offering of those shares designated for sale by Roche. Sales of a substantial number of shares of our common stock by Roche in the public market could adversely affect the market price of our common stock.

### ***We Are Exposed to Market Risk***

We are 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, we enter into various derivative investment transactions pursuant to our investment and risk management policies and procedures in areas such as hedging and counterparty exposure practices. We do not use derivatives for speculative purposes.

We maintain risk management control systems to monitor the risks associated with interest rates, foreign currency exchange rates and equity investment price changes, and our derivative and financial instrument positions. The risk management control systems use analytical techniques, including sensitivity analysis and market values. Though we intend for our risk management control systems to be comprehensive, there are inherent risks that may only be partially offset by our 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 we 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 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 J.P. Morgan Riskmetrics™ dataset as of December 31, 2000.

### ***Our Interest Income Is Subject to Fluctuations in Interest Rates***

Our material interest bearing assets, or interest bearing portfolio, consisted of cash equivalents, restricted cash, short-term investments, convertible preferred stock investments, convertible loans and long-term investments. The balance of our interest bearing portfolio was \$1,879.6 million or 28% of total assets at December 31, 2000. Interest income related to this portfolio was \$90.4 million or 5% of total revenues. Our interest income is sensitive to changes in the general level of interest rates, primarily U.S. interest rates. In this regard, changes in the U.S. interest rates affect the interest bearing portfolio. To mitigate the impact of fluctuations in U.S. interest rates, for a portion of our portfolio, we have entered 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.

Based on our overall interest rate exposure at December 31, 2000, 1999 and 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.

### ***We Are Exposed to Risks Relating to Foreign Currency Exchange Rates and Foreign Economic Conditions***

We evaluate our foreign currency exposure on a net basis. We receive royalty revenues from licensees selling products in countries throughout the world. Increasingly, however, these royalties are being offset by expenses arising from our foreign facility as well as non-U.S. dollar expenses incurred in our collaborations. Currently, our foreign royalty revenues exceed our expenses. As a result, our 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 our licensed products are sold. We are exposed to changes in exchange rates in Europe, Asia (primarily Japan) and Canada. Our 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 our royalty revenues as expressed in U.S. dollars. In addition, as part of our overall investment strategy, a portion of our portfolio is primarily in non-dollar denominated investments. As a result, we are exposed to changes in the exchange rates of the countries in which these non-dollar denominated investments are made.

To mitigate our net foreign exchange exposure, we could hedge certain of our 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 non-dollar denominated revenues will be at least partly offset by an associated increase in the value of the option. Currently, the term of these options is generally one to two years. We may also enter into foreign currency forward contracts to lock in the dollar value of a portion of these anticipated revenues. To hedge the non-dollar denominated investment portfolio, we enter into forward contracts.

Based on our overall currency rate exposure at December 31, 2000, 1999 and 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.

*Our Investments in Equity Securities Are Subject to Market Risks*

As part of our strategic alliance efforts, we invest in equity instruments of biotechnology companies. Our biotechnology equity investment portfolio totaled \$652.7 million or 10% of total assets at December 31, 2000. These investments are subject to fluctuations from market value changes in stock prices. To mitigate this risk, certain equity securities are hedged with costless collars and equity swaps. 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 us from a decline in the market value of the security below a certain minimum level (the put “strike” level), while the call effectively limits our potential to benefit from an increase in the market value of the security above a certain maximum level (the call “strike” level). An equity swap is a derivative instrument where Genentech pays the counterparty the total return of the security above the current spot price and receives interest income on the notional amount for the swap term. The equity swap protects us from a decline in the market value of the security below the spot price and limits our potential benefit from an increase in the market value of the security above the spot price. In addition, as part of our strategic alliance efforts, we hold dividend-bearing convertible preferred stock and have made interest-bearing loans that are convertible into the equity securities of the debtor.

Based on our overall exposure to fluctuations from market value changes in marketable equity prices at December 31, 2000, 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 \$94.0 million. We estimated that the potential loss in fair value of the equity securities portfolio was \$43.2 million at December 31, 1999 and \$10.6 million at December 31, 1998.

**Recent Accounting Pronouncements Could Impact Our Financial Position and Results of Operations**

We will adopt Statement of Financial Accounting Standards 133, or FAS 133, “Accounting for Derivative Instruments and Hedging Activities,” on January 1, 2001. 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 our derivative positions at December 31, 2000, we estimate that upon adoption, we will record a charge from the cumulative effect of a change in accounting principle of approximately \$9.0 million being recognized in the consolidated statement of operations and an increase of approximately \$8.0 million in other comprehensive income.

**We Are Exposed to Credit Risk of Counterparties**

We could be exposed to losses related to the financial instruments described above under “We Are Exposed to Market Risk” should one of our counterparties default. We attempt to mitigate this risk through credit monitoring procedures.

**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, 2000 and 1999, and the related consolidated statements of operations, stockholders’ equity and cash flows for the year ended December 31, 2000, and for the period from June 30, 1999 to December 31, 1999 (all “New Basis”). We have also audited the related consolidated statements of operations, stockholders’ equity and cash flows for the period from January 1, 1999 to June 30, 1999, and for the year ended December 31, 1998 (all “Old Basis”). These financial statements are the responsibility of Genentech, Inc.’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Genentech, Inc. at December 31, 2000 and 1999, and the consolidated results of its operations and its cash flows for the year ended December 31, 2000, the period from June 30, 1999 to December 31, 1999, the period from January 1, 1999 to June 30, 1999, and for the year ended December 31, 1998 in conformity with accounting principles generally accepted in the United States.

As discussed in the notes to the consolidated financial statements, the balance sheet as of December 31, 1999, and the statements of operations, stockholders’ equity and cash flows for the periods in the year ended December 31, 1999 have been restated. In addition, in 2000 the Company changed its method of accounting for revenue recognition.

Palo Alto, California  
January 17, 2001

**REPORT OF MANAGEMENT**

Genentech, Inc. is responsible for the preparation, integrity and fair presentation of its published financial statements. We have prepared the financial statements in accordance with accounting principles generally accepted in the United States. As such, the statements include amounts based on judgments and estimates made by management. We also prepared the other information included in the annual report and are 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. We believe 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. We continually review and modify these systems, where appropriate, to maintain such assurance. Through our 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 our independent auditors has been approved by our Board of Directors and ratified by the stockholders. The Audit Committee of the Board of Directors is composed of three 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.

<i>/s/ Arthur D. Levinson</i>	<i>/s/ Louis J. Lavigne, Jr.</i>	<i>/s/ John M. Whiting</i>
Arthur D. Levinson, Ph.D.	Louis J. Lavigne, Jr.	John M. Whiting
<i>Chairman and Chief Executive Officer</i>	<i>Executive Vice President and Chief Financial Officer</i>	<i>Vice President, Controller and Chief Accounting Officer</i>

## CONSOLIDATED STATEMENTS OF OPERATIONS

(thousands, except per share amounts)

Year Ended December 31	2000	1999	1998
		New Basis (June 30 to December 31) <sup>(1)</sup> Restated <sup>(1)</sup>	Old Basis (January 1 to June 30) <sup>(1)</sup> Restated <sup>(1)</sup>
<b>Revenues</b>			
Product sales (including amounts from related parties: 2000—\$67,392; 1999—\$41,324; 1998—\$28,738)	\$ 1,278,344	\$ 535,671	\$ 503,424
Royalties (including amounts from related parties: 2000—\$46,795; 1999—\$42,528; 1998—\$35,028)	207,241	96,666	92,604
Contract and other (including amounts from related parties: 2000—\$3,506; 1999—\$17,170; 1998—\$61,583)	160,363	26,398	56,844
Interest	90,408	45,049	44,385
<b>Total revenues</b>	<b>1,736,356</b>	<b>703,784</b>	<b>697,257</b>
<b>Costs and expenses</b>			
Cost of sales (including amounts from related parties: 2000—\$56,674; 1999—\$36,267; 1998—\$23,155)	364,892	187,145	98,404
Research and development (including contract related: 2000—\$25,709; 1999—\$18,366; 1998—\$27,660)	489,879	182,387	184,951
Marketing, general and administrative	497,036	253,356	214,573
Special charges:			
Related to redemption	—	1,207,700	—
Legal settlements	—	180,008	50,000
Recurring charges related to redemption	375,300	197,742	—
Interest	5,276	2,641	2,719
<b>Total costs and expenses</b>	<b>1,732,383</b>	<b>2,210,979</b>	<b>898,292</b>
Income (loss) before taxes and cumulative effect of accounting change	3,973	(1,507,195)	146,610
Income tax provision (benefit)	20,414	(262,083)	58,974
Income (loss) before cumulative effect of accounting change	(16,441)	(1,245,112)	87,636
Cumulative effect of accounting change, net of tax	(57,800)	—	—
<b>Net income (loss)</b>	<b>\$ (74,241)</b>	<b>\$ (1,245,112)</b>	<b>\$ 87,636</b>
<b>Earnings (loss) per share:</b>			
<b>Basic:</b> Earnings (loss) before cumulative effect of accounting change	\$ (0.03)	\$ (2.43)	\$ 0.17
Cumulative effect of accounting change, net of tax	(0.11)	—	—
Net earnings (loss) per share	\$ (0.14)	\$ (2.43)	\$ 0.17
<b>Diluted:</b> Earnings (loss) before cumulative effect of accounting change	\$ (0.03)	\$ (2.43)	\$ 0.16
Cumulative effect of accounting change, net of tax	(0.11)	—	—
Net earnings (loss) per share	\$ (0.14)	\$ (2.43)	\$ 0.16
Weighted-average shares used to compute basic earnings (loss) per share:	522,179	513,352	512,368
Weighted-average shares used to compute diluted earnings (loss) per share:	522,179	513,352	531,868
<b>Pro forma amounts assuming the new revenue recognition policy was applied retroactively (unaudited):</b>			
Net income (loss)	\$ (16,441)	\$ (1,248,632)	\$ 79,916

(1) All amounts related to the Redemption of our Special Common Stock transaction are reflected in the New Basis presentation.  
See Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(thousands)

Year Ended December 31	2000	1999	1998
		New Basis (June 30 to December 31) <sup>(1)</sup> Restated <sup>(1)</sup>	Old Basis (January 1 to June 30) <sup>(1)</sup> Restated <sup>(1)</sup>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>			
<b>Cash flows from operating activities:</b>			
Net income (loss)	\$ (74,241)	\$ (1,245,112)	\$ 87,636
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	463,004	236,365	44,317
In-process research and development	—	752,500	—
Non-cash compensation related to stock options, net of tax	—	119,153	—
Deferred income taxes	(235,315)	(143,371)	(924)
Gain on sales of securities available-for-sale	(132,307)	(7,092)	(12,283)
Loss on sales of securities available-for-sale	3,957	884	921
Write down of securities available-for-sale	4,800	4,955	8,467
Write down of non-marketable securities	—	—	432
Loss (gain) on fixed asset dispositions	1,123	902	(16)
Changes in assets and liabilities:			
Investments in trading securities	(20,963)	(5,215)	(4,944)
Receivables and other current assets	(60,719)	(29,299)	(38,644)
Inventories, including inventory write-up effect	9,415	49,228	10,333
Accounts payable, other current liabilities and other long-term liabilities	234,777	135,084	28,277
<b>Net cash provided by (used in) operating activities</b>	<b>193,531</b>	<b>(131,018)</b>	<b>123,572</b>
<b>Cash flows from investing activities:</b>			
Purchases of securities held-to-maturity	—	—	(186,612)
Proceeds from maturities of securities held-to-maturity	—	136,140	150,357
Purchases of securities available-for-sale	(560,405)	(294,814)	(300,254)
Proceeds from sales of securities available-for-sale	574,145	369,311	257,752
Purchases of non-marketable equity securities	(5,663)	(13,781)	(39,177)
Capital expenditures	(112,681)	(53,495)	(41,513)
Change in other assets	(55,604)	(62,430)	38,879
Transfer to restricted cash included in other assets	—	—	(56,600)
<b>Net cash (used in) provided by investing activities</b>	<b>(160,208)</b>	<b>80,931</b>	<b>(177,168)</b>
<b>Cash flows from financing activities:</b>			
Stock issuances	180,379	95,912	64,291
<b>Net cash provided by financing activities</b>	<b>180,379</b>	<b>95,912</b>	<b>64,291</b>
Net increase in cash and cash equivalents	213,702	45,825	10,695
Cash and cash equivalents at beginning of period	337,682	291,857	281,162
<b>Cash and cash equivalents at end of period</b>	<b>\$ 551,384</b>	<b>\$ 337,682</b>	<b>\$ 291,857</b>
<b>Supplemental cash flow data:</b>			
Cash paid during the year for:			
Interest, net of portion capitalized	\$ 5,282	\$ (1,109)	\$ 6,469
Income taxes paid (received)	(5,005)	2,842	15,898
Stock received as consideration for outstanding loans	5,000	16,000	—

(1) All amounts related to the Redemption of our Special Common Stock transaction are reflected in the New Basis presentation.  
See Notes to Consolidated Financial Statements.

## CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except par value)

December 31	2000	1999 Restated <sup>(1)</sup>
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 551,384	\$ 337,682
Short-term investments	642,475	405,003
Accounts receivable—trade (net of allowances of: 2000—\$14,126; 1999—\$15,767)	162,121	120,497
Accounts receivable—other (net of allowances of: 2000—\$3,184; 1999—\$3,184)	63,262	61,054
Accounts receivable—related party	36,299	33,234
Inventories	265,830	275,245
Deferred tax assets	40,619	81,922
Prepaid expenses and other current assets	26,821	11,870
<b>Total current assets</b>	<b>1,788,811</b>	<b>1,326,507</b>
Long-term marketable securities	1,265,515	1,214,757
Property, plant and equipment, net	752,892	730,086
Goodwill (net of accumulated amortization of: 2000—\$843,494; 1999—\$690,209)	1,455,778	1,609,063
Other intangible assets (net of accumulated amortization of: 2000—\$1,282,090; 1999—\$1,062,181)	1,280,359	1,453,268
Other long-term assets	168,458	201,101
<b>Total assets</b>	<b>\$ 6,711,813</b>	<b>\$ 6,534,782</b>
<b>Liabilities and stockholders' equity:</b>		
Current liabilities:		
Accounts payable	\$ 34,503	\$ 33,123
Accrued liabilities—related party	12,265	14,960
Deferred revenue	15,433	2,000
Other accrued liabilities	386,480	427,333
<b>Total current liabilities</b>	<b>448,681</b>	<b>477,416</b>
Long-term debt	149,692	149,708
Deferred tax liabilities	349,848	626,466
Deferred revenue	87,600	2,972
Other long-term liabilities	1,789	8,363
<b>Total liabilities</b>	<b>1,037,610</b>	<b>1,264,925</b>
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.02 par value; authorized: 100,000,000 shares; none issued	—	—
Common stock, \$0.02 par value; authorized: 600,000,000 shares; outstanding: 2000—525,476,771 and 1999—516,220,558	10,510	10,324
Additional paid-in capital	6,651,428	6,245,146
Accumulated deficit, since June 30, 1999	(1,319,353)	(1,245,112)
Accumulated other comprehensive income	331,618	259,499
<b>Total stockholders' equity</b>	<b>5,674,203</b>	<b>5,269,857</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 6,711,813</b>	<b>\$ 6,534,782</b>

(1) All amounts related to the Redemption of our Special Common Stock transaction are reflected in the New Basis presentation.  
See Notes to Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(thousands)

	Shares						Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
	Special Common Stock	Common Stock	Special Common Stock	Common Stock	Additional Paid-in Capital				
<b>Old Basis<sup>(1)</sup></b>									
<b>Balance December 31, 1997</b>	190,427	306,484	\$ 3,809	\$ 6,130	\$ 1,456,313	\$ 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	
<b>Comprehensive income</b>								<b>187,340</b>	
Issuance of stock upon exercise of options	9,840		196		86,688			86,884	
Issuance of stock under employee stock plan	1,708		35		21,029			21,064	
Income tax benefits realized from employee stock option exercises					17,332			17,332	
<b>Balance December 31, 1998</b>	201,975	306,484	\$ 4,040	\$ 6,130	\$ 1,581,362	\$ 693,050	\$ 59,263	\$ 2,343,845	
Period from January 1 to June 30, 1999 (Restated) <sup>(1)</sup>									
Comprehensive income									
Net income						87,636		87,636	
Net unrealized (loss) on securities available-for-sale							(1,158)	(1,158)	
<b>Comprehensive income</b>								<b>86,478</b>	
Issuance of stock upon exercise of options	5,085		102		51,613			51,715	
Issuance of stock under employee stock plan	1,014		20		12,557			12,577	
Income tax benefits realized from employee stock option exercises					6,162			6,162	
<b>Balance June 30, 1999</b>	208,074	306,484	\$ 4,162	\$ 6,130	\$ 1,651,694	\$ 780,686	\$ 58,105	\$ 2,500,777	
<b>New Basis (Effective June 30, 1999)<sup>(1)</sup></b>									
Period from June 30 to December 31, 1999 (Restated) <sup>(1)</sup>									
Push-down accounting:									
Redemption of Special Common Stock and related issuance of Common Stock	(208,074)	202,710	\$ (4,162)	\$ 4,054	\$ 5,361,972	\$ —	\$ (20,337)	\$ 5,341,527	
Eliminate Retained Earnings (Old Basis)					780,686	(780,686)		—	
Adjustments related to the 1990 through 1997 purchase period:									
In-process research and development					(500,500)			(500,500)	
Amortization of goodwill, intangibles and fair value adjustment to inventories, net of tax					(1,221,644)			(1,221,644)	
Comprehensive loss									
Net loss						(1,245,112)		(1,245,112)	
Net unrealized gain on securities available-for-sale							221,731	221,731	
<b>Comprehensive loss</b>								<b>(1,023,381)</b>	
Issuance of stock upon exercise of options		6,551		131	90,056			90,187	
Issuance of stock under employee stock plan		476		9	6,057			6,066	
Income tax benefits realized from employee stock option exercises					76,825			76,825	
<b>Balance December 31, 1999</b>	—	516,221	\$ —	\$ 10,324	\$ 6,245,146	\$ (1,245,112)	\$ 259,499	\$ 5,269,857	
Comprehensive loss									
Net loss						(74,241)		(74,241)	
Net unrealized gain on securities available-for-sale							72,119	72,119	
<b>Comprehensive loss</b>								<b>(2,122)</b>	
Issuance of stock upon exercise of options		8,259		166	148,241			148,407	
Issuance of stock under employee stock plan		997		20	31,968			31,988	
Income tax benefits realized from employee stock option exercises					226,073			226,073	
<b>Balance December 31, 2000</b>	—	525,477	\$ —	\$ 10,510	\$ 6,651,428	\$ (1,319,353)	\$ 331,618	\$ 5,674,203	

(1) All amounts related to the Redemption of our Special Common Stock transaction are reflected in the New Basis presentation.  
See Notes to Consolidated Financial Statements.

In this Annual Report, "Genentech," "we," "us" and "our" refer to Genentech, Inc. "Common Stock" refers to Genentech's common stock, par value \$0.02 per share, "Special Common Stock" refers to Genentech's callable putable common stock, par value \$0.02 per share and "Redeemable Common Stock" refers to Genentech's redeemable common stock, par value \$0.02 per share. All numbers related to the number of shares, price per share and per share amounts of Common Stock, Special Common Stock and Redeemable Common Stock give effect to the two-for-one splits of our Common Stock that were effected in October 2000 and November 1999.

**BASIS OF PRESENTATION AND RESTATEMENT**

On June 30, 1999, we redeemed all of our outstanding Special Common Stock held by stockholders other than Roche Holdings, Inc., commonly known as Roche, with funds deposited by Roche for that purpose. This event, referred to as the "Redemption" in this report, caused Roche to own 100% of the outstanding common stock of Genentech on that date. The Redemption of our Special Common Stock on June 30, 1999 was reflected as a purchase of a business which, under U.S. generally accepted accounting principles, required push-down accounting to reflect in our financial statements the amounts paid for our stock in excess of our net book value. The Redemption created our New Basis of accounting as discussed further below. The Redemption was effective as of June 30, 1999, however, the transaction was reflected as of the end of the day on June 30, 1999 in the financial statements. We previously issued consolidated financial statements that presented limited information related to the results of operations for the period January 1, 1999 through June 30, 1999 immediately prior to the Redemption ("Old Basis"), and the period June 30, 1999 (including and subsequent to the Redemption) to December 31, 1999 ("New Basis"). We did not present separate statements of operations, stockholders' equity or cash flows reflecting the New Basis of accounting. Upon further review and based on discussions with the Securities and Exchange Commission, our statements of operations, cash flows and stockholders' equity have been revised and presented on the New Basis of accounting that resulted from the Redemption transaction. As such, a vertical black line is inserted to separate the "Old Basis" and "New Basis" presentation in the financial statements. Accordingly, the Old Basis reflects the period January 1 through June 30, 1999, and all periods prior to the Redemption, and the New Basis reflects the period from June 30 through December 31, 1999, and all subsequent periods. As a result of the accounting change, we reclassified \$941.5 million from accumulated deficit to additional paid-in capital.

We also restated our financial statements to correct the accounting related to the write up of the valuation allowance pertaining to unrealized gains on certain marketable equity securities, resulting from the Redemption. As a result of this accounting change, the aggregate

amount of contract and other income in 1999 decreased by \$20.3 million, and net income decreased by \$13.6 million (\$0.03 per share) for the quarter and six month periods ended June 30, 1999. In addition, amortization expense decreased by \$0.6 million (less than \$0.01 per share) during the six month period ended December 31, 1999, and goodwill, net of accumulated amortization, decreased by \$19.7 million, other accrued liabilities decreased by \$6.8 million and accumulated deficit increased by \$12.9 million at December 31, 1999.

**DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES**

Genentech is a leading biotechnology company using human genetic information to discover, develop, manufacture and market human pharmaceuticals that address significant unmet medical needs. Fourteen of the approved products of biotechnology stem from our science. We manufacture and market nine protein-based pharmaceuticals, and license several additional products to other companies.

On July 23, 1999, October 26, 1999, and March 29, 2000, Roche completed public offerings of our Common Stock. We did not receive any of the net proceeds from these offerings. On January 19, 2000, Roche completed an offering of zero-coupon notes that are exchangeable for an aggregate of 13,034,618 shares of our Common Stock held by Roche. Roche's percentage ownership of our outstanding Common Stock is approximately 58.4% at December 31, 2000.

**Principles of Consolidation**

The consolidated financial statements include the accounts of Genentech and all 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.

**Change in Accounting Principle**

We previously recognized non-refundable, upfront product license fees as revenue when the technology was transferred and when all of our significant contractual obligations relating to the fees had been fulfilled. Effective January 1, 2000, we changed our method of accounting for non-refundable upfront product license fees and certain guaranteed payments to recognize such fees over the term of the related development collaboration when, at the execution of the agreement, the development period involves significant risk due to the incomplete stage of the product's development, or over the period of the manufacturing obligation when, at the execution of

the agreement, the product is approved for marketing, or nearly approvable, and development risk has been substantially eliminated. Deferred revenue related to manufacturing obligations will be recognized on a straight-line basis over the longer of the contractual term of the manufacturing obligation or the expected period over which we will supply the product. We believe the change in accounting principle is preferable based on guidance provided in the Securities and Exchange Commission's, or SEC, Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements."

The cumulative effect of the change in accounting principle was reported as a charge in the year ended December 31, 2000. The cumulative effect was initially recorded as deferred revenue that will be recognized as revenue over the remaining term of the research and development collaboration or distribution agreements, as appropriate. For the year ended December 31, 2000, the impact of the change in accounting was to increase net loss by \$52.6 million, or \$0.10 per share, comprised of the \$57.8 million cumulative effect of the change (net of tax impact) as described above (\$0.11 per share), net of \$5.2 million of the related deferred revenue (less related tax impact of \$3.4 million) that was recognized as revenue during the year (\$0.01 per share). The remainder of the related deferred revenue of \$90.7 million will be recognized in 2001 through 2019. Pro forma amounts of net income (loss) and related per share amounts, assuming retroactive application of the accounting change for all periods presented, are as follows (in thousands, except per share amounts):

	2000	1999	1998
As Reported:			
Net income (loss)	\$ (74,241)	\$ (1,157,476)	\$ 181,909
Net income (loss) per share—diluted	\$ (0.14)	\$ (2.26)	\$ 0.35
Pro forma amounts with the change in accounting principle related to revenue recognition applied retroactively (unaudited):			
Net income (loss)	\$ (16,441)	\$ (1,168,716)	\$ 154,549
Net income (loss) per share—diluted	\$ (0.03)	\$ (2.28)	\$ 0.30

**Cash and Cash Equivalents**

We consider 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**

We invest our excess cash balances in short-term and long-term marketable securities, primarily corporate notes, certificates of deposit, preferred stock, asset-backed securities and municipal bonds. As part of our strategic alliance efforts, we also invest in equity securities, dividend bearing convertible preferred stock and interest bearing con-

vertible debt of other biotechnology companies. All of our equity investments represent less than a 20% ownership position. 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. We periodically monitor the liquidity progress and financing activities of these entities to determine if impairment write downs are required. We had investments of \$48.5 million at December 31, 2000, and \$53.3 million at December 31, 1999, 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 we have the positive intent and ability to hold the securities to maturity. 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, marketable equity securities are written down to estimated fair value with a charge to marketing, general and administrative expenses. Other than temporary declines in fair value on short-term and long-term investments are charged against interest income. The cost of all securities sold is based on the specific identification method.

**Long-Lived Assets**

The carrying value of our long-lived assets is reviewed for impairment whenever events or changes in circumstances indicate that the asset may not be recoverable. An impairment loss would be recognized when estimated future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Long-lived assets include property, plant and equipment, goodwill and other intangible assets.

**FDA Validation Costs**

U.S. Food and Drug Administration, or FDA, validation costs are capitalized as part of the effort required to acquire and construct long-lived assets, including readying them for their intended use, and are amortized over the estimated useful life of the asset or the term of the lease, whichever is shorter.

**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:

	Useful Lives
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. Capitalized interest on construction-in-progress is included in property, plant and equipment. The repairs and maintenance expenses and capitalized interest were as follows (in millions):

	2000	1999	1998
Repairs and maintenance expenses	\$ 42.1	\$ 39.9	\$ 35.9
Capitalized interest	2.2	2.1	3.0

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

	2000	1999
At cost:		
Land	\$ 90,274	\$ 89,983
Buildings	392,119	380,236
Equipment	761,696	667,884
Leasehold improvements	18,456	4,655
Construction-in-progress	94,679	106,824
	1,357,224	1,249,582
Less: accumulated depreciation	604,332	519,496
<b>Net property, plant and equipment</b>	<b>\$ 752,892</b>	<b>\$ 730,086</b>

**Goodwill**

Goodwill represents the difference between the purchase price and the fair value of the net assets when accounted for by the purchase method of accounting arising from Roche's purchase of our Special Common Stock and push-down accounting. Goodwill is amortized on a straight-line basis over 15 years.

**Other Intangible Assets**

Other intangible assets arising from Roche's purchases of our Special Common Stock and push-down accounting are amortized over their estimated useful lives ranging from five to 15 years. Costs of patents and patent applications related to products and processes of significant importance to us are capitalized and amortized on a straight-line basis over their estimated useful lives of approximately 12 years. Other intangible assets are generally amortized on a straight-line basis over their estimated useful lives.

**Other Assets**

Under certain lease agreements, we may be required from time to time to set aside cash as collateral. At December 31, 2000 and 1999, other assets included \$56.6 million of restricted cash related to such a lease agreement.

**Product Sales and Royalty Revenue**

We recognize revenue from product sales when there is persuasive evidence that an arrangement exists, delivery has occurred, the price is fixed and determinable and collectibility is reasonably assured. Allowances are established for estimated product returns and discounts. Royalties from licensees are based on third-party sales and recorded as earned in accordance with contract terms, when third-party results are reliably measured and collectibility is reasonably assured.

We receive royalties on sales of rituximab, outside of the U.S. (excluding Japan), on sales of Pulmozyme and Herceptin outside of the U.S. and on sales of certain of our products in Canada from F. Hoffmann-La Roche Ltd, a subsidiary of Roche that is commonly known as Hoffmann-La Roche. See "Relationship With Roche" note below for further discussion.

We receive royalties on sales of growth hormone products and tissue-plasminogen activator outside of the U.S. and Canada, and on sales of rituximab in Japan through other licensees. We also receive worldwide royalties on seven additional licensed products that are marketed by other companies. Six of these products originated from our technology.

**Contract Revenue**

Contract revenue for research and development, or R&D, is recorded as earned based on the performance requirements of the contract. Non-refundable contract fees for which no further performance obligations exist, and there is no continuing involvement by Genentech, are recognized on the earlier of when the payments are received or when collection is assured.

Revenue from non-refundable upfront license fees and certain guaranteed payments where we continue involvement through development collaboration or an obligation to supply product is recognized ratably over the development period when, at the execution of the agreement, the development period involves significant risk due to the incomplete stage of the product's development, or over the period of the manufacturing obligation, when, at the execution of the agreement, the product is approved for marketing, or nearly approvable, and development risk has been substantially eliminated. Deferred revenues related to manufacturing obligations are recognized on a straight-line basis over the longer of the contractual term

of the manufacturing obligation or the expected period over which we will supply the product.

Revenue associated with performance milestones is recognized based upon the achievement of the milestones, as defined in the respective agreements. Revenue under R&D cost reimbursement contracts is recognized as the related costs are incurred.

Advance payments received in excess of amounts earned are classified as deferred revenue.

**Royalty Expenses**

Royalty expenses directly related to product sales are classified in cost of sales. Other royalty expenses, relating to royalty revenue, totaled \$34.4 million in 2000, \$39.0 million in 1999, and \$38.3 million in 1998 and are classified in marketing, general and administrative expenses.

**Advertising Expenses**

We expense the costs of advertising, which also includes promotional expenses, as incurred. Advertising expenses were \$86.5 million in 2000, \$80.0 million in 1999, and \$47.7 million in 1998.

**Income Taxes**

We account for income taxes by the asset and liability approach for financial accounting and reporting of income taxes.

**Earnings (Loss) Per Share**

Basic earnings (loss) per share is computed based on the weighted-average number of shares of our Common Stock and Special Common Stock outstanding. Diluted earnings (loss) per share is computed based on the weighted-average number of shares of our Common Stock, Special Common Stock and other dilutive securities. See also "Earnings (Loss) Per Share" note below. All numbers relating to the number of shares, price per share and per share amounts of Common Stock, Special Common Stock and Redeemable Common Stock give effect to the two-for-one splits of our Common Stock that were effected on October 24, 2000 and November 2, 1999.

**Financial Instruments**

As part of our overall portfolio, we have contracted with two external money managers to manage part of our investment portfolio that is held for trading purposes and one external manager that manages our available-for-sale securities portfolio. The investment portfolios consist entirely of debt securities. When the money managers purchase securities denominated in a foreign currency, they enter into derivative instruments such as foreign currency forward contracts, or forward contracts, which are recorded at fair value with the related gain or loss recorded in interest income.

We also enter into derivative forward contracts as hedging instruments of our foreign denominated available-for-sale debt securities. These forward contracts are not recorded on our balance sheet. Any gains and losses from these forward contracts are recorded in interest income with the related hedged revenues.

We purchase derivative instruments such as simple foreign currency put options, or 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 "Financial Instruments" note below for further information on these options. 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.

Interest rate swaps are derivative instruments used to adjust the duration of the investment portfolio in order to meet duration targets. Interest rate swaps, or swaps, are contracts in which two parties agree to swap future streams of payments over a specified period. The accrued net settlement amounts on swaps are reflected on the balance sheet as a component of interest receivable. 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 corre-

sponding termination or sale of the underlying asset, the amounts are recognized through interest income. As of December 31, 2000, we had not terminated any of our swap contracts prior to maturity. Changes in the fair value of swap hedging instruments that qualify as a hedge are not recognized and changes on the fair value of swap instruments that do not qualify as a hedge would be recognized in other income. As of December 31, 2000, our interest rate swap contracts qualified as a hedge and none were held for trading purposes.

Our marketable equity securities 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, we enter into derivative instruments such as costless collar instruments or equity swaps to hedge equity securities against changes in market value. See "Financial Instruments" note below 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 or equity swap 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 component would be recognized through earnings and the intrinsic value component would adjust the cost basis of the underlying security.

**401(k) Plan**

Our 401(k) Plan, or the Plan, covers substantially all of our employees. Under the Plan, eligible employees may contribute up to 15% of their eligible compensation, subject to certain Internal Revenue Service restrictions. We match 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. We provided \$10.1 million in 2000, \$8.5 million in 1999 and \$7.3 million in 1998, for our match under the Plan.

**Comprehensive Income**

Comprehensive income is comprised of net income and other comprehensive income. Other comprehensive income includes certain changes in equity that are excluded from net income. Specifically, unrealized holding gains and losses on our available-for-sale securities, which were reported separately in stockholders' equity, are included in accumulated other comprehensive income. Comprehensive income for years ended December 31, 2000, 1999, and 1998 has been reflected in the Consolidated Statements of Stockholders' Equity.

**New Accounting Standards**

We will adopt Statement of Financial Accounting Standards 133, or

FAS 133, "Accounting for Derivative Instruments and Hedging Activities," on January 1, 2001. 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 our derivative positions at December 31, 2000, we estimate that upon adoption, we will record a charge from the cumulative effect of a change in accounting principle of approximately \$9.0 million being recognized in the consolidated statement of operations and an increase of approximately \$8.0 million in other comprehensive income.

**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 in 2000 decreased from 1999 due primarily to the Redemption and push-down accounting offset by increases in inventory production. As a result of push-down accounting, we recorded \$186.2 million related to the write up of inventory, of which \$92.8 million of expense was recognized through the sale of inventory in 2000 and \$93.4 million of expense was recognized through the sale of inventory in 1999. Inventories at December 31, 2000 and 1999 are summarized below (in thousands):

	2000	1999
Raw materials and supplies	\$ 17,621	\$ 19,903
Work in process	233,121	228,092
Finished goods	15,088	27,250
<b>Total</b>	<b>\$ 265,830</b>	<b>\$ 275,245</b>

**Reclassifications**

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

**REDEMPTION OF OUR SPECIAL COMMON STOCK**

Roche accounted for the Redemption as a purchase of a business. As a result, we were required to push down the effect of the Redemption and Roche's 1990 through 1997 purchases of our Common and Special Common Stock into our consolidated financial statements at the date of the Redemption, which results in our New Basis presentation. Under this method of accounting, our assets and liabilities, including other intangible assets, were recorded at their fair values not to exceed the aggregate purchase price plus Roche's transaction costs at June 30, 1999. In 1990 and 1991 through 1997 Roche purchased 60% and 5%,

respectively, of the outstanding stock of Genentech. In June 1999, we redeemed all of our Special Common Stock held by stockholders other than Roche resulting in Roche owning 100% of our Common Stock. The push-down effect of Roche's aggregate purchase price and the Redemption price in our consolidated balance sheet as of June 30, 1999 was allocated based on Roche's ownership percentages as if the purchases occurred at the original purchase dates for the 1990 and 1991 through 1997 purchases, and at June 30, 1999 for the Redemption. Management of Genentech determined the values of tangible and intangible assets, including in-process research and development, or IPR&D, used in allocating the purchase prices. The aggregate purchase prices for the acquisition of all of Genentech's outstanding shares, including Roche's estimated transaction costs of \$10.0 million, was \$6,604.9 million, consisting of approximately \$2,843.5 million for the 1990 and 1991 through 1997 purchases and approximately \$3,761.4 million for the Redemption.

The following table shows details of the excess of purchase price over net book value (in millions):

	Purchase Period		Total
	1990-1997	1999	
Total purchase price	\$ 2,843.5	\$ 3,761.4	\$ 6,604.9
Less portion of net book value purchased	566.6	836.4	1,403.0
<b>Excess of purchase price over net book value</b>	<b>\$ 2,276.9</b>	<b>\$ 2,925.0</b>	<b>\$ 5,201.9</b>

The following table shows the allocation of the excess of the purchase price over net book value (in millions):

	Purchase Period		Total
	1990-1997	1999	
Inventories	\$ 102.0	\$ 186.2	\$ 288.2
Land	—	16.6	16.6
In-process research and development	500.5	752.5	1,253.0
Developed product technology	429.0	765.0	1,194.0
Core technology	240.5	203.0	443.5
Developed license technology	292.5	175.0	467.5
Trained and assembled workforce	32.5	49.0	81.5
Tradenames	39.0	105.0	144.0
Key distributor relationships	6.5	73.5	80.0
Goodwill	1,091.2	1,208.1	2,299.3
Deferred tax liability	(456.8)	(629.2)	(1,086.0)
Write up of valuation allowance related to marketable securities	—	20.3	20.3
<b>Total</b>	<b>\$ 2,276.9</b>	<b>\$ 2,925.0</b>	<b>\$ 5,201.9</b>

**Push-Down Accounting Adjustments**

The following is a description of accounting adjustments and related useful lives that reflect push-down accounting in our financial statements. These adjustments were based on management's estimates of the value of the tangible and intangible assets acquired

- We recorded charges of \$1,207.7 million in 1999. These charges primarily included: a non-cash charge of \$752.5 million for IPR&D; \$284.5 million of compensation expense related to early cash settlement of certain employee stock options; and an aggregate of approximately \$160.1 million of non-cash compensation expense in connection with the modification and remeasurement, for accounting purposes, of continuing employee stock options, which represents the difference between each applicable option exercise price and the redemption price of the Special Common Stock. (You should read the "Capital Stock" note below for further information on these charges.)
- We recorded an income tax benefit of \$177.8 million related to the above early cash settlement and non-cash compensation related to certain employee stock options. The income tax benefit reduced the current tax payable in other accrued liabilities by \$56.9 million and reduced long-term deferred income taxes by \$120.9 million.
- The estimated useful life of the inventory adjustment to fair value resulting from the Redemption was approximately one year based upon the expected time to sell inventories on hand at June 30, 1999. As the fair-valued inventory is sold, the related write up amount is charged to cost of sales. In 2000, we recognized \$92.8 million of expense related to the inventory write up adjustment. In 1999, we recognized \$93.4 million of expense related to the inventory write up adjustment. All inventory written up as a result of the Redemption has been sold as of December 31, 2000. The entire inventory adjustment related to Roche's 1990 through 1997 purchases was reflected as an adjustment to additional paid-in capital.
- An adjustment was made to record the fair value of land as a result of the Redemption. There were no such adjustments for the purchase periods from 1990 through 1997.
- Recorded \$1,091.2 million of goodwill, which reflects Roche's 1990 through 1997 purchases, net of related accumulated amortization of \$613.6 million through June 30, 1999. The accumulated amortization was recorded as an adjustment to additional paid-in capital at June 30, 1999. Included in goodwill was \$456.8 million related to the recording of deferred tax liabilities. Deferred taxes were recorded for the adjustment to fair value for other intangible assets and inventories as a result of Roche's 1990 through 1997 purchases. The deferred tax liability was calculated based on a

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

marginal tax rate of 40%. The goodwill related to the 1990 through 1997 purchases was amortized over 15 years.

- \$1,208.1 million of goodwill was recorded as a result of the Redemption. Included in goodwill was \$629.2 million related to the recording of deferred tax liabilities. Deferred taxes were recorded for the adjustment to fair value for other intangible assets, inventories and land. The deferred tax liability was calculated based on a marginal tax rate of 40% and was allocated between short- and long-term classifications to match the asset classifications. The goodwill related to the Redemption is being amortized over 15 years.
- We recorded a write up of our valuation allowance related to marketable securities of \$20.3 million related to Roche's percentage ownership purchased, at the time of Redemption, of the net unrealized gains on investments.
- In 2000, we recorded amortization expense of \$153.3 million related to goodwill and \$211.0 million related to other intangible assets. In 1999, we recorded amortization expense of \$76.6 million related to goodwill and \$113.8 million related to other intangible assets.
- The existing deferred tax asset valuation allowance of \$62.8 million related to the tax benefits of stock option deductions which have been realized and credited to paid-in capital as a result of establishing deferred tax liabilities under push-down accounting was eliminated at June 30, 1999.
- The redemption of our Special Common Stock and the issuance of new shares of Common Stock to Roche resulted in substantially the same number of total shares outstanding as prior to the Redemption.
- The balances of our Common Stock and additional paid-in capital at the Redemption include Roche's cost of acquiring our shares in 1990 and the cost of subsequent equity purchases, net of the amortization of the goodwill, IPR&D and other prior period charges related to the 1990 through 1997 purchases. The excess of purchase price over net book value of \$2,276.9 million for 1990 through 1997 and \$2,925.0 million in 1999, and \$160.1 million for the remeasurement of continuing employee stock options at the remeasurement date was recorded in additional paid-in capital.

In addition, the following adjustments were made to additional paid-in capital for the 1990 through 1997 purchase period (in millions):

	1990-1997 Purchases
In-process research and development	\$ (500.5)
Amortization of goodwill, intangibles and fair value adjustment to inventories, net of tax	(1,221.6)
<b>Total adjustment to additional paid-in capital</b>	<b>\$ (1,722.1)</b>

- Our retained earnings prior to the Redemption was not carried forward. This resulted in an adjustment of \$780.7 million to increase additional paid-in capital and eliminate the retained earnings balance immediately prior to the Redemption.
- The tax provision benefit of \$203.1 million for 1999 consists of tax expense of \$114.8 million on pretax income excluding the income and deductions attributable to push-down accounting and legal settlements, and tax benefits of \$317.9 million for 1999 related to the income and deductions attributable to push-down accounting and legal settlements.
- Recorded \$1,040.0 million of other intangible assets, which reflects Roche's 1990 through 1997 purchases, net of related accumulated amortization of \$911.5 million of those assets through June 30, 1999. The accumulated amortization was recorded as an adjustment to additional paid-in capital at June 30, 1999. The components of other intangible assets related to these purchases and their estimated lives are as follows (in millions):

	Fair Value	Accumulated Amortization	Estimated Life
Developed product technology	\$ 429.0	\$ 361.8	10
Core technology	240.5	202.9	10
Developed license technology	292.5	286.9	6
Trained and assembled workforce	32.5	31.6	7
Tradenames	39.0	21.9	15
Key distributor relationships	6.5	6.4	5
<b>Total</b>	<b>\$ 1,040.0</b>	<b>\$ 911.5</b>	

- \$1,370.5 million of other intangible assets was recorded as a result of the Redemption. The components of other intangible assets related to the Redemption and their estimated lives are as follows (in millions):

	Fair Value	Estimated Life
Developed product technology	\$ 765.0	10
Core technology	203.0	10
Developed license technology	175.0	6
Trained and assembled workforce	49.0	7
Tradenames	105.0	15
Key distributor relationships	73.5	5
<b>Total</b>	<b>\$ 1,370.5</b>	

- \$500.5 million and \$752.5 million of IPR&D was recorded as a result of Roche's 1990 through 1997 purchases and the Redemption, respectively. At the date of each purchase, Genentech concluded that technological feasibility of the acquired in-process

technology was not established and that the in-process technology had no future alternative uses. The amount related to the 1990 through 1997 purchases was recorded as an adjustment to additional paid-in capital at June 30, 1999. The amount related to the Redemption was charged to operations at June 30, 1999.

The amounts of IPR&D were determined based on an analysis using the risk-adjusted cash flows expected to be generated by the products that result from the in-process projects. The analysis included forecasting future cash flows that were expected to result from the progress made on each of the in-process projects prior to the purchase dates. These cash flows were estimated by first forecasting, on a product-by-product basis, total revenues expected from sales of the first generation of each in-process product. A portion of the gross in-process product revenues was then removed to account for the contribution provided by any core technology, which was considered to benefit the in-process products. The net in-process revenue was then multiplied by the project's estimated percentage of completion as of the purchase dates to determine a forecast of net IPR&D revenues attributable to projects completed prior to the purchase dates. Appropriate operating expenses, cash flow adjustments and contributory asset returns were deducted from the forecast to establish a forecast of net returns on the completed portion of the in-process technology. Finally, these net returns were discounted to a present value at discount rates that incorporate both the weighted-average cost of capital (relative to the biotech industry and us) as well as the product-specific risk associated with the purchased IPR&D products. The product specific risk factors included each phase of development, type of molecule under development, likelihood of regulatory approval, manufacturing process capability, scientific rationale, pre-clinical safety and efficacy data, target product profile and development plan. The discount rates ranged from 16% to 19% for the 1999 valuation and 20% to 28% for the 1990 purchase valuation, all of which represent a significant risk premium to our weighted-average cost of capital.

The forecast data employed in the analysis was based on internal product level forecast information maintained by our management in the ordinary course of managing the business. The inputs used by us in analyzing IPR&D were based on assumptions, which we believed to be reasonable but which are inherently uncertain and unpredictable. These assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur.

The following table represents unaudited consolidated pro forma information as if the June 30, 1999 redemption of our Special Common Stock occurred at January 1, 1999, and January 1, 1998. The pro forma information also gives effect to the 1990 through 1997

purchases of our Common Stock and Special Common Stock by Roche. The pro forma results for each of the years ended December 31, 1999 and 1998 include amortization of goodwill (\$153.3 million) and other intangible assets (\$227.6 million), and compensation expense (\$13.7 million) related to certain stock option arrangements. In addition, the 1998 and 1999 pro forma results reflect the sale of inventories adjusted to fair value at the beginning of each period (such adjustments totaling \$186.2 million for the periods 1998 and 1999) related to the allocation to our financial statements of Roche's purchase prices and our redemption of the Special Common Stock. The pro forma results also reflect the book tax benefits related to each of these pretax pro forma adjustments other than goodwill (which will have no book tax benefits) at a 40% marginal rate. The pro forma results exclude \$1,207.7 million of non-recurring Redemption-related charges, including charges for IPR&D, as these items are non-recurring. (Refer to above for further information on these charges and adjustment.) The following table is in thousands, except per share amounts.

Year Ended December 31	Pro Forma 1999	Pro Forma 1998
Total revenues	\$ 1,382,941	\$ 1,133,743
Total costs and expenses	1,843,578	1,479,018
Net loss	\$ (345,755)	\$ (226,645)
Earnings (loss) per share:		
Basic	\$ (0.67)	\$ (0.45)
Diluted	(0.67)	(0.45)

## SEGMENT, SIGNIFICANT CUSTOMER AND GEOGRAPHIC INFORMATION

Our operations are treated as one operating segment as we only report profit and loss information on an aggregate basis to our chief operating decision-makers. Information about our product sales, major customers and material foreign source of revenues is as follows (in millions):

### Product Sales

	2000	1999	1998
Herceptin	\$ 275.9	\$ 188.4	\$ 30.5
Rituxan	444.1	279.4	162.6
Activase/TNKase	206.2	236.0	213.0
Growth hormone (Nutropin Depot, Nutropin AQ, Nutropin and Protropin)	226.6	221.2	214.0
Pulmozyme	121.8	111.4	93.8
Actimmune	3.7	2.7	3.9
<b>Total product sales</b>	<b>\$ 1,278.3</b>	<b>\$ 1,039.1</b>	<b>\$ 717.8</b>



# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Hoffmann-La Roche contributed approximately 7% of our total revenues in 2000, 7% in 1999 and 11% in 1998. 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 our total revenues in at least one of the last three years. Although Caremark, a national distributor, did not contribute over 10% of our total revenues in 2000 and 1999, it accounted for 10% in 1998 of our total revenues. Caremark distributes primarily our growth hormone products through its extensive branch network and is then reimbursed through a variety of sources. Bergen Brunswig, a national wholesaler distributor of all of our products, contributed 13% in 2000, 14% in 1999 and 11% in 1998 of our total revenues. Cardinal Distribution, a national wholesaler distributor of all our products, contributed 15% in 2000, 13% in 1999 and 11% in 1998 of our total revenues.

Net foreign revenues were \$164.2 million in 2000, \$155.0 million in 1999 and \$199.6 million in 1998. Material foreign revenues by country were as follows (in millions):

	2000	1999	1998
Europe:			
Switzerland	\$ 72.6	\$ 61.5	\$ 88.8
Germany	22.5	39.6	24.2
Italy	10.4	14.6	21.5
Denmark	—	—	20.0
Others	24.3	17.9	16.5
Canada	19.8	11.8	11.7
Asia	14.6	9.6	16.9
<b>Total</b>	<b>\$ 164.2</b>	<b>\$ 155.0</b>	<b>\$ 199.6</b>

We currently sell primarily to distributors and health care companies throughout the U.S., perform ongoing credit evaluations of our customers' financial condition and extend credit generally without collateral. In 2000, 1999 and 1998, we did not record any material additions to, or losses against, our 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 our potential new products, we establish strategic alliances with various companies. These strategic alliances include the acquisition of marketable and non-marketable equity investments and convertible debt of companies developing technologies that fall outside our 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. We also entered into product-specific collaborations to acquire development and marketing rights for products.

In December 1997, we entered into a collaboration agreement with Alteon Inc. to develop and market pimagedine, an advanced glycosylation end-product formation inhibitor to treat kidney disease in diabetic patients, and invested \$37.5 million in Alteon stock. In 1998, as a result of the decline in Alteon's stock value and the unsuccessful clinical trials with pimagedine, we took an other than temporary charge of \$24.2 million of our investment in Alteon. In 1999, due to the continued decline of Alteon's stock value and unsuccessful negotiations with Alteon, we took another charge of our remaining \$10.8 million investment in Alteon.

## INCOME TAXES

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

	2000	1999	1998
		New Basis	Old Basis
Current:			
Federal	\$ 191,334	\$(110,991)	\$ 76,819
State	25,862	(6,165)	1,366
Total current	217,196	(117,156)	78,185
Deferred:			
Federal	(151,817)	(119,624)	(16,397)
State	(44,965)	(25,303)	(2,814)
Total deferred	(196,782)	(144,927)	(19,211)
<b>Total income tax provision (benefit)</b>	<b>\$ 20,414</b>	<b>\$(262,083)</b>	<b>\$ 58,974</b>

Tax benefits of \$226.1 million in 2000, \$83.0 million in 1999 and \$17.3 million in 1998 related to employee stock options and stock purchase plans were credited to stockholders' equity, and reduced the amount of taxes currently payable and deferred income taxes.

A reconciliation between our income tax provision and the U.S. statutory rate follows (in thousands):

	2000	1999	1998
		New Basis	Old Basis
Tax at U.S. statutory rate of 35%	\$ 1,391	\$(527,518)	\$ 51,313
Research credits	(32,092)	(5,803)	(5,802)
Tax benefit of certain realized gains on securities available-for-sale	(6,604)	(617)	(2,388)
Foreign losses realized	—	(1,363)	(1,364)
State taxes	959	(22,924)	5,371
Goodwill amortization	53,649	26,825	—
Legal settlements	—	—	12,250
IPR&D	—	263,375	—
Other	3,111	5,942	(406)
<b>Income tax provision (benefit)</b>	<b>\$ 20,414</b>	<b>\$(262,083)</b>	<b>\$ 58,974</b>

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

	2000	1999
Deferred tax liabilities:		
Depreciation	\$ (130,892)	\$ (85,036)
Unrealized gain on securities available-for-sale	(229,294)	(181,233)
Adjustment to fair value of inventories	—	(38,272)
Adjustment to fair value of intangibles	(476,313)	(560,699)
Other	(18,999)	(16,893)
<b>Total deferred tax liabilities</b>	<b>(855,498)</b>	<b>(882,133)</b>
Deferred tax assets:		
Capitalized R&D costs	58,333	45,436
Federal credit carryforwards	109,917	111,711
Expenses not currently deductible	150,638	93,121
State credit carryforwards	73,827	44,109
Net operating losses	153,097	41,619
Other	457	1,593
<b>Total deferred tax assets</b>	<b>546,269</b>	<b>337,589</b>
<b>Total net deferred taxes</b>	<b>\$ (309,229)</b>	<b>\$ (544,544)</b>

Total tax credit carryforwards of \$183.7 million expire in the years 2006 through 2017, except for \$81.0 million of R&D credits and \$43.0 million of alternative minimum tax credits which have no expiration date.

Net operating loss carryforwards of \$456.4 million expire in the years 2017 through 2020.

## EARNINGS (LOSS) PER SHARE

The following is a reconciliation of the numerator and denominators of the basic and diluted earnings (loss) per share computations for the years ended December 31, 2000, 1999, and 1998 (in thousands):

	2000	1999	1998
		New Basis	Old Basis
<b>Numerator:</b>			
Net income (loss)—numerator for basic and diluted earnings (loss) per share	\$ (74,241)	\$(1,245,112)	\$ 87,636
<b>Denominator:</b>			
Denominator for basic earnings (loss) per share—weighted-average shares	522,179	513,352	512,368
Effect of dilutive securities:			
Stock options	—	—	19,500
Denominator for diluted earnings (loss) per share—adjusted weighted-average shares and assumed conversions	522,179	513,352	531,868

Options to purchase 40,944,862 shares of our Common Stock ranging from \$12.53 to \$95.66 per share were outstanding during 2000, but were not included in the computation of diluted earnings per share. Options to purchase 41,551,604 shares of our Common Stock ranging from \$12.03 to \$42.94 per share were outstanding during 1999, but were not included in the computation of diluted earnings per share. Options to purchase 714,300 shares of our Special Common Stock ranging from \$17.63 to \$17.79 per share and 414,800 shares of Special Common Stock at \$14.75 per share were outstanding during 1998, but were not included in the computation of diluted earnings per share. The above option exercise prices were greater than the average market prices of the Common Stock and Special Common Stock and therefore, the effect would be anti-dilutive. See "Capital Stock" note for information on option expiration dates.

During 1998, we had convertible subordinated debentures which were convertible to 4,053,788 of Special Common Stock, but were not included in the computation of diluted earnings per share because they were anti-dilutive. As a result of the Redemption, the convertible subordinated debentures are no longer convertible to Special Common Stock. For additional information, you should read the "Long-Term Debt" note below.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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## INVESTMENT SECURITIES

Securities classified as trading and available-for-sale at December 31, 2000 and 1999 are summarized below. Estimated fair value is based on quoted market prices for these or similar investments.

December 31, 2000	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(thousands)			
<b>TOTAL TRADING SECURITIES (carried at estimated fair value)</b>	<b>\$ 273,348</b>	<b>\$ 1,827</b>	<b>\$ (4,152)</b>	<b>\$ 271,023</b>
<b>SECURITIES AVAILABLE-FOR-SALE (carried at estimated fair value):</b>				
Equity securities	\$ 120,416	\$ 585,961	\$ (21,546)	\$ 684,831
Preferred stock	88,517	4,335	(20)	92,832
U.S. Treasury securities and obligations of other U.S. government agencies maturing:				
between 5–10 years	84,796	2,497	(242)	87,051
Corporate debt securities maturing:				
within 1 year	169,569	2,079	(2,248)	169,400
between 1–5 years	217,838	1,865	(1,463)	218,240
between 5–10 years	103,309	935	(1,572)	102,672
Other debt securities maturing:				
within 1 year	109,132	211	(123)	109,220
between 1–5 years	138,854	284	(1,541)	137,597
between 5–10 years	34,911	492	(279)	35,124
<b>TOTAL AVAILABLE-FOR-SALE</b>	<b>\$1,067,342</b>	<b>\$ 598,659</b>	<b>\$ (29,034)</b>	<b>\$1,636,967</b>

December 31, 1999	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(thousands)			
<b>TOTAL TRADING SECURITIES (carried at estimated fair value)</b>	<b>\$ 252,608</b>	<b>\$ 101</b>	<b>\$ (2,649)</b>	<b>\$ 250,060</b>
<b>SECURITIES AVAILABLE-FOR-SALE (carried at estimated fair value):</b>				
Equity securities	\$ 97,818	\$ 499,800	\$ (17,780)	\$ 579,838
U.S. Treasury securities and obligations of other U.S. government agencies maturing:				
between 5–10 years	41,385	—	(2,432)	38,953
Corporate debt securities maturing:				
within 1 year	144,996	7	(165)	144,838
between 1–5 years	350,652	151	(5,623)	345,180
between 5–10 years	137,366	—	(7,550)	129,816
Other debt securities maturing:				
within 1 year	8,044	2,122	(61)	10,105
between 1–5 years	85,022	—	(1,816)	83,206
between 5–10 years	39,342	—	(1,578)	37,764
<b>TOTAL AVAILABLE-FOR-SALE</b>	<b>\$ 904,625</b>	<b>\$ 502,080</b>	<b>\$ (37,005)</b>	<b>\$1,369,700</b>

The carrying value of all investment securities held at December 31, 2000 and 1999 is summarized below (in thousands):

Security	2000	1999
Trading securities	\$ 271,023	\$ 250,060
Securities available-for-sale maturing within one year	278,620	154,943
Preferred stock	92,832	—
<b>Total short-term investments</b>	<b>\$ 642,475</b>	<b>\$ 405,003</b>
Securities available-for-sale maturing between 1–10 years, including equity securities	\$ 1,265,515	\$ 1,214,757
<b>Total long-term marketable securities</b>	<b>\$ 1,265,515</b>	<b>\$ 1,214,757</b>

In 2000, proceeds from the sales of available-for-sale securities totaled \$574.1 million; gross realized gains totaled \$132.3 million and gross realized losses totaled \$4.0 million. In 1999, proceeds from the sales of available-for-sale securities totaled \$627.1 million; gross realized gains totaled \$19.4 million and gross realized losses totaled \$1.8 million. We recorded charges of \$0.8 million in 2000 and \$13.4 million in 1999, to write down certain available-for-sale biotechnology equity securities for which the decline in fair value below cost was other than temporary.

Net change in unrealized holding gains (losses) on trading securities included in net income totaled \$0.2 million in 2000, (\$6.1) million in 1999 and \$7.4 million in 1998.

The marketable debt securities we hold are issued by a diversified selection of corporate and financial institutions with strong credit ratings. Our investment policy limits the amount of credit exposure with any one institution. Other than asset-backed securities, these debt securities are generally not collateralized. In 2000, we recorded a charge of \$4.0 million for credit impairment on marketable debt securities. In 1999 and 1998, no material charges were recorded.

## FINANCIAL INSTRUMENTS

### Foreign Currency Instruments

Certain of our revenues are earned outside of the U.S. 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, we currently purchase options and may enter into forward contracts. At December 31, 2000, we hedged approximately 50% of probable net foreign revenues anticipated within 12 months and 25% of probable net foreign revenues through the year 2002. The notional amounts of the options totaled \$37.6 million at December 31, 2000, and \$51.9 million at December 31, 1999. The notional amounts consisted of the following currencies: Australian dollars, Euro, British pounds, Canadian dollars, Japanese yen, Swiss franc and Swedish krona. All option contracts mature within the next two years. The fair value of the options was based on the forward exchange rates as of December 31, 2000 and 1999. Total aggregate foreign exchange loss including option amortization included in earnings was \$4.4 million, \$0.8 million and \$3.7 million for 2000, 1999 and 1998, respectively.

We have entered into forward contracts to hedge our foreign dollar denominated available-for-sale debt securities. The notional amounts of the forward contracts were \$66.9 million and \$65.0 million at December 31, 2000 and 1999, respectively.

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. We have not experienced any material losses due to credit impairment of our 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, we have entered into swaps as part of our overall strategy of limiting our exposure to fluctuations in U.S. short-term interest rates.

As of December 31, 2000, we had interest rate swaps and a commercial paper portfolio with notional amounts of \$200.0 million. During 2000, counterparties paid us interest at a fixed rate of 7.08% and we paid counterparties interest at a weighted-average variable rate, based upon a three-month LIBOR rate, of 6.74%. The three-month LIBOR rate applicable to these agreements was 6.4% at December 31, 2000. The amounts exchanged are based on the notional amounts multiplied by the interest rates in effect. The weighted-average variable rates are subject to change over time as LIBOR fluctuates. Terms expire at various dates throughout 2003.

We and our counterparties, which are prominent financial institutions with strong credit ratings, are not required to collateralize our respective obligations under the agreements. We are exposed to losses if one or more of the counterparties default. As of December 31, 2000, we were exposed to potential credit losses of \$8.2 million, the unrealized gains associated with these contracts. During 2000, we did not incur any credit losses associated with interest rate swaps. We do not believe that any reasonable likely change in interest rates would have a material adverse effect on our financial position, the results of operations or cash flows. In 1999, as a result of eliminating the interest rate swap portfolio, we recognized a \$5.0 million gain which was recorded in interest income.

For further discussion, see "Forward-Looking Information and Cautionary Factors That May Affect Future Results—We Are Exposed to Market Risk."

### Equity Instruments

To hedge against fluctuations in the market value of a portion of the marketable equity portfolio, we entered into costless collars that expire in 2001 and will require physical or cash settlement. The fair value of the equity derivatives was determined based on closing market prices of the underlying securities at year end. At December 31, 2000, the notional amount of the put options was \$165.0 million and the call options was \$251.0 million. At December 31, 1999, the notional amount of the put options was \$7.1 million and the call options was \$9.7 million.

We have also entered into equity swaps that mature in 2002. An equity swap is a derivative instrument where Genentech pays the counterparty the total return of the security above the current spot

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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price and receives interest income on the notional amount for the swap term. The equity swap protects us from a decline in the market value of the security below the spot price and limits our potential benefit from an increase in the market value of the security above the spot price. At December 31, 2000, the notional amount of the equity swaps was \$111.0 million. We did not enter into equity swaps in 1999.

## Financial Instruments Held for Trading Purposes

As part of our 2000 overall investment strategy, we have contracted with two external money managers to manage part of our investment portfolio. These portfolios at December 31, 2000, 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, 2000 and 1999 were \$110.9 million and \$146.2 million, respectively. The fair value at December 31, 2000 and 1999 of the forward contracts totaled (\$5.8) million and \$3.1 million, respectively. The average fair value during 2000 and 1999 totaled \$2.8 million and \$2.5 million, respectively. Net realized and unrealized trading gains (loss) on the portfolio totaled approximately \$3.5 million in 2000 and (\$2.5) million in 1999 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, 2000 and 1999, of our financial instruments. The fair value of the long-term debt was estimated based on the quoted market price at year end (in thousands):

Financial Instrument	2000		1999	
	Carrying Value	Fair Value	Carrying Value	Fair Value
<b>Assets:</b>				
Investment securities (including accrued interest and traded forward contracts)	\$1,907,990	\$1,907,990	\$1,619,760	\$1,619,760
Convertible equity loans	48,492	48,492	53,295	53,295
Purchased foreign exchange put options	384	3,342	1,547	1,957
Equity forwards	7,372	7,372	—	—
Outstanding interest rate swaps	2,519	8,228	—	—
<b>Liabilities:</b>				
Long-term debt	149,692	151,438	149,708	148,938
Equity collars	32,172	41,569	33,499	33,602
Forward contracts	—	300	—	1,500

## OTHER ACCRUED LIABILITIES

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

	2000	1999
Accrued legal settlement	\$ —	\$ 200,000
Accrued compensation	56,028	52,005
Accrued royalties	34,811	37,692
Hedge payable	32,172	33,499
Accrued clinical and other studies	35,626	18,012
Accrued marketing and promotion costs	21,229	17,897
Taxes payable	29,022	—
Accrued collaborations	111,254	20,708
Other	66,338	47,520
<b>Total other accrued liabilities</b>	<b>\$ 386,480</b>	<b>\$ 427,333</b>

## LONG-TERM DEBT

Our long-term debt consists of \$149.7 million of convertible subordinated debentures, with interest payable at 5%, due in March 2002. As a result of the redemption of our Special Common Stock, upon conversion, the holder receives, for each \$74 in principal amount of debenture converted, \$59.25 in cash, of which \$18 will be reimbursed to us by Roche. Generally, we 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, 2000, are as follows (in thousands):

2001	2002	2003	2004	2005	Thereafter	Total
\$ 47,545	48,029	46,419	41,848	32,973	1,731	<b>\$ 218,545</b>

We lease various real property under operating leases that generally require us to pay taxes, insurance and maintenance. Rent expense was approximately \$17.5 million in 2000, \$13.9 million in 1999 and \$12.7 million in 1998. Sublease income was not material in any of the three years presented.

Under several lease agreements, we have the option to purchase the properties at an amount that does not constitute a bargain. Alternatively, we can cause the property to be sold to a third party. We are contingently liable, under residual value guarantees, for approximately \$536.4 million. We are also required to maintain certain financial ratios and are limited to the amount of additional debt we can assume.

### Commitments

We entered into a research collaboration agreement with CuraGen Corporation in November 1997, whereby we made a \$5.0 million equity investment in CuraGen and agreed to provide a convertible equity loan to CuraGen of up to \$26.0 million. In October 1999, CuraGen exercised its right to borrow \$16.0 million. Simultaneously, with this draw down, CuraGen repaid the loan by issuing 977,636 shares of CuraGen stock valued at \$16.37 per share at such issuance, or an aggregate of \$16.0 million. At December 31, 2000, there were no outstanding loans to CuraGen.

Also, in December 1997, we entered into a collaboration agreement with Millennium Pharmaceuticals, Inc., or Millennium, formerly LeukoSite, Inc., to develop and commercialize Millennium's LDP-02, a humanized monoclonal antibody for the potential treatment of inflammatory bowel disease. Under the terms of the agreement, we made a \$4.0 million equity investment in Millennium and have 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 Millennium agrees to fund 25% of Phase III development costs, we have agreed to provide a second loan to Millennium for such funding. As of December 31, 2000, there were no outstanding loans to Millennium.

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

We are a limited partner in the Vector Later-Stage Equity Fund II, L.P., which is referred to as the Vector Fund. The General Partner is Vector Fund Management II, L.L.C., 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, we contribute to the capital of the Vector Fund through installments in cash as called by the General Partner. Our total commitment to the Vector Fund through September 2003 is \$25.0 million, of which \$15.9 million was contributed as of December 31, 2000. The Vector Fund will terminate and be dissolved in September 2007.

### Contingencies

We are a party to various legal proceedings, including patent infringement litigation relating to our human growth hormone products and antibody products, product liability litigation, licensing and contract disputes, and other matters.

In 1990 and 1997, the Regents of the University of California, or UC, filed patent infringement lawsuits against Genentech, alleging that the manufacture, use and sale of our Protropin and Nutropin human

growth hormone products infringe a patent known as the "Goodman patent" that is owned by UC. On November 19, 1999, we and UC announced a proposed settlement of those lawsuits, and on or about December 17, 1999, the parties entered into a definitive written agreement on the terms of the settlement. Under the terms of the settlement, Genentech agreed to pay UC \$150.0 million and agreed to make a contribution in the amount of \$50.0 million toward construction of the first biological sciences research building at the University of California, San Francisco Mission Bay campus, and Genentech and UC granted certain releases to one another and dismissed with prejudice the 1990 and 1997 patent infringement lawsuits and related appeals. Such amounts were included in other accrued liabilities at December 31, 1999. The settlement resolves all outstanding litigation between Genentech and UC relating to our growth hormone products.

On May 28, 1999, GlaxoSmithKline plc, or Glaxo, filed a patent infringement lawsuit against us in the U.S. District Court in Delaware. The suit asserts that we infringe four U.S. patents owned by Glaxo. Two of the patents relate to the use of specific kinds of antibodies for the treatment of human disease, including cancer. The other two patents asserted against us relate to preparations of specific kinds of antibodies which are made more stable and the methods by which such preparations are made. Glaxo's complaint fails to specify which of our products or methods of manufacture are allegedly infringing the four patents at issue. However, we believe that the suit relates to the manufacture, use and/or sale of our Herceptin and Rituxan antibody products. On July 19, 1999, we filed our answer to the complaint, and in our answer we also stated counterclaims against Glaxo. On or about October 27, 2000, Glaxo filed a motion for summary judgment that our Herceptin and Rituxan antibody products infringe two of the patents asserted against us in this suit, U.S. Patent Nos. 5,543,403 and 5,545,405. On November 21, 2000, we filed an opposition to that motion. The trial of this suit was previously scheduled to begin January 29, 2001, but has been rescheduled to begin April 16, 2001.

On September 14, 2000, Glaxo filed another patent infringement lawsuit against us in the U.S. District Court in Delaware, alleging that we are infringing U.S. Patent No. 5,633,162 owned by Glaxo. The patent relates to specific methods for culturing Chinese Hamster Ovary cells. Glaxo's complaint fails to specify which of our products or methods of manufacture are allegedly infringing that patent. However, the complaint makes a general reference to Genentech's making, using and selling "monoclonal antibodies," and so we believe that the suit relates to our Herceptin and Rituxan antibody products. On October 4, 2000, we filed our answer to the complaint, and in our answer we also stated counterclaims against Glaxo. The judge has scheduled the trial for this suit to begin January 25, 2002.

This lawsuit is separate from and in addition to the Glaxo suit mentioned above.

We and the City of Hope National Medical Center are parties to a 1976 agreement relating to work conducted by two City of Hope employees, Arthur Riggs and Keiichi Itakura, and patents that resulted from that work, which are referred to as the "Riggs/Itakura Patents." Since that time, Genentech has entered into license agreements with various companies to make, use and sell the products covered by the Riggs/Itakura Patents. On August 13, 1999, the City of Hope filed a complaint against us in the Superior Court in Los Angeles County, California alleging that we owe royalties to the City of Hope in connection with these license agreements, as well as product license agreements that involve the grant of licenses under the Riggs/Itakura Patents. The complaint states claims for declaratory relief, breach of contract, breach of implied covenant of good faith and fair dealing, and breach of fiduciary duty. On December 15, 1999, we filed our answer to the City of Hope's complaint, denying all the claims made by the City of Hope. On or about December 22, 2000, City of Hope filed a dismissal of its declaratory relief claims. On January 4, 2001, we filed a motion to dismiss the case. The judge denied the motion on February 1, 2001, but issued a temporary stay of proceedings to permit us to file a petition with the appellate court. We filed our petition on February 13, 2001, which was denied by the appellate court on February 22, 2001. The trial of this suit has been rescheduled to begin on August 22, 2001.

On December 1, 1994, Genentech filed suit against Bio-Technology General Corporation, or BTG, in the United States District Court in Delaware charging BTG with infringement of two Genentech patents applicable to its human growth hormone product. On February 28, 1995, Genentech filed an Amended Complaint against BTG alleging infringement of an additional Genentech patent. On January 6, 1995, BTG filed suit against Genentech in the United States District Court for the Southern District of New York seeking declaratory judgments that those patents and another Genentech patent are invalid and not infringed by BTG. Genentech's suit in Delaware was then transferred to New York and consolidated with BTG's suit there.

At the time of filing its suit and thereafter, BTG alleged various antitrust, abuse of process, civil rights, malicious prosecution and unfair competition claims against Genentech. All of those claims were dismissed by the District Court.

On August 10, 1995, the District Court issued a preliminary injunction which prohibited BTG, pending the Court's final determination of the action, from importing, making, using, selling, offering for sale or distributing in the United States BTG's human growth hormone products except for certain ongoing FDA approved clinical trials. BTG

filed an appeal from the District Court's issuance of the preliminary injunction to the United States Court of Appeals for the Federal Circuit. On April 8, 1996, the Federal Circuit affirmed the preliminary injunction granted by the District Court. On May 20, 1996, the Federal Circuit denied BTG's petition for rehearing, and on October 7, 1996, the United States Supreme Court declined to review the case.

In 1999, the case was transferred to a different judge of the District Court for further proceedings. A jury trial of BTG's patent invalidity claim began on January 10, 2000. On January 18, 2000, the jury returned a verdict in Genentech's favor on a certain factual issue underlying BTG's invalidity claim, but the judge nevertheless entered judgment in favor of BTG and lifted the preliminary injunction that had been in effect against BTG since 1995. On February 23, 2000, we filed a motion with the Federal Circuit requesting that the injunction against BTG be reinstated pending appeal and for an expedited appeal. On May 8, 2000, the Federal Circuit denied our motion.

Genentech and BTG each filed appeals with the Federal Circuit relating to the proceedings in the District Court, and those appeals are now pending. Genentech filed its appeal brief with the Federal Circuit on May 15, 2000. BTG filed its appeal brief on July 11, 2000. In it, BTG included a request that its antitrust claims against Genentech (which previously had been dismissed by the District Court) be reinstated. The Federal Circuit held a hearing on the appeals on December 4, 2000, but has not yet given a decision on the appeals. At this time, and in the future if Genentech's appeal is not successful, BTG could enter the United States market with its human growth hormone product.

On June 7, 2000, Chiron Corporation filed a patent infringement suit against us in the U.S. District Court in the Eastern District of California (Sacramento), alleging that the manufacture, use, sale and offer for sale of our Herceptin antibody product infringes Chiron's U.S. Patent No. 6,054,561. This patent relates to certain antibodies that bind to breast cancer cells and/or other cells. On August 4, 2000, we filed our answer to Chiron's complaint, and in our answer we also stated counterclaims against Chiron. The judge has scheduled the trial of this suit to begin June 25, 2002.

We and Pharmacia AB are parties to a 1978 agreement relating to Genentech's development of recombinant human growth hormone products, under which Pharmacia is obligated to pay Genentech royalties on sales of Pharmacia's growth hormone products throughout the world. On January 5, 1999, Pharmacia filed a request for arbitration with the International Chamber of Commerce to resolve several disputed issues between Genentech and Pharmacia under the agreement. One of the claims made by Pharmacia is for a refund of some of the

royalties previously paid to Genentech for sales of Pharmacia's growth hormone products in certain countries. Although the International Chamber of Commerce has not yet given a decision on that claim, we do not believe its decision is likely to have a material adverse effect on our financial position, result of operations or cash flows.

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

In addition to the above, in April 1999, we paid \$50.0 million to settle a federal investigation relating to our past clinical, sales and marketing activities associated with human growth hormone.

#### RELATIONSHIP WITH ROCHE

On June 30, 1999, Roche exercised its option to cause us to redeem all of our Special Common Stock held by stockholders other than Roche, at a price of \$20.63 per share in cash with funds deposited by Roche for such purpose and we retired all of the shares of Special Common Stock including those held by Roche. As a result of the Redemption, on that date, Roche owned 100% of our outstanding Common Stock. On July 23, 1999, Roche completed a public offering of 88.0 million shares of our Common Stock. On October 26, 1999, Roche completed a public offering of 80.0 million shares of our Common Stock. On January 19, 2000, Roche completed an offering of zero-coupon notes that are exchangeable for an aggregate of 13,034,618 shares of our Common Stock held by Roche. On March 29, 2000, Roche completed a public offering of 34.6 million shares of our Common Stock. Roche's percentage ownership of our Common Stock was approximately 58.4% at December 31, 2000.

In July 1999, we entered into certain affiliation arrangements with Roche, amended our licensing and marketing agreement with F. Hoffmann-La Roche Ltd, an affiliate of Roche commonly known as Hoffmann-La Roche, and entered into a tax sharing agreement with Roche.

#### Affiliation Arrangements

In July 1999, we amended our certificate of incorporation and bylaws and entered into an affiliation agreement with Roche. As a result, our board changed to consist of two Roche directors, three independent directors nominated by a nominating committee currently controlled by Roche, and one Genentech employee. However, under the affiliation agreement, Roche has the right to obtain proportional representation on our board at any time. Roche intends to continue to allow

our current management to conduct our business and operations as we have done in the past. However, we cannot ensure that Roche will not implement a new business plan in the future.

#### Licensing Agreement

In 1995, we entered into a licensing and marketing agreement with Hoffmann-La Roche and its affiliates granting it a ten-year option to license to use and sell our products in non-U.S. markets. In July 1999, we amended that agreement, the major provisions of which include:

- extended Hoffmann-La Roche's option until at least 2015;
- Hoffmann-La Roche may exercise its option to license our products upon the occurrence of any of the following: (1) our decision to file an Investigational New Drug exemption application, or IND, for a product, (2) completion of a Phase II trial for a product or (3) if Hoffmann-La Roche previously paid us a fee of \$10.0 million to extend its option on a product, completion of a Phase III trial for that product;
- we have agreed, in general, to manufacture for and supply to Hoffmann-La Roche its clinical requirements of our products at cost, and its commercial requirements at cost plus a margin of 20%; however, Hoffmann-La Roche will have the right to manufacture our products under certain circumstances;
- Hoffmann-La Roche has agreed to pay, for each product for which Hoffmann-La Roche exercises its option upon either a decision to file an IND with the U.S. Food and Drug Administration, or FDA, or completion of the Phase II trials, a royalty of 12.5% on the first \$100.0 million on its aggregate sales of that product and thereafter a royalty of 15% on its aggregate sales of that product in excess of \$100.0 million until the later in each country of the expiration of our last relevant patent or 25 years from the first commercial introduction of that product; and
- Hoffmann-La Roche will pay, for each product for which Hoffmann-La Roche exercises its option after completion of the Phase III trials, a royalty of 15% on its sales of that product until the later in each country of the expiration of our relevant patent or 25 years from the first commercial introduction of that product; however, \$5.0 million of any option extension fee paid by Hoffmann-La Roche will be credited against royalties payable to us in the first calendar year of sales by Hoffmann-La Roche in which aggregate sales of that product exceed \$100.0 million.

#### Tax Sharing Agreement

Since the redemption of our Special Common Stock, and until Roche completed its second public offering of our Common Stock in October 1999, we were included in Roche's U.S. federal consolidated income tax group. Accordingly, we entered into a tax sharing agreement with Roche. Pursuant to the tax sharing agreement, we and Roche are to

make payments such that the net amount paid by us on account of consolidated or combined income taxes is determined as if we had filed separate, stand-alone federal, state and local income tax returns as the common parent of an affiliated group of corporations filing consolidated or combined federal, state and local returns.

Effective with the consummation of the second public offering on October 26, 1999, Genentech ceased to be a member of the consolidated federal income tax group (and certain consolidated or combined state and local income tax groups) of which Roche is the common parent. Accordingly, our tax sharing agreement with Roche now pertains only to the state and local tax returns in which we will be consolidated or combined with Roche. We will continue to calculate our tax liability or refund with Roche for these state and local jurisdictions as if we were a stand-alone entity.

**Roche's Right to Maintain Its Percentage Ownership Interest in Our Stock**

We expect from time to time to issue additional shares of common stock in connection with our stock option and stock purchase plans, and we may issue additional shares for other purposes. Our affiliation agreement with Roche requires us to, among other things, establish a stock repurchase program designed to maintain Roche's percentage ownership interest in our common stock. In addition, Roche will have a continuing option to buy stock from us at prevailing market prices to maintain its percentage ownership interest. To ensure that, with respect to any issuance of common stock by Genentech in the future, the percentage of Genentech common stock owned by Roche immediately after such issuance will be no lower than Roche's lowest percentage ownership of Genentech common stock at any time after the offering of common stock occurring in July 1999 and prior to the time of such issuance, except that Genentech may issue shares up to an amount that would cause Roche's lowest percentage ownership to be no more than 2% below the "Minimum Percentage." The Minimum Percentage equals the lowest number of shares of Genentech common stock owned by Roche since the July 1999 offering (to be adjusted in the future for dispositions of shares of Genentech common stock by Roche) divided by 509,194,352 (to be adjusted in the future for stock splits or stock combinations), which is the number of shares of Genentech common stock outstanding at the time of the July 1999 offering adjusted for the two-for-one splits of Genentech common stock that were effected in October 2000 and November 1999. As long as Roche's percentage ownership is greater than 50%, prior to issuing any shares, Genentech must repurchase a sufficient number of shares of its common stock to ensure that, immediately after its issuance of shares, Roche's percentage ownership will be greater than 50%. Genentech has also agreed, upon Roche's request, to

repurchase shares of its common stock to increase Roche's ownership to the Minimum Percentage.

**RELATED PARTY TRANSACTIONS**

We enter into transactions with Roche, Hoffmann-La Roche and its affiliates in the ordinary course of business. We recorded contract revenues from Hoffmann-La Roche of \$40.0 million for Herceptin, marketing rights outside of the U.S. in 1998 (see below). All other contract revenue from Hoffmann-La Roche, including reimbursement for ongoing development expenses after the option exercise date, totaled \$3.5 million in 2000, \$17.2 million in 1999, and \$21.6 million in 1998. All other revenue from Roche, Hoffmann-La Roche and their affiliates, principally royalties and product sales, totaled \$114.2 million in 2000, \$83.9 million in 1999, and \$63.8 million in 1998.

In the second quarter of 1999, we entered into a license agreement with Immunex Corporation that grants rights under our immunoadhesin patent portfolio to Immunex for its product Enbrel® (etanercept) biologic response modifier. In exchange for a worldwide, co-exclusive license covering fusion proteins such as Enbrel, Immunex paid us an initial non-refundable license fee which was recorded in contract revenues net of a portion paid to Roche pursuant to an agreement between Roche and us.

In July 1998, we entered into an agreement with Hoffmann-La Roche to provide them with exclusive marketing rights outside of the U.S. for Herceptin. Under the agreement, Hoffmann-La Roche paid us \$40.0 million and has agreed to pay us cash milestones tied to future product development activities, to share equally global development costs up to a maximum of \$40.0 million and to make royalty payments on product sales. As of December 31, 1999, Hoffmann-La Roche paid an additional \$10.0 million toward global development costs.

**CAPITAL STOCK**

**Common Stock and Special Common Stock**

On June 30, 1999, we redeemed all of our outstanding Special Common Stock held by stockholders other than Roche. Subsequently, in July and October 1999, and March 2000, Roche consummated public offerings of our Common Stock. On January 19, 2000, Roche completed an offering of zero-coupon notes that are exchangeable for an aggregate of 13,034,618 shares of our Common Stock held by Roche. See "Redemption of Our Special Common Stock" and "Relationship With Roche" notes above for a discussion of these transactions.

On October 24, 2000, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech

Common Stock of each share held at the close of business on October 17, 2000. Our stock began trading on a split-adjusted basis on October 25, 2000. On November 2, 1999, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech Common Stock for each share held at the close of business on October 29, 1999. Our stock began trading on a split-adjusted basis on November 3, 1999.

**Stock Award Plans**

In connection with the redemption of our Special Common Stock, the following changes occurred with respect to our stock options that were outstanding as of June 30, 1999:

- Options for the purchase of approximately 27.2 million shares of Special Common Stock were canceled in accordance with the terms of the applicable stock option plans, and the holders received cash payments in the amount of \$20.63 per share, less the exercise price;
- Options for the purchase of approximately 16.0 million shares of Special Common Stock were converted into options to purchase a like number of shares of Common Stock at the same exercise price; and
- Options for the purchase of approximately 19.6 million shares of Special Common Stock were canceled, in accordance with the terms of our 1996 Stock Option/Stock Incentive Plan, or the 1996 Plan. With certain exceptions, we granted new options for the purchase of 1.333 times the number of shares under the previous options with an exercise price of \$24.25 per share, which was the public offering price of the Common Stock. The number of shares that were the subject of these new options, which were issued under our 1999 Stock Plan, or the 1999 Plan, was approximately 20.0 million. Certain key employees who held unvested options under the 1996 Plan were provided the opportunity to participate in a cash basis long-term incentive plan in lieu of their options.

Of the approximately 16.0 million shares of converted options, options with respect to approximately 4.0 million shares were outstanding at December 31, 2000, all of which are currently exercisable except for options with respect to approximately 320,507 shares. These outstanding options are held by 1,420 employees; no non-employee directors hold these options.

Our board of directors and Roche, then our sole stockholder, approved the 1999 Plan on July 16, 1999. Under the 1999 Plan, we granted new options to purchase approximately 26.0 million shares (including the 20.0 million shares referred to above) of Common Stock to approximately 2,400 employees at an exercise price of \$24.25 per share. The grant date of such options was July 16, 1999. Of the options to purchase these 26.0 million shares, options to pur-

chase approximately 19.8 million shares were outstanding at December 31, 2000, of which options to purchase approximately 7.7 million shares are currently exercisable.

In connection with these stock option transactions, we recorded:

- (1) cash compensation expense of approximately \$284.5 million associated with the cash-out of such stock options and (2) non-cash compensation expense of approximately \$160.1 million associated with the remeasurement, for accounting purposes, of the converted options, which non-cash amount represents the difference between each applicable option exercise price and the redemption price of the Special Common Stock; and
- Over a two-year period beginning July 1, 1999, an aggregate of approximately \$27.4 million of deferred cash compensation available to be earned by a limited number of employees who elected the alternative arrangements described above. As of December 31, 2000 and 1999, \$11.1 million and \$7.3 million, respectively, of compensation expense has been recorded related to these alternative arrangements.

We have a stock option plan adopted in 1999, and amended in 2000, which variously allows for the granting of non-qualified stock options, stock awards and stock appreciation rights to employees, directors and consultants of Genentech. Incentive stock options may only be granted to employees under this plan. Generally, non-qualified options have a maximum 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 we may grant options with different vesting terms from time to time. No stock appreciation rights have been granted to date.

We adopted the 1991 Employee Stock Plan, or the 1991 Plan, on December 4, 1990, and amended it during 1993, 1995, 1997 and 1999. The 1991 Plan allows eligible employees to purchase Common Stock at 85% of the lower of the fair market value of the 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 Genentech are eligible to participate in the 1991 Plan. Of the 21.2 million shares of Common Stock reserved for issuance under the 1991 Plan, 17.5 million shares have been issued as of December 31, 2000. During 2000, 4,013 of the eligible employees participated in the 1991 Plan.

We have elected to continue to follow Accounting Principles Board, or APB 25, to account for 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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

*Issued to Employees,* no compensation expense is recognized because the exercise price of our employee stock options equals the market price of the underlying stock on the date of grant.

The information regarding net income and earnings per share with FAS 123 has been determined as if we had accounted for our 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 net income and earnings per share with FAS 123 disclosed is not likely to be representative of the effects on net income and earnings per share with FAS 123 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 2000, 1999 and 1998, respectively: risk-free interest rates of 5.3%, 5.8% and 5.5%; dividend yields of 0%; volatility factors of the expected market price of our Common Stock of 75.0%, 45.0% and 11.9%; 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 our employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of disclosures with FAS 123, the estimated fair value of options is amortized to expense over the options' vesting period. Information with FAS 123 for the periods presented (in thousands, except per share amounts):

	2000	1999		1998
		New Basis	Old Basis	
Net (loss) income— as reported	\$ (74,241)	\$(1,245,112)	\$ 87,636	\$ 181,909
Net (loss) income— with FAS 123	(159,067)	(1,275,577)	57,105	140,995
Earnings (loss) per share—as reported:				
Basic	(0.14)	(2.43)	0.17	0.36
Diluted	(0.14)	(2.43)	0.16	0.35
Earnings (loss) per share—with FAS 123:				
Basic	(0.31)	(2.49)	0.11	0.28
Diluted	(0.31)	(2.49)	0.11	0.27

A summary of our stock option activity and related information is as follows:

	Shares	Weighted-Average Price
Options outstanding at December 31, 1997	64,958,436	\$ 11.11
Grants	18,379,700	16.96
Exercises	(9,843,628)	8.83
Cancellations	(4,992,084)	13.66
Options outstanding at December 31, 1998	68,502,424	\$ 12.82
Grants	34,092,336	28.54
Exercises	(11,638,378)	12.19
Cancellations	(49,404,778)	13.03
Options outstanding at December 31, 1999	41,551,604	\$ 25.65
Grants	9,986,353	78.70
Exercises	(8,258,743)	17.96
Cancellations	(2,334,352)	30.82
Options outstanding at December 31, 2000	40,944,862	\$ 39.84

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

Range of Exercise Prices	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$12.531–\$17.782	3,819,753	13.20	\$ 14.97	3,595,599	\$ 14.87
\$20.000–\$24.250	19,968,555	10.09	24.22	7,795,989	24.22
\$32.094–\$42.938	7,238,099	10.13	42.80	1,985,115	42.67
\$55.000–\$82.000	9,718,733	10.01	78.47	38,933	73.35
\$88.500–\$95.655	199,722	10.01	90.75	1,254	91.05
	<b>40,944,862</b>			<b>13,416,890</b>	

Using the Black-Scholes option valuation model, the weighted-average fair value of options granted was \$51.05 in 2000, \$13.66 in 1999 and \$4.31 in 1998. Shares of Common Stock available for future grants under all stock option plans were 8,131,998 at December 31, 2000.

## SUBSEQUENT EVENT (UNAUDITED)

During 1999, we entered into a license and collaboration agreement with Aradigm Corporation to develop an advanced pulmonary delivery system for our Pulmozyme product in the U.S. As part of the agreement, we agreed to provide Aradigm a loan of up to \$10.4 million, for development costs. In late January 2001, we canceled the program and forgave the loan. We expect to record a charge of approximately \$7.0 million to development cost in the first quarter of 2001 related to this cancellation.

# QUARTERLY FINANCIAL DATA (UNAUDITED)

(thousands, except per share amounts)

2000 Quarter Ended	December 31	September 30 Restated <sup>(7)</sup>	June 30 Restated <sup>(7)</sup>	March 31 Restated <sup>(7)</sup>
Total revenues	\$ 485,340	\$ 447,340	\$ 415,826	\$ 387,850
Product sales	351,579	334,173	309,414	283,178
Gross margin from product sales	281,835 <sup>(1)</sup>	242,817 <sup>(1)</sup>	211,757 <sup>(1)</sup>	177,043 <sup>(1)</sup>
Income (loss) before cumulative effect of accounting change <sup>(2)</sup>	15,274	5,760	(12,865)	(24,610)
Cumulative effect of accounting change, net of tax	—	—	—	(57,800)
Net income (loss)	15,274	5,760	(12,865)	(82,410)
Earnings (loss) per share <sup>(3)</sup> :				
Basic	0.03	0.01	(0.02)	(0.16)
Diluted	0.03	0.01	(0.02)	(0.16)
Increase (decrease) <sup>(7)</sup> :				
Revenues	\$ —	\$ 2,158	\$ 2,158	\$ 2,158
Net income (loss)	—	1,295	1,295	(56,505)
Earnings (loss) per share—diluted	—	0.00	0.00	(0.11)

1999 Quarter Ended	December 31	September 30	June 30	April 1 to June 30 Old Basis <sup>(8)</sup> Restated <sup>(8)</sup>	March 31 Old Basis <sup>(8)</sup>
Total revenues	\$ 358,456	\$ 345,328	\$ —	\$ 374,905 <sup>(4)</sup>	\$ 322,352
Product sales	268,703	266,968	—	269,355	234,069
Gross margin from product sales	174,308 <sup>(1)</sup>	174,218 <sup>(1)</sup>	—	216,674	188,346
Net income (loss)	(172,567) <sup>(2)</sup>	(62,506) <sup>(2)</sup>	(1,010,039) <sup>(3)</sup>	73,221	14,415 <sup>(4)</sup>
Earnings (loss) per share <sup>(5)</sup> :					
Basic	(0.33)	(0.13)	(1.97)	0.14	0.03
Diluted	(0.33)	(0.13)	(1.97)	0.13	0.03

(1) Reflects expense of \$2.3 million, \$15.8 million, \$31.4 million and \$43.3 million in the fourth, third, second and first quarters of 2000, respectively, related to the sale of inventory that was written up to fair value as a result of the Redemption on June 30, 1999, and related push-down accounting. For 1999, reflects expense of \$46.6 million in the fourth quarter and \$46.8 million in the third quarter related to the sales of inventory that was written up to fair value as a result of the Redemption on June 30, 1999, and related push-down accounting. (2) Primarily reflects the impact of the Redemption and push-down accounting, including: the sale of inventory that was written up to fair value, see note (1) above; the amortization of goodwill and other intangible assets of \$78.6 million, \$95.2 million, \$95.2 million and \$95.2 million in the fourth, third, second and first quarters of 2000, respectively, and \$95.2 million in both the fourth and third quarters of 1999; and \$57.8 million for the remeasurement of the value of continuing employee stock options in the third quarter of 1999. This also reflects the \$180.0 million charge in the fourth quarter of 1999 related to the legal settlement with the Regents of the University of California. (3) Primarily reflects a \$1,147.3 million special charge related to the Redemption and push-down accounting. Included in this charge is \$752.5 million for in-process research and development, \$284.5 million for the early cash settlement of certain employee stock options and \$102.3 million for the remeasurement of the value of continuing employee stock options. (4) Primarily reflects the legal settlement of \$50.0 million with the Office of the U.S. Attorney for the Northern District of California. (5) Restated to reflect the two-for-one stock splits in each of 2000 and 1999. (6) Includes initial license fee from Immunex Corporation for Enbrel<sup>®</sup> and from Schwarz Pharma AG for Nutropin AQ and Nutropin Depot sustained-release growth hormone. In addition we received a milestone payment from F. Hoffmann-La Roche for Herceptin. (7) We adopted the Securities and Exchange Commission's *Staff Accounting Bulletin No. 101* on revenue recognition effective January 1, 2000, and recorded a \$57.8 million charge, net of tax, as a cumulative effect of a change in accounting principle related to contract revenues recognized in prior periods. The related deferred revenue is being recognized over the term of the agreements. The increase (decrease) in revenues, net income (loss) and earnings (loss) per diluted shares reflect the impact of this adoption. (8) As a result of the Redemption, we revised our presentation of our quarterly data to reflect the New Basis and Old Basis of accounting and also corrected the accounting related to the write-up of the valuation allowance pertaining to unrealized gains on certain marketable securities, which resulted in a reduction in revenues of \$20.3 million during the quarter ended June 30, 1999 and a reduction of goodwill of \$20.3 million as of June 30, 1999. The aggregate effect of this revision was an increase in net loss by approximately \$13.6 million (\$0.03 per share), as compared to amounts previously reported for the quarter ended June 30, 1999. Amortization expense and net loss was reduced by \$0.3 million in each of the quarters ended September 30, 1999 and December 31, 1999 (less than \$0.01 per share in each quarter).

# 11-YEAR FINANCIAL SUMMARY (UNAUDITED)

(millions, except per share and employee data)

	2000		1999		1998	1997	1996	1995	1994	1993	1992	1991	1990
	Actual	Pro Forma <sup>(10)</sup>	Restated <sup>(9)</sup> Actual	Pro Forma <sup>(10)</sup>									
<b>Total revenues</b>	\$ 1,736.4	\$ 1,727.7	\$ 1,401.0	\$ 1,401.0	\$ 1,150.9	\$ 1,016.7	\$ 968.7	\$ 917.8	\$ 795.4	\$ 649.7	\$ 544.3	\$ 515.9	\$ 476.1
Product sales	1,278.3	1,278.3	1,039.1	1,039.1	717.8	584.9	582.8	635.3	601.0	457.4	391.0	383.3	367.2
Royalties	207.2	207.2	189.3	189.3	229.6	241.1	214.7	190.8	126.0	112.9	91.7	63.4	47.6
Contract & other	160.4	151.7	83.2	83.2	114.8	121.6	107.0	31.2	25.6	37.9	16.7	20.4	31.9
Interest	90.4	90.4	89.4	89.4	88.7	69.1	64.2	60.5	42.8	41.5	44.9	48.8	29.4
<b>Total costs and expenses</b>	\$ 1,732.4	\$ 1,264.2	\$ 2,761.6	\$ 1,032.8	\$ 898.3	\$ 846.9	\$ 820.8	\$ 745.6	\$ 665.8	\$ 590.8	\$ 522.3	\$ 469.8	\$ 572.7
Cost of sales	364.9 <sup>(3)</sup>	272.1	285.6 <sup>(3)</sup>	192.2	138.6	102.5	104.5	97.9	95.8	70.5	66.8	68.4	68.3
Research & development	489.9	489.9	367.3	367.3	396.2	470.9	471.1	363.0	314.3	299.4	278.6	221.3	173.1
Marketing, general & administrative	497.0	497.0	467.9	467.9	358.9	269.9	240.1	251.7	248.6	214.4	172.5	175.3	158.1
Special charges	—	—	1,437.7 <sup>(5)</sup>	—	—	—	—	25.0 <sup>(1)</sup>	—	—	—	—	167.7 <sup>(2)</sup>
Recurring charges related to redemption	375.3 <sup>(6)</sup>	—	197.7 <sup>(6)</sup>	—	—	—	—	—	—	—	—	—	—
Interest	5.3	5.3	5.4	5.4	4.6	3.6	5.1	8.0	7.1	6.5	4.4	4.8	5.5
<b>Income (loss) data</b>													
Income (loss) before taxes and cumulative effect of accounting change	\$ 4.0	\$ 463.5	\$ (1,360.6)	\$ 368.2	\$ 252.6	\$ 169.8	\$ 147.9	\$ 172.2	\$ 129.6	\$ 58.9	\$ 22.0	\$ 46.1	\$ (96.6)
Income tax (benefit) provision	20.4	143.7	(203.1)	121.5	70.7	40.8	29.6	25.8	5.2	—	1.1	1.8	1.5
Income (loss) before cumulative effect of accounting change	(16.4)	319.8	(1,157.5)	246.7	181.9	129.0	118.3	146.4	124.4	58.9	20.9	44.3	(98.0)
Cumulative effect of accounting change, net of tax	(57.8) <sup>(8)</sup>	—	—	—	—	—	—	—	—	—	—	—	—
Net income (loss)	(74.2)	319.8	(1,157.5)	246.7	181.9	129.0	118.3	146.4	124.4	58.9	20.9	44.3	(98.0)
Earnings (loss) per share:													
Basic	\$ (0.14)	\$ 0.61	\$ (2.26)	\$ 0.48	\$ 0.36	\$ 0.26	\$ 0.25	\$ 0.31	\$ 0.27	\$ 0.13	\$ 0.05	\$ 0.10	—
Diluted	(0.14)	0.60	(2.26)	0.47	0.35	0.26	0.24	0.30	0.26	0.12	0.05	0.10	(0.26) <sup>(4)</sup>
<b>Selected balance sheet data</b>													
Cash, short-term investments & long-term marketable securities	\$ 2,459.4	—	\$ 1,957.4	—	\$ 1,604.6	\$ 1,286.5	\$ 1,159.1	\$ 1,096.8	\$ 920.9	\$ 719.8	\$ 646.9	\$ 711.4	\$ 691.3
Accounts receivable	261.7	—	214.8	—	149.7	189.2	197.6	172.2	146.3	130.5	93.9	69.0	58.8
Inventories	265.8	—	275.2	—	148.6	116.0	91.9	93.6	103.2	84.7	65.3	56.2	39.6
Property, plant & equipment, net	752.9	—	730.1	—	700.2	683.3	586.2	503.7	485.3	456.7	432.5	342.5	300.2
Goodwill	1,455.8	—	1,609.1	—	—	—	—	—	—	—	—	—	—
Other intangible assets	1,280.4	—	1,453.3	—	65.0	54.7	40.1	42.2	16.0	13.8	12.7	25.9	42.7
Other long-term assets	168.5	—	201.1	—	131.3	122.5	109.1	63.3	45.0	50.3	24.4	16.8	19.0
Total assets	6,711.8	—	6,534.8	—	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
Total current liabilities	448.7	—	477.4	—	291.3	289.6	250.0	233.4	220.5	190.7	133.5	118.6	101.4
Long-term debt	149.7	—	149.7	—	150.0	150.0	150.0	150.0	150.4	151.2	152.0	152.9	153.5
Total liabilities	1,037.6	—	1,264.9	—	511.6	476.4	425.3	408.9	396.3	352.0	297.8	281.7	264.5
Total stockholders' equity	5,674.2	—	5,269.9 <sup>(7)</sup>	—	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
<b>Other data</b>													
Depreciation & amortization expense	\$ 463.0	—	\$ 280.7	—	\$ 78.1	\$ 65.5	\$ 62.1	\$ 58.4	\$ 53.5	\$ 44.0	\$ 52.2	\$ 46.9	\$ 47.6
Capital expenditures	112.7	—	95.0	—	88.1	154.9	141.8	70.2	82.8	87.5	126.0	71.3	36.0
<b>Share information</b>													
Shares used to compute EPS:													
Basic	522.2	522.2	512.9	512.9	503.3	492.2	482.5	473.1	464.0	455.6	447.7	444.1	—
Diluted	522.2	536.1	512.9	529.5	519.5	505.6	495.9	487.0	480.8	475.0	460.0	452.9	372.0 <sup>(4)</sup>
Actual year-end	525.5	525.5	516.2	516.2	508.5	497.0	485.7	477.1	469.0	459.3	451.5	445.2	442.4
<b>Per share data</b>													
Market price:													
High	\$ 117.25	—	\$ 22.50	—	\$ 19.94	\$ 15.16	\$ 13.85	\$ 13.25*	\$ 13.38	\$ 12.63	\$ 9.88	\$ 9.07	\$ 7.72
			\$ 71.50***	—									\$ 6.88**
Low	\$ 46.13	—	\$ 18.63	—	\$ 14.82	\$ 13.32	\$ 12.85	\$ 11.13*	\$ 10.44	\$ 7.82	\$ 6.47	\$ 5.19	\$ 5.03
			\$ 24.25***	—									\$ 5.44**
Book value	\$ 10.80	—	\$ 10.21	—	\$ 4.61	\$ 4.09	\$ 3.71	\$ 3.36	\$ 2.88	\$ 2.43	\$ 2.23	\$ 2.14	\$ 2.02
<b>Number of employees</b>	4,459	—	3,883	—	3,389	3,242	3,071	2,842	2,738	2,510	2,331	2,202	1,923

(continued)

NOTES

We have paid no dividends.

The Financial Summary reflects adoption of SAB 101 in 2000, FAS 130 and 131 in 1998, FAS 128 and 129 in 1997, FAS 121 in 1996, FAS 115 in 1994 and FAS 109 in 1992.

All share and per share amounts reflect two-for-one stock splits that were effected in 2000 and 1999.

\*Special Common Stock began trading October 26, 1995. On October 25, 1995, pursuant to the 1995 Agreement with Roche, each share of our 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 September 7, 1990, received for each common share owned, \$18 in cash from Roche and one share of newly issued Redeemable Common Stock from Genentech.

\*\*\*Common Stock began trading July 20, 1999; prior to that date, shares were Special Common Stock. On June 30, 1999, we redeemed all of our outstanding Special Common Stock held by stockholders other than Roche. Roche's percentage ownership of our outstanding equity increased from 65% to 100%. On July 23, 1999, October 26, 1999, and March 29, 2000, Roche completed public offerings of our Common Stock. On January 19, 2000, Roche completed an offering of zero-coupon notes that are

exchangeable for an aggregate of 13,034,618 shares of our Common Stock held by Roche. Roche's percentage ownership was approximately 58.4% at December 31, 2000.

- (1) Charges related to 1995 merger and the 1995 Agreement with Roche (\$21.0 million) and resignation of our former CEO (\$4.0 million).
- (2) Charges primarily related to 1990 Roche merger.
- (3) Includes costs related to the sale of inventory that was written up at the Redemption due to push-down accounting.
- (4) Information was not available to restate these amounts pursuant to FAS 128. Reflects amounts previously reported adjusted for the stock splits in 2000 and 1999.
- (5) Charges related to 1999 Redemption (\$1,207.7 million) and legal settlements (\$230.0 million).
- (6) Primarily reflects amortization of other intangible assets and goodwill related to the Redemption.
- (7) Reflects the impact of the Redemption and related push-down accounting of \$5,201.9 million of excess purchase price over net book value, net of charges and accumulated amortization of goodwill and other intangible assets.
- (8) Reflects the impact of the adoption of SAB 101 on revenue recognition effective January 1, 2000. Pro forma amounts of net income (loss) and related diluted per share amounts, assuming retroactive application of the change in accounting principle for the years

ended 1997 through 2000 (previous amounts were not material) are as follows (in millions, except per share amounts):

	2000	1999	1998	1997
Pro forma:				
Net income (loss)	\$ (16.4)	\$(1,168.7)	\$ 154.5	\$ 109.8
Earnings (loss) per share—diluted	\$ (0.03)	\$( 2.28)	\$ 0.30	\$ 0.22

(9) Actual 1999 results include the combined New Basis and Old Basis periods presented in the 1999 Consolidated Statements of Operations and Consolidated Statements of Cash Flows reflecting the June 30, 1999, Redemption. We revised the presentation of our 1999 results to reflect the New and Old basis of accounting and also corrected the accounting related to the write up of the valuation allowance pertaining to unrealized gains on certain marketable securities from amounts previously reported. Refer to "Basis of Presentation and Restatement" as disclosed in the *Notes to Consolidated Financial Statements*.

(10) Pro forma amounts exclude special charges related to legal settlements and the Redemption, recurring charges related to the Redemption, costs related to the sale of inventory that was written up at the Redemption, and their related tax effects. In addition, pro forma excludes the cumulative effect of the change in accounting principle, net of tax, adopted in 2000.

STOCK INFORMATION

COMMON STOCK, SPECIAL COMMON STOCK AND REDEEMABLE COMMON STOCK INFORMATION

Stock Trading Symbol: **DNA**

Stock Exchange Listings

Our Common Stock began trading on the New York Stock Exchange under the symbol "DNA" on July 20, 1999. On June 30, 1999, we redeemed all of our outstanding Callable Putable Common Stock, or Special Common Stock, held by stockholders other than Roche Holdings, Inc. Our Special Common Stock had traded on the New York Stock Exchange and the Pacific Exchange under the symbol GNE from October 26, 1995, through June 16, 1999. On October 25, 1995, our non-Roche stockholders approved an agreement (the Agreement) with Roche Holdings, Inc. (Roche). Pursuant to the Agreement, each share of our 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, our Common Stock was traded on the New York Stock Exchange under the symbol GNE. After the close of business on June 30, 1995, each share of our Redeemable Common Stock automatically converted to one share of 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 our merger with a wholly owned subsidiary of Roche was consummated. Our Redeemable Common Stock traded on the New York Stock Exchange under the symbol GNE from September 10, 1990, to June 30, 1995. Our 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. Our 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. We currently intend to retain all future income for use in the operation of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. On October 24, 2000, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech Common Stock for each share held at the close of business on October 17, 2000. Our stock began trading on a split-adjusted basis on October 25, 2000. On November 2, 1999, we effected a two-for-one stock split of our Common Stock in the form of a dividend of one share of Genentech Common Stock for each share held at the close of business on October 29, 1999. Our stock began trading on a split-adjusted basis on November 3, 1999.

Common Stockholders

As of December 31, 2000, there were approximately 1,205 stockholders of record of our Common Stock.

Stock Prices	Common/Special Common Stock			
	2000		1999	
	High	Low	High	Low
4th Quarter	\$ 90.75	\$ 65.25	\$ 71.50	\$ 33.44
3rd Quarter	95.66	73.44	44.88	24.25
2nd Quarter	85.95	46.13	22.50	20.48
1st Quarter	117.25	61.25	22.23	18.63

Headquarters

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

Stock Listing

Genentech is listed on the New York Stock Exchange under the symbol DNA.



Transfer Agent

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

EquiServe, LP  
 Stockholder Services  
 Post Office Box 43010  
 Providence, Rhode Island 02940-3010

Telephone: (800) 733-5001  
 Fax: (781) 828-8813  
[www.equiserve.com](http://www.equiserve.com)

Annual Meeting

The annual meeting of stockholders will be held at 10:00 a.m. Pacific time on May 10, 2001, 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 to each stockholder of record as of March 13, 2001.

Investor Relations

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

Susan Bentley  
 Senior Director, Investor Relations  
 (650) 225-1260

Mike Burchmore  
 Associate Director, Investor Relations  
 (650) 225-8852

Genentech, Inc.  
 1 DNA Way  
 South San Francisco, California 94080-4990  
 e-mail: [investor.relations@gene.com](mailto: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 by sending an e-mail message to [investor.relations@gene.com](mailto:investor.relations@gene.com) or calling (650) 225-1599. You can direct requests for literature to Genentech's literature request line at (800) 488-6519 or you can visit Genentech's site on the World Wide Web at [www.gene.com](http://www.gene.com).

Independent Auditors

Ernst & Young LLP  
 Palo Alto, California

Want to learn more about Genentech?

Visit us on the World Wide Web: [www.gene.com](http://www.gene.com)

Interested in biology?

Visit Access Excellence®, the site for health and bioscience teachers and learners. Originally developed by Genentech, the site was donated in 1999 to the National Health Museum, a non-profit organization founded by former U.S. Surgeon General C. Everett Koop as a national center for health education: [www.accessexcellence.org](http://www.accessexcellence.org).





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Research

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Research

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Research

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### Robert van Reis

Process Sciences

\*Member of Executive Committee

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Our mission is to be the leading biotechnology company, using human genetic information to develop, manufacture and market pharmaceuticals that address significant unmet medical needs. We commit ourselves to high standards of integrity in contributing to the best interests of patients, the medical profession, and our employees, and to seeking significant returns to our stockholders based on the continued pursuit of excellent science.