UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2006

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: 0-27488

INCYTE CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-3136539**
(State of other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
Experimental Station, Route 141 & Henry Clay Road, Building E336, Wilmington, DE 19880	**(302) 498-6700**
(Address of principal executives offices)	(Registrant's telephone number, including area code)

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

Title of each class	**Name of exchange on which registered**
Common Stock, par value $.001 per share	The NASDAQ Stock Market LLC
Series A Participating Preferred Stock Purchase Rights	The NASDAQ Stock Market LLC

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

None

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒ Non accelerated filer ☐

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

The aggregate market value of Common Stock held by non-affiliates (based on the closing sale price on the Nasdaq Global Market on June 30, 2006) was approximately $278.6 million.

As of February 23, 2007 there were 83,984,758 shares of Common Stock, $.001 per share par value, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Items 10 (as to directors and Section 16(a) Beneficial Ownership Reporting Compliance), 11, 12, 13 and 14 of Part III incorporate by reference information from the registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for the registrant's 2007 Annual Meeting of Stockholders to be held on May 22, 2007.

Table of Contents

Item 1. ***Business***

This report contains forward-looking statements that involve risks and uncertainties. These statements relate to future periods, future events or our future operating or financial plans or performance. These statements can often be identified by the use of forward-looking terminology such as "expects," "believes," "intends," "anticipates," "estimates," "plans," "may," or "will," or the negative of these terms, and other similar expressions. These forward-looking statements include statements as to:

- *the discovery, development, formulation, manufacturing and commercialization of our compounds and our product candidates;*
- *the increase in our drug discovery and development efforts;*
- *the expected timing, progress, results and other information regarding our Investigational New Drug applications, preclinical testing, clinical trials and drug development programs;*
- *conducting clinical trials internally, with collaborators, or with contract research organizations;*
- *our collaboration and strategic alliance efforts; anticipated benefits and disadvantages of entering into collaboration agreements;*
- *our licensing and investment strategies;*
- *the regulatory approval process, including determinations to seek U.S. Food and Drug Administration, or FDA, approval for, and plans to commercialize, our products in the United States and abroad;*
- *the safety, effectiveness and potential benefits and indications of our product candidates and other compounds under development; potential uses for our product candidates and our other compounds; our ability to manage expansion of our drug discovery and development operations;*
- *future required expertise relating to clinical trials, manufacturing, sales and marketing; obtaining and terminating licenses to products, compounds or technology, or other intellectual property rights;*
- *the receipt from or payments to collaborators resulting from milestones or royalties; the decrease in revenues from our information product-related activities;*
- *plans to develop and commercialize products on our own;*
- *the relative priority of clinical testing of our compounds;*
- *expected expenses and expenditure levels; expected uses of cash; expected revenues, sources of revenues;*
- *expected losses; fluctuation of losses;*
- *our profitability; the adequacy of our capital resources;*
- *the need to raise additional capital; the costs associated with resolving matters in litigation; our expectations regarding competition; our investments, including anticipated expenditures, losses and expenses;*
- *costs associated with prosecuting, maintaining, defending and enforcing patent claims and other intellectual property rights;*
- *our ability to obtain, maintain or increase coverage of product liability and other insurance;*
- *adequacy of our product liability insurance; and*
- *our indebtedness, including any plans to restructure some or all of our outstanding convertible notes.*

These forward-looking statements reflect our current views with respect to future events, are based on assumptions and are subject to risks and uncertainties. These risks and uncertainties could cause actual results to differ materially from those projected and include, but are not limited to:

- *our ability to discover, develop, formulate, manufacture and commercialize a drug candidate or product;*
- *the risk of unanticipated delays in research and development efforts;*
- *the risk that previous preclinical testing or clinical trial results are not necessarily indicative of future clinical trial results;*
- *risks relating to the conduct of our clinical trials;*
- *changing regulatory requirements;*
- *the risk of adverse safety findings;*
- *the risk that results of our clinical trials do not support submission of a marketing approval application for our product candidates;*
- *the risk of significant delays or costs in obtaining regulatory approvals;*
- *risks relating to our reliance on third party manufacturers, collaborators, and contract research organizations;*
- *risks relating to the development of new products and their use by us and our current and potential collaborators;*
- *risks relating to our inability to control the development of out-licensed drug compounds or drug candidates;*
- *our ability to in-license a potential drug compound or drug candidate;*
- *the cost of accessing, licensing or acquiring potential drug compounds or drug candidates developed by other companies;*
- *the costs of terminating any licensing or access arrangement for third party drug compounds or drug candidates;*
- *the risk that our product candidates may not obtain regulatory approval;*
- *the impact of technological advances and competition;*
- *the ability to compete against third parties with greater resources than ours;*
- *competition to develop and commercialize similar drug products;*
- *our ability to obtain patent protection and freedom to operate for our discoveries and to continue to be effective in expanding our patent coverage;*
- *the impact of changing laws on our patent portfolio;*
- *developments in and expenses relating to litigation;*
- *the results of businesses in which we have made investments;*
- *our ability to obtain additional capital when needed;*
- *our history of operating losses; and*
- *the risks set forth under "Risk Factors."*

Given these risks and uncertainties, you should not place undue reliance on these forward-looking statements. Except as required by federal securities laws, we undertake no obligation to update any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

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

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

Overview

Incyte is a drug discovery and development company focused on developing proprietary small molecule drugs to treat serious unmet medical needs. We have a pipeline with programs in human immunodeficiency virus (HIV), diabetes, oncology and inflammation.

Thus far in our drug discovery and development activities, which began in early 2002, we have taken five internally developed compounds into clinical development, and have progressed four of these compounds into Phase II clinical trials. Of the four compounds progressed into Phase II clinical trials, the first was from our CCR2 program for inflammatory diseases, which is now the basis of a broad collaboration with Pfizer Inc. ("Pfizer") established in January 2006, the second is our sheddase inhibitor from our most advanced oncology program, the third is our lead CCR5 antagonist for HIV and the fourth is our lead 11-beta hydroxysteroid dehydrogenase type 1, more commonly called 11βHSD1, inhibitor for type 2 diabetes.

Incyte's wholly-owned pipeline includes the following compounds:

Drug Target	Indication	Development Status
HIV		
CCR5 Antagonists		
INCB9471	HIV	Phase IIa
INCB15050	HIV	Phase I
DIABETES		
11ßHSD1 Inhibitor		
INCB13739	Diabetes	Phase IIa
ONCOLOGY		
Sheddase Inhibitor		
INCB7839	Solid Tumors	Phase IIa
JAK Inhibitor	Myeloproliferative disorders and cancer	Preclinical
INFLAMMATION		
CCR2 Antagonists		
INCB8696	Multiple Sclerosis	IND filed
	Lupus Nephritis	Preclinical
JAK Inhibitor	Inflammation	Preclinical

In April 2006, we announced that we were discontinuing the development of dexelvucitabine or DFC (formerly known as Reverset), a nucleoside analog reverse transcriptase inhibitor that we in-licensed from Pharmasset, Inc. At the time, this compound was in Phase IIb development as a treatment for HIV.

During 2006, we filed four Investigational New Drug applications (INDs):

- one for our lead CCR5 compound that is now in Phase IIa clinical trials;
- a second for our lead 11βHSD1 inhibitor for type 2 diabetes that is also in Phase IIa clinical trials;
- a third for a follow-on CCR5 antagonist that is in Phase I development; and
- a fourth for a CCR2 antagonist for multiple sclerosis.

We expect to file additional INDs in the first half of 2007 for a new program targeting Janus-associated kinases (JAK). We believe our orally available JAK inhibitors have potential in chronic inflammatory conditions, myeloproliferative disorders and certain cancers.

Our productivity in drug discovery is primarily a result of our core competency in medicinal chemistry, integrated with and supported by an experienced team of biologists with expertise in multiple therapeutic areas. As a number of our compounds have progressed into clinical development, we have also built a clinical development and regulatory team. This team utilizes clinical research organizations (CROs), expert scientific advisory boards and leading consultants in relevant therapeutic areas with a view toward ensuring that we conduct our clinical trials as efficiently and effectively as possible while maintaining strategic control of the design and management of our programs.

Incyte's Approach to Drug Discovery and Development

To succeed in our objective to create a pipeline of novel, orally available drugs that address serious unmet medical needs, we have established a broad range of discovery capabilities in-house, including target validation, high-throughput screening, medicinal chemistry, computational chemistry, and pharmacological and ADME (absorption, distribution, metabolism and excretion) assessment. We augment these capabilities through collaborations with academic and contract laboratory resources with relevant expertise.

We select drug targets with strong preclinical or clinical validation in areas where we have the potential to generate either first-in-class molecules or compounds that are highly differentiated from existing treatments.

Our chemistry and biology efforts are highly integrated and are characterized by the rapid generation of relevant data on a broad and diverse range of compounds for each therapeutic target we pursue. This process allows our scientists to better understand, in real time, the potency and selectivity of the compounds, how they are likely to be absorbed and eliminated in the body, and to assess the potential safety of the compounds. We believe that this approach, along with stringent criteria for the selection of clinical candidates, will help us to select appropriate candidates for clinical development.

Given our chemistry-driven discovery process, our pipeline has grown to encompass multiple therapeutic areas: HIV, diabetes, oncology and inflammation. While our productivity has created a diverse pipeline, we conduct a limited number of discovery programs in parallel at any one time. This focus allows us to allocate resources to our selected programs at a level that we believe is competitive with much larger pharmaceutical companies. We believe this level of resource allocation, applied to the discovery process outlined above, has been critical to our success in our current programs, and that it remains a meaningful competitive advantage.

In all of our programs we strive to generate a diverse and broad range of proprietary compounds which we believe enhances the overall probability of success for our programs and creates the potential for multiple products.

Once our compounds reach clinical development, our objective, whenever possible, is to rapidly progress the lead candidate into a proof-of-concept clinical trial prior to initiating larger definitive

Phase IIb clinical trials to quickly assess the therapeutic potential of the clinical candidate itself and its underlying mechanism.

Incyte's Clinical Development and Regulatory Team

Our clinical development and regulatory team is responsible for ensuring that our clinical candidates are expeditiously progressed from preclinical development and IND-enabling studies into Phase I and Phase II development. Our internal multi-disciplinary project teams work with experienced external CROs with expertise in managing clinical trials, process chemistry, product formulation and manufacturing to support our development efforts. Thus far while at Incyte, this team has filed six INDs and advanced five compounds into clinical development.

Commercial Strategy

We intend to develop and commercialize some of our compounds on our own in selected markets where a company of our size can compete effectively, such as HIV, oncology, and certain inflammatory conditions. For programs that target large primary care indications such as diabetes and/or require lengthy and expensive clinical development plans, we may seek to form strategic alliances as we did with Pfizer for our CCR2 antagonist program.

Collaborative Research and License Agreement with Pfizer

Effective in January 2006, we entered a collaborative research and license agreement with Pfizer for the pursuit of our CCR2 antagonist program. We received an upfront nonrefundable payment of $40.0 million in January 2006, $10.0 million was received through the purchase of a convertible subordinated note (the "Pfizer Note") in February 2006 and we are eligible to receive additional future development and milestone payments of up to $743.0 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. Pfizer gained worldwide development and commercialization rights to our portfolio of CCR2 antagonist compounds, the most advanced of which was in Phase IIa clinical trials in rheumatoid arthritis and insulin-resistant obese patients at the time the agreement became effective in January 2006. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and lupus nephritis and other autoimmune nephritides, for which we retained worldwide rights, along with certain compounds. We do not have obligations to Pfizer on preclinical development candidates we select for pursuit in these indications. At our option, prior to September 28, 2007, once we are able to initiate Phase I clinical trials of a CCR2 antagonist in a retained Incyte indication, Pfizer may purchase from us an additional $10.0 million convertible subordinated note.

Clinical Pipeline

Our pipeline includes compounds in various stages of development in the areas of HIV, diabetes, oncology and inflammation. The following summarizes the status of and rationale for our most advanced compounds.

CCR5 Antagonist Program for HIV

CCR5 is a major chemokine receptor that the HIV virus uses to enter CD4 cells, which are critical to the human immune system. CCR5 antagonists belong to a new, investigational class of antiretrovirals known as HIV entry inhibitors. This new class includes various experimental compounds designed to block cell surface receptors, such as CCR5 or CXCR4, as well as other novel compounds that block HIV fusion with the cell surface. Entry inhibitors work by blocking HIV before the virus enters the cell and begins its replication process. In contrast, existing HIV drugs such as nucleoside or nucleotide reverse transcriptase

inhibitors (NRTIs), non-nucleoside reverse transcriptase inhibitors (NNRTIs) and protease inhibitors work inside the cell and target the proteins, reverse transcriptases and proteases that are involved in the replication of the virus.

Our CCR5 antagonist program has yielded potent, selective, proprietary compounds with pharmacokinetic properties that have the potential to allow once-daily dosing without use of ritonavir boosting, a key distinction from other CCR5 antagonists in development. Ritonavir is a protease inhibitor that is often used in combination with other drugs to improve or 'boost' the bioavailability and cellular penetration of other drugs but which is associated with increased cardiovascular risk. This dosing profile is particularly attractive in patients who are in the earlier stages of disease, where CCR5 is most prevalent, where the majority of regimens are once-daily (which improves patient compliance), and where ritonavir, which increases the risk of cardiovascular disease, is less frequently used. Once-a-day dosing also offers the potential for the development of once-daily fixed dose combination formulations with other anti-HIV medications.

We have two CCR5 antagonists in development, INCB9471 and INCB15050. INCB9471 is the most advanced compound in this program and is currently being studied in a 14-day double-blind placebo-controlled Phase IIa proof-of-concept trial in HIV patients. We have seen preliminary positive results that suggest that INCB9471 may offer sustained inhibition of viral replication in patients who are intermittently non-compliant as compared to other CCR5 antagonists and other antiretroviral drugs that have shorter half-lives. Lack of adherence with drugs that have short half lives, less than 24 hours, can lead to insufficient drug levels, which reduces the effectiveness of the drug regimen and allows the virus to replicate.

Our follow-on CCR5 antagonist, INCB15050, is currently in Phase I development. While the initial results from the Phase I clinical trials suggest that INCB15050 also has the potential to be a potent once-a-day treatment, based on the positive preliminary Phase IIa clinical trial data that we have seen with the lead compound, INCB9471, we do not plan to advance INCB15050 beyond Phase I clinical trials at this time.

11βHSD1 Program for Type 2 Diabetes and Related Disorders

We have developed a broad chemically diverse series of novel proprietary oral inhibitors of 11ßHSD1, an enzyme that converts the biologically-inactive steroid cortisone into the potent biologically-active hormone cortisol. Cortisol acts as a functional antagonist of insulin action in multiple tissue types, including the liver, adipose, skeletal muscle, and pancreas. Inhibition of 11βHSD1 offers the potential to reduce insulin resistance and restore glycemic control in type 2 diabetes, and may also offer potential benefits in allied conditions such as dyslipidemia, atherosclerosis, and coronary heart disease.

We have completed single- and multiple-dose Phase I clinical trials in healthy volunteers with our lead 11ßHSD1 inhibitor compound, INCB13739. We have also obtained preliminary data from our first Phase IIa trial, in which a single dose of INCB13739 completely inhibited 11βHSD1 activity over a 24-hour period in both adipose tissue and liver of obese insulin-resistant subjects. The ability to fully inhibit 11βHSD1 in these tissues, which are major contributors to the body's control of glucose metabolism, suggests that INCB13739 has the necessary properties to demonstrate the potential therapeutic effect of 11βHSD1 inhibition and support its continued development. A 28-day Phase IIa clinical trial of INCB13739 in type 2 diabetic patients is expected to begin in the first quarter of 2007.

CCR2 Receptor Antagonist Program for Inflammatory Diseases

Chemokines are proteins secreted at sites of injury or inflammation that attract and activate leukocytes, or white blood cells, such as monocytes. CCR2 is a key chemokine receptor found on monocytes that controls their migration into sites of inflammation. Once inside the monocytes differentiate

into tissue scavenger cells known as macrophages. In their normal role, macrophages scavenge foreign organisms or injured tissues; however, excessive or inappropriately triggered macrophage activity results in the production of pro-inflammatory mediators that can cause damage to tissues and can lead to a chronic inflammatory response. There is substantial preclinical data from multiple academic centers suggesting that CCR2 antagonism could be of therapeutic benefit in multiple sclerosis (MS). Activated macrophages accumulate in MS lesions, where they are associated with and presumed to be required for the destruction of the myelin sheath, the protective coating around the nerves which disrupts nerve signaling and leads to loss of muscle control, vision, balance and sensation. Blocking macrophage accumulation at these sites could thus lead to significant amelioration of this chronic and debilitating disease.

We established a collaborative research and license agreement with Pfizer in January 2006 in which Pfizer gained worldwide development and commercialization rights to our portfolio of CCR2 antagonist compounds. We retained rights to certain CCR2 antagonists for MS and lupus nephritis and other autoimmune nephritides.

We are pursuing MS first given the preclinical evidence suggesting that selective CCR2 antagonism has therapeutic potential in this disease. We have selected a lead clinical candidate, INCB8696, and filed the IND for this compound in December of 2006. We plan to initiate a Phase I clinical trial in healthy volunteers in the first half of 2007.

JAK 2 Program for Inflammatory Diseases, Myeloproliferative Disorders and Cancer

Our second inflammation program is directed toward inhibitors of a different target, JAK2. There are four JAK enzymes—JAK1, JAK2, JAK3 and TYK2. JAKs are required for the signaling triggered by a number of growth factors and pro-inflammatory cytokines, and excessive signaling through JAK-driven pathways is believed to play a critical role in the pathogenesis of multiple inflammatory diseases, myeloproliferative disorders, and certain cancers.

Recently presented clinical data from another company has demonstrated the efficacy of an oral JAK inhibitor in rheumatoid arthritis and psoriasis. While this compound was described as a moderately selective JAK3 inhibitor, we believe the efficacious doses of this JAK3 inhibitor also inhibited JAK2.

We have focused our efforts on JAK2 inhibitors because of the following observations:

- Monoclonal antibodies that block the function of cytokines which signal through JAK2, but not JAK3, appear to be as efficacious as the aforementioned oral JAK3 inhibitor in rheumatoid arthritis and psoriasis.
- To date, JAK3 inhibition has been demonstrated to suppress T-lymphocyte function. Beyond the risks inherent in immunosuppression, immunosuppressive drugs that impair T-lymphocyte function have only been modestly effective in rheumatoid arthritis.
- A mutation in JAK2, V617F, is highly prevalent in myeloproliferative disorders, a cluster of diseases characterized by abnormal production of formed elements in the blood, which are associated with a significant risk of thrombosis and progress to life threatening conditions such as myelofibrosis and leukemia. The presence of this mutation in virtually all patients with polycythemia vera (>90%) as well as a significant proportion of patients with essential thrombocythemia (50%), and myeloid metaplasia (50%) suggests that blocking JAK2-driven proliferation may provide therapeutic benefit in myeloproliferative disorders.

For these reasons, we believe that JAK inhibitors that are more effective against JAK2 than JAK3 may achieve equivalent or possibly superior clinical efficacy to JAK3-focused agents in inflammatory diseases, with less potential for immunosuppression, and that JAK2 inhibitors may also be of value in the treatment of myeloproliferative disorders and certain cancers.

Our JAK2 program includes multiple potent and orally bioavailable JAK2 inhibitors from multiple distinct chemical scaffolds which may have therapeutic potential as treatments for chronic inflammatory conditions, myeloproliferative disorders, and certain cancers. A number of these compounds are expected to enter clinical trials beginning in the first half of 2007.

Sheddase Inhibitor Program for Solid Tumors

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

The signaling pathways that utilize the receptors and ligands of the epidermal growth factor receptor (EGFR) family play a key role in the growth and survival of multiple tumor types, including breast, colorectal, and non-small cell lung cancers. The EGFR, or HER, signaling pathways consist of four known cellular receptors: HER1 (also known as EGFR), HER2, HER3, and HER4. Under normal conditions, these pathways are tightly regulated. However, in cancer, the pathways can become dysregulated and changes in the amount or the activity of HER family members, primarily HER1, HER2 and HER3, have been shown to impact the growth, proliferation, migration, and survival of cancer cells. Sheddase is an enzyme that is believed to activate all four EGFR pathways.

Currently approved therapies target one or more of the EGFR pathways. However these currently available therapeutics may not block all EGFR family-mediated signaling, even in the tumor types in which they are approved. In contrast, we believe our sheddase inhibitor targets all four EGFR signaling pathways and may provide meaningful advantages over therapies that target one or two.

We have identified novel, potent, and orally available small-molecule inhibitors of sheddase that, in preclinical models, show efficacy as single agents and show synergy with other targeted therapeutic agents and with cytotoxics. We have completed single and multiple dose Phase I clinical trials in healthy volunteers with the lead compound from this program, INCB7839, and we have initiated a Phase Ib/IIa dose-ranging trial in refractory cancer patients with solid tumors such as breast, non-small cell lung, prostate, colorectal and head and neck cancer. In this trial, we are seeking to establish the maximum tolerated dose of the compound and select a dose for advancing INCB7839 into Phase II trials in breast cancer and possibly one other solid tumor type.

Preclinical Programs

We have a number of early discovery programs at various stages of preclinical testing. We do not typically disclose these programs and/or targets until we have successfully completed preclinical toxicology tests with the lead clinical candidate.

Patents and Other Intellectual Property

We regard the protection of patents and other enforceable intellectual property rights that we own or license as critical to our business and competitive position. Accordingly, we rely on patent, trade secret and copyright law, as well as nondisclosure and other contractual arrangements, to protect our intellectual

property. We have established a patent portfolio of owned or in-licensed patents and patent applications that cover aspects of all our drug candidates, as well as other patents and patent applications that relate to full-length genes and genomics-related technologies obtained as a result of our past high-throughput gene sequencing efforts. The patents and patent applications relating to our drug candidates generally include claims directed to the drug candidates, methods of using the drug candidates, formulations of the drug candidates, and methods of manufacturing the drug candidates. Our policy is to pursue patent applications on inventions and discoveries we believe that are commercially important to the development and growth of our business.

Patents extend for varying periods according to the date of patent filing or grant and the legal term of patents in the various countries where patent protection is obtained. The actual protection afforded by a patent, which can vary from country to country, depends on the type of patent, the scope of its coverage and the availability of legal remedies in the country.

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

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

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

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

Competition

Our drug discovery and development activities face, and will continue to face, intense competition from organizations such as pharmaceutical and biotechnology companies, as well as academic and research institutions and government agencies. Our major competitors include fully integrated pharmaceutical companies that have extensive drug discovery efforts and are developing novel small molecule

pharmaceuticals. We face significant competition from organizations that are pursuing pharmaceuticals that are competitive with our potential products.

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

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

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

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

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

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

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

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

In a number of countries, including in particular, developing countries, government officials and other groups have suggested that pharmaceutical companies should make drugs available at a low cost. In some cases, governmental authorities have indicated that where pharmaceutical companies do not do so, their patents might not be enforceable to prevent generic competition. Some major pharmaceutical companies have greatly reduced prices for HIV drugs in certain developing countries. If certain countries do not

permit enforcement of any of our patents, sales of our products in those countries, and in other countries by importation from low-price countries, could be reduced by generic competition or by parallel importation of our product. Alternatively, governments in those countries could require that we grant compulsory licenses to allow competitors to manufacture and sell their own versions of our products in those countries, thereby reducing our product sales, or we could respond to governmental concerns by reducing prices for our products. In all of these situations, our results of operations could be adversely affected.

Government Regulation

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

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

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

Preclinical testing includes laboratory evaluation of product chemistry, toxicity and formulation, as well as animal studies. The results of the preclinical tests, together with manufacturing information and analytical data, are submitted to the FDA as part of an IND. An IND will automatically become effective 30 days after receipt by the FDA, unless before that time, the FDA raises concerns or questions about issues such as the conduct of the clinical trials as outlined in the IND. In the latter case, the IND sponsor and the FDA must resolve any outstanding FDA concerns or questions before clinical trials can proceed. We cannot be sure that submission of an IND will result in the FDA allowing clinical trials to commence.

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

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

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

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

Even after initial FDA approval has been obtained, further studies, including post-approval trials, may be required to provide additional data on safety and will be required to gain approval for the sale of a product as a treatment for clinical indications other than those for which the product was initially tested and approved. Also, the FDA will require post-approval reporting to monitor the side effects of the drug. Results of post-approval programs may limit or expand the indications for which the drug product may be marketed. Further, if there are any requests for modifications to the initial FDA approval for the drug, including changes in indication, manufacturing process, labeling or manufacturing facilities, a supplemental NDA may be required to be submitted to the FDA.

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

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

- slow patient enrollment due to the nature of the protocol, the proximity of patients to clinical sites, the eligibility criteria for the study, competition with clinical trials for other drug candidates or other factors;

- inadequately trained or insufficient personnel at the study site to assist in overseeing and monitoring clinical trials;
- delays in approvals from a study site's IRB;
- longer than anticipated treatment time required to demonstrate effectiveness or determine the appropriate product dose;
- lack of sufficient supplies of the drug candidate for use in clinical trials;
- adverse medical events or side effects in treated patients; and
- lack of effectiveness of the drug candidate being tested.

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

The FDA's fast track program is intended to facilitate the development and expedite the review of drug candidates intended for the treatment of serious or life-threatening diseases and that demonstrate the potential to address unmet medical needs for these conditions. Under this program, the FDA can, for example, review portions of an NDA for a fast track product before the entire application is complete, thus potentially beginning the review process at an earlier time.

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

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

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

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

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

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

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

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

Research and Development

Since our inception, we have made substantial investments in research and technology development. During 2006, 2005 and 2004, we incurred research and development expenses of $87.6 million, $95.6 million and $88.3 million, respectively.

Human Resources

As of December 31, 2006, we had 186 employees, including 152 in research and development and 34 in finance, operations support and administrative positions. Of these employees, 116 employees have advanced technical degrees including 7 MD's and 65 Ph.D's. None of our employees are covered by collective bargaining agreements, and management considers relations with our employees to be good.

Available Information

We were incorporated in Delaware in 1991 and our website is located at *www.incyte.com*. We make available free of charge on our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after we electronically file or furnish such materials to the Securities and Exchange Commission. Our website and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K.

Item 1A. *Risk Factors*

RISKS RELATING TO OUR BUSINESS

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

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

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

Of the compounds that we identify as potential drug products or that we in-license from other companies, only a few, if any, are likely to lead to successful drug development programs. Significant research and development efforts will be necessary. For example, in April 2006, we announced the discontinuation of development of DFC, which was at the time our most advanced drug candidate and was in Phase IIb clinical trials. Prior to discontinuation of the DFC program, we expended a significant amount of effort and money on that program. We have limited experience with the activities listed above and may not be successful in discovering, developing, or commercializing drug products. If we choose to outsource some of these activities, we may be unable to enter into outsourcing or licensing agreements on commercially reasonable terms, if at all. In addition, if we elect to manufacture our products in our own manufacturing facilities, we will require substantial additional capital resources to lease or build and maintain those facilities, including attracting and retaining qualified personnel to lease or build and operate our facilities.

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

We are currently engaged in a number of different approaches to discover and develop novel drug candidates. Our drug candidates in clinical trials are in early Phase I and Phase IIa trials for indications in HIV, diabetes and oncology. Our other earlier stage internal drug discovery programs are focused on compounds with potential applications in myeloproliferative disorders, oncology and inflammation. We

have also licensed to Pfizer our lead CCR2 antagonist, which was in Phase IIa clinical trials at the time of licensing to Pfizer. We have no control over the further clinical development of any compounds we licensed to Pfizer. Discovery and development of potential drug candidates are expensive and time-consuming, and we do not know if our efforts will lead to discovery of any drug candidates that can be successfully developed and marketed. If our efforts do not lead to the discovery of a suitable drug candidate, we may be unable to grow our clinical pipeline or we may be unable to enter into agreements with collaborators who are willing to develop our drug candidates.

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

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

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

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

The biotechnology and pharmaceutical industries are intensely competitive and subject to rapid and significant technological change. Our drug discovery and development efforts may target diseases and conditions that are already subject to existing therapies or that are being developed by our competitors, many of which have substantially greater resources, larger research and development staffs and facilities, more experience in completing preclinical testing and clinical trials, and formulation, marketing and manufacturing capabilities. As a result of these resources, our competitors may develop drug products that render our products obsolete or noncompetitive by developing more effective drugs or by developing their

products more efficiently. Our ability to develop competitive products would be limited if our competitors succeeded in obtaining regulatory approvals for drug candidates more rapidly than we were able to or in obtaining patent protection or other intellectual property rights that limited our drug development efforts. Any drugs resulting from our research and development efforts, or from our joint efforts with collaborators or licensees, might not be able to compete successfully with our competitors' existing and future products, or obtain regulatory approval in the United States or elsewhere.

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

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

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

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

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

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

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

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

In addition to establishing collaborative or license arrangements under which other parties license our drug candidates for development and commercialization, we intend to continue to explore opportunities to develop our clinical pipeline by in-licensing drug compounds that fit within our expertise and research and development capabilities. We may be unable to enter into any additional in-licensing agreements because

suitable product candidates that are within our expertise may not be available to us on terms that are acceptable to us or because competitors with greater resources seek to in-license the same product candidates. Product candidates that we would like to develop may not be available to us because they are controlled by competitors who are unwilling to license the rights to the drug compound or candidate to us. In addition, we may enter into license agreements that are unsuccessful and our business and operations might be adversely affected by the termination of a drug candidate and termination and winding down of the related license agreement. For example, in April 2006, we announced the discontinuation of development of DFC and we gave notice of termination of our collaborative license agreement with Pharmasset, Inc., which licensed DFC to us. DFC was at the time our most advanced drug candidate. We may also need to license drug delivery or other technology in order to continue to develop our drug candidate pipeline. If we are unable to enter into additional agreements to license drug candidates, drug delivery technology or other technology or if these arrangements are unsuccessful, our research and development efforts could be adversely affected.

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

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

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

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

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

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

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

Data obtained from the clinical trials are susceptible to varying interpretation, which may delay, limit or prevent regulatory approval. A number of companies in the pharmaceutical industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after achieving promising results in earlier clinical trials. In addition, regulatory authorities may refuse or delay approval as a result of other factors, such as changes in regulatory policy during the period of product development and regulatory agency review. For example, the FDA has in the past required and could in the future require that we conduct additional trials of any of our product candidates, which would result in delays.

Due, in part, to the early stage of our drug candidate research and development process, we cannot predict whether regulatory approval will be obtained for any product we develop. Our drug candidates in clinical trials are in early stage Phase I and Phase IIa trials. Our other drug candidates are still undergoing preclinical testing. We have also licensed to Pfizer our lead CCR2 antagonist; further clinical development of this compound, which was in Phase IIa clinical trials at the time of licensing, is under Pfizer's control. Compounds developed by us, alone or with other parties, may not prove to be safe and effective in clinical trials and may not meet all of the applicable regulatory requirements needed to receive marketing approval. If regulatory approval of a product is granted, this approval will be limited to those disease states and conditions for which the product is demonstrated through clinical trials to be safe and effective. Failure to obtain regulatory approval would delay or prevent us from commercializing products.

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

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

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

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

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

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

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

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

We have a limited number of drug candidates in early stage Phase I and Phase IIa clinical trials. We have also licensed to Pfizer our lead CCR2 antagonist, which was in Phase IIa clinical trials at the time of licensing. We, or our collaborators or licensees, may decide to discontinue development of any or all of our drug candidates at any time for commercial, scientific or other reasons. We discontinued development of DFC in April 2006 for safety reasons. If a product is developed, but is not marketed, we may have spent significant amounts of time and money on it, which would adversely affect our operating results and financial condition. Even if a drug candidate that we develop receives regulatory approval, we may decide not to commercialize it if we determine that commercialization of that product would require more money and time than we are willing to invest. For example, drugs that receive approval are subject to post-regulatory surveillance and may have to be withdrawn from the market if previously unknown side effects occur. At this point, the regulatory agencies may require additional clinical trials or testing. Once a drug is marketed, if it causes side effects, the drug product may be recalled or may be subject to reformulation, additional studies, changes in labeling, warnings to the public and negative publicity. As a result, we may not continue to commercialize a product even though it has obtained regulatory approval. Further, we may decide not to continue to commercialize a product if the market does not accept the product because it is too expensive and third parties such as insurance companies or Medicare have not approved it for substantial reimbursement. In addition, we may decide not to continue to commercialize a product if another product comes on the market that is as effective but has fewer side effects. There is also a risk that competitors may develop similar or superior products or have proprietary rights that preclude us from ultimately marketing our products.

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

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

Our ability to commercialize our products successfully will depend in part on the extent to which appropriate reimbursement levels for the cost of our products and related treatment are obtained by governmental authorities, private health insurers and other organizations, such as HMOs. Third-party payors are increasingly challenging the prices charged for medical products and services. Also, the trend toward managed health care in the United States and the concurrent growth of organizations such as HMOs, which could control or significantly influence the purchase of health care services and products, as well as legislative proposals to reform health care or reduce government insurance programs, may all result in lower prices for or rejection of our products. The cost containment measures that health care payors and providers are instituting and the effect of any health care reform could materially and adversely affect our ability to generate revenues.

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

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

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

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

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

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

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

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

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

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

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

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

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

RISKS RELATING TO OUR FINANCIAL RESULTS

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

We had net losses from inception in 1991 through 1996 and in 1999 through 2006. Because of those losses, we had an accumulated deficit of $913.5 million as of December 31, 2006. We will continue to spend significant amounts on our efforts to discover and develop drugs. As a result, we expect to continue to incur losses in 2007 and in future periods as well.

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

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

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

Additional factors that may affect our future funding requirements include:

- any changes in the breadth of our research and development programs;
- the results of research and development, preclinical testing and clinical trials conducted by us or our future collaborative partners or licensees, if any;
- the acquisition or licensing of businesses, technologies or compounds, if any;

- our ability to maintain and establish new corporate relationships and research collaborations;
- competing technological and market developments;
- the amount of revenues generated from our business activities, if any;
- the time and costs involved in filing, prosecuting, defending and enforcing patent and intellectual property claims;
- the receipt of contingent licensing or milestone fees or royalties on product sales from our current or future collaborative and license arrangements, if established; and
- the timing of regulatory approvals, if any.

If we require additional capital at a time when investment in companies such as ours, or in the marketplace generally, is limited due to the then prevailing market or other conditions, we may have to scale back our operations, eliminate one or more of our research or development programs, or attempt to obtain funds by entering into an agreement with a collaborative partner that would result in terms that are not favorable to us or relinquishing our rights in certain of our proprietary technologies or drug candidates. If we are unable to raise funds at the time that we desire or at any time thereafter on acceptable terms, we may not be able to continue to develop our potential drug products. The sale of equity or additional convertible debt securities in the future would be dilutive to our stockholders, and debt financing arrangements may require us to pledge certain assets or enter into covenants that could restrict our operations or our ability to incur further indebtedness.

Our current revenues are derived from collaborations and from licensing our intellectual property. If we are unable to achieve milestones, develop products or renew or enter into new collaborations, our revenues may decrease, and future milestone and royalty payments from our gene and genomics-related intellectual property may not contribute significantly to revenues for several years, and may never result in revenues.

We derived substantially all of our revenues for the year ended December 31, 2006 from our collaborative research and license agreement with Pfizer and from licensing our intellectual property to others. We may be unable to enter into additional collaborative agreements. Revenues from research and development collaborations depend upon continuation of the collaborations, the achievement of milestones and royalties we earn from any future products developed from our research. If we are unable to successfully achieve milestones or our collaborators fail to develop successful products, we will not earn the revenues contemplated under our collaborative agreements. Part of our prior strategy was to license to our database customers and to other pharmaceutical and biotechnology companies our know-how and patent rights associated with the information we have generated in the creation of our proprietary databases, for use in the discovery and development of potential pharmaceutical, diagnostic or other products. Any potential product that is the subject of such a license will require several years of further development, clinical trials and regulatory approval before commercialization, all of which is beyond our control, and possibly beyond the control of our licensee. These licensees may not develop the potential product if they do not devote the necessary resources or decide that they do not want to expend the resources to do the clinical trials necessary to obtain the necessary regulatory approvals. Therefore, milestone or royalty payments from these licenses may not contribute to our revenues for several years, if at all. We have decided to discontinue some of our gene and genomics-related patent prosecution and maintenance, and may in the future decide to discontinue additional gene and genomics-related patent prosecution and maintenance, which could limit our ability to receive license-based revenues from our gene and genomics-related patent portfolio.

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

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

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

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

We have a large amount of debt and our debt service obligations may prevent us from taking actions that we would otherwise consider to be in our best interests.

As of December 31, 2006, the aggregate principal amount of total consolidated debt was $411.8 million and our stockholders' deficit was $84.9 million. The indentures pursuant to which our outstanding convertible senior and subordinated notes were issued do not limit the issuance of additional indebtedness. Our substantial leverage could have significant negative consequences for our future operations, including:

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

In the past five years, we have had negative cash flow from operations. We likely will not generate sufficient cash flow from our operations in the future to enable us to meet our anticipated fixed charges, including our debt service requirements with respect to our outstanding convertible senior notes and convertible subordinated notes. As of December 31, 2006, $151.8 million aggregate principal amount of our 3½% convertible senior notes due 2011 was outstanding. Our annual interest payments, beginning in 2007, for the 3½% convertible senior notes through 2010, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $5.3 million, and an additional $2.7 million in interest is payable in 2011. As of December 31, 2006, $250.0 million aggregate principal amount of our 3½% convertible

subordinated notes due 2011 was outstanding. Our annual interest payments for the 3½% convertible subordinated notes through 2010, assuming none of these notes are converted, redeemed, repurchased or exchanged, are $8.8 million, and an additional $4.4 million in interest is payable in 2011. As of December 31, 2006, we also had outstanding the $10.0 million aggregate principal amount of the convertible subordinated note held by Pfizer, which is due in 2013 but does not bear interest. If we are unable to generate cash from our operations or raise additional cash through financings sufficient to meet these obligations, we will need to use existing cash or liquidate marketable securities in order to fund these obligations, which may delay or curtail our research, development and commercialization programs.

RISKS RELATING TO INTELLECTUAL PROPERTY AND LEGAL MATTERS

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

The technology that we use to make and develop our drug products, the technology that we incorporate in our products, and the products we are developing may be subject to claims that they infringe the patents or proprietary rights of others. The success of our drug discovery and development efforts will also depend on our ability to develop new compounds, drugs and technologies without infringing or misappropriating the proprietary rights of others. We are aware of patents and patent applications filed in certain countries claiming certain intellectual property relating to certain drug discovery targets such as CCR5. While the validity of issued patents, patentability of pending patent applications and applicability of any of them to our programs are uncertain, if any of these patents are asserted against us, our ability to commercialize our products could be harmed.

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

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

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

We may be unsuccessful in defending or pursuing these lawsuits or claims. Regardless of the outcome, litigation can be very costly and can divert management's efforts. For example, we recently settled patent litigation with Invitrogen Corporation. We incurred significant expenses related to this litigation and, as part of the settlement, paid Invitrogen $3.4 million. An adverse determination may subject us to significant liabilities or require us or our collaborators or licensees to seek licenses to other parties' patents or proprietary rights. We or our collaborators or licensees may also be restricted or prevented from manufacturing or selling a drug product that we develop. Further, we or our future collaborators or licensees may not be able to obtain any necessary licenses on acceptable terms, if at all.

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

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

Additionally, when we do not control the prosecution, maintenance and enforcement of certain important intellectual property, such as a drug compound in-licensed to us or subject to a collaboration with a third party, the protection of the intellectual property rights may not be in our hands. If we do not control the intellectual property rights in-licensed to us with respect to a compound and the entity that controls the intellectual property rights does not adequately protect those rights, our rights may be impaired, which may impact our ability to develop, market and commercialize the in-licensed compound.

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

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

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

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

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

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

Biotechnology and pharmaceutical patent law outside the United States is even more uncertain and costly than in the United States and is currently undergoing review and revision in many countries. Further, the laws of some foreign countries may not protect our intellectual property rights to the same extent as United States laws. For example, certain countries do not grant patent claims that are directed to

the treatment of humans. We may participate in opposition proceedings to determine the validity of our foreign patents or our competitors' foreign patents, which could result in substantial costs and diversion of our efforts.

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

None.

Item 2. ***Properties***

Our corporate headquarters is in Wilmington, Delaware, which is where our drug discovery and development operations are also located. These facilities are leased to us until September 2008, and we have options to renew our lease until September 2010. We believe that these facilities are adequate to meet our business requirements for the near-term and that additional space will be available on commercially reasonable terms, if required. In addition to this lease, we had lease agreements as of December 31, 2006 for facilities that were closed as a part of the restructurings of our genomic information business in Palo Alto and San Diego, California. As of December 31, 2006, we had multiple sublease and lease agreements covering approximately 271,000 square feet that expire on various dates ranging from June 2007 to March 2011. Of the approximately 271,000 square feet leased, approximately 174,000 square feet of this space has been vacated by us and is currently subleased to others.

Item 3. ***Legal Proceedings***

We are not currently a party to any material legal proceedings. We may from time to time become involved in various legal proceedings arising in the ordinary course of business.

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

No matters were submitted to a vote of our security holders during the fourth quarter of 2006.

Executive Officers of the Registrant

Our executive officers are as follows:

Paul A. Friedman, M.D., age 64, joined Incyte as the Chief Executive Officer and a Director in November 2001. Dr. Friedman also serves as our President. From 1998 until October 2001, Dr. Friedman served as President of DuPont Pharmaceuticals Research Laboratories, a wholly owned subsidiary of DuPont Pharmaceuticals Company (formerly The DuPont Merck Pharmaceutical Company), from 1994 to 1998 he served as President of Research and Development of The DuPont Merck Pharmaceutical Company, and from 1991 to 1994 he served as Senior Vice President at Merck Research Laboratories. Prior to his work at Merck and DuPont, Dr. Friedman was an Associate Professor of Medicine and Pharmacology at Harvard Medical School. Dr. Friedman is a Diplomat of the American Board of Internal Medicine and a Member of the American Society of Clinical Investigation. He received his A.B. in Biology from Princeton University and his M.D. from Harvard Medical School. Dr. Friedman is also a director of Bausch & Lomb Incorporated.

David C. Hastings, age 45, has served as Executive Vice President and Chief Financial Officer since October 2003. From February 2000 to September 2003, Mr. Hastings served as Vice President, Chief Financial Officer, and Treasurer of ArQule, Inc. Prior to his employment with ArQule, Mr. Hastings was Vice President and Corporate Controller at Genzyme, Inc., where he was responsible for the management of the finance department. Prior to his employment with Genzyme, Mr. Hastings was the Director of Finance at Sepracor, Inc., where he was primarily responsible for Sepracor's internal and external

reporting. Mr. Hastings is a Certified Public Accountant and received his B.A. in Economics at the University of Vermont.

John A. Keller, Ph.D., age 42, has served as Executive Vice President and Chief Business Officer since September 2003. From January 2001 to September 2003, Dr. Keller served as Vice President, Business Development at GlaxoSmithKline. From February 1987 to January 2001, Dr. Keller held a range of positions at SmithKline Beckman and SmithKline Beecham, in areas encompassing discovery research, project management, R&D strategy, alliance management and business development. Dr. Keller received his B.A. from Johns Hopkins University and his Ph.D. in Microbiology from Rutgers University.

Brian W. Metcalf, Ph.D., age 61, has served as Executive Vice President and Chief Drug Discovery Scientist since February 2002. From March 2000 to February 2002, Dr. Metcalf served as Senior Vice President and Chief Scientific Officer of Kosan Biosciences Incorporated. From December 1983 to March 2000, Dr. Metcalf held a number of executive management positions with SmithKline Beecham, most recently as Senior Vice President, Discovery Chemistry and Platform Technologies. Prior to joining SmithKline Beecham, Dr. Metcalf held positions with Merrell Research Center from 1973 to 1983. Dr. Metcalf received his B.S. and Ph.D. in Organic Chemistry from the University of Western Australia.

Patricia A. Schreck, age 53, joined Incyte as Executive Vice President and General Counsel in December 2003. Prior to joining Incyte, Ms. Schreck was Chief Patent Counsel at Elan Drug Delivery, Inc. Previously, she served as General Counsel for Genomics Collaborative, Inc. and diaDexus, Inc. (a SmithKline Beecham & Incyte joint venture). From 1992 through 1998, Ms. Schreck held a variety of senior patent and corporate legal positions at SmithKline Beecham. Ms. Schreck holds a B.A. in Chemistry and Biology from the University of Colorado and a J.D. from Villanova University School of Law. Ms. Schreck is admitted to practice before the United States Patent bar.

Paula Swain, age 49, has served as Executive Vice President, Human Resources, of Incyte since August 2002 and joined the company as Senior Vice President of Human Resources in January 2002. Ms. Swain served as Senior Vice President of Human Resources at Bristol Meyers Squibb from October 2001 to January 2002, after they acquired DuPont Pharmaceuticals Company. From July 1998 to October 2001, Ms. Swain was Senior Vice President of Human Resources at DuPont Pharmaceuticals. From October 1992 to July 1998, Ms. Swain held a variety of human resources positions of increasing responsibility at DuPont Pharmaceuticals. Ms. Swain received her B.A. in Psychology and Industrial Relations from Rockhurst University.

PART II

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

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

	High	Low
2005		
First Quarter	$10.11	$6.52
Second Quarter	8.50	6.43
Third Quarter	9.10	3.88
Fourth Quarter	6.65	4.13
2006		
First Quarter	$ 6.25	$5.01
Second Quarter	4.62	3.51
Third Quarter	5.20	3.85
Fourth Quarter	6.10	4.12

As of December 31, 2006, our Common Stock was held by 337 stockholders of record. We have never declared or paid dividends on our capital stock and do not anticipate paying any dividends in the foreseeable future.

Item 6. *Selected Consolidated Financial Data*

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

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

	Year Ended December 31,				
	2006	2005	2004	2003	2002
Consolidated Statement of Operations Data(1):					
Revenues:					
Contract revenues(2)	$ 24,226	$ —	$ —	$ —	$ —
License and royalty revenues	3,417	7,846	14,146	41,197	95,473
Total revenues	27,643	7,846	14,146	41,197	95,473
Costs and expenses:					
Research and development	87,596	95,618	88,271	111,404	145,308
Selling, general and administrative	14,027	11,656	20,551	29,370	45,148
Loss on sale of assets	—	—	—	—	313
Purchased in-process research and development	—	—	—	33,952	—
Other expenses(3)	2,884	1,356	54,177	15,823	37,331
Total costs and expenses	104,507	108,630	162,999	190,549	228,100
Loss from operations	(76,864)	(100,784)	(148,853)	(149,352)	(132,627)
Interest and other income (expense), net	20,679	12,527	3,563	(7,988)	9,417
Interest expense	(17,911)	(16,052)	(17,241)	(9,561)	(9,797)
Gain (loss) on certain derivative financial instruments	—	(106)	(454)	151	(1,782)
Gain (loss) on redemption/repurchase of convertible subordinated notes	(70)	506	(226)	706	1,937
Loss from continuing operations before income taxes	(74,166)	(103,909)	(163,211)	(166,044)	(132,852)
Provision (benefit) for income taxes	—	(552)	453	342	945
Loss from continuing operations	(74,166)	(103,357)	(163,664)	(166,386)	(133,797)
Gain (loss) from discontinued operation, net of tax	—	314	(1,153)	(77)	(3,088)
Net loss	$ (74,166)	$ (103,043)	$ (164,817)	$ (166,463)	$ (136,885)
Basic and diluted per share data					
Continuing operations	$ (0.89)	$ (1.24)	$ (2.19)	$ (2.33)	$ (1.98)
Discontinued operation	—	—	(0.02)	—	(0.05)
	$ (0.89)	$ (1.24)	$ (2.21)	$ (2.33)	$ (2.03)
Number of shares used in computation of basic and diluted per share data	83,799	83,321	74,555	71,369	67,403

(1) In December 2004, we entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts, which transaction subsequently closed in January 2005. Fiscal years 2002 through 2004 have been restated to present the operations of our Proteome facility as a discontinued operation.

(2) 2006 contract revenues relate to our collaborative research and license agreement with Pfizer Inc.

(3) 2006 charges relate to restructuring charges and $3.4 million paid to Invitrogen as a settlement fee. 2005 charges relate to restructuring charges. 2004 and 2003 charges relate to restructuring charges and impairment of a long-lived asset. 2002 charges relate to restructuring charges.

	December 31,				
	2006	2005	2004	2003	2002
Consolidated Balance Sheet Data:					
Cash, cash equivalents, and short-term and long-term marketable securities	$329,810	$344,971	$469,764	$293,807	$429,018
Working capital	278,421	326,119	449,832	268,937	394,854
Total assets	353,603	374,108	516,919	379,545	552,139
Convertible senior notes	113,981	—	—	—	—
Convertible subordinated notes	257,122	341,862	378,766	167,786	172,036
Stockholders' equity (deficit)	(84,908)	(19,397)	78,517	154,333	302,410

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

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

Overview

Incyte is a drug discovery and development company focused on developing proprietary small molecule drugs to treat serious unmet medical needs. We have a pipeline with programs in human immunodeficiency virus (HIV), diabetes, oncology and inflammation.

Thus far in our drug discovery and development activities, which began in early 2002, we have taken five internally developed compounds into clinical development, and have progressed four of these compounds into Phase II clinical trials. Of the four compounds progressed into Phase II clinical trials, the first was from our CCR2 program for inflammatory diseases, which is now the basis of a broad collaboration with Pfizer Inc. ("Pfizer") established in January 2006, the second is our sheddase inhibitor from our most advanced oncology program, the third is our lead CCR5 antagonist for HIV and the fourth is our lead 11-beta hydroxysteroid dehydrogenase type 1, more commonly called 11βHSD1, inhibitor for type 2 diabetes.

Incyte's wholly-owned pipeline includes the following compounds:

Drug Target	Indication	Development Status
HIV		
CCR5 Antagonists		
INCB9471	HIV	Phase IIa
INCB15050	HIV	Phase I
DIABETES		
11ßHSD1 Inhibitor		
INCB13739	Diabetes	Phase IIa
ONCOLOGY		
Sheddase Inhibitor		
INCB7839	Solid Tumors	Phase IIa
JAK Inhibitor	Myeloproliferative disorders and cancer	Preclinical
INFLAMMATION		
CCR2 Antagonists		
INCB8696	Multiple Sclerosis	IND filed
	Lupus Nephritis	Preclinical
JAK Inhibitor	Inflammation	Preclinical

In April 2006, we announced that we were discontinuing the development of dexelvucitabine or DFC (formerly known as Reverset), a nucleoside analog reverse transcriptase inhibitor that we in-licensed from Pharmasset, Inc. At the time, this compound was in Phase IIb development as a treatment for HIV.

During 2006, we filed four Investigational New Drug applications (INDs):

- one for our lead CCR5 compound that is now in Phase IIa clinical trials;
- a second for our lead 11βHSD1 inhibitor for type 2 diabetes that is also in Phase IIa clinical trials;

- a third for a follow-on CCR5 antagonist that is in Phase I development; and
- a fourth for a CCR2 antagonist for multiple sclerosis.

We expect to file additional INDs in the first half of 2007 for a new program targeting Janus-associated kinases (JAK). We believe our orally available JAK inhibitors have potential in chronic inflammatory conditions, myeloproliferative disorders and certain cancers.

We anticipate incurring additional losses for several years as we expand our drug discovery and development programs. We also expect that losses will fluctuate from quarter to quarter and that such fluctuations may be substantial. Conducting clinical trials for our drug candidates in development is a lengthy, time-consuming and expensive process. We do not expect to generate product sales from our drug discovery and development efforts for several years, if at all. If we are unable to successfully develop and market pharmaceutical products over the next several years, our business, financial condition and results of operations would be adversely impacted.

Collaborative Research and License Agreement with Pfizer

Effective in January 2006, we entered a collaborative research and license agreement with Pfizer for the pursuit of our CCR2 antagonist program. We received an upfront nonrefundable payment of $40.0 million in January 2006, $10.0 million was received through the purchase of a convertible subordinated note (the "Pfizer Note") in February 2006 and we are eligible to receive additional future development and milestone payments of up to $743.0 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. Pfizer gained worldwide development and commercialization rights to our portfolio of CCR2 antagonist compounds, the most advanced of which was in Phase IIa clinical trials in rheumatoid arthritis and insulin-resistant obese patients at the time the agreement became effective in January 2006. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and lupus nephritis and other autoimmune nephritides, for which we retained worldwide rights, along with certain compounds. We do not have obligations to Pfizer on preclinical development candidates we select for pursuit in these indications. At our option, prior to September 28, 2007, once we are able to initiate Phase I clinical trials of a CCR2 antagonist in a retained Incyte indication, Pfizer may purchase from us an additional $10.0 million convertible subordinated note.

Restructuring Programs

In February 2004, we made the decision to discontinue further development of the information products, close our Palo Alto headquarters and focus solely on the discovery and development of novel drugs. We recorded $42.1 million in restructuring charges in 2004, including charges related to the closure of our facilities, prior tenant improvements and equipment, a workforce reduction and other items. The restructuring charge originally included the present value of future lease obligations for two facilities. In the fourth quarter of 2004, we made a lease termination payment to satisfy our remaining lease obligation with respect to one of the facilities. The lease obligation for the second facility extends through March 2011. As a result of the long term nature of the remaining lease obligation, we will be recording a charge each period through the March 2011 termination date of the lease related to increases in the fair value of the lease obligations in accordance with the provisions of Financial Accounting Standards Board ("FASB") Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which total approximately $1.4 million at December 31, 2006. The cash impact in 2006 from restructuring related charges was $6.1 million.

In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded a charge of $12.1 million to adjust the carrying value of previously capitalized costs associated with the preparation, prosecution and maintenance of our gene

patent portfolio to its estimated fair market value. In January 2005 we sold certain assets and liabilities related to our Proteome facility in Beverly, Massachusetts. Our consolidated financial statements have been restated to present the operations of our Proteome facility as a discontinued operation.

Critical Accounting Policies and Significant Estimates

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

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

- Revenue recognition;
- Research and development costs;
- Valuation of long-lived assets;
- Accounting for long-term investments;
- Restructuring charges; and
- Stock compensation.

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

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

Under agreements involving multiple products, services and/or rights to use assets, the multiple elements are divided into separate units of accounting when certain criteria are met, including whether the delivered items have stand alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. When separate units of accounting exist, consideration is allocated among the separate elements based on their respective fair values. The determination of fair value of each element is based on objective evidence from historical sales of the individual elements by us to other customers. If such evidence of fair value for each undelivered element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value for each

undelivered element does exist or until all elements of the arrangement are delivered. When elements are specifically tied to a separate earnings process, revenue is recognized when the specific performance obligation tied to the element is completed. When revenues for an element are not specifically tied to a separate earnings process, they are recognized ratably over the term of the agreement.

In connection with our collaborative research and license agreement with Pfizer, we received an upfront non-refundable payment of $40.0 million in January 2006. The $40.0 million upfront fee was recorded as deferred revenue and is being recognized on a straight-line basis over two years, our estimated performance period under the agreement. Pfizer also purchased the Pfizer Note for $10.0 million from us in February 2006. As the Pfizer Note is non-interest bearing, it has been discounted to its net present value. The difference between the cash received and the present value of the Pfizer Note in the amount of $3.2 million represents additional consideration from Pfizer under the agreement. We have accounted for this additional consideration as deferred revenue and will recognize it over two years, our estimated performance period under the agreement. We recognize contract revenues in connection with research services provided to Pfizer as earned. Future development and milestone payments will be recognized as earned.

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

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

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

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

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

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

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

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

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

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

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

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

At the end of each reporting period, we evaluate the remaining accrued balances to ensure their adequacy, that no excess accruals are retained and the utilization of the provisions are for their intended purposes in accordance with developed exit plans. We periodically evaluate current available information and adjust our restructuring reserve as necessary. We also make adjustments related to accrued professional fees to adjust estimated amounts to actual. For the year ended December 31, 2006, such adjustments were made for the 2002 restructuring program, 2004 restructuring program, and the acquisition of Maxia.

Stock Compensation. Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment*, which revised Statement of Financial Accounting Standards 123 ("SFAS 123"), *Accounting for Stock-Based Compensation*. SFAS 123R requires all share-based payment transactions with employees, including grants of employee stock options, to be recognized as compensation expense over the requisite service period based on their relative fair values. SFAS 123R is a new and complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility and expected option lives, as well as expected option forfeiture rates, to value equity-based compensation. SFAS 123R requires the recognition of the fair value of stock compensation in the statement of operations. Prior to the adoption of SFAS 123R, stock-based compensation expense related to employee stock options was not recognized in the statement of operations. Prior to January 1, 2006, we had adopted the disclosure-only provisions under SFAS 123. Under the provisions of SFAS 123R, we recorded $8.9 million of stock compensation expense on our audited condensed consolidated statement of operations for the year ended December 31, 2006. As a result of adopting SFAS 123R, our net loss for the year ended December 31, 2006, is $8.9 million higher than if we had continued to account for share-based compensation under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees.* Basic and diluted net loss per share for the year ended December 31, 2006 are $0.11 higher than if we had continued to account for share-based compensation under APB Opinion No. 25. For the years ended December 31, 2005 and 2004 we recorded stock compensation expense of $0.2 million and $0.5 million, respectively on our audited condensed consolidated statement of operations related to restricted shares issued to our Chief Executive Officer.

Results of Operations

Years Ended December 31, 2006 and 2005

We recorded net losses from continuing operations for the years ended December 31, 2006 and 2005 of $74.2 million and $103.4 million, respectively. On a basic and diluted per share basis, net loss from continuing operations was $0.89 and $1.24 for the years ended December 31, 2006 and 2005, respectively.

Revenues

	For the Years Ended, December 31,	
	2006	2005
	(in millions)	
Contract revenues	$24.2	$ —
License and royalty revenues	3.4	7.8
Total revenues	$27.6	$7.8

Our contract revenues were $24.2 million and $0.0 million in 2006 and 2005, respectively. Contract revenues were derived from recognition of revenue associated with the Pfizer $40.0 million upfront fee, recognition of revenue associated with the debt discount and beneficial conversion feature related to the Pfizer Note, and research services provided to Pfizer.

Our license and royalty revenues were $3.4 million and $7.8 million in 2006 and 2005, respectively. License and royalty revenues were derived from database subscriptions and licensing of our gene- and genomic-related intellectual property. The decrease in license and royalty revenues from 2005 to 2006 is attributable to our decision to discontinue offering information products. We expect that revenues generated from information products, including licensing of gene- and genomic-related intellectual property, will continue to decline as we focus on our drug discovery and development programs.

For the years ended December 31, 2006 and 2005 revenues from companies considered to be related parties, as defined by FASB Statement No. 57, *Related Party Disclosures* ("SFAS 57") were $0.3 million and $0.0 million, respectively. Our related parties consist of companies in which members of our Board of Directors have invested, either directly or indirectly, or in which a member of our Board of Directors is an officer or holds a seat on the Board of Directors (other than an Incyte-held Board seat).

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

Operating Expenses

Research and development expenses

	For the Years Ended December 31,	
	2006	2005
	($ in millions)	
Salary and benefits related	$25.7	$26.0
Stock compensation	5.7	—
Collaboration and outside services	38.1	49.0
Occupancy and all other costs	18.1	20.6
Total research and development expenses	$87.6	$95.6

We currently track research and development costs by natural expense line and not costs by project. Stock compensation costs for the year ended December 31, 2006 was the result of our adoption of SFAS 123R which required the recognition of stock compensation expense in our consolidated statement of operations. Stock compensation expense may fluctuate from period to period based on the number of

options granted, stock price volatility and expected option lives, as well as expected option forfeiture rates which are used to value equity-based compensation. The decrease in collaboration and outside services from 2005 to 2006 is due primarily the result of decreased drug discovery and development costs due to our collaborative research and license agreement with Pfizer and the decision in April 2006 to discontinue the development of our DFC program. The decrease in occupancy and other costs from 2005 to 2006 was primarily the result of increased efficiency in our use of laboratory and reagent supplies.

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

Selling, general and administrative expenses

	For the Years Ended December 31,	
	2006	2005
	($ in millions)	
Salary and benefits related	$ 6.5	$ 6.9
Stock compensation	3.2	0.2
Other contract services and outside costs	4.3	4.6
Total selling, general and administrative expenses	$14.0	$11.7

Stock compensation costs for the year ended December 31, 2006 was the result of our adoption of SFAS 123R which required the recognition of stock compensation expense in our consolidated statement of operations. Stock compensation expense may fluctuate from period to period based on the number of options granted, stock price volatility and expected option lives, as well as expected option forfeiture rates which are used to value equity-based compensation.

Other expenses. Other expenses for the years ended December 31, 2006 and 2005 were $2.9 million and $1.4 million, respectively. The increase from 2005 to 2006 is due primarily to the settlement agreement with Invitrogen related to our discontinued genomic information business which resulted in a $3.4 million charge recorded in other expenses. This settlement resolved all outstanding claims included in the litigation.

In 2006, we recorded $1.0 million of expense in connection with our 2004 restructuring program and $(1.5) million of benefit in connection with our 2002 restructuring program and a facility closed in connection with our acquisition of Maxia. In 2005, we recorded $1.0 million of expense in connection with our 2004 restructuring program and $0.4 million of expense in connection with our 2002 restructuring program and a facility closed in connection with our acquisition of Maxia.

Other income (expense)

Interest and other income (expense), net. Interest and other income (expense), net, for the years ended December 31, 2006 and 2005 was $20.7 million and $12.5 million, respectively. The increase in 2006 from 2005 was primarily attributable to the $6.2 million realized gain recorded from the sale of our investment in a publicly-held company in March 2006 and due to higher interest rates in 2006 offset by an impairment charge of $1.3 million recorded in June 2006 to reduce the carrying value of our investment in a privately-held investee. In 2005 we realized a $2.8 million gain from the sale of securities of a strategic investee.

Interest expense. Interest expense for the years ended December 31, 2006 and 2005 was $17.9 million and $16.1 million, respectively. The increase in 2006 from 2005 is primarily attributable to the accretion of $2.1 million of the discount related to the 3½% convertible senior notes due 2011 (the "3½% Senior Notes") issued in September 2006.

Gain (loss) on redemption/repurchase of convertible subordinated notes. In 2006 we redeemed $91.6 million principal amount and in 2005 we repurchased, on the open market, $36.5 million face value of our 5.5% convertible subordinated notes due 2007 (the "5.5% Notes"). The redemption and repurchase resulted in a gain (loss) of $(0.1) million and $0.5 million, respectively, for the years ended December 31, 2006 and 2005.

Provision (benefit) for income taxes. Due to our net losses in 2006 and 2005, we had a minimal effective annual income tax rate. The benefit for income taxes for 2005 is primarily attributable to foreign withholding taxes.

Gain from discontinued operation. The gain from discontinued operation of $0.3 million in 2005 represents the gain on sale of our Proteome facility based in Beverly, Massachusetts. In December 2004, we entered into an agreement to sell certain assets and liabilities related to our Proteome facility, which transaction subsequently closed in January 2005. The consolidated financial statements have been restated to present the operations of our Proteome facility as a discontinued operation for all periods presented.

Years Ended December 31, 2005 and 2004

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

Revenues

	For the Years Ended, December 31,	
	2005	2004
	(in millions)	
License and royalty revenues	$7.8	$14.1

Our revenues of $7.8 million and $14.1 million in 2005 and 2004, respectively were derived primarily from information products, which included database subscriptions, licensing of our intellectual property, and partner programs. The decrease in revenues from 2004 to 2005 was due primarily to the 2004 closure of our Palo Alto, California facility and the decision to discontinue offering information products.

For the years ended December 31, 2005 and 2004 revenues from companies considered to be related parties, as defined by SFAS 57 were $0.0 million and $1.1 million.

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

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

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

Operating Expenses

Research and development expenses

	For the Years Ended December 31,	
	2005	2004
	($ in millions)	
Salary and benefits related	$26.0	$28.6
Collaboration and outside services	49.0	30.6
Occupancy and all other costs	20.6	29.1
Total research and development expenses	$95.6	$88.3

The decrease in salary and benefits related costs from 2004 to 2005 is due primarily to a reduction in headcount. The number of employees engaged in research and development activities declined due to the closure of our Palo Alto facility in 2004 and the cessation of the development of the information products developed at this facility. We expect that there will be no further research and development related to our information business. The increase in collaboration and outside services from 2004 to 2005 is due primarily to our increased efforts in our drug discovery and development, the expansion of clinical trials for our compounds and additional preclinical expenditures for potential pharmaceutical candidates partially offset by reduced expenditures related to our information business. The decrease in occupancy and other costs from 2004 to 2005 is due primarily to the reduction in our facility costs resulting from the closure of our Palo Alto facility in 2004.

Selling, general and administrative expenses

	For the Years Ended December 31,	
	2005	2004
	($ in millions)	
Salary and benefits related	$ 6.9	$ 7.8
Stock compensation	0.2	0.5
Other contract services and outside costs	4.6	12.3
Total selling, general and administrative expenses	$11.7	$20.6

The decrease in salary and benefit related costs from 2004 to 2005 are due primarily to a reduction in headcount due to the closure of our Palo Alto facility. The decline in other contract and outside costs from 2004 to 2005 is due primarily to the closure of Palo Alto and the elimination of expenses through our restructuring programs.

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

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

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

market value. During 2004, we also recorded charges of $3.1 million related primarily to a reduction in estimated sublease income for a facility closed in connection with our 2002 restructuring program and a facility closed in connection with our acquisition of Maxia.

Other income (expense)

Interest and other income (expense), net. Interest and other income (expense), net, for the years ended December 31, 2005 and 2004 was $12.5 million and $3.6 million, respectively. The increase in 2005 from 2004 was primarily due to higher interest rates in 2005, a $2.8 million gain from the 2005 sale of securities of a strategic investee and a $5.2 million decline in long-term investment impairment charges from 2004 to 2005, partially offset by a lower average cash balance.

Interest expense. Interest expense for the years ended December 31, 2005 and 2004 was $16.1 million and $17.2 million, respectively. The decrease in 2005 from 2004 is related to lower interest expense associated with our 2005 repurchase of $36.5 million face value of our 5.5% convertible subordinated notes due 2007.

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

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

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

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

Recent Accounting Pronouncements

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109* ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not expect the adoption of FIN 48 to have a material impact on our consolidated financial statements.

In November 2005, the FASB issued staff position FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* ("FSP 115-1"). FSP 115-1 addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary and the measurement of an impairment loss. FSP 115-1 also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures

about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in FSP 115-1 amends FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and Accounting Principles Board ("APB") Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

FSP 115-1 replaces the impairment evaluation guidance of EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-1"), with references to existing other-than-temporary impairment guidance. EITF 03-1's disclosure requirements remain in effect, and are applicable for year-end reporting and for interim periods if there are significant changes from the previous year-end. FSP 115-1 also supersedes EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*, and clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. FSP 115-1 applies to reporting periods beginning after December 15, 2005. FSP 115-1 did not have a material impact on our results of operations or cash flows for the year ended December 31, 2006.

We adopted SFAS 123R effective January 1, 2006. SFAS 123R is a new and complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility, expected option lives, and expected option forfeiture rates, to value equity-based compensation. SFAS 123R requires the recognition of the fair value of stock compensation in the statement of operations.

Liquidity and Capital Resources

	2006	2005	2004
		(in millions)	
December 31:			
Cash, cash equivalents, and short-term and long-term marketable securities	$329.8	$ 345.0	$ 469.8
Working capital	$278.4	$ 326.1	$ 449.8
Year ended December 31:			
Cash provided by (used in):			
Operating activities	$ (50.4)	$ (101.9)	$ (114.7)
Investing activities	$ 26.0	$ 15.5	$ (77.2)
Financing activities	$ 31.7	$ (34.3)	$ 294.2
Capital expenditures (included in investing activities above)	$ 1.6	$ 1.6	$ 1.4

Sources and Uses of Cash. Due to our significant research and development expenditures, we have not been profitable and have generated operating losses since we were incorporated in 1991 through 1996 and in 1999 through 2006. As such, we have funded our research and development operations through sales of equity securities, the issuance of convertible subordinated notes, cash received from customers, and collaborative arrangements. As of December 31, 2006, approximately $11.2 million of marketable securities were classified as long-term assets on the condensed consolidated balance sheet as they had been in an unrealized loss position for longer than six months and we had the ability to hold them until the carrying value recovers, which may be longer than one year. At December 31, 2006, we had available cash, cash equivalents, and marketable securities of $329.8 million. Our cash and marketable securities balances are held in a variety of interest-bearing instruments including obligations of U.S. government agencies, high-grade corporate bonds, commercial paper and money market accounts. Available cash is invested in accordance with our investment policy's primary objectives of liquidity, safety of principal and diversity of investments.

Cash Flows from Operating Activities. Net cash used in operating activities was $50.4 million, $101.9 million and $114.7 million for the years ended December 31, 2006, 2005 and 2004, respectively. The $51.5 million decrease from 2005 to 2006 was due primarily to the $40.0 million upfront fee received from Pfizer in January 2006. The $12.8 million decrease from 2004 to 2005 was due primarily to a decrease of $21.4 million used to fund restructuring expenses and $1.2 million decrease used to fund interest expense. These items were partially offset by a $7.1 million reduction in cash received from customer sales and an increase of $6.0 million used to fund research and development and selling, general, and administrative expenses.

Cash Flows from Investing Activities. Our investing activities, other than purchases, sales and maturities of marketable securities, have consisted predominantly of capital expenditures and sales and purchases of long-term investments. Capital expenditures for the years ended December 31, 2006, 2005 and 2004, were $1.6 million, $1.6 million and $1.4 million, respectively. In the future, net cash used by investing activities may fluctuate significantly from period to period due to the timing of strategic equity investments, acquisitions, including possible earn-out payments to former Maxia stockholders, capital expenditures and maturities/sales and purchases of marketable securities.

Cash Flows from Financing Activities. Net cash provided by financing activities was $31.7 million for the year ended December 31, 2006, while net cash used in financing activities was $34.3 million for the year ended December 31, 2005, and net cash provided by financing activities was $294.2 million for the year ended December 31, 2004. During 2006, we issued a total of $151.8 million of 3½% Senior Notes, which resulted in proceeds of approximately $111.9 million and redeemed $91.6 million of the 5.5% Notes. In connection with the collaborative research and license agreement, Pfizer purchased the $10.0 million Pfizer Note in February 2006. During 2005, we paid $35.8 million in connection with repurchases of $36.5 million in face value of the 5.5% Notes, offset partially by $1.5 million of proceeds from issuance of common stock under our stock plans and employee stock purchase plan. During 2004, we issued a total of $250.0 million of 3½% convertible subordinated notes due 2011 (the "3½% Subordinated Notes"), which resulted in net proceeds of approximately $242.5 million. In 2004, we also repurchased $38.4 million face value of 5.5% Notes on the open market for $38.4 million. In November 2004, we completed a public offering of 9 million shares of common stock, resulting in net proceeds of $83.3 million after deducting the underwriting discounts, commissions and offering expenses. Cash proceeds from the issuance of common stock under our stock option and employee stock purchase plans in 2004 were $6.8 million. We may seek to restructure some or all of our outstanding convertible debt instruments in the future depending upon market and other conditions.

The following summarizes our significant contractual obligations as of December 31, 2006 and the effect those obligations are expected to have on our liquidity and cash flow in future periods (in millions):

	Total	Less Than 1 Year	Years 1 – 3	Years 4 – 5	Over 5 Years
Contractual Obligations:					
Principal on convertible subordinated debt	$260.0	$ —	$ —	$250.0	$10.0
Principal on convertible senior debt	151.8	—	—	151.8	—
Interest on convertible subordinated debt	39.4	8.8	17.5	13.1	—
Interest on convertible senior debt	23.9	5.3	10.6	8.0	—
Non-cancelable operating lease obligations:					
Related to current operations	6.8	4.5	2.2	—	—
Related to vacated space	33.7	8.2	16.3	9.3	—
Total contractual obligations	$515.6	$26.8	$46.6	$432.2	$10.0

The amounts and timing of payments related to vacated facilities may vary based on negotiated timing of lease terminations. We have entered into sublease agreements for our vacated space with scheduled

payments to us of $2.1 million (less than 1 year), $4.1 million (years 1-3), $2.0 million (years 4-5), and $0.0 million (over 5 years); these scheduled payments are not reflected in the above table.

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

Commitments related to Maxia are considered contingent commitments as future events must occur to cause these commitments to be enforceable. In February 2003, we completed our acquisition of Maxia. Under the merger agreement, former Maxia stockholders have the right to receive certain earn out amounts of up to a potential aggregate amount of $14.0 million upon the occurrence of certain research and development milestones set forth in the merger agreement. Twenty percent of each earn out payment, if earned, will be paid in cash and the remaining eighty percent will be paid in shares of our common stock such that an aggregate of $2.8 million in cash and $11.2 million in our common stock (based upon the then fair value) could potentially be paid pursuant to the earn out milestones. The milestones are set to occur as Maxia products enter various stages of human clinical trials and may be earned at any time prior to the tenth anniversary of the consummation of the merger. In any event, no more than 13,531,138 shares of our common stock may be issued to former Maxia stockholders in the aggregate pursuant to the merger agreement. None of these milestones has been achieved as of December 31, 2006.

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

We expect to use net cash in 2007 as we invest in our drug discovery and development programs; make payments related to our restructuring programs; and continue to seek access to technologies through investments, research and development and new alliances, license agreements and/or acquisitions.

We believe that our cash, cash equivalents and marketable securities will be adequate to satisfy our capital needs for at least the next twelve months. Our cash requirements depend on numerous factors, including our expenditures in connection with alliances, license agreements and acquisitions of and investments in complementary products, technologies and businesses; expenditures in connection with potential repayments of our 3½% Senior Notes, 3½% Subordinated Notes, and the Pfizer Note; expenditures in connection with our drug discovery and development programs; expenditures in connection with litigation; competing technological and market developments; the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights; our receipt of any milestone or other payments under any collaborative agreements we may enter into, including the agreement with Pfizer; and costs associated with the integration of new operations assumed through mergers and acquisitions. Changes in our research and development plans or other changes affecting our operating expenses may result in changes in the timing and amount of expenditures of our capital resources. We expect that future revenues generated from information products, including licensing of intellectual property, will continue to decline as we focus on drug discovery and development programs, and in 2007, will not represent a significant source of cash inflow for us.

Off Balance Sheet Arrangements

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

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

Our investments in marketable securities, which are composed primarily of investment-grade corporate bonds, U.S. government agency debt securities and mortgage and asset-backed securities, are subject to default, changes in credit rating and changes in market value. These investments are also subject to interest rate risk and will decrease in value if market interest rates increase. As of December 31, 2006, cash, cash equivalents and marketable securities were $329.8 million. Due to the nature of these investments, if market interest rates were to increase immediately and uniformly by 10% from levels as of December 31, 2006, the decline in fair value would not be material.

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

INDEX

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Incyte Corporation

We have audited the accompanying consolidated balance sheets of Incyte Corporation, as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive loss, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2006. Our audits also included the financial statement schedule listed in the Index at item 15 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Incyte Corporation, at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, Incyte Corporation changed its method of accounting for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) on January 1, 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Incyte Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
February 22, 2007

INCYTE CORPORATION

CONSOLIDATED BALANCE SHEETS

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

	December 31, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,861	$ 11,494
Marketable securities—available-for-sale	299,712	333,477
Accounts receivable, net	2,073	1,423
Prepaid expenses and other current assets	7,115	7,582
Total current assets	327,761	353,976
Marketable securities—available-for-sale	11,237	—
Property and equipment, net	5,890	7,667
Long-term investments(1)	—	1,312
Intangible and other assets, net	8,715	11,153
Total assets	$ 353,603	$ 374,108
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 5,916	$ 3,573
Accrued compensation	6,879	7,590
Interest payable	4,668	5,382
Accrued and other current liabilities	4,024	5,124
Deferred revenue	22,883	604
Accrued restructuring	4,970	5,584
Total current liabilities	49,340	27,857
Convertible senior notes	113,981	—
Convertible subordinated notes	257,122	341,862
Deferred revenue	348	—
Other liabilities	17,720	23,786
Total liabilities	438,511	393,505
Stockholders' deficit:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; none issued and outstanding as of December 31, 2006 and 2005	—	—
Common stock, $0.001 par value; 200,000,000 shares authorized; 83,972,726 and 83,597,080 shares issued and outstanding as of December 31, 2006 and 2005, respectively	84	84
Additional paid-in capital	828,936	818,638
Accumulated other comprehensive income (loss)	(415)	1,228
Accumulated deficit	(913,513)	(839,347)
Total stockholders' deficit	(84,908)	(19,397)
Total liabilities and stockholders' deficit	$ 353,603	$ 374,108

(1) Includes investments in companies considered related parties under SFAS 57 of $1.3 million as of December 31, 2005.

See accompanying notes.

INCYTE CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Year Ended December 31,		
	2006	2005	2004
Revenues:			
Contract revenues	$ 24,226	$ —	$ —
License and royalty revenues(1)	3,417	7,846	14,146
Total revenues	27,643	7,846	14,146
Costs and expenses:			
Research and development(2)	87,596	95,618	88,271
Selling, general and administrative(3)	14,027	11,656	20,551
Other expenses(4)	2,884	1,356	54,177
Total costs and expenses	104,507	108,630	162,999
Loss from operations	(76,864)	(100,784)	(148,853)
Interest and other income (expense), net(5)	20,679	12,527	3,563
Interest expense	(17,911)	(16,052)	(17,241)
Gain (loss) on certain derivative financial instruments	—	(106)	(454)
Gain (loss) on redemption/repurchase of convertible subordinated notes(6)	(70)	506	(226)
Loss from continuing operations before income taxes	(74,166)	(103,909)	(163,211)
Provision (benefit) for income taxes	—	(552)	453
Loss from continuing operations	(74,166)	(103,357)	(163,664)
Gain (loss) from discontinued operation, net of tax	—	314	(1,153)
Net loss	$ (74,166)	$ (103,043)	$ (164,817)
Basic and diluted per share data:			
Continuing operations	$ (0.89)	$ (1.24)	$ (2.19)
Discontinued operation	—	—	(0.02)
	$ (0.89)	$ (1.24)	$ (2.21)
Shares used in computing basic and diluted net loss per share	83,799	83,321	74,555

(1) Includes revenues from transactions with companies considered related parties under SFAS 57 of $0.3 million, $0.0 million and $1.1 million for the years ended December 31, 2006, 2005 and 2004, respectively.

(2) Includes expenses from transactions with companies considered related parties under SFAS 57 of $0.0 million, $0.1 million and $0.3 million for the years ended December 31, 2006, 2005 and 2004, respectively. Also includes stock-based compensation charges of $5.7 million in 2006.

(3) Includes stock-based compensation charges of $3.2 million, $0.2 million and $0.5 million in 2006, 2005 and 2004.

(4) 2006 charges relate to $3.4 million settlement fee paid to Invitrogen and restructuring charges. 2005 charges are related to restructuring charges. 2004 charges are related to restructuring charges and an impairment of a long-lived asset.

(5) Includes a gain on the sale of securities of $6.2 million and $2.8 million for the years ended December 31, 2006 and 2005, respectively, and losses on long-term investments in companies considered related parties under SFAS 57 of $1.3 million and $4.4 million for the years ended December 31, 2006 and 2004, respectively.

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

See accompanying notes.

INCYTE CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(in thousands)

	Year Ended December 31,		
	2006	2005	2004
Net loss	$(74,166)	$(103,043)	$(164,817)
Other comprehensive gain (loss):			
Unrealized gains (losses) on marketable securities	1,428	3,776	(1,022)
Reclassification adjustment for realized gains (losses) on marketable securities	(3,071)	(1,281)	(709)
Foreign currency translation adjustment	—	959	71
Other comprehensive gain (loss)	(1,643)	3,454	(1,660)
Comprehensive loss	$(75,809)	$ (99,589)	$(166,477)

See accompanying notes.

INCYTE CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

(in thousands, except number of shares)

	Common Stock	Additional Paid-in Capital	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Stockholders' Equity (Deficit)
Balances at December 31, 2003	$73	$726,962	$(649)	$ (566)	$(571,487)	$ 154,333
Issuance of 987,911 shares of Common Stock upon exercise of stock options and 448,861 shares of Common Stock under the ESPP	1	6,830	—	—	—	6,831
Issuance of 9,000,000 shares of Common Stock, net of offering costs.	9	83,310	—	—	—	83,319
Stock compensation expense	—	48	—	—	—	48
Amortization of deferred compensation	—	—	463	—	—	463
Other comprehensive loss	—	—	—	(1,660)	—	(1,660)
Net loss	—	—	—	—	(164,817)	(164,817)
Balances at December 31, 2004	$83	$817,150	$(186)	$(2,226)	$(736,304)	$ 78,517
Issuance of 184,865 shares of Common Stock upon exercise of stock options and 389,801 shares of Common Stock under the ESPP	1	1,488	—	—	—	1,489
Amortization of deferred compensation	—	—	186	—	—	186
Other comprehensive gain	—	—	—	3,454	—	3,454
Net loss	—	—	—	—	(103,043)	(103,043)
Balances at December 31, 2005	$84	$818,638	$ —	$ 1,228	$(839,347)	$ (19,397)
Issuance of 61,931 shares of Common Stock upon exercise of stock options and 313,715 shares of Common Stock under the ESPP	—	1,408	—	—	—	1,408
Stock compensation expense	—	8,890	—	—	—	8,890
Other comprehensive loss	—	—	—	(1,643)	—	(1,643)
Net loss	—	—	—	—	(74,166)	(74,166)
Balances at December 31, 2006	$84	$828,936	$ —	$ (415)	$(913,513)	$ (84,908)

See accompanying notes.

INCYTE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year Ended December 31,		
	2006	2005	2004
Cash flows from operating activities:			
Net loss	$ (74,166)	$ (103,043)	$ (164,817)
Adjustments to reconcile net loss to net cash used in operating activities:			
Loss (gain) from discontinued operations	—	(314)	1,153
Non-cash restructuring charges and impairment of long-lived assets	(552)	2,324	32,825
Depreciation and amortization	7,411	8,192	13,913
Stock-based compensation	8,890	186	463
Loss (gain) on repurchase of convertible subordinated notes	(70)	(506)	226
Compensation expense on executive loans	18	75	75
Loss (gain) on derivative financial instruments, net	—	106	454
Impairment of long-term investments	1,312	—	5,247
Realized gain on long-term investments, net	(6,230)	(2,791)	(123)
Changes in operating assets and liabilities:			
Accounts receivable	(650)	721	3,085
Prepaid expenses and other assets	586	2	513
Accounts payable	2,343	1,252	(4,151)
Accrued and other liabilities	(8,653)	(6,849)	(404)
Deferred revenue	19,394	(1,203)	(2,728)
Net cash used in continuing operating activities	(50,367)	(101,848)	(114,269)
Net cash used in discontinued activities	—	(24)	(398)
Net cash used in operating activities	(50,367)	(101,872)	(114,667)
Cash flows from investing activities:			
Capital expenditures	(1,568)	(1,633)	(1,391)
Proceeds from the sale of long-term investments	—	—	123
Proceeds from the sale of equipment	—	59	1,628
Purchases of marketable securities	(511,408)	(348,540)	(830,494)
Sales of marketable securities	109,971	134,327	378,911
Maturities of marketable securities	429,040	231,315	374,151
Investing activities of discontinued operations	—	—	(88)
Net cash provided by (used in) investing activities	26,035	15,528	(77,160)
Cash flows from financing activities:			
Proceeds from issuance of common stock under stock plans	1,408	1,489	6,831
Redemption/repurchase of convertible subordinated notes	(91,614)	(35,837)	(38,412)
Net proceeds from issuance of convertible senior and subordinated notes	121,905	—	242,500
Net proceeds from issuance of common stock	—	—	83,319
Net cash provided by (used in) financing activities	31,699	(34,348)	294,238
Effect of exchange rate on cash and cash equivalents	—	6	71
Net increase (decrease) in cash and cash equivalents	7,367	(120,686)	102,482
Cash and cash equivalents at beginning of year	11,494	132,180	29,698
Cash and cash equivalents at end of year	$ 18,861	$ 11,494	$ 132,180
Supplemental Schedule of Cash Flow Information			
Interest paid	$ 14,839	$ 15,467	$ 13,554
Taxes paid	$ —	$ 24	$ 175

See accompanying notes.

INCYTE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Organization and Summary of Significant Accounting Policies

Organization and Business. Incyte Corporation ("Incyte," "we," "us," or "our") is a drug discovery and development company focused on developing proprietary small molecule drugs to treat serious unmet medical needs. We have a pipeline with programs in HIV, diabetes, oncology and inflammation.

We were founded and incorporated in Delaware in 1991. Until 2001, we devoted substantially all of our resources to the development, marketing and sales of information and genomic products. We began our drug discovery and development activities in early 2002.

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

Reclassifications. Certain amounts reported in previous years have been reclassified to conform to the 2006 financial statement presentation.

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

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

Concentrations of Credit Risk. Cash, cash equivalents, marketable securities, trade receivables, and long-term strategic investments are financial instruments which potentially subject us to concentrations of credit risk. The estimated fair value of financial instruments approximates the carrying value based on available market information. We primarily invest our excess available funds in notes and bills issued by the U.S. government and its agencies and corporate debt securities and, by policy, limit the amount of credit exposure to any one issuer and to any one type of investment, other than securities issued or guaranteed by the U.S. government. Our customers for our information products are primarily pharmaceutical and biotechnology companies which are typically located in the United States and Europe. We have not experienced any significant credit losses on cash, cash equivalents, marketable securities or trade receivables to date and do not require collateral on receivables.

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

Marketable Securities—Available-for-Sale. All marketable securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, based on quoted market prices, with unrealized gains and losses, net of tax, reported as a separate component of stockholders' equity (deficit). We classify marketable securities available to fund current operations as current assets on the consolidated balance sheet. Marketable securities are classified as long-term assets on the consolidated balance sheets if (i) they

have been in an unrealized loss position for longer than six months and (ii) we have the ability to hold them until the carrying value is recovered and such holding period may be longer than one year. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretions of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other than temporary for available-for-sale securities are included in "Interest and other income (expense), net." The cost of securities sold is based on the specific identification method.

Accounts Receivable. Accounts receivable as of December 31, 2006 and 2005 were net of an allowance for doubtful accounts of $0.0 million and $0.2 million, respectively. We provide an allowance for doubtful accounts based on experience and specifically identified risks. Accounts receivable are carried at fair value and charged off against the allowance for doubtful accounts when we determine that recovery is unlikely and we cease collection efforts.

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

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

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

Long-Term Investments. We have made equity and debt investments in a number of companies whose businesses may be complementary to our business. Most of these investments were made in connection with the establishment of a collaborative arrangement between us and the investee company. Our long-term investments have historically consisted of investments in both privately and publicly-held companies in which we have owned less than 20% of the outstanding voting stock and have not had the ability to exert significant influence over the investees. Accordingly, our long-term investments in privately-held companies have been accounted for under the cost method and our investments in publicly-held companies have been accounted for in accordance with Financial Accounting Standards Board ("FASB") Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Our investments in publicly-held companies are classified as available-for-sale and are adjusted to their fair value each period

based on their quoted market price with any adjustments being recorded in accumulated other comprehensive income (loss) as a separate component of stockholders' equity (deficit).

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

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

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

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

Intangible and Other Assets. Patent application costs relating to ongoing drug discovery and development are charged to expense as incurred. In prior years, costs of patents, patent applications and patent defense for gene and genomic patents were capitalized and amortized on a straight-line basis over their estimated useful lives of approximately five years in accordance with the provisions of Accounting Principles Board Opinion No. 17, *Intangible Assets* ("APB 17").

Income Taxes. Income taxes are accounted for using SFAS No. 109 "Accounting for Income Taxes." Deferred income taxes are provided at the currently enacted income tax rates for the difference between the financial statement and income tax basis of assets and liabilities and carry-forward items. The effective tax rate and the tax basis of assets and liabilities reflect management's estimates of the ultimate outcome of various tax audits and issues. In addition, valuation allowances are established for deferred tax assets

where the amount of expected future taxable income from operations does not support the realization of the asset. We believe that the current assumptions and other considerations used to estimate the current year effective and deferred tax positions are appropriate. However, if the actual outcome of future tax consequences differs from our estimates and assumptions, the resulting change to the provision for income taxes could have a material impact on our consolidated financial statements.

Financing Costs Related to Long-term Debt. Costs associated with obtaining long-term debt are deferred and amortized over the term of the related debt using the effective interest method.

Net Income (Loss) Per Share. We follow the provisions of SFAS No. 128, *Earnings Per Share,* which requires us to present basic and diluted earnings per share. Our basic and diluted losses per share are calculated by dividing the net loss by the weighted average number of shares of common stock outstanding during all periods presented. Options to purchase stock and convertible debt are included in diluted earnings per share calculations, unless the effects are anti-dilutive.

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

	December 31,	
	2006	2005
	(in thousands)	
Unrealized gains (losses) on marketable securities	$(408)	$1,235
Cumulative translation adjustment	(7)	(7)
	$(415)	$1,228

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

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

Under agreements involving multiple products, services and/or rights to use assets, the multiple elements are divided into separate units of accounting when certain criteria are met, including whether the delivered items have stand alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered items. When separate units of accounting exist, consideration is allocated among the separate elements based on their respective fair values. The determination of fair value of each element is based on objective evidence from historical sales of the individual elements by us

to other customers. If such evidence of fair value for each undelivered element of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value for each undelivered element does exist or until all elements of the arrangement are delivered. When elements are specifically tied to a separate earnings process, revenue is recognized when the specific performance obligation tied to the element is completed. When revenues for an element are not specifically tied to a separate earnings process, they are recognized ratably over the term of the agreement.

In connection with our collaborative research and license agreement with Pfizer Inc. ("Pfizer"), we received an upfront non-refundable payment of $40.0 million in January 2006. The $40.0 million upfront fee was recorded as deferred revenue and is being recognized on a straight-line basis over two years, our estimated performance period under the agreement. Pfizer also purchased a $10.0 million principal amount convertible subordinated note (the "Pfizer Note") for $10.0 million from us in February 2006. As the Pfizer Note is non-interest bearing, it has been discounted to its net present value. The difference between the cash received and the present value of the Pfizer Note in the amount of $3.2 million represents additional consideration from Pfizer under the agreement. We have accounted for this additional consideration as deferred revenue and will recognize it over two years, our estimated performance period under the agreement. We recognize contract revenues in connection with research services provided to Pfizer as earned. Future development and milestone payments will be recognized as earned.

Revenues received from agreements with customers in which we have an equity interest were $0.0 million, $0.0 million and $1.1 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Revenues recognized from transactions in which there was originally a concurrent commitment to purchase goods or services from the other party to the transaction for the years ended December 31, 2006, 2005 and 2004 were $0.0 million, $0.0 million and $1.5 million, respectively. No new transactions in which there was a concurrent commitment by us to purchase goods or services from the other party to the transaction were entered into during the year ended December 31, 2006. Of commitments made in prior periods, we expensed $0.0 million, $0.0 million and $7.5 million for the years ended December 2006, 2005 and 2004, respectively.

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

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

These CRO contracts typically call for payment of fees for services at the initiation of the contract and/or upon the achievement of certain clinical trial milestones. In the event that we prepay CRO fees for future milestones, we record the prepayment as a prepaid asset and amortize the asset into research and development expense over the period of time the contracted research and development services are

performed. Most professional fees, including project and clinical management, data management, monitoring, and medical writing fees are incurred throughout the contract period. These professional fees are expensed based on their percentage of completion at a particular date.

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

Other Expenses. We recognize other expenses in connection with our plans to exit certain activities. In connection with our exit activities, we record other expenses for employee termination benefit costs, long-lived asset impairments, costs related to leased facilities to be abandoned or subleased, and other exit-related costs. These charges were incurred pursuant to formal plans developed by management and accounted for in accordance with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, ("SFAS 146"), EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)* ("EITF 94-3") and EITF Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination* ("EITF 95-3"). Fixed assets that are written off or impaired as a result of restructuring plans are typically held for sale or scrapped. The remaining carrying value of such assets was not material as of December 31, 2006 and 2005. The recognition of other expenses requires our management to make judgments and estimates regarding the nature, timing, and amount of costs associated with the planned exit activity, including estimating sublease income and the fair value, less sales costs, of equipment to be disposed of. Management's estimates of future liabilities may change, requiring us to record additional restructuring charges or reduce the amount of liabilities already recorded. At the end of each reporting period, we evaluate the remaining accrued balances to ensure that they are adequate, that no excess accruals are retained, and that the utilization of the provisions are for their intended purposes in accordance with developed exit plans.

Stock-Based Compensation. Effective January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004) ("SFAS 123R"), *Share-Based Payment*, which revised Statement of Financial Accounting Standards 123 ("SFAS 123"), *Accounting for Stock-Based Compensation*. SFAS 123R requires all share-based payment transactions with employees, including grants of employee stock options, to be recognized as compensation expense over the requisite service period based on their relative fair values. SFAS 123R is a new and complex accounting standard, the application of which requires significant judgment and the use of estimates, particularly surrounding Black-Scholes assumptions such as stock price volatility and expected option lives, as well as expected option forfeiture rates, to value equity-based compensation. SFAS 123R requires the recognition of the fair value of stock compensation in the statement of operations. Prior to the adoption of SFAS 123R, stock-based compensation expense related to employee stock options was not recognized in the statement of operations. Prior to January 1, 2006, we had adopted the disclosure-only provisions under SFAS 123. Under the provisions of SFAS 123R, we recorded $8.9 million of stock compensation expense on our audited consolidated statement of operations for the year ended December 31, 2006. As a result of adopting SFAS 123R, our net loss for the year ended December 31, 2006, is $8.9 million higher than if we had continued to account for share-based compensation under Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees.* Basic and diluted net loss per share for the year ended December 31, 2006 are $0.11 higher than if we had continued to account for share-based

compensation under APB Opinion No. 25. For the years ended December 31, 2005 and 2004 we recorded stock compensation expense of $0.2 million and $0.5 million, respectively on our audited consolidated statement of operations related to restricted shares issued to our Chief Executive Officer.

Recent Accounting Pronouncements. In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109*, ("FIN 48"). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not expect the adoption of FIN 48 to have a material impact on our consolidated financial statements.

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

FSP 115-1 replaces the impairment evaluation guidance of EITF Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments* ("EITF 03-1"), with references to existing other-than-temporary impairment guidance. EITF 03-1's disclosure requirements remain in effect, and are applicable for year-end reporting and for interim periods if there are significant changes from the previous year-end. FSP 115-1 also supersedes EITF Topic No. D-44, *Recognition of Other-Than-Temporary Impairment upon the Planned Sale of a Security Whose Cost Exceeds Fair Value*, and clarifies that an investor should recognize an impairment loss no later than when the impairment is deemed other-than-temporary, even if a decision to sell an impaired security has not been made. FSP 115-1 applies to reporting periods beginning after December 15, 2005. FSP 115-1 did not have a material impact on our results of operations, or cash flows for the year ended December 31, 2006.

Note 2. Marketable Securities

The following is a summary of our marketable security portfolio as of December 31, 2006 and 2005, respectively.

	Amortized Cost	Net Unrealized Gains	Net Unrealized Losses	Estimated Fair Value
		(in thousands)		
December 31, 2006				
Debt securities fund	$ 30,662	$ —	$ —	$ 30,662
U.S. Treasury notes	34,743	4	(174)	34,573
U.S. government and agency securities	5,750	—	—	5,750
Mortgage backed securities	46,120	15	(212)	45,923
Corporate debt securities	194,082	181	(222)	194,041
	$311,357	$ 200	$ (608)	$310,949
December 31, 2005				
Equity securities	$ 11,000	$3,072	$ —	$ 14,072
Money markets with maturities over 90 days	11,585	—	(35)	11,550
U.S. Treasury notes	55,338	—	(339)	54,999
U.S. government and agency securities	2,400	—	(5)	2,395
Mortgage backed securities	56,982	—	(489)	56,493
Corporate debt securities	194,938	—	(970)	193,968
	$332,243	$3,072	$(1,838)	$333,477

The debt securities fund is a third party managed investment portfolio that invests primarily in U.S. Treasury notes, U.S. government and agency securities, mortgage backed securities, and corporate debt securities.

As of December 31, 2006, our marketable securities, excluding equity securities, had the following maturities:

	Amortized Cost	Estimated Fair Value
	(in thousands)	
Less than one year	$ 94,288	$ 94,106
Between one and two years	47,383	47,376
Between two and five years	2,124	2,128
	143,795	143,610
Mortgage and asset-backed securities	167,562	167,339
Total	$311,357	$310,949

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

Our net unrealized losses and fair value of investments with net unrealized losses were as follows:

	December 31, 2006					
	Loss Position For Less Than Twelve Months		Loss Position For Greater Than Twelve Months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury notes and other U.S. government and agency securities	$10,492	$(19)	$21,953	$(155)	$ 32,445	$(174)
Mortgage backed securities	7,139	(13)	17,437	(199)	24,576	(212)
Corporate debt securities	26,371	(34)	2,881	(10)	29,252	(44)
Asset-backed securities	10,856	(7)	39,378	(171)	50,234	(178)
Total—Marketable securities	$54,858	$(73)	$81,649	$(535)	$136,507	$(608)

As of December 31, 2006, approximately $11.2 million of marketable securities were classified as long-term assets on the consolidated balance sheet as they have been in an unrealized loss position for longer than six months and we have the ability to hold them until the carrying value recovers, which may be longer than one year. As of December 31, 2005 all of our marketable securities were classified as short-term because they were available-for-sale and may not be held until maturity as we had not yet adopted FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments* ("FSP 115-1").

Net realized gains (losses) of $6.1 million, $1.3 million and $(0.7) million from sales of marketable securities were included in "Interest and other income/ (expense), net" in 2006, 2005 and 2004, respectively.

Note 3. Concentrations of Credit Risk

As of December 31, 2006, we previously had entered into agreements for information products and services, which include licensing a portion of our intellectual property, with pharmaceutical, biotechnology and agricultural companies and academic institutions. Such agreements represented 100% of license and royalty revenues in 2006, 2005 and 2004. In general, customers agree to pay, during the term of the agreement, fees to receive non-exclusive access to selected modules of our databases and/or licenses of certain of our intellectual property. In addition, if a customer develops certain products utilizing our technology or proprietary information, we could potentially receive royalty and milestone payments. In November 2005, we entered into a collaborative research and license agreement with Pfizer, which became effective in January 2006.

A single customer contributed 88%, 21% and 11% of total revenues for the years ended December 31, 2006, 2005 and 2004, respectively.

Three customers comprised 78% and 67% of the accounts receivable balance as of December 31, 2006 and 2005, respectively.

Note 4. Collaborative License Agreement

Effective in January 2006, we entered a collaborative research and license agreement with Pfizer for the pursuit of our CCR2 antagonist program. Pfizer gained worldwide development and commercialization

rights to our portfolio of CCR2 antagonist compounds. Pfizer's rights extend to the full scope of potential indications, with the exception of multiple sclerosis and autoimmune nephritides, where we retained worldwide rights, along with certain compounds. We do not have obligations to Pfizer on pre-clinical development candidates we select for pursuit in these indications.

We received an upfront nonrefundable payment of $40.0 million in January 2006 and are eligible to receive additional future development and milestone payments of up to $743.0 million for the successful development and commercialization of CCR2 antagonists in multiple indications, as well as royalties on worldwide sales. The $40.0 million upfront fee was recorded as deferred revenue and is being recognized on a straight-line basis over two years, our estimated performance period under the agreement. Contract revenues related thereto of approximately $20.3 million were recognized for the year ended December 31, 2006. Future development and milestone payments will be recognized as earned.

We also recognized contract revenues of approximately $2.4 million for the year ended December 31, 2006 in connection with research services provided to Pfizer. We recognize contract revenues in connection with research services provided to Pfizer as earned. At December 31, 2006 approximately $0.7 million was receivable from Pfizer for reimbursement of expenses incurred by us pursuant to the agreement.

Note 5. Property and Equipment

Property and equipment consists of the following:

	December 31,	
	2006	2005
	(in thousands)	
Office equipment	$ 571	$ 563
Laboratory equipment	13,108	12,379
Computer equipment	9,153	8,364
Leasehold improvements	2,016	2,016
	24,848	23,322
Less accumulated depreciation and amortization	(18,958)	(15,655)
	$ 5,890	$ 7,667

Depreciation expense, including amortization expense of assets leasehold improvements, was $3.3 million, $3.9 million and $5.8 million for 2006, 2005 and 2004, respectively.

Note 6. Long-Term Investments

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

In June 2006, we recorded an impairment charge of $1.3 million to reduce the carrying value of our investment in a privately-held investee because the investee had less than six months of cash and we believed that the likelihood of obtaining future debt or equity financing that would not result in an impairment was remote.

In March 2006, we sold a portion of our investment in a publicly-held company accounted for under FASB Statement No.115, *Accounting for Certain Investments in Debt and Equity Securities*, for $11.5 million, and in October 2006, we sold the remaining portion of this investment for $5.8 million, which resulted in a aggregate realized gain of $6.2 million for the year ended December 31, 2006.

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

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

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

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

Note 7. Intangible and Other Assets

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

	December 31, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net	Gross Carrying Amount	Accumulated Amortization	Intangible Assets, Net
Gene and genomics-related patent costs	$ 1,381	$ (651)	$ 730	$ 1,381	$ (325)	$ 1,056
Debt issuance cost	8,529	(3,377)	5,152	13,222	(6,724)	6,498
Other assets	4,000	(1,167)	2,833	4,457	(858)	3,599
Total intangible and other assets	$13,910	$(5,195)	$8,715	$19,060	$(7,907)	$11,153

Amortization expense for the years ended December 31, 2006, 2005 and 2004 related to intangible assets was $2.3 million, $2.7 million and $5.0 million, respectively. The expected future annual amortization expense of our gene and genomics-related patent costs is $0.3 million per year through 2008.

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

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

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

In December 2004, we assigned one of our existing facility operating leases to a third party. Under the terms of the consent agreement with the facility's landlord, we were required to obtain a letter of credit in favor of the landlord in the amount of $2.6 million. The deposit and the related amount required under the letter of credit declines monthly on a pro-rata basis through March 2011, the remaining term of the lease agreement assigned. The deposit is included in other assets at December 31, 2006.

Note 8. Convertible Notes

The components of the Notes are as follows:

Debt	December 31, 2006 Interest Rates	Maturities	December 31, Carrying Amount 2006	2005
5.5% Convertible Subordinated Notes due 2007	—	—	$ —	$ 91,862
3½% Convertible Senior Notes due 2011	3.5%	2011	113,981	—
3½% Convertible Subordinated Notes due 2011	3.5%	2011	250,000	250,000
Pfizer Convertible Subordinated Note due 2013	0.0%	2013	7,122	—
Less current portion			—	—
			$371,103	$341,862

Annual maturities of all Notes are as follows:

2007	$ —
2008	—
2009	—
2010	—
2011	401,800
Thereafter	10,000
	$411,800

The carrying amount and fair value of the our Notes are as follows:

	December 31, 2006 Carrying Amount	2006 Fair Value	2005 Carrying Amount	2005 Fair Value
5.5% Convertible Subordinated Notes due 2007 ...	$ —	$ —	$ 91,862	$ 91,058
3½% Convertible Senior Notes due 2011	113,981	126,563	—	—
3½% Convertible Subordinated Notes due 2011 ...	250,000	200,625	250,000	194,375
Pfizer Convertible Subordinated Note due 2013 ...	7,122	7,122	—	—
	$371,103	$334,310	$341,862	$285,433

In September 2006, we received proceeds of $111.9 million from the sale of $151.8 million aggregate principal amount of the 3½% convertible senior notes due 2011 (the "3½% Senior Notes"). The 3½% Senior Notes bear interest at the rate of 3.5% per year, payable semi-annually on February 15 and August 15, and are due February 15, 2011. The 3½% Senior Notes are convertible into shares of Incyte common stock at an initial conversion rate of 89.1385 shares per $1,000 principal amount of the 3½% Senior Notes, equivalent to an initial conversion price of approximately $11.22 per share. The 3½% Senior Notes are senior in right of payment to Incyte's outstanding 3½% convertible subordinated notes due 2011 (the "3½% Subordinated Notes") and the Pfizer Note. We may redeem the 3½% Senior Notes beginning on February 20, 2007. The 3½% Senior Notes were issued at a discount to par of approximately $39.9 million. The carrying value of the 3½% Senior Notes is $114.0 million at

December 31, 2006. The 3½% Senior Notes will accrete up to their face value over the 53 month term of the notes by recording interest expense under the effective interest method.

In connection with the collaborative research and license agreement, Pfizer purchased the $10.0 million principal amount Pfizer Note in February 2006. At our option, prior to September 28, 2007, once we are able to initiate Phase I clinical trials of a CCR2 antagonist in a retained Incyte indication, Pfizer may purchase from us an additional $10.0 million convertible subordinated note. The Pfizer Note purchased in February 2006 bears no interest, is due seven years from the date of issuance and is convertible into our common stock at an initial conversion price of $6.8423 per share, subject to adjustments. The Pfizer Note is subordinated to all senior indebtedness, including the 3½% Senior Notes, and pari passu in right of payment with our 3½% Subordinated Notes. We may, at our option, repay the Pfizer Note beginning February 3, 2009. Pfizer may require us to repay the Pfizer Note upon a change of control, as defined. As the Pfizer Note is non interest bearing, it has been discounted to its net present value of $6.8 million by imputing interest at a rate of 4.5%, which represented market conditions in place at the time the note was issued. The carrying value of the Pfizer Note was $7.1 million at December 31, 2006. We will accrete the Pfizer Note up to its face value over its term of seven years by recording interest expense under the effective interest method. The difference between the cash received and the present value of the Pfizer Note, which equals the face value less the non interest bearing portion and beneficial conversion feature, represents additional consideration from Pfizer under the agreement. We have accounted for this additional consideration as deferred revenue and will recognize it over two years, our estimated performance period under the agreement. Contract revenues related thereto of approximately $1.5 million were recognized for the year ended December 31, 2006.

In February and March 2004, in a private placement, we issued a total of $250.0 million of the 3½% Subordinated Notes, which resulted in net proceeds of approximately $242.5 million. The notes bear interest at the rate of 3.5% per year, payable semi-annually on February 15 and August 15. The notes are subordinated to all senior indebtedness, including the 3½% Senior Notes, and pari passu in right of payment with the Pfizer Note. The notes are convertible into shares of our common stock at an initial conversion price of approximately $11.22 per share, subject to adjustments. Holders may require us to repurchase the notes upon a change in control, as defined. We may redeem the notes beginning February 20, 2007.

In February 2000, in a private placement, we issued $200.0 million of 5.5% convertible subordinated notes due February 1, 2007 (the "5.5% Notes"), which resulted in net proceeds of approximately $196.8 million. The notes bore interest at 5.5%, payable semi-annually on February 1 and August 1 and were subordinated to all senior indebtedness, as defined. The notes could be converted at the option of the holder at an initial conversion price of $67.42 per share, subject to adjustment. We repurchased on the open market, and retired, $36.5 million and $38.4 million in face value of 5.5% Notes during the years ended December 31, 2005 and 2004, respectively. Gains (losses) of $0.5 million and $(0.2) million on these transactions were recognized for the years ended December 31, 2005 and 2004, respectively. All gains or losses on repurchase are presented as "Gain (loss) on redemption/repurchase of convertible subordinated notes" in our statements of operations. In October 2006, all of the remaining outstanding 5.5% Notes were redeemed for 100% of their principal amount plus accrued and unpaid interest to the redemption date, which resulted in a $0.1 million charge in the three months ended December 31, 2006 as a result of the write-off of the remaining deferred financing costs related to the 5.5% Notes.

Note 9. Other Expenses

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

2004 Restructuring and Other Impairments (in thousands)

	2004 Charges to Operations	2004 Accrual Utilized	Accrual Balance as of December 31, 2004	2005 Charges to Operations	2005 Accrual Utilized	Accrual Balance as of December 31, 2005	2006 Charges to Operations	2006 Accrual Utilized	Accrual Balance as of December 31, 2006
Workforce reduction	$ 6,745	$ (6,743)	$ 2	$ (2)	$ —	$ —	$ —	$ —	$ —
Lease commitments and related costs	20,207	(4,710)	15,497	733	(2,685)	13,545	893	(2,966)	11,472
Other costs	671	(671)	—	255	(255)	—	92	(92)	—
Subtotal	27,623	(12,124)	15,499	986	(2,940)	13,545	985	(3,058)	11,472
Impairment of tenant improvements, equipment and other items	11,363	(11,363)	—	—	—	—	—	—	—
Impairment of gene and genomics-related patent costs	12,099	(12,099)	—	—	—	—	—	—	—
Total other expenses	$51,085	$(35,586)	$15,499	$986	$(2,940)	$13,545	$985	$(3,058)	$11,472

In February 2004, we announced a restructuring plan to close our information products research facility and headquarters in Palo Alto, California and move our headquarters to our Wilmington, Delaware pharmaceutical research and development facility. The closure of the Palo Alto facility corresponded with terminating further development activities around our Palo Alto-based information products line. The restructuring plan included the elimination of 183 employees and charges related to the closure of our Palo Alto facilities, previously capitalized tenant improvements and equipment and other items. The lease commitment and related costs originally included the present value of future lease obligations for two facilities. In the fourth quarter of 2004, we made a lease termination payment to satisfy our remaining lease obligation with respect to one of the facilities. The lease obligation for the second facility extends through March 2011. As a result of the long term nature of the remaining lease obligation, we will be recording a charge each period through the March 2011 termination date of the lease related to increases in the fair value of the lease obligations in accordance with the provisions of FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities,* which total approximately $1.4 million at December 31, 2006.

In December 2004, based on declining estimated future cash flows associated with our gene and genomics-related intellectual property, we recorded expense of $12.1 million to adjust the carrying value of previously capitalized costs associated with the preparation, prosecution and maintenance of our gene patent portfolio to its estimated fair market value.

2003 Restructuring and Other Impairments

As a result of a decision made in the fourth quarter of 2003 to restructure our information product line in connection with the discontinuation of our clone activities and support functions, we recognized other expenses of $11.5 million. The plan included elimination of certain employees and write-down of

certain assets related to our genomic information product line. We recorded charges of approximately $5.0 million related to the severance and benefits of approximately 75 employees, who worked at our Palo Alto, California location. We also recorded a charge of $1.9 million related to the write-off of excess equipment and other assets associated with the activities being exited. The write-down of equipment and other assets relates primarily to computer equipment and related software, lab equipment and office equipment. As of January 2, 2004, all of these employees had been terminated under this restructuring program and the plan was completed in the second quarter of 2004. There were no additional restructuring charges recorded for this program for the years ended December 31, 2006 and 2005.

2002 Restructuring (in thousands)

	Accrual Balance as of December 31, 2003	2004 Charges to Operations	2004 Charges Utilized	Accrual Balance as of December 31, 2004	2005 Charges to Operations	2005 Charges Utilized	Accrual Balance as of December 31, 2005	2006 Charges to Operations	2006 Charges Utilized	Accrual Balance as of December 31, 2006
Lease commitments and other restructuring charges	$17,893	$1,642	$(3,380)	$16,155	$57	$(2,512)	$13,700	$(1,450)	$(2,250)	$10,000

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

We currently have one remaining lease related to an exited site that is due to expire in December 2010. During the years ended December 31, 2006, 2005 and 2004, we recognized additional charges of $(1.5) million, $0.1 million and $1.6 million, respectively, primarily relating to this facility for lease expenses in excess or less than of amounts originally estimated. We estimated the costs based on the contractual terms of agreements and current real estate market conditions. We may incur additional costs associated with these subleasing and lease termination activities.

2001 Restructuring and Other Impairments

In October 2001, we announced a restructuring of our operations in order to focus on our database licensing and partnership programs and our drug discovery and development programs. As a result, we recorded an expense of $55.6 million related to restructuring activities in the fourth quarter of 2001. In 2004, the remaining facility operating leases expired and all restructuring related activities were completed. There were no additional restructuring or impairment charges recorded for this program for the years ended December 31, 2006 and 2005.

Maxia Acquisition (in thousands)

	Accrual Balance as of December 31, 2003	2004 Charges to Operations	2004 Accrual Utilized	Accrual Balance as of December 31, 2004	2005 Charges to Operations	2005 Accrual Utilized	Accrual Balance as of December 31, 2005	2006 Charges to Operations	2006 Accrual Utilized	Accrual Balance as of December 31, 2006
Lease commitments and other costs	$1,334	$1,628	$(589)	$2,373	$312	$(616)	$2,069	$(79)	$(772)	$1,218

In accordance with EITF 95-3, we recorded a $2.9 million charge in 2003 related to restructuring costs for Maxia Pharmaceuticals, Inc., which consisted of workforce reductions and consolidation of facilities. We recorded employee termination costs of approximately $0.8 million for 28 employee positions. The job eliminations were completed in July 2003. We also recorded restructuring costs related to lease payments for property that has been vacated and other costs of $2.0 million. In 2006, 2005 and 2004 we recorded additional charges of ($0.1) million, $0.3 million and $1.6 million, respectively, relating to facilities lease expenses in excess of amounts originally estimated. The operating lease related to the vacated facility expires in November 2008.

Note 10. Stockholders' Deficit

Preferred Stock. We are authorized to issue 5,000,000 shares of preferred stock, none of which was outstanding as of December 31, 2006 or 2005. The Board of Directors may determine the rights, preferences and privileges of any preferred stock issued in the future. We have reserved 250,000 shares of preferred stock designated as Series A Participating Preferred Stock for issuance in connection with the Stockholders Rights plan described below.

Common Stock. As of December 31, 2006, we had reserved a total of 14,860,801 shares of our common stock for future issuance related to our stock plans as described below.

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

In May 2006, our stockholders approved an increase in the number of shares available for grant under the 1997 Employee Stock Purchase Plan ("ESPP") from 3,100,000 shares to 3,850,000 shares.

Stock Compensation Plans. Summaries of stock option activity for our stock option plans as of December 31, 2006, 2005 and 2004, and related information for the years ended December 31 are included in the plan descriptions below.

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

During 2001, we granted 490,000 restricted stock units under the Stock Plan to certain management personnel. In connection with the grant of these restricted stock units, we recorded deferred compensation of $7.9 million in 2001. These restricted stock units had cliff vesting terms over one to four years and were being amortized to stock compensation expense over those vesting terms. Stock compensation expense of $0.5 million and $0.2 million was recorded in 2004 and 2005, respectively. As of December 31, 2005, all of the restricted stock units had vested or had been previously forfeited.

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

Under the Directors' Plan, each new non-employee director joining the Board will receive an option to purchase 35,000 shares of common stock. Additionally, members who continue to serve on the Board will receive annual option grants for 20,000 shares exercisable in full on the first anniversary of the date of the grant. All options are exercisable at the fair market value of the stock on the date of grant.

Activity under the combined plans was as follows:

	Shares Available for Grant	Shares Subject to Outstanding Options	
		Shares	Weighted Average Exercise Price
Balance at December 31, 2003	6,227,861	8,531,886	$10.58
Additional authorization	—	—	—
Options granted	(1,527,375)	1,527,375	$ 8.44
Options exercised	—	(987,911)	$ 5.65
Options expired	8,000	(8,000)	$ 2.66
Options cancelled	2,538,751	(2,544,605)	$13.67
Balance at December 31, 2004	7,247,237	6,518,745	$ 9.61
Additional authorization	400,000	—	—
Options granted	(2,794,200)	2,794,200	$ 8.53
Options exercised	—	(203,602)	$ 1.33
Options expired	20,000	(20,000)	$ 3.78
Options cancelled	1,275,121	(1,290,942)	$11.97
Balance at December 31, 2005	6,148,158	7,798,401	$ 8.99
Additional authorization	—	—	—
Options granted	(2,834,227)	2,834,227	$ 5.25
Options exercised	—	(61,931)	$ 4.72
Options expired	33,736	(33,736)	$ 9.39
Options cancelled	442,814	(442,814)	$ 9.55
Balance at December 31, 2006	3,790,481	10,094,147	$ 7.94

Options to purchase a total of 5,577,911, 4,181,999 and 3,525,632 shares as of December 31, 2006, 2005 and 2004, respectively, were exercisable and vested. The aggregate intrinsic value of options exercised for the years ended December 31, 2006, 2005 and 2004 were $0.0 million, $1.2 million and $3.2 million, respectively. At December 31, 2006 the aggregate intrinsic value of options outstanding and vested are $2.9 million and $1.1 million, respectively.

The following table summarizes information about stock options outstanding as of December 31, 2006 for the 1991 Stock Plan and the 1993 Directors' Stock Option Plan:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$3.10 – 4.89	1,088,928	7.90	$ 4.35	529,414	$ 4.51
$4.92 – 5.43	670,171	6.66	$ 5.20	537,954	$ 5.20
$5.46 – 5.46	2,082,625	9.03	$ 5.46	0	$ 0.00
$5.52 – 6.95	1,027,542	6.75	$ 6.07	761,924	$ 6.07
$7.02 – 8.19	1,227,474	7.37	$ 7.91	868,928	$ 7.92
$8.49 – 8.93	345,000	7.31	$ 8.68	248,997	$ 8.70
$8.99 – 8.99	1,861,545	8.05	$ 8.99	895,744	$ 8.99
$9.12 – 13.80	1,078,793	5.45	$11.66	1,022,881	$11.76
$14.13 – 24.94	711,569	4.37	$17.30	711,569	$17.30
$35.00 – 35.00	500	3.85	$35.00	500	$35.00
	10,094,147	7.37	$ 7.94	5,577,911	$ 9.19

Employee Stock Purchase Plan. On May 21, 1997, our stockholders adopted the ESPP. In May 2006, our stockholders approved an increase in the number of shares available for grant from 3,100,000 shares to 3,850,000 shares. Each regular full-time and part-time employee working 20 hours or more per week is eligible to participate after one month of employment. We issued 313,715, 389,801 and 448,861 shares under the ESPP in 2006, 2005 and 2004, respectively. For the year ended December 31, 2006 we recorded stock compensation expense of $0.4 million under SFAS 123R as the ESPP is considered compensatory under SFAS 123R. As of December 31, 2006, 976,173 shares remain available for issuance under the ESPP.

Stockholders Rights Plan. On September 25, 1998, the Board of Directors adopted a Stockholder Rights Plan (the "Rights Plan"), pursuant to which one preferred stock purchase right (a "Right") was distributed for each outstanding share of common stock held of record on October 13, 1998. One Right will also attach to each share of common stock issued by the Company subsequent to such date and prior to the distribution date defined below. Each Right represents a right to purchase, under certain circumstances, a fractional share of our Series A Participating Preferred Stock at an exercise price of $100.00, subject to adjustment. In general, the Rights will become exercisable and trade independently from the common stock on a distribution date that will occur on the earlier of (i) the public announcement of the acquisition by a person or group of 15% or more of the common stock or (ii) ten days after commencement of a tender or exchange offer for the common stock that would result in the acquisition of 15% or more of the common stock. Upon the occurrence of certain other events related to changes in ownership of the common stock, each holder of a Right would be entitled to purchase shares of common stock, or an acquiring corporation's common stock, having a market value of twice the exercise price. Under certain conditions, the Rights may be redeemed at $0.01 per Right by the Board of Directors. The Rights expire on September 25, 2008.

11. Stock compensation

We adopted SFAS 123R on January 1, 2006. SFAS 123R requires the recognition of the fair value of stock compensation in net income. We recognize the stock compensation expense over the requisite service period of the individual grants, which generally equals the vesting period. Prior to January 1, 2006, we followed APB Opinion 25, *Accounting for Stock Issued to Employees,* and related interpretations in accounting for our stock compensation.

We elected the modified prospective method in adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. In addition, the unrecognized expense of awards not yet vested at the date of adoption is recognized in net income in the periods after the date of adoption using the same valuation method (Black-Scholes) and assumptions determined under the original provisions of SFAS 123, *Accounting for Stock-Based Compensation,* as disclosed in our previous filings.

Under the provisions of SFAS 123R, we recorded $8.9 million of stock compensation expense on our audited consolidated statement of operations for the year ended December 31, 2006. As a result of adopting SFAS 123R, our net loss for the year ended December 31, 2006 is $8.9 million higher than if we had continued to account for share-based compensation under APB Opinion 25. Basic and diluted net loss per share for the years ended December 31, 2006 are $0.11 higher than if we had continued to account for share-based compensation under APB Opinion 25. For the years ended December 31, 2005 and 2004 we recorded stock compensation expense of $0.2 million and $0.5 million, respectively on our audited consolidated statement of operations related to restricted shares issued to our Chief Executive Officer. We utilized the Black-Scholes valuation model for estimating the fair value of the stock compensation granted, with the following weighted-average assumptions:

	Employee Stock Options For the Year Ended December 31,			Employee Stock Purchase Plan For the Year Ended December 31,		
	2006	2005	2004	2006	2005	2004
Average risk-free interest rates	4.43%	3.95%	2.40%	4.80%	3.64%	1.59%
Average expected life (in years)	3.13	3.29	3.27	0.50	0.50	1.11
Volatility	76%	86%	89%	63%	90%	90%
Weighted-average fair value (in dollars)	2.75	4.94	4.87	1.26	2.81	1.99

The risk-free interest rate is derived from the U.S. Federal Reserve rate in effect at the time of grant. The expected life calculation is based on the observed and expected time to the exercise of options by our employees based on historical exercise patterns for similar type options. Expected volatility is based on the historical volatility of our common stock over the period commensurate with the expected life of the options. A dividend yield of zero is assumed based on the fact that we have never paid cash dividends and have no present intention to pay cash dividends.

Based on our historical experience, we have assumed an annualized forfeiture rate of 5% for our options. Under the true-up provisions of SFAS 123R, we will record additional expense if the actual forfeiture rate is lower than we estimated, and will record a recovery of prior expense if the actual forfeiture is higher than we estimated.

SFAS 123R requires us to present pro forma information for the comparative period prior to the adoption as if we had accounted for all our stock options under the fair value method of the original SFAS 123. The following table illustrates the effect on net loss and loss per share if we had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation in the prior-year period (dollars in thousands, except per-share data).

	For the Year Ended December 31, 2005	For the Year Ended December 31, 2004
Net loss, as reported	$(103,043)	$(164,817)
Add: Stock-based employee compensation	186	511
Deduct: Total stock-based employee compensation determined under the fair value-based method for all awards	(9,777)	(6,217)
Pro forma net loss	$(112,634)	$(170,523)
Net loss per share:		
Basic and diluted net loss per share-as reported	$ (1.24)	$ (2.21)
Basic and diluted net loss per share-as SFAS 123 adjusted	$ (1.35)	$ (2.29)

The amortization of stock compensation under SFAS 123R for the period after its adoption, and under APB Opinion 25 or SFAS 123 (pro forma disclosure) for the period prior to its adoption was calculated in accordance with FASB Interpretation ("FIN") No. 28. Total compensation cost of options granted but not yet vested, as of December 31, 2006, was $6.8 million, which is expected to be recognized over the weighted average period of 3.16 years.

Note 12. Income Taxes

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

	Year Ended December 31,		
	2006	2005	2004
Current			
Foreign	$—	$(228)	$385
State	—	(324)	68
Total provision (benefit) for income taxes	$—	$(552)	$453

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

	Year Ended December 31,		
	2006	2005	2004
U.S. taxable entities	$(74,161)	$(103,030)	$(162,044)
Other	(5)	(879)	(1,167)
	$(74,166)	$(103,909)	$(163,211)

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

	Year Ended December 31,		
	2006	2005	2004
Provision (benefit) at U.S. federal statutory rate	$(26,000)	$(36,300)	$(57,100)
Unbenefitted net operating losses and tax credits	25,800	36,200	56,800
Other	200	(452)	753
Provision (benefit) for income taxes	$ —	$ (552)	$ 453

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

	December 31,	
	2006	2005
Deferred tax assets:		
Federal and state net operating loss carryforwards	$ 303,000	$ 302,300
Federal and state research credits	35,000	30,000
Capitalized research and development	52,000	32,400
Investments	6,000	3,600
Federal and state capital loss carryforwards	11,000	14,700
Other, net	23,000	8,800
Total gross deferred tax assets	430,000	391,800
Less valuation allowance for deferred tax assets	(430,000)	(391,800)
Net deferred tax assets	$ —	$ —

The valuation allowance for deferred tax assets increased by approximately $38.2 million, $48.8 million and $60.2 million during the years ended December 31, 2006, 2005 and 2004, respectively.

Approximately $61.5 million of the valuation allowance for deferred tax assets relates to benefits from stock option deductions which, when recognized, will be allocated directly to contributed capital.

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

As of December 31, 2006, we had federal and state net operating loss carryforwards of approximately $755.0 million. We also had federal and state research and development tax credit carryforwards of approximately $35.0 million. The net operating loss carryforwards and tax credits will expire at various dates, beginning in 2006 through 2024, if not utilized. Utilization of the net operating losses and credits may be subject to an annual limitation, due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. We also had federal and state capital loss carryforwards of approximately $27.5 million that will expire beginning in 2009.

Note 13. Net Loss Per Share

For all periods presented, both basic and diluted net loss per common share are computed by dividing the net loss by the number of weighted average common shares outstanding during the period. Stock options and potential common shares issuable upon conversion of our 3½% Senior Notes, 3½% Subordinated Notes and 5.5% Notes were excluded from the computation of diluted net loss per share, as their share effect was anti-dilutive for all periods presented. The potential common shares that were excluded from the diluted net loss per share computation are as follows:

	December 31,		
	2006	2005	2004
Outstanding stock options	10,094,147	7,798,401	6,518,745
Common shares issuable upon conversion of 3½% Senior Notes	13,531,224	—	—
Common shares issuable upon conversion of 3½% Subordinated Notes	22,284,625	22,284,625	22,284,625
Common shares issuable upon conversion of Pfizer Note	1,461,496	—	—
Common shares issuable upon conversion of 5.5% Notes	—	1,358,865	1,900,043
Total potential common shares excluded from diluted net loss per share computation	47,371,492	31,441,891	30,703,413

Note 14. Segment Reporting

Our operations are treated as one operating segment, biotechnology drug discovery and development, in accordance with FASB Statement No. 131 ("SFAS 131"). For the twelve months ended December 31, 2006, we recorded revenue from customers throughout the United States and in Canada, Germany, Sweden, and the United Kingdom. Export revenues for the years ended December 31, 2006, 2005 and 2004 were $0.6 million, $2.8 million and $5.3 million, respectively.

Note 15. Defined Contribution Plan

We have a defined contribution plan qualified under Section 401(k) of the Internal Revenue Code covering all domestic employees. Employees may contribute a portion of their compensation, which is then matched by us, subject to certain limitations. Defined contribution expense was $0.0 million, $0.5 million and $0.9 million in 2006, 2005 and 2004, respectively.

Note 16. Discontinued Operations

In December 2004, we also entered into an agreement to sell certain assets and liabilities related to our Proteome facility based in Beverly, Massachusetts ("Proteome"), which transaction subsequently closed in January 2005. The consolidated statements of operations and consolidated cash flows have been restated to present Proteome as a discontinued operation for the years ended December 31, 2005 and 2004.

Note 17. Litigation

Invitrogen

In October 2001, Invitrogen Corporation ("Invitrogen") filed an action against us in the federal court for the District of Delaware, alleging infringement of three patents. On June 15, 2006 we entered into a settlement agreement with Invitrogen pursuant to which we agreed to pay Invitrogen $3.4 million as a settlement fee. This amount was paid on June 20, 2006 and is included in other expenses in the accompanying condensed consolidated statements of operations for the year ended December 31, 2006.

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

Note 18. Related Party Transactions

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

During 1997, we purchased diaDexus Series B Preferred Stock at a cost of $1.3 million. We do not have the ability to exert significant influence over diaDexus. We have an executive officer who sits on diaDexus' Board of Directors. In June 2006, we recorded an impairment charge of $1.3 million to reduce the carrying value of this investment because the investee had less than six months of cash and the likelihood of future debt or equity financing that would not result in an impairment was remote.

During 2000 and 2001 we purchased shares of Series A Preferred Stock and Series C Preferred Stock of Genomic Health, Inc. ("Genomic Health") for an aggregate purchase price of $6.0 million. In connection with the completion of its initial public offering on October 4, 2005, these shares were converted into common shares. Additionally as part of its initial public offering, Genomic Health exercised an election under which we were required to acquire an additional $5.0 million of Genomic Health common stock. In March 2006, we sold our initial investment for $11.5 million, and in October 2006, we sold the remaining portion of this investment for $5.8 million, which resulted in a aggregate realized gain of $6.2 million for the year ended December 31, 2006. Julian C. Baker, one of our directors, is also a director of Genomic Health and holds shares, directly or beneficially, of both companies.

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

During 2005, we repurchased on the open market, and retired, $36.5 million in face value of 5.5% Notes. One such transaction in 2005 involved the repurchase, at a purchase price of 98.25% of face value, of $5.0 million in face value of such notes from a limited partnership of which Julian C. Baker, one of our directors, is a controlling member of the general partner of the general partner and may have a pecuniary interest. Mr. Baker did not participate in our decision to engage in such a repurchase transaction. The price paid by us in such repurchase transaction was equal to the price paid by us to an independent third party in a comparable transaction negotiated on an arms'-length basis a short time prior to such repurchase transaction.

Note 19. Commitments

As of December 31, 2006, we had noncancelable operating leases on multiple facilities and equipment, including facilities in Palo Alto, California; San Diego, California; and Wilmington, Delaware. The leases expire on various dates ranging from June 2007 to March 2011. Certain leases have renewal options for periods ranging up to 5 years. Rent expense, excluding rent expense recognized in the restructuring charges in 2004, for the years ended December 31, 2006, 2005 and 2004, was approximately $4.4 million, $4.2 million and $6.7 million, respectively.

As of December 31, 2006, future noncancelable minimum payments under operating leases, including leases for sites included in the restructuring programs were as follows:

Year ended December 31,	Operating Leases (in thousands)
2007	$12,754
2008	10,613
2009	7,921
2010	8,136
2011	1,134
Thereafter	—
Total minimum lease payments	$40,558

The amounts and timing of payments related to vacated facilities may vary based on negotiated timing of lease terminations. We have entered into sublease agreements for our vacated space with scheduled payments to us of $2.1 million (less than 1 year), $4.1 million (years 1-3), $2.0 million (years 4-5), and $0.0 million (over 5 years).

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

Commitments related to Maxia Pharmaceuticals, Inc. ("Maxia") are considered contingent commitments as future events must occur to cause these commitments to be enforceable. In

February 2003, we completed our acquisition of Maxia. Under the merger agreement, former Maxia stockholders have the right to receive certain earn out amounts of up to a potential aggregate amount of $14.0 million upon the occurrence of certain research and development milestones set forth in the merger agreement. Twenty percent of each earn out payment, if earned, will be paid in cash and the remaining eighty percent will be paid in shares of our common stock such that an aggregate of $2.8 million in cash and $11.2 million in our common stock (based upon the then fair value) could potentially be paid pursuant to the earn out milestones. The milestones occur as Maxia products enter various stages of human clinical trials and may be earned at any time prior to the tenth anniversary of the consummation of the merger. In any event, no more than 13,531,138 shares of our common stock may be issued to former Maxia stockholders in the aggregate pursuant to the merger agreement. None of these milestones had been achieved as of December 31, 2006.

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

Note 20. Interim Consolidated Financial Information (Unaudited)

(in thousands, except per share data)

	Fiscal 2006 Quarter Ended			
	March 31	June 30	September 30	December 31
Revenues(1)	$ 6,465	$ 6,855	$ 7,268	$ 7,056
Net loss(2)	(17,306)	(20,520)	(15,838)	(20,502)
Basic and diluted net loss per share	$ (0.21)	$ (0.24)	$ (0.19)	$ (0.24)
Shares used in computation of basic and diluted net loss per share	83,627	83,786	83,852	83,931

	Fiscal 2005 Quarter Ended			
	March 31	June 30	September 30	December 31
Revenues(3)	$ 2,915	$ 2,676	$ 1,228	$ 1,027
Net loss	(20,131)	(25,145)	(30,210)	(27,557)
Basic and diluted net loss per share	$ (0.24)	$ (0.30)	$ (0.36)	$ (0.33)
Shares used in computation of basic and diluted net loss per share	83,049	83,303	83,414	83,520

(1) In November 2005, we entered into a collaborative research and license agreement with Pfizer, which became effective in January 2006. The March 31, 2006, June 30, 2006, September 30, 2006, and December 31, 2006 quarters include $5.5 million, $6.3 million, $6.2 million, and $6.2 million, respectively, of contract revenues relating to the agreement.

(2) The June 30, 2006 quarter includes a $3.4 million charge related to the settlement fee paid to Invitrogen.

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

SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS

Description—Year Ended December 31,	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at End of Period
		(in thousands)		
Allowance for doubtful accounts—2004	$577	57	360	$274
Allowance for doubtful accounts—2005	274	35	114	195
Allowance for doubtful accounts—2006	$195	—	195	$ —

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

Not applicable.

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

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

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

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

Management's annual report on internal control over financial reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of the effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control—Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2006. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2006 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Incyte Corporation

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Incyte Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Incyte Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that Incyte Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Incyte Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Incyte Corporation as of December 31, 2006 and 2005, and the related consolidated statements of operations, comprehensive loss, stockholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2006 of Incyte Corporation and our report dated February 22, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
February 22, 2007

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

None.

PART III

Item 10. ***Directors, Executive Officers and Corporate Governance***

The information required by this item (with respect to Directors) is incorporated by reference from the information under the caption "Election of Directors" contained in our Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for our 2007 Annual Meeting of Stockholders to be held on May 22, 2007 (the "Proxy Statement"). Certain information required by this item concerning executive officers is set forth in Part I of this Report under the caption "Executive Officers of the Registrant" and is incorporated herein by reference.

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

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

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

Our Board of Directors has appointed an Audit Committee, comprised of Mr. Barry M. Ariko, as Chairman, Mr. Roy A. Whitfield and Mr. Matthew W. Emmens. The Board of Directors has also determined that all three members of the Audit Committee are qualified as Audit Committee Financial Experts under the definition outlined by the Securities and Exchange Commission. In addition, each of the members of the Audit Committee qualifies as an "independent director" under applicable Nasdaq Stock Market standards.

Item 11. ***Executive Compensation***

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

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

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

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

Item 13. ***Certain Relationships and Related Transactions, and Director Independence***

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

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

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

PART IV

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

(a) Documents filed as part of this report:

(1) Financial Statements

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

(2) Financial Statement Schedules

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

Schedule II—Valuation and Qualifying Accounts for each of the three years in the period ended December 31, 2006.

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

(3) Exhibits

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

(b) Exhibits

Exhibit Number	Description of Document
2.1	Agreement and Plan of Merger, dated as of November 11, 2002, by and among the Company, Maxia Pharmaceuticals, Inc. and other parties signatory thereto (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed February 25, 2003).

2.2	Amendment to Agreement and Plan of Merger, dated as of December 19, 2002, by and among the Company, Monaco Acquisition Corporation, Maxia Pharmaceuticals, Inc. and Maxia Pharmaceuticals, LLC (incorporated by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K filed February 25, 2003).
3(i)(a)	Integrated copy of the Restated Certificate of Incorporation, as amended (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002).
3(i)(c)	Certificate of Ownership and Merger merging Incyte Corporation into Incyte Genomics, Inc. (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002).
3(ii)	Bylaws of the Company, as amended as of May 25, 2004 (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2004).
4.1	Form of Common Stock Certificate (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 2002).
4.2	Rights Agreement dated as of September 25, 1998 between the Company and Chase Mellon Shareholder Services, L.L.C., which includes as Exhibit B, the rights certificate (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form 8-A filed September 30, 1998).
4.3	Indenture dated as of February 19, 2004 between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-3 (File No. 333-114863)).
4.4†	Form of Convertible Subordinated Promissory Note (incorporated by reference to the Company's Current Report on Form 8-K/A filed February 6, 2006).
4.5	Indenture dated as of September 26, 2006 between the Company and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 28, 2006).
4.6	Registration Rights Agreement, dated as of September 26, 2006, by and between Incyte Corporation and Piper Jaffray & Co. (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on September 28, 2006).
10.1#	1991 Stock Plan of Incyte Genomics, Inc., as amended and restated on February 27, 2002 (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 (File No. 333-91542)).
10.2#	Form of Incentive Stock Option Agreement under the 1991 Plan (incorporated by reference to the exhibit of the same number to the Company's Registration Statement on Form S-1 (File No. 33-68138)).
10.3#	Form of Nonstatutory Stock Option Agreement under the 1991 Plan (incorporated by reference to the exhibit of the same number to the Company's Registration Statement on Form S-1 (File No. 33-68138)).
10.4#	1993 Directors' Stock Option Plan of Incyte Genomics, Inc., as amended and restated (incorporated by reference to the exhibit of the same number to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2005).

10.5#	Form of Indemnity Agreement between the Company and its directors and officers (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1 (File No. 33-68138)).
10.6	Lease Agreement dated June 19, 1997 between the Company and The Board of Trustees of the Leland Stanford Junior University (incorporated by reference to the exhibit of the same number to the Company's Annual Report on Form 10-K for the year ended December 31, 1999).
10.7#	1997 Employee Stock Purchase Plan of Incyte Corporation, as amended and restated September 15, 2006 (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on September 19, 2006).
10.8#	Form of Restricted Stock Unit Agreement under the 1991 Stock Plan of Incyte Genomics, Inc. (incorporated by reference to Exhibit 10.23 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
10.9#	Offer of Employment Letter, dated November 21, 2001, from the Company to Paul A. Friedman (incorporated by reference to Exhibit 10.30 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
10.10#	Employment Agreement, dated November 26, 2001, between Paul A. Friedman and Incyte Genomics, Inc. (incorporated by reference to Exhibit 10.32 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
10.11†	Settlement Agreement dated December 21, 2001, between Affymetrix, Inc. and Incyte Genomics, Inc. (incorporated by reference to Exhibit 10.34 to the Company's Annual Report on Form 10-K for the year ended December 31, 2001).
10.12	Sublease Agreement, dated June 16, 2003, between E. I. DuPont de Nemours and Company and Incyte Corporation (incorporated by reference to Exhibit 10.45 to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2003).
10.13#	Offer of Employment Letter, dated September 2, 2003, from the Company to David C. Hastings (incorporated by reference to Exhibit 10.46 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
10.14#	Offer of Employment Letter, dated September 2, 2003, from the Company to John A. Keller (incorporated by reference to Exhibit 10.47 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
10.15#	Form of Employment Agreement, effective as of November 21, 2003 between Incyte Corporation and David C. Hastings, John A. Keller, Brian W. Metcalf, Patricia A. Schreck (effective date of December 8, 2003) and Paula J. Swain (incorporated by reference to Exhibit 10.48 to the Company's Annual Report on Form 10-K for the year ended December 31, 2003).
10.16†	Collaborative Research and License Agreement, dated as of November 18, 2005, by and between the Company and Pfizer Inc. (incorporated by reference to Exhibit 10.49 to the Company's Annual Report on Form 10-K for the year ended December 31, 2005).
10.17	Note Purchase Agreement, dated as of November 18, 2005, by and between the Company and Pfizer Overseas Pharmaceuticals (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K/A filed February 6, 2006).
10.18*	Amendment No. 1 to Note Purchase Agreement, by and between the Company and Pfizer Overseas Pharmaceuticals, dated as of January 4, 2007.
21.1*	Subsidiaries of the Company.

23.1*	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1*	Power of Attorney (see page 90 of this Form 10-K).
31.1*	Rule 13a-14(a) Certification of Chief Executive Officer.
31.2*	Rule 13a-14(a) Certification of the Chief Financial Officer.
32.1**	Statement of the Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350).
32.2**	Statement of the Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C Section 1350).

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* Filed herewith.

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

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

# Indicates management contract or compensatory plan or arrangement.

(c) Financial Statements and Schedules

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

SIGNATURES

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

INCYTE CORPORATION

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

Date: February 28, 2007

POWER OF ATTORNEY

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

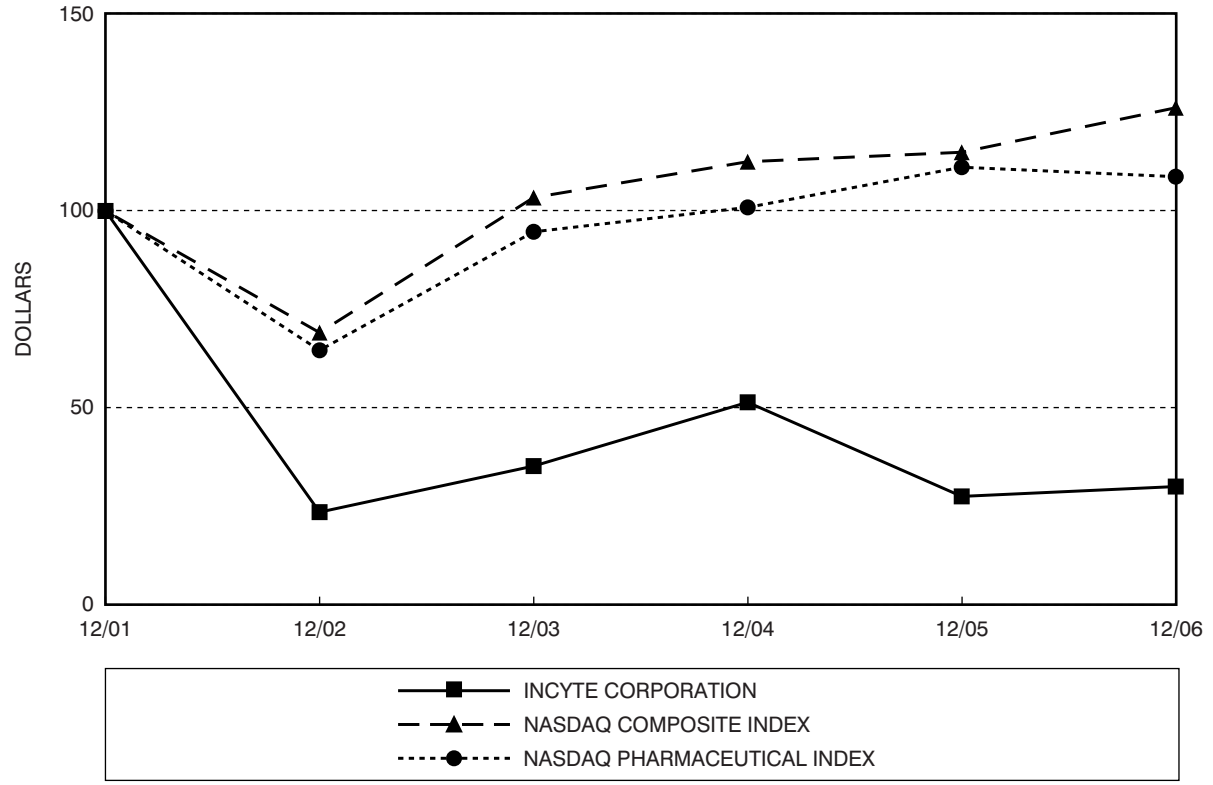
Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ PAUL A. FRIEDMAN Paul A. Friedman	Chief Executive Officer (Principal Executive Officer) and Director	February 28, 2007
/s/ DAVID C. HASTINGS David C. Hastings	Chief Financial Officer (Principal Financial Officer)	February 28, 2007
/s/ LAURENT CHARDONNET Laurent Chardonnet	Vice President, Finance and Treasurer (Principal Accounting Officer)	February 28, 2007
/s/ RICHARD U. DESCHUTTER Richard U. De Schutter	Chairman	February 28, 2007
/s/ BARRY M. ARIKO Barry M. Ariko	Director	February 28, 2007
/s/ JULIAN C. BAKER Julian C. Baker	Director	February 28, 2007
/s/ PAUL A. BROOKE Paul A. Brooke	Director	February 28, 2007

Signature	Title	Date
/s/ MATTHEW W. EMMENS Matthew W. Emmens	Director	February 28, 2007
/s/ JOHN F. NIBLACK John F. Niblack	Director	February 28, 2007
 Roy A. Whitfield	Director	February 28, 2007

STOCK PRICE PERFORMANCE GRAPH

The following graph illustrates a comparison of the cumulative total stockholder return (change in stock price plus reinvested dividends) of the Company's Common Stock with the Center for Research in Security Prices ("CRSP"), the CRSP Total Return Index for the NASDAQ U.S. Stocks (the "NASDAQ Composite Index"), and Total Return Index for the NASDAQ Pharmaceutical Stocks (the "NASDAQ Pharmaceutical Index"), assuming an investment of $100 in each on December 31, 2001. The Company's Common Stock is traded on the NASDAQ Global Market. The graph is required by the Securities and Exchange Commission and is not intended to forecast or be indicative of possible future performance of the Company's Common Stock.



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