GENENCOR INTERNATIONAL INC
Form 10-Q
November 13, 2003

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

FORM 10-Q

(MARK ONE)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 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.

NUMBER OF SHARES OUTSTANDING

CLASS	AT OCTOBER 31, 2003
COMMON STOCK, PAR VALUE $0.01 PER SHARE	59,197,758

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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 Annual Report on Form 10-K for the year ended December 31, 2002. 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)

	SEPTEMBER 30, 2003	DECEMBER 31 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 157,097	$ 169,001
Trade accounts receivable, net	59,476	51,576
Inventories	56,916	54,215
Other current assets	40,879	27,569
Total current assets	314,368	302,361
Property, plant and equipment, net	221,401	217,110
Goodwill	29,380	29,384
Intangible assets, net	42,897	45,898
Other assets	67,268	60,169
Total assets	$ 675,314	$ 654,922
LIABILITIES, REDEEMABLE PREFERRED STOCK AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ 8,221	$ 7,942
Current maturities of long-term debt	28,291	28,291
Accounts payable and accrued expenses	36,006	47,549
Other current liabilities	18,806	15,536
Total current liabilities	91,324	99,318
Long-term debt	56,761	84,897
Other long-term liabilities	41,001	32,700
Total liabilities	189,086	216,915
Redeemable preferred stock:		
7 1/2% cumulative series A preferred stock, without par value, authorized 1 shares, 1 shares issued and outstanding	175,207	169,750
Stockholders' equity:		
Common stock, par value $0.01 per share, 200,000 shares authorized, 60,897 and 60,251 shares issued at September 30, 2003 and December 31, 2002, respectively	609	602
Additional paid-in capital	356,094	349,579
Treasury stock, 1,780 shares at cost at September 30, 2003 and December 31, 2002	(21,030)	(21,030
Deferred stock-based compensation	(1,160)	(1,164

Accumulated deficit	(2,162)	(14,944
Accumulated other comprehensive loss	(21,330)	(44,786
Total stockholders' equity	311,021	268,257
Total liabilities, redeemable preferred stock and stockholders' equity	$ 675,314	$ 654,922

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

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GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Revenues:				
Product revenue	$ 89,795	$ 85,931	$ 269,577	$ 246,94
Fees and royalty revenues	4,349	4,566	16,575	14,99
Total revenues	94,144	90,497	286,152	261,93
Operating expenses:				
Cost of products sold	52,096	50,270	154,723	138,48
Research and development	18,315	17,360	51,608	50,30
Sales, marketing and business development	8,320	8,293	23,921	24,00
General and administrative	7,946	8,790	23,729	25,08
Amortization of intangible assets	1,414	1,355	4,304	3,98
Restructuring and related charges	--	43	--	16,42
Other (income)/expense	(351)	161	408	(3,29
Total operating expenses	87,740	86,272	258,693	254,98
Operating income	6,404	4,225	27,459	6,95
Non operating expenses/(income):				
Investment expense	--	--	1,018	-
Interest expense	1,539	1,995	5,128	6,55
Interest income	(601)	(1,347)	(3,004)	(4,05
Total non operating expenses/(income)	938	648	3,142	2,50
Income before income taxes	5,466	3,577	24,317	4,45
Provision for/(benefit from) income taxes	1,367	625	6,079	(2,22
Net income	$ 4,099	$ 2,952	$ 18,238	$ 6,67
Net income available to holders of common stock	$ 2,281	$ 1,134	$ 12,782	$ 1,22
Earnings per common share:				
Basic	$ 0.04	$ 0.02	$ 0.22	$ 0.0

Diluted	$ 0.04	$ 0.02	$ 0.21	$ 0.0
Weighted average common shares:				
Basic	58,895	59,311	58,655	59,54
Diluted	61,859	59,312	60,296	59,85

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

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002
Cash flows from operating activities:		
Net income	$ 18,238	$ 6,676
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	26,639	24,418
Amortization of deferred stock-based compensation	679	3,557
Loss on disposition of property, plant and equipment	631	331
Loss from impairment of investment in marketable equity securities	1,018	--
Non-cash portion of restructuring and related charges	--	9,495
(Increase) decrease in operating assets:		
Trade accounts receivable	(4,134)	(1,339)
Inventories	1,239	(384)
Other assets	(12,894)	(4,991)
(Decrease) increase in operating liabilities:		
Accounts payable and accrued expenses	(13,440)	(13,231)
Other liabilities	3,625	2,577
Net cash provided by operating activities	21,601	27,109
Cash flows from investing activities:		
Purchases of property, plant and equipment	(18,640)	(11,872)
Purchases of intangible assets	--	(100)
Proceeds from sale of acquired assets	1,145	--
Payment to acquire equity securities	--	(3,000)
Proceeds from sale of property, plant and equipment	--	191
Acquisition of business, net of cash acquired	--	(35,809)
Net cash used in investing activities	(17,495)	(50,590)

Cash flows from financing activities:		
Proceeds from exercise of stock options	4,362	500
Proceeds from employee stock purchase plan	1,103	1,137
Purchases of treasury shares	--	(198)
Net proceeds from (payments on) notes payable of foreign affiliate	278	(82)
Payment of long-term debt	(28,185)	(28,143)
Net cash used in financing activities	(22,442)	(26,786)
Effect of exchange rate changes on cash	6,432	6,546
Net decrease in cash and cash equivalents	(11,904)	(43,721)
Cash and cash equivalents -- beginning of period	169,001	215,023
Cash and cash equivalents -- end of period	$ 157,097	$ 171,302

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 April 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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 FASB 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 applied the provisions of this statement as of July 1, 2003. The adoption of SFAS No. 149 has had no

material impact on the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how the Company classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that the Company classify a financial instrument within its scope as a liability. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, "Elements of Financial Statements." The remaining provisions of this Statement are consistent with the FASB's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 has had no material impact on the Company's financial position or its results of operations.

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 to holders of common stock, undeclared and unpaid dividends on redeemable preferred stock of $1,818 and $5,456 were deducted from net income for each quarter presented and for each nine month period presented, respectively.

Diluted earnings 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 to holders of common stock of the Company. As a result of stock options outstanding under the Company's 2002 Omnibus Incentive Plan and its predecessor plan, the Stock Option and Stock

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Appreciation Right Plan, there were dilutive securities for the three and nine months ended September 30, 2003 and 2002. The weighted-average impact of these has been reflected in the calculation of diluted earnings per common share for the respective periods presented.

The following table reflects the calculation of basic and diluted earnings per common share for the three and nine months ended September 30, 2003 and 2002:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Net income	$ 4,099	$ 2,952	$ 18,238	$ 6,676
Less: Accrued dividends on preferred stock	(1,818)	(1,818)	(5,456)	(5,456)

Net income available to holders of common stock	$ 2,281	$ 1,134	$ 12,782	$ 1,220
Weighted average common shares:				
Basic	58,895	59,311	58,655	59,549
Effect of stock options	2,964	1	1,641	310
Diluted	61,859	59,312	60,296	59,859
Earnings per common share:				
Basic	$ 0.04	$ 0.02	$ 0.22	$ 0.02
Diluted	$ 0.04	$ 0.02	$ 0.21	$ 0.02

4 -- STOCK-BASED COMPENSATION

The Company adopted the disclosure provisions of SFAS No. 148 effective January 1, 2003. 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 and earnings per share would have been reduced to the pro forma amounts shown below for the three and nine months ended September 30, 2003 and 2002:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Net income available to holders of common stock - as reported	$ 2,281	$ 1,134	$ 12,782	$ 1,220
Add: Stock-based employee compensation expense included in reported net income available, net of related tax	16	222	302	760
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(1,516)	(3,137)	(4,140)	(5,415)
Net income available to holders of common stock - pro forma	$ 781	$ (1,781)	$ 8,944	$ (3,435)
Basic - as reported	$ 0.04	$ 0.02	$ 0.22	$ 0.02
Basic - pro forma	$ 0.01	$ (0.03)	$ 0.15	$ (0.06)
Diluted - as reported	$ 0.04	$ 0.02	$ 0.21	$ 0.02
Diluted - pro forma	$ 0.01	$ (0.03)	$ 0.15	$ (0.06)

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

On June 6, 2003, the Company granted 47 shares of restricted common stock to certain executive officers. These restricted shares were granted at fair market value at the date of grant and the restrictions on these awards expire three years from the grant date. Deferred compensation of $675 was recorded in connection with these awards and was determined based on the number of granted restricted shares and the fair market value on the grant date. This amount was recorded as a component of stockholders' equity and will be amortized as a charge to operations over the vesting period of the awards.

5 -- INVENTORIES

Inventories consist of the following:

	SEPTEMBER 30, 2003	DECEMBER 31, 2002
Raw materials	$ 8,122	$ 8,373
Work-in-progress	7,488	8,003
Finished goods	41,306	37,839
Inventories	$56,916	$54,215

During the three months ended June 30, 2003, the Company sustained damage to its finished bioproducts inventory as a result of an accident in a third party warehouse in Rotterdam, the Netherlands. At that time, the Company reduced its inventories by $7,487 to reflect the estimated amount of product that was lost and recorded $1,041 of other costs incurred as a result of the accident in other current assets as a receivable from the Company's insurer. During the three months ended September 30, 2003, the Company reduced its estimate of the inventory loss by $234 and recognized an additional $2,008 in costs associated with the accident as an additional receivable in other current assets. Certain reduced profits and additional costs, such as production inefficiencies, additional freight and use of overtime are reflected in the results of operations during the nine months ended September 30, 2003. While the Company believes that these reduced profits and additional costs will be subject to insurance recovery, the Company is unable to estimate the ultimate recovery at this time. As of September 30, 2003, the Company has received $2,087 from the insurer.

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 September 30, 2003:

	INTANGIBLE ASSETS			GOODWILL
	TECHNOLOGY	OTHER AMORTIZABLE ASSETS	TOTAL	
Balances, December 31, 2002	$ 15,617	$ 65,429	$ 81,046	$ 29,384
Foreign currency translation and other adjustments	--	2,068	2,068	(4)
Balances, September 30, 2003	$ 15,617	67,497	83,114	$ 29,380
Less: Accumulated amortization		(40,217)	(40,217)	
Intangible assets, net ..		$ 27,280	$ 42,897	

In conjunction with the acquisition discussed in Note 10, 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 amortizable intangible assets and will be segregated among the major classes once the Company completes its allocation of the purchase price.

The foreign currency translation and other adjustments of $2,068 consist of $3,165 of foreign currency translation. Also included are additional acquisition costs of $48 to acquire assets and the sale of certain acquired assets for $1,145, which were sold at fair market value resulting in no gain or loss on the sale.

Estimated fiscal year amortization expense is as follows:

2003..	$5,300
2004..	3,600
2005..	3,100
2006..	2,700
2007..	1,700

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	20,352	3,104	--	23,456
Balances, September 30, 2003 ...	$ (18,848)	$ (359)	$ (2,123)	$ (21,330)

The change in the marketable securities valuation adjustment for the nine months ended September 30, 2003 includes unrealized holding gains of $2,820 ($4,476 pre-tax) on the Company's available-for-sale securities. The remaining $284 ($451 pre-tax) relates to a reduction to other comprehensive loss resulting from the investment loss discussed in Note 8.

8 -- INVESTMENT EXPENSE

During the three months ended June 30, 2003, the Company recorded an investment loss of $1,018 as a result of the Company's assessment of an "other than temporary" decline in the fair market value of an investment in certain common stock. This amount is included in investment expense as part of total non operating expenses/(income) for the period. There was no such investment income or loss in the nine months ended September 30, 2002.

9 -- INCOME TAXES

The effective income tax rate for the nine months ended September 30, 2003 was a 25% tax expense, compared to a 50% tax benefit for the nine months ended September 30, 2002. Factors that affect the Company's estimated annual effective income tax rate include increased research and development expenditures in the United States, the statutory income tax rates in foreign jurisdictions, amortization of certain intangible assets, other operating expense increases and other items which are not deductible for tax purposes, and research and experimentation tax credits. In addition, the estimated annual effective rate for the nine months ended September 30, 2003 includes the effect of estimated valuation allowances, since the Company does 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 nine months ended September 30, 2002 was driven by anticipated annual tax benefits from operating losses in high tax jurisdictions, partially offset by taxes on operating income generated in low tax jurisdictions. The effective rate for the nine months ended September 30, 2002 also included the effect of restructuring and related charges. The tax benefit related to these restructuring and related charges was approximately $6,100 for the nine months ended September 30, 2002.

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10 -- 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, additional acquisition costs and the sale of certain acquired assets, the carrying costs of these intangible assets are $8,815 at September 30, 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 by the end of 2003.

11 -- 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 $16,422 were recorded in the Company's operating earnings in the nine months ended September 30, 2002. This restructuring was completed during 2002.

12 -- 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 consolidated financial statements in 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 three months ended March 31, 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 three months and nine months ended September 30, 2003 and 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 primarily engaged in the performance of research and development, securing intellectual property and the establishment of strategic investments and collaborations in support of the Company's product objectives in the health care market.

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

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2003

	Bioproducts	Health Care	Segment Subtotal	Corporate and Other	Consolidated Totals
Product revenue	$ 89,795	$ --	$ 89,795	$ --	$ 89,795
Fees and royalty revenues ...	4,149	200	4,349	--	4,349
Total revenues	93,944	200	94,144	--	94,144
Research and development	10,925	7,390	18,315	--	18,315
Operating income/(loss)	15,379	(9,183)	6,196	208	6,404

FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2002

	Bioproducts	Health Care	Segment Subtotal	Corporate and Other	Consolidated Totals
Product revenue..............	$ 85,931	$ --	$ 85,931	$ --	$ 85,931
Fees and royalty revenues....	4,566	--	4,566	--	4,566
Total revenues...............	90,497	--	90,497	--	90,497
Research and development.....	9,927	7,433	17,360	--	17,360
Operating income/(loss)......	14,975	(10,479)	4,496	(271)	4,225

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003

	Bioproducts	Health Care	Segment Subtotal	Corporate and Other	Consolidated Totals
Product revenue..............	$269,577	$ --	$269,577	$ --	$269,577
Fees and royalty revenues....	16,150	425	16,575	--	16,575
Total revenues...............	285,727	425	286,152	--	286,152
Research and development.....	32,159	19,449	51,608	--	51,608
Operating income/(loss)......	52,174	(24,625)	27,549	(90)	27,459

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2002

	Bioproducts	Health Care	Segment Subtotal	Corporate and Other	Consolidated Totals
Product revenue..............	$246,949	$ --	$246,949	$ --	$246,949
Fees and royalty revenues....	14,915	75	14,990	--	14,990
Total revenues...............	261,864	75	261,939	--	261,939
Research and development.....	28,683	21,619	50,302	--	50,302
Operating income/(loss)......	33,550	(29,870)	3,680	3,271	6,951

	DECEMBER 31, 2002				
	Bioproducts	Health Care	Segment Subtotal	Corporate and Other	Consolidated Totals
Total assets.................	$467,782	$ 5,719	$473,501	$181,421	$654,922
Depreciation and amortization	31,127	2,064	33,191	--	33,191
Capital additions............	18,153	1,397	19,550	--	19,550

The following table provides a reconciliation of segment information to total consolidated information:

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2003	2002	2003	2002
Net income:				
Operating income/(loss) for reportable segments	$ 6,196	$ 4,496	$ 27,549	$ 3,680
Other (income)/expense	(208)	271	90	(3,271)
Investment expense	--	--	1,018	--
Interest expense	1,539	1,995	5,128	6,559
Interest (income)	(601)	(1,347)	(3,004)	(4,059)
Provision for/(benefit from) income taxes	1,367	625	6,079	(2,225)
Consolidated net income	$ 4,099	$ 2,952	$ 18,238	$ 6,676

	DECEMBER 31, 2002
Total assets:	
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

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 Annual Report on Form 10-K for the year ended December 31, 2002 and the condensed consolidated unaudited financial statements and related notes included elsewhere in this Report. In addition to disclosing results for the three months and nine months ended September 30, 2003 and 2002 that are determined in accordance with United States' 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 to common stockholders and diluted earnings 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, textile, food, and animal feed 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 nine months ended September 30, 2003, we derived approximately 55% of our revenues from foreign operations.

SUMMARY OF RESULTS

For the three months ended September 30, 2003, we reported net income available to common stockholders of $2.3 million, or $0.04 per diluted share, compared to net income available to common stockholders of $1.1 million, or $0.02 per diluted share for the three months ended September 30, 2002. For the nine months ended September 30, 2003, net income available for common stockholders was $12.8 million, or $0.21 per diluted share, compared to net income available to common stockholders of $1.2 million, or $0.02 per diluted share for the nine months ended September 30, 2002. During the nine months ended September 30, 2002, we recorded restructuring and related charges of $16.4

million, or $10.4 million on an after-tax basis. Before these charges, we would have reported net income available to common stockholders of $11.6 million, or $0.19 per diluted share for the nine months ended September 30, 2002.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended September 30, 2003 and 2002

Revenues. Total revenues for the three-month period ended September 30, 2003 increased $3.6 million, or 4%, to $94.1 million from the three-month period ended September 30, 2002, due to increases in product revenues.

Product Revenues. Product revenues for the three months ended September 30, 2003 increased $3.9 million, or 4%, to $89.8 million from the three months ended September 30, 2002. For the three months ended September 30, 2003, unit volume/mix increased 2% and the impact of foreign currency increased revenues 5% while average prices fell 3%.

Volume/mix increased primarily in our food, feed and specialties markets, fuel ethanol markets and textile markets, partially offset by decreases in our sweetener markets and cleaning markets.

Regionally, North American product revenues for the three months ended September 30, 2003 decreased $1.3 million, or 3%, to $38.7 million from the three months ended September 30, 2002, driven primarily by decreased sales to our cleaning markets, sweetener markets and textile markets, partially offset by increased sales to our food, feed and specialties markets and fuel ethanol markets. Product revenues in Europe, Africa and the Middle East for the three months ended September 30, 2003 increased $4.8 million, or 15%, to $36.3 million from the three months ended September 30, 2002, driven primarily by increased sales to our food, feed, and specialties markets, cleaning markets, sweetener markets and textile markets, partially offset by decreased sales to our fuel ethanol markets. Our product revenues in the Asia Pacific region increased $0.5 million, or 5%, to $11.6 million for the three months ended September 30, 2003 from the three months ended September 30, 2002 due primarily to increased sales to our fuel ethanol markets, sweetener markets and cleaning markets, partially offset by decreased sales to our textiles markets and food, feed, and specialties markets. Our product revenues in Latin America for the three months ended September 30, 2003 decreased $0.1 million, or 3%, to $3.2 million from the three months ended September 30, 2002, primarily due to decreased sales to our cleaning markets and sweetener markets, partially offset by increased sales to our textile markets and food, feed, and specialties markets.

Fees and Royalty Revenues. Fees and royalty revenues decreased $0.3 million, or 7%, to $4.3 million for the three months ended September 30, 2003 from the three months ended September 30, 2002, due to decreases in government funded research revenues partially offset by increases in customer funded research.

Funded research revenues for the three months ended September 30, 2003 decreased $0.3 million, or 7%, to $4.1 million from the three months ended September 30, 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 decreased $0.8 million, to less than $0.1 million for the three months ended September 30, 2003 from the three months ended September 30, 2002 primarily due to completion of our agreement with the National Renewable Energy Laboratory to develop an enzymatic process to convert biomass into bioethanol. Funded research revenues provided by customers increased $0.5 million, or 14%, to $4.1 million for the three months ended September 30, 2003 from the three months ended September 30, 2002, primarily driven by funding from our strategic alliance with the Dow Corning Corporation.

Royalty revenues are based on the sales of customers' products produced using our technology. These royalty payments were $0.2 million for the three months ended September 30, 2003 and September 30, 2002. There were no license fees for the three months ended September 30, 2003 and September 30, 2002.

Operating Expenses

Cost of Products Sold. Cost of products sold increased $1.8 million, or 4%, to $52.1 million for the three months ended September 30, 2003 from the three months ended September 30, 2002. Our expanded sales volume/mix increased costs by $2.6 million, along with a $2.6 million increase due to the impact of the U.S. Dollar against foreign currencies, primarily the Euro. These increases in costs were offset by lower unit production costs of $3.4 million.

Gross Profit and Margins from Products Sold. Gross profit from products sold increased $2.1 million, or 6%, to $37.7 million for the three months ended September 30, 2003 from the three months ended September 30, 2002. This increase in gross profit was primarily driven by lower unit production costs of $3.4 million and a $2.0 million favorable impact of the U.S. Dollar against foreign currencies, primarily the Euro. This net increase in gross profit was partially offset by the 3% decline in average selling prices. As a result of these factors, gross margin increased to 42.0% for the three months ended September 30, 2003 from 41.5% for the three months ended September 30, 2002.

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 5%, to $18.3 million for the three months ended September 30,

2003 from the three months ended September 30, 2002, due primarily to an increase in personnel-related costs, including salaries, benefits, travel expenses and other costs of $0.9 million and facilities expense of $0.2 million, partially offset by a decrease in incentive compensation of $0.2 million. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers decreased $1.6 million, or 40%, to $2.4 million for the three months ended September 30, 2003 from the three months ended September 30, 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 and business development functions. These expenses were $8.3 million for the three months ended September 30, 2003 and September 30, 2002. Decreases in incentive compensation costs of $0.7 million were offset by an increase in personnel-related costs, including salaries, benefits, commissions and travel expenses of $0.7 million.

General and Administrative. General and administrative expenses include the

costs of our corporate executive, finance, information technology, legal, human resources, and communications functions. These expenses decreased $0.9 million, or 10%, to $7.9 million for the three months ended September 30, 2003 from the three months ended September 30, 2002, due primarily to decreases in incentive compensation of $0.7 million, outside services of $0.6 million and communication expenses of $0.1 million, partially offset by an increase in personnel-related costs, including salaries, benefits and travel expenses of $0.6 million.

Amortization of Intangible Assets. We amortize our definite-lived intangible assets, consisting of patents, licenses, customer lists and other contractual agreements on a straight-line basis over their estimated useful lives. Amortization expense was $1.4 million for the three months ended September 30, 2003 and September 30, 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 income for the three months ended September 30, 2003 was $0.3 million as compared with other expense of $0.2 million for the three months ended September 30, 2002. This $0.5 million increase in income was due mainly to Argentine Peso and Euro-driven currency transaction gains.

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

In connection with the grant of stock options to employees during 2000, amortization of deferred compensation expense for the three months ended September 30, 2002 was $1.8 million, which included the acceleration of deferred compensation expense related to elimination of all stock-related loans resulting from the surrender to us of approximately 1.4 million restricted shares by certain executive officers.

In total, amortization of deferred stock-based compensation expense was $0.1 million and $2.0 million for the three months ended September 30, 2003 and 2002, respectively, and was reported in our Consolidated Statements of Operations as follows (in millions):

	2003	2002
Cost of products sold	$ --	$ 0.2
Research and development	--	0.3
Sales, marketing and business development	--	0.7
General and administrative	0.1	0.8
Total amortization of deferred compensation expense	$ 0.1	$ 2.0

Non Operating Expense and Income

Interest Income. Interest income decreased $0.7 million, or 54%, to $0.6 million for the three months ended September 30, 2003 from the three months ended September 30, 2002, due mainly to reductions in interest rates and lower cash balances, as discussed below under the heading "Liquidity and Capital Resources."

Income Taxes. The effective income tax rate for the three months ended September 30, 2003 was 25%, compared to 17% for the three months ended September 30, 2002. The effective rate for the three months ended September 30, 2003 is representative of our most recent assessment of our annual effective income tax rate. Factors that affect our estimated annual effective income tax rate include increased research and development expenditures in the United States, the statutory income

tax rates in foreign jurisdictions, amortization of certain intangible assets, other operating expense increases and other items which are not deductible for tax purposes, and research and experimentation tax credits. In addition, the estimated effective rate for the three months ended September 30, 2003 includes the effect of estimated valuation allowances, since we do not have the ability to carry back or anticipate the ability to carry forward our United States net operating losses.

Comparison of the Nine Months Ended September 30, 2003 and 2002

Revenues. Total revenues for the nine months ended September 30, 2003 increased $24.2 million, or 9%, to $286.2 million from the nine months ended September 30, 2002, due to increases in both product revenues and fees and royalty revenues.

Product Revenues. Product revenues in the nine months ended September 30, 2003 increased $22.7 million, or 9%, to $269.6 million from the nine months ended September 30, 2002. For the nine months ended September 30, 2003, unit volume/mix grew 6% along with a positive currency impact of 7%, while average prices fell 4%. Volume/mix increased in our food, feed, and specialties markets, fuel ethanol markets, textile markets and sweeteners markets, partially offset by a decrease in our cleaning markets.

Regionally, North American product revenues for the nine months ended September 30, 2003 decreased $2.6 million, or 2%, to $115.4 million from the nine months ended September 30, 2002, driven primarily by a decrease in sales to our cleaning markets, textile markets and sweetener markets, partially offset by an increase in sales to our food, feed and specialties markets and fuel ethanol markets. Product revenues in Europe, Africa and the Middle East for the nine months ended September 30, 2003 increased $20.5 million, or 23%, to $108.1 million from the nine months ended September 30, 2002, driven primarily by increased sales to our food, feed and specialties markets, sweetener markets, cleaning markets, and textile markets, partially offset by a decreased sales in our fuel ethanol markets. Product revenues in the Asia Pacific region increased $4.5 million, or 14%, to $36.0 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, due mainly to increased sales to our cleaning markets, sweetener markets, fuel ethanol markets, textile markets and food, feed and specialties markets. Our product revenues in Latin America for the nine months ended September 30, 2003 increased $0.2 million, or 2%, to $10.0 million from the nine months ended September 30, 2002, due primarily to increased sales to our sweetener markets and food, feed and specialties markets, partially offset by decreased sales to our textile markets and cleaning markets.

Fees and Royalty Revenues. Fees and royalty revenues increased $1.6 million, or 11%, to $16.6 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, due to increases in funded research revenues and royalties.

Funded research revenues increased $1.2 million, or 9%, to $15.3 million for the nine months ended September 30, 2003 from the nine months ended September 30, 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 8%, to $2.8 million for the nine months ended September 30, 2003 from the nine months ended September 30, 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 $1.0 million, or 9%, to $12.5 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, primarily driven by funding from our strategic alliance with the Dow Corning Corporation.

Royalties increased $0.3 million, or 38%, to $1.1 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, due primarily to the timing of customer royalty payments. License fees increased $0.1 million to $0.2 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002.

Operating Expenses

Cost of Products Sold. Cost of products sold increased $16.2 million, or 12%, to $154.7 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002. Our expanded sales volume/mix increased costs by $10.6 million, along with increases of $10.2 million due to the impact of the U.S. Dollar against foreign currencies, primarily the Euro. These increases were partially offset by lower unit production costs of $4.6 million.

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Gross Profit and Margins from Products Sold. Gross profit from products sold increased $6.5 million, or 6%, to $114.9 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002. This increase in gross profit was primarily driven by a $7.0 million favorable impact of the U.S. Dollar against foreign currencies, primarily the Euro, lower unit production costs of $4.6 million and the sales volume/mix increase of 6%. These increases were partially offset by the 4% decline in average selling prices. As a result of these factors however, gross margin on product revenue decreased to 42.6% for the nine months ended September 30, 2003 from 43.9% for the nine months ended September 30, 2002, primarily driven by the impact of lower average selling prices.

Research and Development. Research and development expenses increased $1.3 million, or 3%, to $51.6 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, primarily due to increases in personnel-related costs, including salaries, benefits and travel expenses of $3.7 million and facility costs of $0.2 million, partially offset by decreases in outside services of $2.0 million, incentive compensation of $0.3 million and supply costs of $0.6 million. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers decreased $2.8 million, or 24%, to $8.8 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002.

Sales, Marketing and Business Development. Sales, marketing and business development expenses decreased $0.1 million to $23.9 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, primarily due to decreases in incentive compensation of $1.2 million and outside

services of $0.3 million, partially offset by an increase in personnel-related costs, including salaries, benefits, commissions and travel expenses of $1.4 million.

General and Administrative. General and administrative expenses decreased $1.4 million, or 6%, to $23.7 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, due primarily to decreases in outside services of $2.2 million, incentive compensation of $0.9 million and advertising and promotions of $0.4 million, partially offset by an increase in personnel-related costs, including salaries, benefits, and travel expenses of $2.1 million.

Amortization of Intangible Assets. Amortization expense increased $0.3 million, or 8%, to $4.3 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002, primarily due to additional amortization of newly acquired intangible assets.

Other Expense and Income. Other expense for the nine months ended September 30, 2003 was $0.4 million as compared to $3.3 million of other income for the nine months ended September 30, 2002. This difference in income of $3.7 million was primarily due to Argentine Peso and Euro-driven foreign currency transaction gains during the nine months ended September 30, 2002.

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

On June 6, 2003, we granted 0.05 million shares of restricted common stock to certain executive officers. These restricted shares were granted at fair market value at the date of grant and the restrictions on these awards expire three years from the date of grant. Deferred compensation expense of $0.7 million was recorded in connection with these awards and was determined based on the number of granted restricted shares and the fair market value on the grant date. This amount was recorded as a component of stockholders' equity and will be amortized as a charge to operations over the vesting period of the awards.

In connection with the grant of stock options to employees during 2000, amortization of deferred compensation expense for the nine months ended September 30, 2002 was $3.2 million, which included the acceleration of deferred compensation expense related to elimination of all stock-related loans resulting from the surrender to us of approximately 1.4 million restricted shares by certain executive officers.

In total, amortization of deferred stock-based compensation expense was $0.7 million and $3.6 million for the nine months ended September 30, 2003 and 2002, respectively, and was reported in our Consolidated Statements of Operations as follows (in millions):

	2003	2002
Cost of products sold	$ --	$ 0.3
Research and development	0.3	0.7
Sales, marketing and business development	0.1	1.4
General and administrative	0.3	1.2
Total amortization of deferred compensation expense	$ 0.7	$ 3.6

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Non Operating Expense and Income

Investment Expense. We recorded an investment loss of $1.0 million in the nine months ended September 30, 2003, as a result of our assessment of an "other than temporary" decline in the fair market value of an investment in certain common stock. There was no such investment income or loss in the nine months ended September 30, 2002.

Interest Income. Interest income decreased $1.1 million, or 27%, to $3.0 million for the nine months ended September 30, 2003 from the nine months ended September 30, 2002 due mainly to the reduction of interest received associated with our lower cash balances, discussed below under the heading "Liquidity and Capital Resources."

Income Taxes. The effective income tax rate for the nine months ended September 30, 2003 was a 25% tax expense, compared to a 50% tax benefit for the nine months ended September 30, 2002. Factors that affect our estimated annual effective income tax rate include increased research and development expenditures in the United States, the statutory income tax rates in foreign jurisdictions, amortization of certain intangible assets, other operating expense increases and other items which are not deductible for tax purposes, and research and experimentation tax credits. In addition, the estimated annual effective rate for the nine months ended September 30, 2003 includes the effect of estimated valuation allowances, since we do 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 nine months ended September 30, 2002 was driven by anticipated annual tax benefits from operating losses in high tax jurisdictions, partially offset by taxes on operating income generated in low tax jurisdictions. The rate for the nine months ended September 30, 2002 also included the effect of the restructuring and related charges. The tax benefit related to these restructuring and related charges was approximately $6.1 million for the nine months ended September 30, 2002.

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 have provided historical financial data in this new financial segment-reporting format for the three months and the nine months ended September 30, 2003 and 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 September 30, 2003, the Bioproducts segment achieved operating income of $15.4 million as compared to an operating income of $15.0 million for the three months ended September 30, 2002. For the nine months ended September 30, 2003, the Bioproducts segment achieved operating income of $52.2 million as compared to an operating income of $33.6 million for the nine months ended September 30, 2002. For the nine months ended September 30, 2002, Bioproducts recorded restructuring and related costs of $16.4 million. Before these restructuring and related charges, the segment would have reported operating income of $50.0 million for the nine months ended September 30, 2002.

The Health Care segment is primarily engaged in the performance of research and development, securing intellectual property and the establishment of strategic investments and collaborations in support of our product objectives in

the health care market. For the three months ended September 30, 2003, the Health Care segment experienced an operating loss of $9.2 million as compared to an operating loss of $10.5 million for the three months ended September 30, 2002. For the nine months ended September 30, 2003, the Health Care segment experienced an operating loss of $24.6 million as compared to an operating loss of $29.9 million for the nine months ended September 30, 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, additional acquisition costs and the sale of certain acquired assets, the carrying costs of these intangible assets are $8.8 million at September 30, 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 by the end of 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 $16.4 million were recorded in our operating earnings for the nine months ended September 30, 2002. This restructuring was completed during 2002.

WAREHOUSE INVENTORY LOSS

During the three months ended June 30, 2003, we sustained damage to our finished bioproducts inventory as a result of an accident in a third party warehouse in Rotterdam, the Netherlands. At that time, we reduced our inventories by $7.5 million to reflect the estimated amount of product that was lost and recorded $1.0 million of other costs incurred as a result of the accident in other current assets as a receivable from our insurer. During the three months ended September 30, 2003, we reduced our estimate of the inventory loss by $0.2 million and recognized an additional $2.0 million in costs associated with the accident as an additional receivable in other current assets. Certain reduced profits and additional costs, such as production inefficiencies, additional freight and use of overtime are reflected in the results of operations during the nine months ended September 30, 2003. While we believe that these reduced profits and additional costs will be subject to insurance recovery, we are unable to estimate the ultimate recovery at this time. As of September 30, 2003, we have received $2.1 million from our insurer.

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 September 30, 2003, cash and cash equivalents totaled $157.1 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 provided by operations was $21.6 million and $27.1 million for the nine months ended September 30, 2003 and 2002, respectively. The decrease of $5.5 million in 2003 from 2002 was generated principally by increases in operating earnings, net of non-cash items such as depreciation and amortization, offset by changes in operating assets and liabilities.

Cash used in investing activities was $17.5 million and $50.6 million for the nine months ended September 30, 2003 and 2002, respectively. This decrease of $33.1 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 nine months ended September 30, 2002. Cash used in investing activities for the nine months ended September 30, 2003 included $1.1 million in proceeds from the sale of certain acquired assets as discussed above in Acquisitions. Capital expenditures for the nine months ended September 30, 2003 were $18.6 million in 2003 compared with $11.9 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, as well as the construction of our Rochester, New York facility for the clinical scale manufacturing of human therapeutic proteins. During the three months ended September 30, 2003, we completed construction of the facility. Equipment installation and facility start-up and validation are currently under way.

Cash used in financing activities was $22.4 million and $26.8 million for the nine months ended September 30, 2003 and 2002, respectively. This decrease of $4.4 million was primarily driven by proceeds received from the exercise of stock options during the nine months ended September 30, 2003. While we are permitted to pay dividends to our common stockholders, we currently intend to utilize our resources 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 September 30, 2003, we had a $40.0 million revolving credit facility with a syndicate of banks which is available for general corporate purposes. The facility makes available to us $40.0 million of committed borrowings and carries fees of 0.35% on the amount of unborrowed principal under the credit agreement. As of September 30, 2003, there were no borrowings under this facility, which is scheduled to expire on January 31, 2004. We currently intend to renew or replace this committed 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 the financial covenants included in the senior note agreement.

NEW ACCOUNTING PRONOUNCEMENTS

In April 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (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 FASB 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 have applied the provisions of this statement as of July 1, 2003. The adoption of SFAS No. 149 has had no material impact on our financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how we classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires that we classify a financial instrument within its scope as a liability. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, "Elements of Financial Statements." The remaining provisions of this Statement are consistent with the FASB's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at

the beginning of the first interim period beginning after June 15, 2003. The adoption of SFAS No. 150 has had no 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 55% of our revenues for the nine months ended September 30, 2003. We believe that we mitigate this risk by locating our manufacturing facilities so that a significant portion of our 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. We recorded a gain of $0.1 million in the statement of operations for the nine months ended September 30, 2003 from foreign currency contracts.

As of September 30, 2003, cash and cash equivalents totaled $157.1 million. Of this amount, $63.9 million was denominated in Euros. The remainder, or $93.2 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 September 30, 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 nine months ended September 30, 2003, we derived approximately 55% of our revenues from foreign operations, and these foreign operations generated income that offset net losses in our U.S. operations during the same nine 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 foreign exchange rates in Europe, Latin America, and Asia. The Euro and Argentine Peso present 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. Our manufacturing and administrative operations for Latin America are located in Argentina. A significant part of our Latin American revenues are denominated in U.S. Dollars. Net foreign exchange losses from U.S. Dollar/Euro and U.S. Dollar/ Argentine Peso transactions were $0.2 million for the nine months ended September 30, 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 $0.1 million in the statement of operations for the nine months ended September 30, 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, results of operations and or our cash flows.

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 continue to invest significant amounts into 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

o 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 decreased volume with Unilever N.V. will cause another buyer to qualify as one of our five largest customers for 2003.

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 accounted for approximately 34% of total 2002 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 market analysts and investors, our stock price would likely decline. Some of the factors that could cause our revenue and operating results to fluctuate include:

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

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

- 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

As of the end of the period covered by 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-15 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 changes in the Company's internal control over financial reporting that occurred during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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. CHANGES 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

Nothing to report

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

A. EXHIBITS

(10) Material Contracts
10.1 Letter agreement, dated February 11, 2003, between Dow Corning Corporation and the Company

(31) Rule 13a-14(a)/15d-14(a) Certifications
31.1 Rule 13a-14(a)/15d-14(a) Certifications

(32) Section 1350 Certifications
32.1 Section 1350 Certifications

B. REPORTS ON FORM 8-K

On July 31, 2003 the Company filed a Current Report on Form 8-K regarding its press release concerning financial results for the three months and six months ended June 30, 2003. The report included condensed financial statements and other financial information.

SIGNATURES

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

GENENCOR INTERNATIONAL, INC.

November 12, 2003	By: /s/ Raymond J. Land
Date	Raymond J. Land Senior Vice President and Chief Financial Officer (Principal Financial Officer)
November 12, 2003	By: /s/ Darryl L. Canfield
Date	Darryl L. Canfield Vice President and Corporate Controller (Chief Accounting Officer)

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