GENENCOR INTERNATIONAL INC
Form 10-Q
November 14, 2001

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

FORM 10-Q

(MARK ONE)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM _____ TO_____

COMMISSION FILE NUMBER 000-31167

GENENCOR INTERNATIONAL, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	16-1362385
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

925 PAGE MILL ROAD
PALO ALTO, CALIFORNIA 94304
(650) 846-7500

(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORT(S), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS

YES [X] NO [ ]

INDICATE THE NUMBER OF SHARES OUTSTANDING OF EACH OF THE ISSUER'S CLASSES OF COMMON STOCK, AS OF THE LATEST PRACTICABLE DATE.

CLASS	NUMBER OF SHARES OUTSTANDING AT OCTOBER 31, 200
COMMON STOCK, PAR VALUE $0.01 PER SHARE	59,923,374

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Throughout this Report on Form 10-Q, the terms "the Company," "we," and "our" refer to Genencor International, Inc. and its subsidiaries collectively.

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED BALANCE SHEETS
(AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	SEPTEMB 20
ASSETS	
Current assets:	
Cash and cash equivalents	$ 201
Trade accounts receivable, net	48
Inventories	49
Other current assets	15
Total current assets	314
Property, plant and equipment, net	210
Intangible assets, net	60
Other assets	52

Total assets	$ 637
LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Notes payable	$ 6
Current maturities of long-term debt	28
Accounts payable and accrued expenses	30
Other current liabilities	13
Total current liabilities	78
Long-term debt	113
Other long-term liabilities	29
Total liabilities	222
Redeemable preferred stock:	
7 -1/2% cumulative series A preferred stock, without par value, authorized 1,000 shares, 970 shares issued and outstanding	160
Shareholders' equity:	
Common stock, par value $0.01 per share, 200,000,000 shares authorized, 59,923,374 and 59,906,500 shares issued and outstanding at September 30, 2001 and December 31, 2000, respectively	
Additional paid-in capital	344
Deferred stock-based compensation	(3
Notes receivable for common stock	(17
Accumulated deficit	(15
Accumulated other comprehensive loss	(53
Total shareholders' equity	254
Total liabilities, redeemable preferred stock and shareholders' equity	$ 637

The accompanying notes are an integral part of the condensed consolidated unaudited financial statements.

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF OPERATIONS
(AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	THREE MONTHS ENDED SEPTEMBER 30,		
	2001	2000	
Revenues:			
Product revenue	$ 77,847	$ 77,359	$
Fees and royalty revenues	2,942	3,369	
Total revenues	80,789	80,728	
Operating expenses:			

Cost of products sold	44,132	44,495	
Research and development	14,811	13,762	
Sales, marketing and business development	7,124	8,521	
General and administrative	7,847	6,959	
Amortization of intangible assets	2,616	2,615	
Other income	(704)	(956)	
Total operating expenses	75,826	75,396	
Operating income	4,963	5,332	
Non operating expenses/(income):			
Investment income	--	--	
Interest expense	2,612	2,608	
Interest income	(2,264)	(2,712)	
Total non operating expenses/(income)	348	(104)	
Income before provision for income taxes	4,615	5,436	
Provision for income taxes	1,245	683	
Net income	$ 3,370	$ 4,753	$
Net income available to holders of common stock	$ 1,552	$ 2,934	$
Earnings per common share:			
Basic	$ 0.03	$ 0.05	$
Diluted	$ 0.03	$ 0.05	$
Weighted average common shares:			
Basic	59,921,848	56,873,167	5
Diluted	60,747,516	59,501,875	6

The accompanying notes are an integral part of the condensed consolidated unaudited financial statements.

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED UNAUDITED STATEMENTS OF CASH FLOWS
(AMOUNTS IN THOUSANDS)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
Cash flows from operating activities:		
Net income	$ 13,756	$ 25,984
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	26,693	26,550
Amortization of deferred stock-based		

compensation	2,020	962
Loss on disposition of property, plant and equipment	--	197
Gain on sale of marketable securities	--	(16,577)
(Increase) decrease in operating assets:		
Trade accounts receivable	(1,968)	(2,356)
Inventories	(3,446)	2,576
Other assets	1,530	(6,298)
(Decrease) increase in operating liabilities:		
Accounts payable and accrued expenses	(15,307)	1,844
Other liabilities	2,004	15
Net cash provided by operating activities	25,282	32,897
Cash flows from investing activities:		
Purchases of property, plant and equipment	(14,880)	(16,516)
Acquisition of intangible assets	(4,098)	--
Payments to acquire marketable securities	(4,630)	--
Proceeds from the sale of marketable securities	--	17,568
Net cash (used in) provided by investing activities	(23,608)	1,052
Cash flows from financing activities:		
Net proceeds from the issuance of common stock	--	132,801
Proceeds from exercise of stock options	164	--
Net (payments) proceeds on notes payable of foreign affiliate	(31)	966
Payment of long-term debt	--	(10,000)
Other	--	(86)
Net cash provided by financing activities	133	123,681
Effect of exchange rate changes on cash	(1,069)	(3,400)
Net increase in cash and cash equivalents	738	154,230
Cash and cash equivalents -- beginning of period	200,591	39,331
Cash and cash equivalents -- end of period	$ 201,329	$ 193,561

The accompanying notes are an integral part of the condensed consolidated unaudited financial statements.

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED UNAUDITED FINANCIAL STATEMENTS (AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

1 -- BASIS OF PRESENTATION

The condensed consolidated unaudited financial statements should be read in conjunction with the audited consolidated financial statements and related footnotes of Genencor International, Inc. and subsidiaries (the Company) for the year ended December 31, 2000, as included in the Company's Report on Form 10-K. These interim financial statements have been prepared in conformity

with the rules and regulations of the U.S. Securities and Exchange Commission. Certain disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations pertaining to interim financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been included therein. The results of operations of any interim period are not necessarily indicative of the results of operations for the full year.

2 -- EARNINGS PER SHARE

Statement of Financial Accounting Standards No. 128, "Earnings per Share," requires the disclosure of basic and diluted earnings per share. Basic earnings per share is computed based on the weighted average number of common shares outstanding during the period. In arriving at net income available to common shareholders, undeclared and unpaid dividends on redeemable preferred stock were deducted from net income for each quarter presented and for each nine month period presented, respectively.

Diluted earnings per share reflects the potential dilution that could occur if dilutive securities and other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the net income available to common shareholders of the Company. As a result of stock options outstanding under the Company's Stock Option and Stock Appreciation Right Plan, there were dilutive securities for the three and nine months ended September 30, 2001 and 2000. The weighted-average impact of these has been reflected in the calculation of diluted earnings per share for the respective periods presented.

The following table reflects the calculation of basic and diluted earnings per common share:

	THREE MONTHS ENDED SEPTEMBER 30,		
	2001	2000	
Net income	$ 3,370	$ 4,753	$
Less: Accrued dividends on preferred stock	(1,818)	(1,819)	
Net income available to holders of common stock	$ 1,552	$ 2,934	$
Weighted average common shares:			
Basic	59,921,848	56,873,167	5
Effect of stock options	825,668	2,628,708	
Diluted	60,747,516	59,501,875	6
Earnings per common share:			
Basic	$ 0.03	$ 0.05	$
Diluted	$ 0.03	$ 0.05	$

3 -- INVENTORIES

Inventories consist of the following:

	SEPTEMBER 30, 2001	DECE 2
Raw materials	$ 8,157	$
Work-in-progress	8,875	
Finished goods	32,529	3
Inventories	$ 49,561	$ 4

4 -- SHAREHOLDERS' EQUITY

Accumulated other comprehensive loss consists of the following:

	FOREIGN CURRENCY TRANSLATION ADJUSTMENT	MARKETABLE SECURITIES VALUATION ADJUSTMENT
Balances, December 31, 2000	$ (48,360)	$ 228
Current period change	(3,991)	(1,362)
Balances, September 30, 2001	$ (52,351)	$ (1,134)

The change in the marketable securities valuation adjustment for the nine months ended September 30, 2001 of $1,362 ($2,643 pre-tax) relates to unrealized holding losses on the Company's available-for-sale securities.

5 -- INVESTMENT INCOME

There was no investment income during the three or nine months ended September 30, 2001. During the nine months ended September 30, 2000, the Company realized gains from sales of marketable securities in the amount of $16,577. This amount is included in investment income as part of total non operating income for the period.

6 -- EPIMMUNE INC. AGREEMENT

During July 2001, the Company acquired a 10% ownership interest in and entered into a license agreement with Epimmune Inc. The Company also entered into a research collaboration agreement with Epimmune Inc. Although the Company's investment in Epimmune Inc. is considered available-for-sale, the

Company has no intent to liquidate its investment in the current period. Therefore, the investment is recorded at fair value within other assets.

7 -- NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." The Statement requires the use of the purchase method of accounting for all business combinations. The Statement also requires the recognition of certain intangible assets acquired in a business combination apart from goodwill. SFAS No. 141 applies to all business combinations initiated after June 30, 2001. Management is currently assessing the impact of this new standard on the Company's financial statements.

In June 2001, the Financial Accounting Standards Board also issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement requires the recognition of separately identifiable intangible assets. Furthermore, it establishes amortization requirements based upon the ability of the intangible assets to provide cash flows. For those intangible assets with readily identifiable useful lives, amortization will be recorded in the statement of operations over such lives. Intangible assets, such as goodwill, which have indefinite lives, will not result in periodic amortization, but must be tested at least annually for impairment. This statement may

result in reclassifications in the Company's financial statements of pre-existing intangible assets. The provisions of SFAS No. 142 will be effective for the Company starting the first quarter 2002. Management is currently assessing the impact of this new standard on the Company's financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The provisions of SFAS No. 143 are required to be adopted by the Company as of January 1, 2003, although earlier adoption is permitted. Management is currently assessing the impact of this new standard on the Company's financial statements.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses the accounting model for long-lived assets to be disposed of by sale and resulting implementation issues. This statement requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2001. The provisions of SFAS No. 144 will be effective for the Company starting the first quarter 2002. Management is currently assessing the impact of this new standard on the Company's financial statements.

8 -- INCOME TAXES

The Company's effective income tax rate for the three months ended September 30, 2001 was 27%, compared with 13% for the three months ended September 30, 2000, which reflects the year-to-date impact of the Company's

assessment of its annual effective income tax rate. For the three months ended September 30, 2000, this assessment included the Company's reevaluation of its ability to utilize certain deferred tax assets, which resulted in the release of valuation allowances.

The Company's effective income tax rate for the nine months ended September 30, 2001 was 27%, compared with 30% for the nine months ended September 30, 2000. The effective rate for the nine months ended September 30, 2000 included the effect of two one-time events. During the nine months ended September 30, 2000, the Company realized $16,577 of pre-tax gains from the sale of marketable equity securities and a $3,500 pre-tax gain from the settlement of certain patent infringement issues, both in the United States and tax effected at a marginal rate of 38.6%.

9 -- SUBSEQUENT EVENTS

During October 2001, the Company entered into a strategic alliance with Dow Corning Corporation. The alliance combines the organizations' expertise in their respective fields of biotechnology and silicon chemistry to create a new, proprietary Silicon Biotechnology(TM) technology platform for the development of new biomaterials. Over the term of the agreement, the Company has the potential to earn up to $35,000, including an up-front payment of $12,000, research funding and milestone payments.

During November 2001, the Company entered into a five-year worldwide supply contract with Procter & Gamble to provide protease enzymes for laundry and dish detergents. Under this agreement, the Company has the potential to earn up to $600,000 in product revenues over the life of the contract.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in our 2000 Annual Report on Form 10-K, and the condensed consolidated unaudited financial statements and related notes included elsewhere in this report. This Report contains forward-looking statements. These include statements concerning plans, objectives, goals, strategies, future events or performance and all other statements which are other than statements of historical fact, including without limitation, statements containing words such as "believes," "anticipates," "expects," "estimates," "projects," "will," "may," "might" and words of a similar nature. The forward-looking statements contained in this Report reflect management's current beliefs and expectations on the date of this Report. Actual results, performance or outcomes may differ materially from those expressed in the forward-looking statements. Some of the important factors, which, in the view of the Company, could cause actual results to differ from those expressed in the forward-looking statements, are discussed below and in our 2000 Annual Report on Form 10-K. The Company undertakes no obligation to publicly announce any revisions to these forward-looking statements to reflect facts or circumstances of which management becomes aware after the date hereof.

OVERVIEW

We are a diversified biotechnology company that develops and delivers products and/or services to the industrial and consumer, agriculture and health care markets. Our current revenues result primarily from the sale of enzyme products to the cleaning, grain processing and textile industries, with the

remainder from research funding, fees and royalties. We intend to apply our proven and proprietary technologies and manufacturing capabilities to expand sales in our existing markets and address new opportunities in the health care, agriculture, industrial and consumer markets. We have formed, and plan to continue to form, strategic alliances with market leaders to collaborate with us to develop and launch products.

We manufacture our products through our eight manufacturing facilities located in the United States, Finland, Belgium, China and Argentina. We conduct our sales and marketing activities through our direct sales organizations in the United States, the Netherlands, Singapore, Japan and Argentina. For the nine months ended September 30, 2001 and 2000, we derived approximately 50% of our revenues from our foreign operations.

SUMMARY OF RESULTS

For the three months ended September 30, 2001, net income available for common shareholders decreased to $1.6 million, or $0.03 per diluted share, from $2.9 million, or $0.05 per diluted share, for the three months ended September 30, 2000. For the nine months ended September 30, 2001, net income available for common shareholders decreased to $8.3 million, or $0.14 per diluted share, from $20.5 million, or $0.37 per diluted share, for the nine months ended September 30, 2000. Net income for the nine month period in 2000 was favorably impacted by gains from sales of marketable equity securities. The after-tax impact to net income for these non-recurring gains was $10.2 million for the nine month period ended September 30, 2000.

RECENT DEVELOPMENTS

In July 2001, we acquired a 10% equity stake in Epimmune Inc. We also entered into a 30-month collaboration with Epimmune focused on the development of therapeutic vaccines for three oncogenic viruses, including research funding and milestone payments. Additionally, we exclusively licensed certain Epimmune technologies and related intellectual property rights on a worldwide basis for the development of vaccines to treat or prevent hepatitis C (HCV), hepatitis B (HBV) and human papilloma virus (HPV).

In August 2001, we announced that we obtained worldwide exclusive rights to Phogen's proprietary VP22 technology to develop second generation therapeutic vaccines for infectious viral diseases and began a collaboration with Phogen to develop the vectosome application of VP22 to enhance DNA vaccine formulation.

Also in August 2001, we announced a two-year collaboration with The Centre for Applied Microbiology and Research that focuses on an enzyme-based process for treating surgical equipment, rendered animal material and blood products to eliminate prion infectivity. The collaboration will also investigate developing an effective rapid prion detection test.

In September 2001, we announced achievement of our first technical milestone in the three-year contract with the U.S. Department of Energy (DOE) Biofuels Program administered by DOE's National Renewable Energy Laboratory. We developed and validated processes for improved cellulase enzymes that meet the intended objective at one-half the cost of currently available technologies.

Also in September 2001, we announced the signing of a licensing agreement with Integrated Genomics, Inc. for three microbial genome sequencing technologies that we believe will help to improve efficiencies in fungal cell factories.

In October 2001, we announced a strategic alliance with Dow Corning Corporation. The alliance combines the organizations' expertise in their respective fields of biotechnology and silicon chemistry to create a new, proprietary Silicon Biotechnology(TM) technology platform for the development of new biomaterials. The alliance anticipates it will see some of its first successes through the introduction of new, biologically mediated silicone based products for the life sciences, personal care, cleaning and fabric care markets. Over the term of the agreement, we have the potential to earn up to $35.0 million, including an up-front payment of $12.0 million, research funding and milestone payments.

In November 2001, we announced the signing of a five-year worldwide supply contract with Procter & Gamble to provide protease enzymes for laundry and dish detergents. The agreement is estimated to be worth up to $600.0 million in product revenues over the life of the contract. This contract extends the companies' almost two-decade-long relationship and further solidifies our position in the innovation and commercialization of protease enzymes for liquid and dry formulations.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended September 30, 2001 and 2000

Revenues. Total revenues for the three months ended September 30, 2001 of $80.8 million were consistent with the three months ended September 30, 2000.

Product Revenues. Product revenues for the three months ended September 30, 2001 increased $0.4 million, or 1%, to $77.8 million from the three months ended September 30, 2000. For the three months ended September 30, 2001, unit volume/mix grew 6%, while average prices fell 5%. Volume increased primarily due to increased protease enzyme sales to a major customer.

Regionally, North American product revenues for the three months ended September 30, 2001 increased $ 0.6 million, or 2%, to $37.6 million from the three months ended September 30, 2000, primarily due to increased sales to our grain processing customers, partially offset by decreased sales to cleaning and fabric care customers. European product revenues for the three months ended September 30, 2001 increased $0.4 million, or 2%, to $26.8 million from the three months ended September 30, 2000, due primarily to increased sales to cleaning and fabric care customers, partially offset by decreased sales to grain processing customers. Our product revenues in Latin America for the three months ended September 30, 2001 decreased $1.4 million, or 26%, to $4.1 million from the three months ended September 30, 2000 due primarily to decreased sales to our cleaning and fabric care customers. Product revenues in Asia increased $0.8 million, or 9%, to $9.3 million for the three months ended September 30, 2001 from the three months ended September 30, 2000 due mainly to increased sales to our cleaning and fabric care customers.

Fees and Royalty Revenues. Fees and royalty revenues decreased $0.4 million, or 12%, to $2.9 million for the three months ended September 30, 2001 from the three months ended September 30, 2000.

Funded research revenues for the three months ended September 30, 2001 decreased $0.6 million, or 18%, to $2.7 million from the three months ended September 30, 2000. Revenues generated by research funding result from collaborative agreements with various parties, including the U.S. Government, whereby we perform research activities and receive revenues that partially reimburse us for expenses incurred. Under such agreements, we retain a proprietary interest in the products and technology developed. Our funded research revenue as it relates to U.S. Government collaborations decreased $1.4 million, or 61%, to $0.9 million for the three months ended September 30, 2001

from the three months ended September 30, 2000. Funded research revenues provided by customers

increased $0.8 million, or 80%, to $1.8 million for the three months ended September 30, 2001 from the three months ended September 30, 2000.

Operating Expenses

Cost of Products Sold. Cost of products sold for the three months ended September 30, 2001 decreased $0.4 million, or 1%, to $44.1 million from the three months ended September 30, 2000. Cost of products sold reflects decreases in fixed and variable costs of $0.9 million, partially offset by increased sales volume/mix of $0.7 million.

Gross Profit and Margins from Products Sold. Gross profit from products sold increased $0.8 million, or 2%, to $33.7 million for the three months ended September 30, 2001 from the three months ended September 30, 2000. This overall increase was caused by significant product revenue related factors including a 6% increase in volume/mix processed through our plants, partially offset by an average price decline of 5%. This net increase in gross profit was partially offset by a $0.3 million decrease due to the impact of the stronger U.S. dollar against foreign currencies, primarily the Euro. As a result of these factors, gross margin on product revenue increased to 43.3% for the three months ended September 30, 2001 from 42.5% for the three months ended September 30, 2000.

Research and Development. Research and development expenses primarily consist of the personnel-related, consulting, and facilities costs incurred in connection with our research activities conducted in Palo Alto, California and Leiden, the Netherlands. These expenses increased $1.0 million, or 7%, to $14.8 million for the three months ended September 30, 2001 from the three months ended September 30, 2000 as we increased our investment in technology and product development for new markets and hired additional internal staff to support our health care and other initiatives. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers increased $1.3 million, or 72%, to $3.1 million for the three months ended September 30, 2001 from the three months ended September 30, 2000.

Sales, Marketing and Business Development. Sales, marketing and business development expenses primarily consist of the personnel-related and marketing costs incurred by our global sales force. These expenses decreased $1.4 million, or 16%, to $7.1 million for the three months ended September 30, 2001 from the three months ended September 30, 2000 due primarily to decreases in incentive compensation of $1.3 million and outside services of $0.7 million, partially offset by an increase in personnel-related costs, including salaries, benefits, commissions and travel expenses of $0.7 million.

General and Administrative. General and administrative expenses include the costs of our corporate executive, finance, information technology, legal, human resources, and communications functions. In total, these expenses increased $0.8 million, or 11%, to $7.8 million for the three months ended September 30, 2001 from the three months ended September 30, 2000 due primarily to increased personnel-related costs, including salaries, benefits, commissions and travel expenses of $1.0 million, partially offset by a decrease in incentive compensation of approximately $0.2 million.

Amortization of Intangible Assets. We amortize our intangible assets, consisting of patents, licenses, technology and goodwill, on a straight-line basis over their estimated useful lives. Amortization expense for the three

months ended September 30, 2001 of $2.6 million was consistent with the three months ended September 30, 2000.

Other Expense and Income. Other income for the three months ended September 30, 2001 decreased $0.3 million, or 30%, to $0.7 million from the three months ended September 30, 2000. The decrease in other income was due mainly to losses associated with foreign currency transactions.

Deferred Compensation. We measure deferred compensation for options granted to employees as the difference between the grant price and the estimated fair value of our common stock on the date we granted the options. This amount is recorded as a separate component of shareholders' equity and amortized as a charge to operations over the vesting period of the options. Amortization of this deferred compensation expense for the three months ended September 30, 2001 and September 30, 2000, was $0.6 million, which was reported in our statements of operations as follows (in millions):

	2001	2000
Research and development	$ 0.2	$ 0.2
Sales, marketing and business development	0.2	0.2
General and administrative	0.2	0.2
Total amortization of deferred compensation expense	$ 0.6	$ 0.6

Non Operating Expense and Income

Investment Income. There was no investment income for the three months ended September 30, 2001 or September 30, 2000.

Interest Income. Interest income decreased $0.4 million, or 15%, to $2.3 million for the three months ended September 30, 2001 from the three months ended September 30, 2000 due mainly to lower interest rates.

Income Taxes. Several factors affected our effective income tax rate for the three months ended September 30, 2001, including the statutory income tax rate in foreign jurisdictions, amortization of intangible assets and other items which are not deductible for tax purposes, and research and experimentation tax credits. The effective income tax rate for the three months ended September 30, 2001 was 27% compared with 13% for the three months ended September 30, 2000. Our effective income tax rate for the three months ended September 30, 2000 of 13% reflects the year-to-date impact of reevaluating our ability to utilize certain deferred tax assets, which resulted in the release of valuation allowances. During both periods we were subject to a tax ruling in the Netherlands that reduces the local effective income tax rate from 35.0% to 17.5%. This ruling will expire at the end of 2005.

Comparison of the Nine Months Ended September 30, 2001 and 2000

Revenues. Total revenues for the nine months ended September 30, 2001 decreased $0.2 million to $239.9 million from the nine months ended September 30, 2000, primarily due to a decrease in fees and royalty revenues, partially

offset by an increase in product revenues.

Product Revenues. Product revenues in the nine months ended September 30, 2001 increased $4.0 million, or 2%, to $231.6 million from the nine months ended September 30, 2000. Without the impact of the stronger U.S. dollar against the Euro in 2001 versus 2000, product revenues in the nine months ended September 30, 2001 would have increased by 4%. In the nine months ended September 30, 2001, unit volume/mix grew 6%, while average prices fell 3%. Volume increased primarily due to increased protease enzyme sales to a major customer.

Regionally, North American product revenues increased $2.4 million, or 2%, to $111.6 million and European product revenues increased $2.5 million, or 3%, to $80.0 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000, each of which were driven primarily by protease enzyme sales. In the nine months ended September 30, 2001, our product revenues in Latin America decreased $1.8 million, or 12%, to $13.6 million from the nine months ended September 30, 2000 due primarily to decreased sales to cleaning and fabric care customers. Product revenues in Asia for the nine months ended September 30, 2001 increased $0.9 million, or 4%, to $26.5 million from the nine months ended September 30, 2000 primarily due to increased sales to cleaning and fabric care customers.

Fees and Royalty Revenues. Fees and royalty revenues decreased $4.3 million, or 34%, to $8.2 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000.

Funded research revenues for the nine months ended September 30, 2001 decreased $1.2 million, or 14%, to $7.4 million from the nine months ended September 30, 2000. Revenues generated by research funding result from collaborative agreements with various

parties, including the U.S. Government, whereby we perform research activities and receive revenues that partially reimburse us for expenses incurred. Under such agreements, we retain a proprietary interest in the products and technology developed. Our funded research revenue as it relates to U.S. Government collaborations decreased $1.4 million, or 34%, to $2.7 million for the three months ended September 30, 2001 from the three months ended September 30, 2000. Funded research revenues provided by customers increased $0.1 million, or 2%, to $4.7 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000.

Royalties decreased $3.0 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000, due primarily to the successful resolution of a patent infringement issue with a customer, for which back royalties of $3.5 million were received during the first quarter of 2000. These royalties pertained to previous sales, using patented technology, made by the customer to third parties.

Operating Expenses

Cost of Products Sold. Cost of products sold decreased $1.2 million, or 1%, to $128.6 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000 even though our expanded sales volume/mix increased costs $2.7 million. This decrease in cost of products sold was driven primarily by reductions due to the impact of the stronger U.S. dollar against foreign currencies of $2.4 million and the sale of lower cost inventories of approximately $1.5 million.

Gross Profit and Margins from Products Sold. Gross profit from products sold

increased $5.2 million, or 5%, to $103.0 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000. This overall increase was caused by significant product revenue related factors including a 6% increase in volume/mix processed through our plants, partially offset by an average price decline of 3%. This net increase in gross profit was partially offset by a $1.8 million decrease due to the impact of the stronger U.S. dollar against foreign currencies, primarily the Euro. As a result of these factors, gross margin on product revenue increased to 44.5% for the nine months ended September 30, 2001 from 43.0% for the nine months ended September 30, 2000.

Research and Development. Research and development expenses increased $4.5 million, or 12%, to $42.8 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000 as we increased our investment in technology and product development for new markets and hired additional internal staff to support our health care and other initiatives. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers decreased $1.9 million, or 21%, to $7.3 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000.

Sales, Marketing and Business Development. Sales, marketing and business development expenses decreased $0.6 million, or 3%, to $20.8 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000, primarily due to decreases in incentive compensation of $1.2 million and outside services of $0.5 million, partially offset by an increase of $1.1 million in personnel-related costs, including salaries, benefits, commissions and travel expenses.

General and Administrative. General and administrative expenses increased $2.4 million, or 12%, to $21.7 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000, due primarily to increased salaries and benefits of $2.2 million, and public relations costs of $0.4 million, partially offset by a decrease in outside services of $0.6 million.

Amortization of Intangible Assets. Amortization expense decreased $0.6 million, or 8%, to $7.3 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000 due primarily to the 2000 release of an income tax valuation allowance that was reallocated to reduce goodwill.

Other Expense and Income. Other income for the nine months ended September 30, 2001 decreased $0.9 million to less than $0.1 million from the nine months ended September 30, 2000 due primarily to losses from foreign currency exchange transactions.

Deferred Compensation. Amortization of deferred compensation expense for the nine months ended September 30, 2001 was $2.0 million and for the three months ended September 30, 2000 was $1.0 million, which was reported in our statements of operations as follows (in millions):

	2001	2000
Cost of products sold	$ 0.1	$ 0.1
Research and development	0.7	0.2
Sales, marketing and business development	0.6	0.3
General and administrative	0.6	0.4

Total amortization of deferred compensation expense	$ 2.0	$ 1.0

Non Operating Expense and Income

Investment Income. There was no investment income for the nine months ended September 30, 2001. Investment income of $16.6 million for the nine months ended September 30, 2000 represents gains from the sale of marketable equity securities.

Interest Income. Interest income increased $3.9 million, or 95%, to $8.0 million for the nine months ended September 30, 2001 from the nine months ended September 30, 2000 due mainly to earnings on proceeds from our initial public offering, partially offset by lower interest rates.

Income Taxes. Several factors affected our effective income tax rate for the nine months ended September 30, 2001, including the statutory income tax rate in foreign jurisdictions, amortization of intangible assets and other items which are not deductible for tax purposes, and research and experimentation tax credits. The effective income tax rate for the nine months ended September 30, 2001 was 27% compared with 30% for the nine months ended September 30, 2000. The effective rate for the nine months ended September 30, 2001 is representative of our most recent assessment of our annual effective income tax rate of approximately 27%. The effective rate for the nine months ended September 30, 2000 included the effect of two one-time events. During the nine months ended September 30, 2000, we realized $16.6 million of pre-tax gains from the sale of marketable equity securities and a $3.5 million pre-tax gain from the settlement of certain patent infringement issues, both in the United States and tax effected at a marginal rate of 38.6%. During both periods we were subject to a tax ruling in the Netherlands that reduces the local effective income tax rate from 35.0% to 17.5%. This ruling will expire at the end of 2005.

LIQUIDITY AND CAPITAL RESOURCES

Our funding needs consist primarily of capital expenditures, research and development activities, sales and marketing expenses, and general corporate purposes. We have financed our operations primarily through cash from the sale of products, the sale of common stock, research and development funding from partners, government grants, and short-term and long-term borrowings.

We believe that our current cash and cash equivalent balances plus funds to be provided from our current year operating activities, together with those available under our lines of credit, will satisfy our funding needs for at least the next twelve months. Factors that could negatively impact our cash position include, but are not limited to, future levels of product, fees and royalty revenues, expense levels, capital expenditures, acquisitions, and foreign currency exchange rate fluctuations.

As of September 30, 2001, cash and cash equivalents totaled $201.3 million. The funds were invested in short-term instruments including A1-P1 rated commercial paper, master notes, U.S. treasury bills, institutional money market funds and bank deposits.

Cash provided by operations was $25.3 million and $32.9 million for the nine months ended September 30, 2001 and 2000, respectively. The decrease of $7.6 million in 2001 from 2000 was generated principally by operating earnings, net of non-cash items such as depreciation and amortization, and changes in operating assets and liabilities.

Cash used by investing activities was $23.6 million for the nine months ended September 30, 2001. Cash provided by investing activities was $1.1 million for the nine months ended September 30, 2000. This difference of $24.7 million was driven primarily by proceeds of $17.6 million received from the sale of marketable equity securities during the nine months ended September 30, 2000. During the third quarter of 2001, we paid $4.6 million to acquire marketable securities. Also during the third quarter

of 2001 we paid $4.1 million to license certain technologies in connection with our collaborative research efforts. Capital expenditures totaled $14.9 million for the nine months ended September 30, 2001 compared with $16.5 million for the nine months ended September 30, 2000. In each of these periods, this spending was driven by process improvement projects at our manufacturing and research and development facilities and information technology enhancements.

Cash provided by financing activities was $0.1 million during the nine months ended September 30, 2001, compared to $123.7 million for the nine months ended September 30, 2000. The cash provided by financing activities for the nine months ended September 30, 2000 resulted primarily from our initial public offering of common stock, partially offset by the payment of a long-term note to Gist-Brocades (G-b) related to the 1995 acquisition of the G-b industrial enzyme business. There were no dividends paid to our common shareholders for the nine months ended September 30, 2001 and 2000. We currently intend to retain future earnings to finance the expansion of our business. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements, general business conditions and other factors that the board of directors may deem relevant, including covenants in our debt instruments that may limit our ability to declare and pay cash dividends on our capital stock. Covenants in our senior note agreement restrict the payment of dividends or other distributions in cash or other property to the extent the payment puts us in default of these covenants. Such covenants include, but are not limited to, maintaining a debt to total capitalization of no greater than 55% and a maximum ratio of debt to EBITDA of 3.5:1.

As of September 30, 2001 we had a $60 million revolving credit facility with a syndicate of banks, which is available for general corporate purposes. The facility, which consists of two separate credit agreements, makes available to us $40 million of committed borrowings pursuant to a three-year credit agreement and $20 million of committed borrowings pursuant to a 364-day credit agreement. The combined facility carries facility fees of 0.35% on the amount of unborrowed principal under the three-year agreement and 0.30% under the 364-day agreement. As of September 30, 2001 there were no borrowings under this facility.

Our long-term debt consists primarily of the 6.82% senior notes issued in 1996 to certain institutional investors. The total principal amount of these notes is $140 million with annual installment payments of $28 million to commence in March 2002. We are currently in compliance with all of the financial covenants included in the senior note agreement.

MARKET RISK

Foreign currency risk and interest rate risk are the primary sources of our market risk. To date, foreign operations, mainly denominated in Euros, account for approximately 50% of our 2001 revenues. We believe that we substantially mitigate this risk by locating our manufacturing facilities so that the costs are denominated in the same currency as our product revenues. We manage the foreign currency exposures that remain through the use of foreign currency forward contracts, currency options and off-setting currency loans where deemed

appropriate. We do not use these instruments for speculative purposes. At September 30, 2001, there were no material forward contracts or option contracts outstanding.

As of September 30, 2001, cash and cash equivalents totaled $201.3 million. Of this amount, $55.7 million was denominated in Euros. The remainder or $145.6 million was primarily denominated in U.S. dollars. Other than the first installment due in March 2002 under our 6.82% senior notes discussed under the heading "Liquidity and Capital Resources," short-term debt outstanding at September 30, 2001 was not significant. To the extent U.S. dollar and Euro interest rates fluctuate either up or down, the return on the cash investments will also fluctuate. To the extent such Euro cash investments remain outstanding, we will be subject to the risks of future foreign exchange fluctuations and its impact on the translation of these cash investments into U.S. dollars.

Our subsidiary based in the Netherlands, which adopted the Euro as its functional currency, has U.S. dollar and Japanese Yen denominated revenues. We use forward currency contracts and option contracts from time to time as deemed appropriate to hedge these anticipated revenues.

Interest Rates

Our interest income is sensitive to changes in the general level of short-term interest rates primarily in the United States and Europe. In this regard, changes in the U.S. dollar and Euro currency rates affect the interest earned on our cash equivalents, short-term investments, and long-term investments.

Foreign Currency Exposure

We conduct business throughout the world. To date, we have derived approximately 50% of our 2001 revenues and approximately all of our 2001 operating income from foreign operations. Economic conditions in countries where we conduct business and changing foreign currency exchange rates affect our financial position and results of operations. We are exposed to changes in exchange rates in Europe, Latin America, and Asia. The Euro presents our most significant foreign currency exposure risk. Changes in foreign currency exchange rates, especially the strengthening of the U.S. dollar, may have an adverse effect on our financial position and results of operations as they are expressed in U.S. dollars.

Management monitors foreign currency exposures and may in the ordinary course of business enter into foreign currency forward contracts or options contracts related to specific foreign currency transactions or anticipated cash flows. These contracts generally cover periods of nine months or less and are not material. We do not hedge the translation of financial statements of consolidated subsidiaries that maintain their local books and records in foreign currencies.

NEW ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations." The Statement requires the use of the purchase method of accounting for all business combinations. The Statement also requires the recognition of certain intangible assets acquired in a business combination apart from goodwill. SFAS No. 141 applies to all business combinations initiated after June 30, 2001. We are currently assessing the impact of this new standard

on our financial statements.

In June 2001, the Financial Accounting Standards Board also issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement requires the recognition of separately identifiable intangible assets. Furthermore, it establishes amortization requirements based upon the ability of the intangible assets to provide cash flows. For those intangible assets with readily identifiable useful lives, amortization will be recorded in the statement of operations over such lives. Intangible assets, such as goodwill, which have indefinite lives, will not result in periodic amortization, but must be tested at least annually for impairment. This statement may result in reclassifications in our financial statements of pre-existing intangible assets. The provisions of SFAS No. 142 will be effective for us starting the first quarter 2002. We are currently assessing the impact of this new standard on our financial statements.

In August 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The provisions of SFAS No. 143 are required to be adopted as of January 1, 2003, although earlier adoption is permitted. We are currently assessing the impact of this new standard on our financial statements.

In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses the accounting model for long-lived assets to be disposed of by sale and resulting implementation issues. This statement requires that those long-lived assets be measured at the lower of carrying amount or fair value less cost to sell. This statement is effective for financial statements issued for fiscal years beginning after December 15, 2001. The provisions of SFAS No. 144 will be effective for the Company starting the first quarter 2002. We are currently assessing the impact of this new standard on our financial statements.

Risk Factors

IF WE FAIL TO DEVELOP PRODUCTS FOR THE HEALTH CARE AND AGRICULTURE MARKETS, THEN WE MAY NEVER ACHIEVE A RETURN ON OUR RESEARCH AND DEVELOPMENT EXPENDITURES OR REALIZE PRODUCT REVENUES FROM THESE MARKETS.

A key element of our business strategy is to utilize our technologies for the development and delivery of products to the health care market and segments of the agriculture market in which we do not currently compete. We have not produced any products for these markets. We intend to significantly increase our investment in research and development to develop products for these markets. The successful development of products is highly uncertain and is dependent on numerous factors, many of which are beyond our control, and may include the following:

- The product may be ineffective or have undesirable side effects in preliminary and commercial testing or, specifically in the health care area, in preclinical and clinical trials;

- The product may fail to receive necessary governmental and regulatory approvals, or the government may delay regulatory approvals significantly;

- The product may not be economically viable because of manufacturing costs or other factors;

- The product may not gain acceptance in the marketplace; or

- The proprietary rights of others or competing products or technologies for the same application may preclude us from commercializing the product.

Due to these factors we may never achieve a return on our research and development expenditures or realize product revenues from the health care and agriculture markets that we are targeting.

IF WE FAIL TO ENTER INTO STRATEGIC ALLIANCES WITH PARTNERS IN OUR TARGET MARKETS OR INDEPENDENTLY RAISE ADDITIONAL CAPITAL, WE WILL NOT HAVE THE RESOURCES NECESSARY TO CAPITALIZE ON ALL OF THE MARKET OPPORTUNITIES AVAILABLE TO US.

We do not currently possess the resources necessary to independently develop and commercialize products for all of the market opportunities that may result from our technologies. We intend to form strategic alliances with industry leaders in our target markets to gain access to funding for research and development, expertise in areas where we lack such expertise, and distribution channels. We may fail to enter into the necessary strategic alliances or fail to commercialize the products anticipated from the alliances. Our alliances could be harmed if:

- We fail to meet our agreed upon research and development objectives;

- We disagree with our strategic partners over material terms of the alliances, such as intellectual property or manufacturing rights; or

- Our strategic partners become competitors of ours or enter into agreements with our competitors.

New strategic alliances that we enter into, if any, may conflict with the business objectives of our current strategic partners and negatively impact existing relationships. In addition, to capitalize on the market opportunities we have identified, we may need to seek additional capital, either through private or public offerings of debt or equity securities. Due to market and other conditions beyond our control, we may not be able to raise additional capital on acceptable terms or conditions, if at all.

WE INTEND TO ACQUIRE BUSINESSES, TECHNOLOGIES AND PRODUCTS, BUT WE MAY FAIL TO REALIZE THE ANTICIPATED BENEFITS OF SUCH ACQUISITIONS AND WE MAY INCUR COSTS THAT COULD SIGNIFICANTLY NEGATIVELY IMPACT OUR PROFITABILITY.

We intend to acquire businesses, technologies and products that we believe are a strategic fit with our business. If we undertake any transaction of this sort, we may not be able to successfully integrate any businesses, products, technologies or personnel that we might acquire without a significant expenditure of operating, financial and management resources, if at all. Further, we may fail to realize the anticipated benefits of any acquisition. Future acquisitions could dilute our stockholders' interest in us and could cause us to incur substantial debt, expose us to contingent liabilities and result in amortization expenses related to goodwill and other intangible assets

and could negatively impact our profitability.

IF THE DEMAND FOR PROTEIN DEGRADING ENZYMES DECREASES, OUR REVENUES COULD SIGNIFICANTLY DECLINE.

Our largest selling family of products, protein degrading enzymes, or proteases, accounted for approximately 55% of our 2000 revenue. If the demand for proteases decreases or alternative proteases render our products noncompetitive, our revenues could significantly decline.

IF WE FAIL TO ATTRACT AND RETAIN QUALIFIED PERSONNEL, WE MAY NOT BE ABLE TO ACHIEVE OUR EXPANSION OBJECTIVES.

Our ability to manage our anticipated growth, if realized, effectively depends on our ability to attract and retain highly qualified executive officers and technology and business personnel. In particular, our product development programs depend on our ability to attract and retain highly skilled researchers. Competition for such individuals is intense. If we fail to attract and retain qualified individuals, we will not be able to achieve our expansion objectives.

WE EXPECT THAT OUR QUARTERLY RESULTS OF OPERATIONS WILL FLUCTUATE, AND THIS FLUCTUATION COULD CAUSE OUR STOCK PRICE TO DECLINE, CAUSING INVESTOR LOSSES.

A large portion of our expenses, including expenses for facilities, equipment and personnel, are relatively fixed. Accordingly, if product revenue declines or does not grow as we anticipate or non-product revenue declines due to the expiration or termination of strategic alliance agreements or the failure to obtain new agreements or grants, we may not be able to correspondingly reduce our operating expenses in any particular quarter. Our quarterly revenue and operating results have fluctuated in the past and are likely to do so in the future. If our operating results in some quarters fail to meet the expectations of stock market analysts and investors, our stock price would likely decline. Some of the factors that could cause our revenue and operating results to fluctuate include:

- The ability and willingness of strategic partners to commercialize products derived from our technology or containing our products on expected timelines;

- Our ability to successfully commercialize products developed independently and the rate of adoption of such products; or

- Fluctuations in geographic conditions including currency and other economic conditions such as economic crises in South America or Asia.

We also have incurred significant one-time charges within given quarters, such as those incurred in conjunction with restructuring activities, and recognized investment income from sales of available-for-sale marketable securities.

IF WE FAIL TO SECURE ADEQUATE INTELLECTUAL PROPERTY PROTECTION OR BECOME INVOLVED IN AN INTELLECTUAL PROPERTY DISPUTE, IT COULD SIGNIFICANTLY HARM OUR FINANCIAL RESULTS AND ABILITY TO COMPETE.

The patent positions of biotechnology companies, including our patent positions, can be highly uncertain and involve complex legal and factual questions and, therefore, enforceability is uncertain. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that we protect our technologies with valid and enforceable patents or as trade secrets. We rely in part on trade secret protection for our confidential and proprietary information by entering into confidentiality agreements and non-

disclosure policies with our employees and consultants. Nonetheless, confidential and proprietary information may be disclosed and others may independently develop substantially equivalent information and techniques or otherwise gain access to our trade secrets.

We file patent applications in the United States and in foreign countries as part of our strategy to protect our proprietary products and technologies. The loss of significant patents or the failure of patents to issue from pending patent applications that we consider significant could impair our operations. In addition, third parties could successfully challenge, invalidate or circumvent our issued patents or patents licensed to us so that our patent rights would not create an effective competitive barrier. Further, we may not obtain the patents or licenses to technologies that we will need to develop products for our target markets. The laws of some foreign countries may also not protect our intellectual property rights to the same extent as United States law.

Extensive litigation regarding patents and other intellectual property rights is common in the biotechnology industry. In the ordinary course of business, we periodically receive notices of potential infringement of patents held by others and patent applications that may mature to patents held by others. The impact of such claims of potential infringement, as may from time to time become known to the Company, are difficult to assess. In the event of an intellectual property dispute, we may become involved in litigation. Intellectual property litigation is expensive and may divert management's time and resources away from our operations. The outcome of any such litigation is inherently uncertain. Even if we are successful, the litigation would be costly in terms of dollars spent and diversion of management time.

If a third party successfully claims an intellectual property right to technology we use, it may force us to discontinue an important product or product line, alter our products and processes, pay license fees, pay damages for past infringement or cease certain activities. Under these circumstances, we may attempt to obtain a license to this intellectual property; however, we may not be able to do so on commercially reasonable terms, or at all. In addition, regardless of the validity of such a claim, its mere existence may affect the willingness of one or more customers to use or continue to use our products and, thereby, materially impact us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information presented in Item 2 of Part I of this Report on Form 10-Q under the heading "Market Risk" is hereby incorporated by reference.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable

ITEM 2. CHANGE IN SECURITIES AND USE OF PROCEEDS

The information presented in Item 2 of Part I of this Report on Form 10-Q under the heading "Liquidity and Capital Resources" is hereby incorporated by reference. The Company's Registration Statement on Form S-1 (Registration No. 333-36452) was effective as of July 27, 2000.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

ITEM 5. OTHER INFORMATION

Not applicable

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. Exhibits

See the Index to Exhibits immediately following the signature page to this Report on Form 10-Q.

b. Reports on Form 8-K

On August 10, 2001, the Company filed a Form 8-K (under Item 5) regarding the adoption of trading plans under Rule 10b5-1 by all of its executive officers and the potential for some or all of its directors and key employees to establish such trading plans in the future. This report did not include any financial statements.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

GENENCOR INTERNATIONAL, INC.

November 14, 2001 — By: /s/ Raymond J. Land

Date — Raymond J. Land
Senior Vice President and
Chief Financial Officer

November 14, 2001 — By: /s/ Darryl L. Canfield

Date	Darryl L. Canfield Vice President and Corporate Controller (Chief Accounting Officer)

INDEX TO EXHIBITS

(2) Plan of acquisition, reorganization, arrangement, liquidation or succession

Not applicable.

(3) (i) Form of Restated Certificate of Incorporation is incorporated herein by reference to Exhibit 3.3 to Amendment No. 3 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on July 24, 2000.

(ii) Form of Amended and Restated Bylaws is incorporated herein by reference to Exhibit 3.4 to Amendment No. 3 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on July 24, 2000.

(4) Instruments defining the rights of securities holders, including indentures

(a) The documents listed under (3) are incorporated herein by reference.

(b) Form of Specimen Common Stock Certificate is incorporated herein by reference to Exhibit 4.1 to Amendment No. 3 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on July 24, 2000.

(c) Note Agreement for the $140,000,000 6.82% Senior Notes due 2006 between the Company and the purchasers identified therein, dated March 28, 1996 is incorporated herein by reference to Exhibit 4.2 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on September 26, 2000.

(d) $32,000,000 Three Year Credit Agreement dated as of January 31, 2001 among the Company, the Lenders party thereto and The Chase Manhattan Bank, as Administrative Agent is incorporated herein by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Registration No. 333-61450) filed on May 23, 2001.

(e) $16,000,000 364-Day Credit Agreement dated as of January 31, 2001 among the Company, the Lenders party thereto and The Chase Manhattan Bank, as Administrative Agent is incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 (Registration No. 333-61450) filed on May 23, 2001.

(f) Amendment No. 1 dated as of April 20, 2001 to the $32,000,000 Three Year Credit Agreement dated as of January 31, 2001 among the Company, the Lenders party thereto and The Chase Manhattan Bank, as Administrative Agent is incorporated herein by

reference to Exhibit 4.3 to the Company's Registration Statement on Form S-8 (Registration No. 333-61450) filed on May 23, 2001.

(g) Amendment No. 1 dated as of April 20, 2001 to the $16,000,000 364-Day Credit Agreement dated as of January 31, 2001 among the Company, the Lenders party thereto and The Chase Manhattan Bank, as Administrative Agent is incorporated herein by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-8 (Registration No. 333-61450) filed on May 23, 2001.

(10) Material Contracts

*+10.1 License Agreement by and between Epimmune Inc. and the Company dated as of July 9, 2001.

*+10.2 Collaboration Agreement by and between Epimmune Inc. and the Company dated as of July 9, 2001.

*+10.3 Securities Purchase Agreement by and between Epimmune Inc. and the Company dated as of July 9, 2001.

(11) Statement re computation of per share earnings Computation can be clearly determined from Note 2 to the financial statements included herein under Item 1.

(15) Letter re unaudited interim financial information

Not applicable.

(18) Letter re change in accounting principles

Not applicable.

(19) Report furnished to security holders

Not applicable.

(22) Published report regarding matters submitted to a vote of security holders

Not applicable.

(23) Consents of experts and counsel

Not applicable.

(24) Power of Attorney

Not applicable.

(99) Additional Exhibits

Not applicable

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* Exhibits filed with this Report.

+ Confidential Treatment requested as to certain information, which has been filed separately with the Commission pursuant to an application for such treatment.