GENENCOR INTERNATIONAL INC
Form 10-Q
May 14, 2003

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

FORM 10-Q

(MARK ONE)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM _____ TO_____

COMMISSION FILE NUMBER 000-31167

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

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

925 PAGE MILL ROAD
PALO ALTO, CALIFORNIA 94304
(650) 846-7500
(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

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

YES [X] NO [ ]

INDICATE BY CHECK MARK WHETHER THE REGISTRANT IS AN ACCELERATED FILER (AS DEFINED IN RULE 12B-2 OF THE EXCHANGE ACT).

YES [X] NO [ ]

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

CLASS	NUMBER OF SHARES OUTSTANDING AT APRIL 30, 2003
COMMON STOCK, PAR VALUE $0.01 PER SHARE	58,592,244

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This Report contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These include statements concerning plans, objectives, goals, strategies, future events or performance and all other statements which are other than statements of historical fact, including without limitation, statements containing the words "believes," "anticipates," "expects," "estimates," "projects," "will," "may," "might" and words of a similar nature. The forward-looking statements contained in this Report reflect the Company's current beliefs and expectations on the date of this Report. Actual results, performance or outcomes may differ materially from those expressed in the forward-looking statements. Some of the important factors which, in the view of the Company, could cause actual results to differ from those expressed in the forward-looking statements are discussed in Part I, Item

2 of this Report and in the Company's 2002 Annual Report on Form 10-K. The Company disclaims any obligation to publicly announce any revisions to these forward-looking statements to reflect facts or circumstances of which the Company becomes aware after the date hereof.

Unless otherwise specified, all references in this Report to the "Company", "we", "us", "our", and "ourselves" refer to Genencor International, Inc. and its subsidiaries collectively, as appropriate in the context of the disclosure.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	MARCH 200
ASSETS	
Current assets:	
Cash and cash equivalents	$ 138,
Trade accounts receivable, net	60,
Inventories	57,
Other current assets	27,
Total current assets	284,
Property, plant and equipment, net	217,
Goodwill	29,
Intangible assets, net	45,
Other assets	59,
Total assets	$ 636,
LIABILITIES, REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Notes payable	$ 8,
Current maturities of long-term debt	28,
Accounts payable and accrued expenses	45,
Other current liabilities	10,
Total current liabilities	92,
Long-term debt	56,
Other long-term liabilities	35,
Total liabilities	184,
Redeemable preferred stock:	
7 1/2% cumulative series A preferred stock, without par value, authorized 1 shares, 1 shares issued and outstanding	171,

Stockholders' equity:	
Common stock, par value $0.01 per share, 200,000 shares authorized, 60,357 and 60,251 shares issued at March 31, 2003 and December 31, 2002, respectively	
Additional paid-in capital	350,
Treasury stock, 1,780 shares at cost at March 31, 2003 and December 31, 2002	(21,
Deferred stock-based compensation	(
Accumulated deficit	(10,
Accumulated other comprehensive loss	(38,
Total stockholders' equity	280,
Total liabilities, redeemable preferred stock and stockholders' equity	$ 636,

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

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
Revenues:		
Product revenue	$ 90,038	$ 75,548
Fees and royalty revenues	5,623	5,262
Total revenues	95,661	80,810
Operating expenses:		
Cost of products sold	50,841	42,118
Research and development	16,460	15,632
Sales, marketing and business development	7,699	7,142
General and administrative	7,801	8,032
Amortization of intangible assets	1,392	1,307
Restructuring and related charges	--	16,294
Other expense/(income)	705	(1,347)
Total operating expenses	84,898	89,178
Operating income/(loss)	10,763	(8,368)
Non operating expenses/(income):		
Interest expense	2,020	2,520
Interest income	(845)	(1,401)
Total non operating expense/(income)	1,175	1,119
Income/(loss) before income taxes	9,588	(9,487)
Provision for/(benefit from) income taxes	3,068	(8,428)

Net income/(loss)	$ 6,520	$ (1,059)
Net income available/(loss applicable) to holders of common stock	$ 4,701	$ (2,878)
Earnings/(loss) per common share:		
Basic	$ 0.08	$ (0.05)
Diluted	$ 0.08	$ (0.05)
Weighted average common shares:		
Basic	58,499	59,596
Diluted	58,799	60,057

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

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
Cash flows from operating activities:		
Net income/(loss)	$ 6,520	$ (1,059)
Adjustments to reconcile net income/(loss) to net cash provided by operating activities:		
Depreciation and amortization	8,760	7,954
Amortization of deferred stock-based compensation	299	863
Non-cash portion of restructuring and related charges	--	9,225
(Increase) decrease in operating assets:		
Trade accounts receivable	(7,875)	1,071
Inventories	(1,569)	(2,048)
Other assets	248	(6,531)
Decrease in operating liabilities:		
Accounts payable and accrued expenses	(3,173)	(5,158)
Other liabilities	(3,431)	(3,309)
Net cash (used in)/provided by operating activities	(221)	1,008
Cash flows from investing activities:		
Purchases of property, plant and equipment	(4,548)	(2,346)
Purchases of intangible assets	--	(100)
Payment to acquire equity securities	--	(3,000)

Acquisition of business, net of cash acquired	--	(35,809)
Net cash used in investing activities	(4,548)	(41,255)
Cash flows from financing activities:		
Proceeds from exercise of stock options	164	57
Proceeds from employee stock purchase plan	345	393
Proceeds from/(payments on) notes of foreign affiliate	91	(143)
Payment of long-term debt	(28,061)	(28,037)
Net cash used in financing activities	(27,461)	(27,730)
Effect of exchange rate changes on cash	1,915	(1,943)
Net decrease in cash and cash equivalents	(30,315)	(69,920)
Cash and cash equivalents -- beginning of period	169,001	215,023
Cash and cash equivalents -- end of period	$ 138,686	$ 145,103

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

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

1 -- BASIS OF PRESENTATION

The condensed consolidated unaudited financial statements should be read in conjunction with the Company's audited consolidated financial statements and related footnotes for the year ended December 31, 2002, as included in the Company's Annual Report on Form 10-K. These interim financial statements have been prepared in conformity with the rules and regulations of the U.S. Securities and Exchange Commission. Certain disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations pertaining to interim financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been included therein. The results of operations of any interim period are not necessarily indicative of the results of operations for the full year.

2 -- NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement

obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The Company adopted the provisions of SFAS No. 143 as of January 1, 2003, and there was no impact for the period ended March 31, 2003.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 does not permit the use of the original SFAS No. 123 prospective method of transition for changes to the fair value based method made in fiscal years after December 15, 2003. The Company currently applies the intrinsic value method and has no plans to convert to the fair value method.

3 -- EARNINGS PER SHARE

SFAS No. 128, "Earnings per Share," requires the disclosure of basic and diluted earnings per share. Basic earnings per share is computed based on the weighted average number of common shares outstanding during the period. In arriving at net income available/(loss applicable) to holders of common stock, undeclared and unpaid dividends on redeemable preferred stock of $1,819 were deducted from net income/(loss) for each quarter presented.

Diluted earnings/(loss) per common share reflects the potential dilution that could occur if dilutive securities and other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the net income available/(loss applicable) to holders of common stock of the Company. As a result of stock options outstanding under the Company's 2002 Omnibus Incentive Plan, successor to the Company's Stock Option and Stock Appreciation Right Plan, there were dilutive securities for the three months ended March 31, 2003 and 2002. The weighted-average impact of these has been reflected in the calculation of diluted earnings/(loss) per common share for the respective periods presented.

The following table reflects the calculation of basic and diluted earnings/(loss) per common share for the three months ended March 31:

	2003	2002
Net income/(loss)	$ 6,520	$ (1,059)
Less: Accrued dividends on preferred stock	(1,819)	(1,819)
Net income available/(loss applicable)		

to holders of common stock	$ 4,701	$ (2,878)
Weighted average common shares:		
Basic	58,499	59,596
Effect of stock options	300	461
Diluted	58,799	60,057
Earnings/(loss) per common share:		
Basic	$ 0.08	$ (0.05)
Diluted	$ 0.08	$ (0.05)

4 -- STOCK-BASED COMPENSATION

As discussed in Note 2 above, the Company adopted the provisions of SFAS No. 148. The Company uses the intrinsic value method to account for stock-based employee compensation in accordance with Accounting Principles Board (APB) Opinion No. 25 "Accounting for Stock Issued to Employees" and has no current plans to convert to the fair value method.

On a pro forma basis, had compensation cost for the Company's stock option plans been determined based on the weighted average fair value at the grant date, the Company's net income/(loss) and earnings/(loss) per share would have been reduced to the pro forma amounts shown below:

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
Net income available/(loss applicable) to holders of common stock as reported	$ 4,701	$ (2,878)
Add: Stock-based employee compensation expense included in reported net income available /(loss applicable), net of related tax	162	320
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(1,300)	(938)
Pro forma net income available/(loss applicable)	$ 3,563	$ (3,496)
Earnings/(loss) per common share:		
Basic - as reported	$ 0.08	$ (0.05)
Basic - pro forma	$ 0.06	$ (0.06)
Diluted - as reported	$ 0.08	$ (0.05)
Diluted - pro forma	$ 0.06	$ (0.06)

The pro forma figures in the preceding table may not be representative of pro forma amounts in future quarters.

5 -- INVENTORIES

Inventories consist of the following:

	MARCH 31, 2003	DECEMBER 31, 2002
Raw materials	$ 8,315	$ 8,373
Work-in-progress	8,204	8,003
Finished goods	40,545	37,839
Inventories	$ 57,064	$ 54,215

6 --GOODWILL AND OTHER INTANGIBLE ASSETS

The Company adopted the provisions of SFAS No. 142 effective as of January 1, 2002. Accordingly, the Company no longer amortizes goodwill or other intangible assets with indefinite useful lives. The Company has identified such other indefinite-lived intangible assets to include certain previously acquired technology. The Company will periodically evaluate its indefinite-lived intangible assets for impairment in accordance with the provisions of SFAS No. 142. The Company also has other intangible assets, such as patents, licenses, and customer lists, which will continue to be amortized using the straight-line method. These assets are expected to have no residual value once they are fully amortized.

The following table summarizes the changes in each major class of intangible assets from December 31, 2002 through March 31, 2003:

	INTANGIBLE ASSETS			G
	TECHNOLOGY	OTHER AMORTIZABLE ASSETS	TOTAL	
Balances, December 31, 2002	$ 15,617	$ 65,429	$ 81,046	$
Foreign currency translation	-	1,123	1,123	
Balances, March 31, 2003	$ 15,617	66,552	82,169	$
Less: Accumulated amortization		(36,815)	(36,815)	
Intangible assets, net		$ 29,737	$ 45,354	

In conjunction with the acquisition discussed in Note 9, the Company acquired certain intangible assets on December 31, 2002. The Company is currently in the process of segregating these intangible assets among the major classes. As such, the estimated value of these intangible assets has been included in other

intangible assets as of December 31, 2002 and will be segregated among the major classes once the Company completes its allocation of the purchase price. There were no intangible assets acquired during the three months ended March 31, 2003.

Estimated fiscal year amortization expense is as follows:

2003	$ 4,700
2004	3,000
2005	2,500
2006	2,100
2007	1,200

7 --STOCKHOLDERS' EQUITY

Accumulated other comprehensive loss consists of the following:

	FOREIGN CURRENCY TRANSLATION ADJUSTMENT	MARKETABLE SECURITIES VALUATION ADJUSTMENT	MINIMUM PENSION LIABILITY	ACCUMULATED OTHER COMPREHENSIVE LOSS
Balances, December 31, 2002 ...	$(39,200)	$ (3,463)	$ (2,123)	$(44,786)
Current period change	7,368	(1,212)	--	6,156
Balances, March 31, 2003	$(31,832)	$ (4,675)	$ 2,123)	$(38,630)

The change in the marketable securities valuation adjustment for the three months ended March 31, 2003, of $1,212, ($1,652 pre-tax) relates to unrealized holding losses on the Company's available-for-sale securities.

8 -- INCOME TAXES

The effective income tax rate for the three months ended March 31, 2003 was a 32% tax expense, compared to an 89% tax benefit for the three months ended March 31, 2002, which reflects the Company's assessment of its annual effective income tax rate. Factors affecting the Company's estimated annual effective income tax rate include increased research and development expenditures in the United States, the statutory income tax rates and mix of earnings among tax jurisdictions, amortization of certain intangible assets and other items which are not deductible for tax purposes, and research and experimentation tax credits. In addition, the estimated annual effective rate in the three months ended March 31, 2003 included the effect of estimated valuation allowances, since the Company did not have the ability to carry back or anticipate the ability to carry forward its United States net operating losses. The effective rate for the three months ended March 31, 2002 included the effect of restructuring and related charges. Accordingly, the tax benefit related to the restructuring and related charges of approximately $6,000 was recorded in the

first quarter of 2002. During both periods, the Company was subject to a tax ruling in the Netherlands that reduces the local effective income tax rate from 35.0% to 17.5%. This ruling will expire in 2005.

9 -- ACQUISITION

On December 31, 2002, the Company acquired the brewing and enzyme business of Rhodia Food UK Limited for a total cash purchase price of $8,925. The acquisition included technology, product lines and personnel. The acquisition expanded the Company's Bioproducts portfolio and technical service capabilities in the food, feed and specialty enzyme market sector. No facilities were included in the transaction. The acquisition has been accounted for under the purchase method in accordance with SFAS No. 141, "Business Combinations." The results of operations of the acquired business were consolidated with the Company's results of operations beginning January 1, 2003.

According to the Company's preliminary allocation of the purchase price on December 31, 2002, the $8,925 consists solely of intangible assets. Due to the effect of foreign currency translation the intangible assets are $9,264 at March 31, 2003. The Company is continuing to evaluate the allocation of the purchase price for the acquisition, including the segregation of separately identifiable intangible assets. The Company anticipates that this process will be completed during 2003.

10 -- RESTRUCTURING AND RELATED CHARGES

During February 2002, as a result of the acquisition of Enzyme Bio-Systems Ltd. (EBS), now known as Genencor International Wisconsin, Inc., from Corn Products International, Inc. and general economic conditions in Latin America, including the devaluation of the Argentine peso, the Company engaged in a plan to restructure its overall supply infrastructure by ceasing operations at its Elkhart, Indiana plant and downsizing its Argentine facilities. As a result of the plan, restructuring and related charges of $16,294 were recorded in the Company's operating earnings in the three months ended March 31, 2002. This restructuring was completed during 2002.

11 -- SEGMENT REPORTING

The Company has adopted SFAS No. 131 "Disclosures about Segments of an Enterprise and Related Information." Segments were determined based on products and services provided by each segment. Accounting policies for the segments are the same as those described in Note 1, "Summary of Significant Accounting Policies" of the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Performance of the segments is evaluated based on operating income of the segment. No items below operating income are allocated to the segments. The Company accounts for transactions, if any, between the segments as though they were transactions with third parties at approximate market prices. There were no material inter-segment transactions in the periods presented. During the first quarter of 2003, the Company modified its managerial financial reporting to reflect two operating segments: Bioproducts and Health Care. Accordingly, the Company is providing data in this new financial structure for the quarter ended March 31, 2003 as well as each of the four quarters of 2002.

The Bioproducts segment develops and delivers products and services to the industrial, consumer and agri-processing markets to a global customer base. All of the Company's current product revenues are derived from this segment.

The Health Care segment is focused on expanding the Company's current technology and product platforms into the health care market. This segment is primarily engaged in the performance of research and development, the securing of intellectual property and the establishment of strategic investments and collaborations.

The following table provides information by business segment; information by quarter for 2002 has been restated to reflect the reorganized business segments:

FOR THE THREE MONTHS ENDED MARCH 31, 2003

	Bioproducts	Health Care	Segment Subtotal	C a
Product revenue.....	$ 90,038	$ --	$ 90,038	$
Fees and royalty revenues.....	5,548	75	5,623	
Total revenues.....	95,586	75	95,661	
Research and development.....	10,320	6,140	16,460	
Operating income/(loss).....	19,058	(7,906)	11,152	

FOR THE THREE MONTHS ENDED MARCH 31, 2002

	Bioproducts	Health Care	Segment Subtotal	C a
Product revenue.....	$ 75,548	$ --	$ 75,548	$
Fees and royalty revenues.....	5,187	75	5,262	
Total revenues.....	80,735	75	80,810	
Research and development.....	8,474	7,158	15,632	
Operating income/(loss).....	(223)	(9,722)	(9,945)	

FOR THE THREE MONTHS ENDED JUNE 30, 2002

	Bioproducts	Health Care	Segment Subtotal

Product revenue	$85,470	$ --	$85,470
Fees and royalty revenues ..	5,162	--	5,162
Total revenues	90,632	--	90,632
Research and development ...	10,282	7,028	17,310
Operating income/(loss)	18,798	(9,669)	9,129

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2002

	Bioproducts	Health Care	Segment Subtotal
Product revenue	$85,931	--	$85,931
Fees and royalty revenues ..	4,566	--	4,566
Total revenues	90,497	--	90,497
Research and development ...	9,927	7,433	17,360
Operating income/(loss)	14,975	(10,479)	4,496

FOR THE THREE MONTHS ENDED DECEMBER 31, 2002

	Bioproducts	Health Care	Segment Subtotal
Product revenue	$82,388	--	$82,388
Fees and royalty revenues ..	5,751	--	5,751
Total revenues	88,139	--	88,139
Research and development ...	12,161	7,727	19,888
Operating income/(loss)	11,014	(11,003)	11

DECEMBER 31, 2002

	Bioproducts	Health Care	Segment Subtotal
Total assets	$467,782	$ 5,719	$473,501
Depreciation and amortization ..	31,127	2,064	33,191
Capital additions	18,153	1,397	19,550

The following table provides a reconciliation of segment information to total

consolidated information:

	FOR THE THREE MONTHS ENDED			
	MARCH 31, 2003	MARCH 31, 2002	JUNE 30, 2002	SEPTEMB 200
Net income:				
Operating income/(loss) for reportable segment	$ 11,152	$ (9,945)	$ 9,129	$ 4,
Other (income)/expense	389	(1,577)	(1,965)	
Investment expense/(income)	--	--	--	
Interest expense	2,020	2,520	2,044	1,
Interest income	(845)	(1,401)	(1,311)	(1,
Provision for/(benefit from) income taxes	3,068	(8,428)	5,578	
Consolidated net income	$ 6,520	$ (1,059)	$ 4,783	$ 2,

Total assets:	DECEMBER 31, 2002
Total assets for reportable segments	$473,501
Cash and cash equivalents not allocated to business segments	163,376
Deferred tax assets	18,045
Total consolidated assets	$654,922

13 -- SUBSEQUENT EVENTS

In April 2003, the Financial Accounting Standards Board issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This Statement amends SFAS No. 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. All provisions of this Statement are to be applied prospectively. The Company will apply the provisions of this statement as of June 30, 2003. The Company believes that the application of SFAS No. 149 will not have a material impact on its financial position or results of operations.

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

OF OPERATIONS

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in our 2002 Annual Report on Form 10-K and the condensed consolidated unaudited financial statements and related notes included elsewhere in this report. In addition to disclosing results for the three months ended March 31, 2003 and 2002 that are determined in accordance with Generally Accepted Accounting Principles ("GAAP"), the Company also discloses non-GAAP financial measures that exclude the effects of restructuring and related charges recorded in the 2002 period on consolidated net income available/loss applicable to common stockholders and diluted earnings/loss per share and on the operating income of its Bioproducts segment. The Company is presenting non-GAAP financial measures excluding the effects of the restructuring and related charges because the Company believes it is useful for investors in assessing the Company's financial results compared to the same period in the prior year. Within the text, in connection with each non-GAAP financial measure presented, the Company has presented the most directly comparable financial measure calculated in accordance with GAAP and has provided a reconciliation of the differences between the non-GAAP financial measure with its most directly comparable financial measure calculated and presented in accordance with GAAP.

OVERVIEW

We are a diversified biotechnology company that develops and delivers products and services to the industrial, consumer, agri-processing and health care markets. Our current revenues result primarily from the sale of enzyme products to the cleaning, grain processing and textile industries, with the remainder of our revenues from research funding, fees and royalties. We intend to apply our proven and proprietary technologies and manufacturing capabilities to expand sales in our existing markets and address new opportunities in the health care, agri-processing, industrial, and consumer markets. We have formed, and plan to continue to form, strategic alliances with market leaders to collaborate with us to develop and launch products.

We manufacture our products at our eight manufacturing facilities located in the United States, Finland, Belgium, China and Argentina. These products are then marketed to the industrial, consumer and agri-processing markets through our direct sales organization and other distribution channels. For the year ended December 31, 2002, we derived approximately 50% of our revenues from our foreign operations. For the three months ended March 31, 2003, we derived approximately 60% of our revenues from foreign operations.

SUMMARY OF RESULTS

For the three months ended March 31, 2003, we reported net income available to common stockholders of $4.7 million, or $0.08 per diluted share, compared to a net loss applicable to common stockholders of $2.9 million, or a loss of $0.05 per diluted share for the three months ended March 31, 2002. During the three months ended March 31, 2002, we recorded restructuring and related charges of $16.3 million, or $10.3 million on an after-tax basis. Before these charges, we would have reported net income available to common stockholders of $7.4 million, or $0.12 per diluted share for the three months ended March 31, 2002.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended March 31, 2003 and 2002

Revenues. Total revenues for the three-month period ended March 31, 2003 increased $14.9 million, or 18%, to $95.7 million from the three-month period ended March 31, 2002, primarily due to an increase in product revenues.

Product Revenues. Product revenues for the three months ended March 31, 2003 increased $14.5 million, or 19%, to $90.0 million from the three months ended March 31, 2002. For the three months ended March 31, 2003, unit volume/mix increased 15% and the impact of foreign currency increased 8% while average prices fell 4%. Volume/mix increased primarily in our agri-processing markets, textile markets, and through protease enzyme sales to a major customer, partially offset by a decrease in sales to another major customer.

Regionally, North American product revenues for the three months ended March 31, 2003 increased $1.4 million, or 4%, to $37.6 million from the three months ended March 31, 2002, driven primarily by sales to our agri-processing markets, partially offset by decreased sales to our cleaning and fabric care markets. Product revenues in Europe, Africa and the Middle East for the three months ended March 31, 2003 increased $8.1 million, or 29%, to $35.9 million from the three months ended March 31, 2002, driven primarily by increased sales to our agri-processing markets and protease enzyme sales to a major customer, partially offset by decreased sales to our cleaning and fabric care markets. Our product revenues in the Asia Pacific region increased $4.3 million, or 48%, to $13.2 million for three months ended March 31, 2003 from the three months ended March 31, 2002 due to increased sales to our cleaning and fabric care markets, agri-processing markets and protease enzyme sales to a major customer. Our product revenues in Latin America for the three months ended March 31, 2003 increased $0.7 million, or 27%, to $3.3 million from the three months ended March 31, 2002, primarily due to increased sales to our agri-processing markets, partially offset by decreased sales to our cleaning and fabric care markets.

Fees and Royalty Revenues. Fees and royalty revenues increased $0.3 million, or 6%, to $5.6 million, for the three months ended March 31, 2003 from the three months ended March 31, 2002, due to increases in government and customer funded research.

Funded research revenues for the three months ended March 31, 2003 increased $0.3 million, or 6%, to $5.1 million from the three months ended March 31, 2002. Revenues generated by research funding result from collaborative agreements with various parties, including the U.S. Government, whereby we perform research activities and receive revenues that partially reimburse us for expenses incurred. Under such agreements, we retain a proprietary interest in the products and technology developed.

Our funded research revenue as it relates to U.S. Government collaborations increased $0.2 million, or 22%, to $1.1 million for the three months ended March 31, 2003 from the three months ended March 31, 2002 primarily due to funding provided by the National Renewable Energy Laboratory to develop an enzymatic process to convert biomass into bioethanol. Funded research revenues provided by customers increased $0.1 million, or 3%, to $4.0 million for the three months ended March 31, 2003 from the three months ended March 31, 2002, primarily driven by funding from our strategic alliance with the Dow Corning Corporation.

Royalties increased $0.1 million, or 25%, to $0.5 million for the three months ended March 31, 2003 from the three months ended March 31, 2002, due primarily to the timing of customer royalty payments that are based on the sales of the customers' products produced using our technology.

Operating Expenses

Cost of Products Sold. Cost of products sold increased $8.7 million, or 21%, to $50.8 million for the three months ended March 31, 2003 from the three months ended March 31, 2002. Our expanded sales volume/mix increased costs $4.9 million along with the sale of higher cost inventories of $0.8 million and increases due to the impact of the weaker U.S. Dollar against foreign currencies, primarily the Euro, of $3.0 million.

Gross Profit and Margins from Products Sold. Gross profit from products sold increased $5.8 million, or 17%, to $39.2 million for the three months ended March 31, 2003 from the three months ended March 31, 2002. This overall increase was caused by significant product revenue related factors including a 15% increase in volume/mix processed through our plants, partially offset by an average price decline of 4%. This net increase in gross profit was also affected by a $2.9 million increase due to the impact of the U.S. dollar against foreign currencies. As a result of these factors however, gross margin on product revenue decreased to 43.5% in 2003 from 44.2% in 2002, primarily driven by price reductions and sales of higher cost inventories, partially offset by increases in sales volume/mix.

Research and Development. Research and development expenses primarily consist of the personnel-related, consulting, and facilities costs incurred in connection with our research activities conducted in Palo Alto, California and Leiden, the Netherlands. These expenses increased $0.9 million, or 6%, to $16.5 million for the three months ended March 31, 2003 from the three months ended March 31, 2002, due primarily to increased personnel-related costs, including salaries, benefits and travel expenses of $1.7 million, partially offset by a decrease in outside services of $0.8 million. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers decreased $0.7 million, or 18%, to $3.1 million for the three months ended March 31, 2003 from the three months ended March 31, 2002.

Sales, Marketing and Business Development. Sales, marketing and business development expenses primarily consist of the personnel-related and marketing costs incurred by our global sales force. These expenses increased $0.6 million, or 8%, to $7.7

million for the three months ended March 31, 2003 from the three months ended March 31, 2002, due primarily to increased personnel-related costs, including salaries, benefits, commissions and travel expenses of $0.6 million, outside services of $0.4 million, partially offset by decreases in incentive compensation of $0.3 million and employee programs of $0.3 million.

General and Administrative. General and administrative expenses include the costs of our corporate executive, finance, information technology, legal, human resources, and communications functions. In total, these expenses decreased $0.2 million, or 3%, to $7.8 million for the three months ended March 31, 2003 from the three months ended March 31, 2002, due primarily to decreases in outside services of $0.8 million, advertising and promotions costs of approximately $0.2 million and employee programs of $0.1 million, partially offset by increased personnel-related costs, including salaries, benefits and travel expenses of $0.9 million.

Amortization of Intangible Assets. We amortize our intangible assets, consisting of patents, licenses, customer lists and other contractual agreements on a straight-line basis over their estimated useful lives. Amortization expense increased $0.1 million, or 7%, to $1.4 million for the three months ended March

31, 2003 from the three months ended March 31, 2002.

Other Expense and Income. Other expense and income relates primarily to foreign currency exchange gains and losses on transactions denominated in other than the functional currency of the entity in which the transaction occurred. Other expense for the three months ended March 31, 2003 was $0.7 million as compared with other income of $1.3 million for the three months ended March 31, 2002. This $2.0 million decrease in income was due mainly to Argentine peso-driven foreign currency transaction gains during the three months ended March 31, 2002.

Deferred Compensation. We measure deferred compensation for options granted to employees as the difference between the grant price and the estimated fair value of our common stock on the date we granted the options.

Primarily driven by the grant of stock options to employees during 2000, amortization of deferred stock-based compensation expense was $0.3 million and $0.9 million for the three months ended March 31, 2003 and 2002, respectively, and was reported in our Consolidated Statement of Operations as follows (in millions):

	2003	2002
Cost of products sold	$ -	$ 0.1
Research and development	0.1	0.2
Sales, marketing and business development	--	0.4
General and administrative	0.2	0.2
Total amortization of deferred compensation expense	$ 0.3	$ 0.9

Non Operating Expense and Income

Interest Income. Interest income decreased $0.6 million, or 43%, to $0.8 million for the three months ended March 31, 2003 from the three months ended March 31, 2002 due mainly to lower cash balances and lower interest rates.

Income Taxes. The effective income tax rate for the three months ended March 31, 2003 was a 32% tax expense, compared to an 89% tax benefit for the three months ended March 31, 2002, which reflects our assessment of the annual effective income tax rate. Factors affecting our estimated annual effective income tax rate include increased research and development expenditures in the United States, the statutory income tax rates and mix of earnings among tax jurisdictions, amortization of certain intangible assets and other items which are not deductible for tax purposes, and research and experimentation tax credits. In addition, the estimated annual effective rate in the three months ended March 31, 2003 included the effect of estimated valuation allowances, since we did not have the ability to carry back or anticipate the ability to carry forward our United States net operating losses. The effective rate for the three months ended March 31, 2002 included the effect of restructuring and related charges. Accordingly, the tax benefit related to the restructuring and related charges of approximately $6.0 million was recorded in the first quarter of 2002. During both periods, we were subject to a tax ruling in the Netherlands that reduces the local effective income tax rate from 35.0% to 17.5%. This ruling will expire in 2005.

FINANCIAL RESULTS BY SEGMENT

During the three months ended March 31, 2003, we modified our managerial financial reporting to provide information that aligns with the two-segment structure of Bioproducts and Health Care. Accordingly, we provided historical financial data in this new financial segment-reporting format for the three months ended March 31, 2003 as well as for each of the four quarters of 2002.

The Bioproducts segment develops and delivers products and services for the industrial, consumer and agri-processing markets to a global customer base. All of our current product revenues are derived from this segment. For the three months ended March 31, 2003, the Bioproducts segment achieved operating income of $19.1 million as compared to an operating loss of $0.2 million for the three months ended March 31, 2002. For the three months ended March 31, 2002, Bioproducts recorded restructuring and related costs of $16.3 million. Before these restructuring and related charges, the segment would have reported operating income of $16.1 million for the three months ended March 31, 2002.

The Health Care segment is focused on expanding our current technology and product platforms into the health care market. This segment is primarily engaged in the performance of research and development, the securing of intellectual property and the establishment of strategic investments and collaborations. For the three months ended March 31, 2003, the Health Care segment experienced an operating loss of $7.9 million as compared to an operating loss of $9.7 million for the three months ended March 31, 2002.

ACQUISITION

On December 31, 2002, we acquired the brewing and enzyme business of Rhodia Food UK Limited for a total cash purchase price of $8.9 million. The acquisition included technology, product lines and personnel. The acquisition expanded our Bioproducts portfolio and technical service capabilities in the food, feed and specialty enzyme market sector. No facilities were included in the transaction. The acquisition has been accounted for under the purchase method in accordance with SFAS No. 141, "Business Combinations." The results of operations of the acquired business were consolidated with our results of operations beginning January 1, 2003.

According to our preliminary allocation of the purchase price on December 31, 2002, the $8.9 million consists solely of intangible assets. Due to the effect of foreign currency translation the intangible assets were $9.3 million at March 31, 2003. We are continuing to evaluate the allocation of the purchase price for the acquisition, including the segregation of separately identifiable intangible assets. We anticipate that this process will be completed during 2003.

RESTRUCTURING AND RELATED CHARGES

During February 2002, as a result of the acquisition of EBS and general economic conditions in Latin America, including the devaluation of the Argentine peso, we engaged in a plan to restructure our overall supply infrastructure by ceasing operations at our Elkhart, Indiana plant and downsizing our Argentine facilities. As a result of the plan, restructuring and related charges of $16.3 million were recorded in our operating earnings in the three months ended March 31, 2002. This restructuring was completed during 2002.

LIQUIDITY AND CAPITAL RESOURCES

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

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

As of March 31, 2003, cash and cash equivalents totaled $138.7 million. The funds were invested in short-term instruments, including A-1/P1 and A-2/P2 rated commercial paper, AAA and AA rated medium term notes, institutional money market funds, auction rate preferred securities and bank deposits.

Cash used in operations was $0.2 million for the three months ended March 31, 2003 and cash provided by operations was $1.0 million for the three months ended March 31, 2002. The decrease of $1.2 million in 2003 from 2002 was generated principally by operating income, net of non-cash items such as depreciation and amortization, and changes in operating assets and liabilities.

Cash used in investing activities was $4.5 million and $41.3 million for the three months ended March 31, 2003 and 2002, respectively. This decrease of $36.8 million was driven primarily by the EBS acquisition of $35.8 million and the equity investment in Seattle Genetics, Inc. of $3.0 million during the three months ended March 31, 2002. Capital expenditures for the first quarter were $4.5 million in 2003 compared with $2.3 million in 2002. A significant portion of the capital spending included process improvement projects at our manufacturing and research and development facilities and information technology enhancements. We also continued our construction of a facility for the clinical-scale manufacture of human therapeutic proteins in Rochester, New York during the three months ended March 31, 2003.

Cash used in financing activities was $27.5 million and $27.7 million for the three months ended March 31, 2003 and 2002, respectively. This decrease of $0.2 million was primarily driven by an increase in borrowing by a foreign affiliate. While we are permitted to pay dividends, we currently intend to retain future earnings to finance the expansion of our business. Any future determination to pay cash dividends to our common stockholders will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements, general business conditions and other factors that the board of directors may deem relevant, including covenants in our debt instruments that may limit our ability to declare and pay cash dividends on our capital stock. Covenants in our senior note agreement restrict the payment of dividends or other distributions in cash or other property to the extent the payment puts us in default of these covenants. Such covenants include, but are not limited to, maintaining a debt to total capitalization of no greater than 55% and a maximum ratio of debt to earnings before interest, taxes, depreciation and amortization (EBITDA) of 3.5:1.

At March 31, 2003, we had a $40.0 million revolving credit facility with a syndicate of banks, which is available for general corporate purposes. The

facility, which consists of a credit agreement, makes available to the Company $40.0 million of committed borrowings, which expires on January 31, 2004. The facility carries fees of 0.40% on the amount of unborrowed principal under the agreement. As of March 31, 2003, there were no borrowings under the facility.

Our long-term debt consists primarily of the 6.82% senior notes issued in 1996 to certain institutional investors. The remaining principal amount of these notes is $84.0 million. Annual installment payments of $28.0 million commenced on March 30, 2002. We are currently in compliance with all of the material financial covenants included in the senior note agreement.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that obligations associated with the retirement of a tangible long-lived asset be recorded as a liability when those obligations are incurred, with the amount of the liability initially measured at fair value. Upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. We adopted the provisions of SFAS No. 143 as of January 1, 2003 and there was no impact for the period ended March 31, 2003.

In December 2002, the Financial Accounting Standards Board issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure-an amendment of FASB Statement No. 123." This statement amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 does not permit the use of

the original SFAS No. 123 prospective method of transition for changes to the fair value based method made in fiscal years after December 15, 2003. We currently apply the intrinsic value method and have no plans to convert to the fair value method.

In April 2003, the Financial Accounting Standards Board issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." This Statement amends SFAS No. 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative. This Statement is effective for contracts entered into or modified after June 30, 2003, and for hedging relationships designated after June 30, 2003. All provisions of this Statement are to be applied prospectively. We will apply the provisions of this statement as of June 30, 2003. We believe that the application of SFAS No. 149 will not have a material impact on our financial position or results of operations.

MARKET RISK

Foreign currency risk and interest rate risk are the primary sources of our market risk. Foreign operations, mainly denominated in Euros, accounted for approximately 60% of our revenues for the three months ended March 31, 2003. We believe that we mitigate this risk by locating our manufacturing facilities so that the costs are denominated in the same currency as our product revenues. We may manage the foreign currency exposures that remain through the use of foreign currency forward contracts, currency options and off-setting currency positions in assets and liabilities where deemed appropriate. We do not use these instruments for speculative purposes. There were no material foreign currency gains in connection with these types of contracts recorded in the statement of operations for the three months ended March 31, 2003.

As of March 31, 2003, cash and cash equivalents totaled $138.7 million. Of this amount, $49.8 million was denominated in Euros. The remainder, or $88.9 million, was primarily denominated in U.S. Dollars. Short-term debt was mainly comprised of our third installment of $28.0 million due March 30, 2004 under our 6.82% senior notes discussed under the heading "Liquidity and Capital Resources" in this Report and $8.0 million of short-term debt held by our Chinese affiliate. We expect to refinance all of the debt held by our Chinese affiliate. To the extent U.S. Dollar and Euro interest rates fluctuate either up or down, the return on the cash investments will also fluctuate. To the extent such Euro cash investments remain outstanding, we will be subject to the risks of future foreign exchange fluctuations and the impact on the translation of these cash investments into U.S. Dollars.

Interest Rates

Our interest income is sensitive to changes in the general level of short-term interest rates primarily in the United States and Europe. In this regard, changes in the U.S. Dollar and Euro currency rates affect the interest earned on our cash equivalents, short-term investments, and long-term investments. Our interest expense is generated primarily from fixed rate debt. The $84.0 million 6.82% senior notes outstanding at March 31, 2003 mature evenly in installments of $28.0 million per year. Annual installment payments commenced March 30, 2002.

Foreign Currency Exposure

We conduct business throughout the world. During the three-month period ended March 31, 2003, we derived approximately 50% of our revenues from foreign operations, and these foreign operations generated income that offset net losses in U.S. operations during the same three-month period. Economic conditions in countries where we conduct business and changing foreign currency exchange rates affect our financial position and results of operations. We are exposed to changes in exchange rates in Europe, Latin America, and Asia. The Euro presents our most significant foreign currency exposure risk. Changes in foreign currency exchange rates, especially the strengthening of the U.S. Dollar, may have an adverse effect on our financial position and results of operations as they are expressed in U.S. Dollars. The gains from the U.S. Dollar/Euro transactions for the three months ended March 31, 2003 were not significant.

Our manufacturing and administrative operations for Latin America are located in Argentina. Due to the fact that a significant part of our Latin American revenues were denominated in U.S. Dollars, our statement of operations reflected a $0.5 million foreign currency loss from the remeasurement of related accounts receivable for the three months ended March 31, 2003.

Management monitors foreign currency exposures and may in the ordinary course of business enter into foreign currency forward contracts or options contracts related to specific foreign currency transactions or anticipated cash flows. These contracts generally cover periods of nine months or less and are not material. We recorded a gain of less than $0.1 million in the statement of operations for the three months ended March 31, 2003 from foreign currency contracts. We do not hedge the translation of financial statements of consolidated subsidiaries that maintain their local books and records in foreign currencies.

RISK FACTORS

If any of the following risks actually occur, they could harm our business, financial condition, and/or results of operations.

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

A key element of our business strategy is to utilize our technologies for the development and delivery of new products to the Health Care market and new segments of the Bioproducts market. We intend to significantly increase our investment in research and development to develop products for these markets. The successful development of products is highly uncertain and is dependent on numerous factors, many of which are beyond our control, and may include the following:

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

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

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

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

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

- Due to these factors we may never achieve a return on our research and development expenditures or realize product revenues from the Health Care and new Bioproducts markets that we are targeting.

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

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

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

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

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

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

IF THE DEMAND FOR PROTEIN DEGRADING ENZYMES DECREASES OR IF MAJOR CUSTOMERS REDUCE OR TERMINATE BUSINESS WITH US, OUR REVENUES COULD SIGNIFICANTLY DECLINE.

Our largest selling family of products, protein degrading enzymes, or proteases, accounted for approximately 52% of our 2002 revenue. If the demand for proteases decreases or alternative proteases render our products noncompetitive, our revenues could significantly decline.

In addition, our five largest customers collectively accounted for over 51% of our 2002 product revenues, with our largest customer, The Procter & Gamble Company, accounting for over 35% of such revenues. Our five largest customers in 2002 were Benckiser N.V., Cargill, Incorporated, Danisco Animal Nutrition - the feed ingredients business unit of Danisco A/S which was formerly known as Finnfeeds, The Procter & Gamble Company, and Unilever N.V. Any one of these customers may reduce their level of business with us. Should any of our largest customers decide to reduce or terminate business with us, our revenues and profitability could decline significantly.

We have arrangements of various durations with our major customers and are routinely involved in discussions regarding the status of these relationships. These discussions may lead to extensions or new commercial arrangements, or may be unsuccessful. Our customer relationships involve uncertainty by virtue of economic conditions, customer needs, competitive pressures, our production capabilities and other factors. Consequently, our customer base will change over time as will the nature of our relationships with individual customers, including major customers. For example, we currently expect that our business with Corn Products International, Inc., combined with decreased volume with Unilever N.V., may cause Corn Products to qualify as one of our five largest customers.

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

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

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

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

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

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

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

Those companies with which we have entered or may enter into strategic alliances encounter similar risks and uncertainties with respect to their intellectual property. To the extent that any such alliance companies suffer a loss or impairment of their respective technologies, we may suffer a corresponding loss or impairment that may materially and adversely affect our investments.

FOREIGN CURRENCY FLUCTUATIONS AND ECONOMIC AND POLITICAL CONDITIONS IN FOREIGN

COUNTRIES COULD CAUSE OUR REVENUES AND PROFITS TO DECLINE.

In 2002, we derived approximately 50% of our product revenues from our foreign operations. Our foreign operations generate sales and incur expenses in local currency. As a result, we are exposed to market risk related to unpredictable interest rates and foreign currency exchange rate fluctuations. We recognize foreign currency gains or losses arising from our operations in the period incurred. As a result, currency fluctuations between the U.S. dollar and the currencies in which we do business could cause our revenues and profits to decline.

Product revenues denominated in Euros account for approximately 34% of total product revenues, and the fluctuations in the currency exchange rate against the U.S. dollar can have a significant impact on our reported product revenues.

We expect to continue to operate in foreign countries and that our international sales will continue to account for a significant percentage of our revenues. As such, we are subject to certain risks arising from our international business operations that could be costly in terms of dollars spent, the diversion of management's time, and revenues and profits, including:

- Difficulties and costs associated with staffing and managing foreign operations;

- Unexpected changes in regulatory requirements;

- Difficulties of compliance with a wide variety of foreign laws and regulations;

- Changes in our international distribution network and direct sales forces;

- Political trade restrictions and exchange controls;

- Political, social, or economic unrest including armed conflict and acts of terrorism;

- Labor disputes including work stoppages, strikes and embargoes;

- Inadequate and unreliable services and infrastructure;

- Import or export licensing or permit requirements; and

- Greater risk on credit terms and long accounts receivable collection cycles in some foreign countries.

IF THE OWNERSHIP OF OUR COMMON STOCK CONTINUES TO BE HIGHLY CONCENTRATED, IT MAY PREVENT OTHER STOCKHOLDERS FROM INFLUENCING SIGNIFICANT CORPORATE DECISIONS AND MAY RESULT IN CONFLICTS OF INTEREST THAT COULD CAUSE OUR STOCK PRICE TO DECLINE.

After our initial public offering and continuing to the present, Eastman Chemical Company and Danisco A/S and their affiliates, referred to as our majority stockholders, each own in excess of 40% of our outstanding common stock. The majority stockholders will therefore have the ability, acting together, to control fundamental corporate transactions requiring stockholder approval, including the election of a majority of our directors, approval of merger transactions involving us and the sale of all or substantially all of our assets or other business combination transactions. The concentration of ownership of our common stock may have the effect of either

delaying or preventing a change to our control favored by our other stockholders or accelerating or approving a change to our control opposed by our other stockholders. In addition, the majority stockholders' control over our management could create conflicts of interest between the majority stockholders and us with respect to the allocation of corporate opportunities and between the majority stockholders and other stockholders.

IF EXISTING STOCKHOLDERS SELL LARGE NUMBERS OF SHARES OF OUR COMMON STOCK, OUR STOCK PRICE COULD DECLINE.

The market price of our common stock could decline as a result of sales by our existing stockholders or holders of stock options of a large number of shares of our common stock in the public market or the perception that these sales could occur. Our two majority stockholders, for example, hold over 80% of our common stock, and all of these shares are subject to registration rights. In addition, we issued stock options to our officers, directors and employees pursuant to our 2002 Omnibus Incentive Plan, approved by our stockholders in May 2002, and its predecessor plan.

OUR STOCK PRICE HAS BEEN, AND MAY CONTINUE TO BE, PARTICULARLY VOLATILE.

The stock market from time to time, has experienced significant price and volume fluctuations that are unrelated to the operating performance of companies. The market prices for securities of biotechnology companies, including ours, have been highly volatile in the period since our initial public offering in July 2000 and may continue to be highly volatile in the future. Our stock may be affected by this type of market volatility, as well as by our own performance. The following factors, among other risk factors, may have a significant effect on the market price of our common stock:

- Developments in our relationships with current or future strategic partners;

- Conditions or trends in the biotechnology industry;

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

- Announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;

- Developments in patent or other intellectual proprietary rights or announcements relating to these matters;

- Investor concern regarding the public acceptance of the safety of biotechnology products or announcements relating to these matters;

- Litigation or governmental proceedings or announcements relating to these matters;

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

- Future royalties from product sales, if any, by our licensees;

- Sales of our common stock or other securities in the open market; and

- Period-to-period fluctuations in our operating results.

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

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

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

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

- Fluctuations in consumer demand for products containing our technologies or products, such as back to school sales of blue jeans and other denim products, resulting in an increase in the use of textile processing enzymes, and fluctuations in laundry detergent use due to promotional campaigns run by consumer products companies; and

- Fluctuations in geographic conditions including currency and other economic conditions such as economic crises in Latin America or Asia and increased energy and related transportation costs.

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

CONCERNS ABOUT GENETICALLY ENGINEERED PRODUCTS COULD RESULT IN OUR INABILITY TO COMMERCIALIZE PRODUCTS.

We produce a significant amount of our products from genetically modified microorganisms. We cannot predict public attitudes and acceptance of existing or future products made from genetically modified microorganisms. As a result, if we are not able to overcome the ethical, legal and social concerns relating to safety and environmental hazards of genetic engineering, the general public may not accept our products and this may prevent us from commercializing products dependent on our technologies or inventions. In addition, public attitudes may influence laws and regulations governing the ownership or use of genetic material, which could result in greater government regulation of genetic research and bioengineered products.

IF WE ARE SUBJECT TO A COSTLY PRODUCT LIABILITY DAMAGE CLAIM OR AWARD, OUR PROFITS COULD DECLINE.

We may be held liable if any product we develop, or any product that a third party makes with the use or incorporation of any of our products, causes injury or is found otherwise unsuitable during product testing, manufacturing, marketing or sale. Our current product liability insurance may not cover our potential liabilities. Inability to obtain sufficient insurance coverage in the future at an acceptable cost or otherwise to protect against potential liability claims could prevent or inhibit the commercialization of products developed by us or our strategic partners. If a third party sues us for any injury caused by

our products, our liability could exceed our insurance coverage amounts and total assets and our profits could decline.

IF WE ARE SUBJECT TO COSTLY ENVIRONMENTAL LIABILITY DUE TO THE USE OF HAZARDOUS MATERIALS IN OUR BUSINESS, OUR PROFITS COULD DECLINE.

Our research and development processes involve the controlled use of hazardous materials, including chemical, radioactive and biological materials. Our operations also generate potentially hazardous waste. We cannot eliminate entirely the risk of contamination or the discharge of hazardous materials and any resultant injury from these materials. Federal, state, local and foreign laws and regulations govern the use, manufacture, storage, handling and disposal of these materials. Third parties may sue us for any injury or contamination that results from our use or the third party's use of these materials. Any accident could partially or completely shut down our research and manufacturing facilities and operations. In addition, if we are required to comply with any additional applicable environmental laws and regulations, we may incur additional costs, and any such current or future environmental regulations may impair our research, development or production efforts.

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

Quarterly Evaluation of the Company's Disclosure Controls and Internal Controls

Within the 90 days prior to the date of this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including Jean-Jacques Bienaime, the Company's Chairman, Chief Executive Officer and President, and Raymond J. Land, the Company's Senior Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (Disclosure Controls) pursuant to Securities and Exchange Commission Rule 13a-14 under the Securities Exchange Act of 1934 (Exchange Act). Based upon that evaluation, Mr. Bienaime and Mr. Land concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company required to be included in the Company's periodic filing with the Securities and Exchange Commission. There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Disclosure Controls and Internal Controls

Disclosure Controls are procedures that are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. "Internal Controls" are procedures which are designed with the objective of providing reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America.

Limitations on the Effectiveness of Controls

The Company's management does not expect that our Disclosure Controls or our Internal Controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls 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; over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Nothing to report

ITEM 2. CHANGE IN SECURITIES AND USE OF PROCEEDS

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Nothing to report

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

Nothing to report

ITEM 5. OTHER INFORMATION

On April 2, 2003, the Board of Directors accepted the resignation of W. Thomas Mitchell as the Company's Chairman and as a member of the Company's Board of Directors. Effective on the same date, The Board of Directors appointed Jean-Jacques Bienaime as Chairman and reduced the number of directors to ten.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. EXHIBITS

(10)	Material Contracts
10.1	Lease by and between the Company and The Board of Trustees of the Leland Stanford Junior University dated January 30, 2003
(99)	Additional Exhibits
99.1	Certifications Pursuant to 18 U.S.C. Section 1350 As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

b. REPORTS ON FORM 8-K

None

SIGNATURES

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

GENENCOR INTERNATIONAL, INC.

May 13, 2003 — Date

By: /s/ Raymond J. Land

Raymond J. Land
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

May 13, 2003

By: /s/ Darryl L. Canfield

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Date

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

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CERTIFICATIONS

I, Jean-Jacques Bienaime, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Genencor International, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

By: /s/ Jean-Jacques Bienaime

Jean-Jacques Bienaime,
Chairman, Chief Executive Officer and
President

I, Raymond J. Land, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Genencor International, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 13, 2003

By: /s/ Raymond J. Land

Raymond J. Land,
Senior Vice President and
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description
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99.1	Certifications Pursuant to 18 U.S.C. Section 1350 As Adopted Pursuant to Secti of the Sarbanes-Oxley Act of 2002.