GENENCOR INTERNATIONAL INC
Form 10-Q
May 15, 2001

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

FORM 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2001

OR

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

COMMISSION FILE NUMBER 000-31167

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

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

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

INDICATE BY CHECK MARK WHETHER THE REGISTRANT (1) HAS FILED ALL REPORTS REQUIRED TO BE FILED BY SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 DURING THE PRECEDING 12 MONTHS (OR FOR SUCH SHORTER PERIOD THAT THE REGISTRANT WAS REQUIRED TO FILE SUCH REPORT(S), AND (2) HAS BEEN SUBJECT TO SUCH FILING REQUIREMENTS FOR THE PAST 90 DAYS
YES [X] NO [ ]

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

CLASS	NUMBER OF SHARES OUTSTANDING AT MAY 10, 2001

COMMON STOCK, PAR VALUE $0.01 PER SHARE 59,912,337

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	MARCH 2001
ASSETS	
Current assets:	
Cash and cash equivalents	$ 197,
Trade accounts receivable, net	44,
Inventories	49,
Other current assets	16,
Total current assets	308,
Property, plant and equipment, net	208,
Intangible assets, net	60,
Other assets	47,
Total assets	$ 625,

LIABILITIES, REDEEMABLE PREFERRED STOCK AND SHAREHOLDERS' EQUITY	
Current liabilities:	
Notes payable	$ 6,
Current maturities of long-term debt	28,
Accounts payable and accrued expenses	37,
Other current liabilities	8,
Total current liabilities	80,
Long-term debt	114,
Other long-term liabilities	28,
Total liabilities	223,
Redeemable preferred stock:	
7 1/2% cumulative series A preferred stock, without par value, authorized 1,000 shares, 970 shares issued and outstanding	157,
Shareholders' equity:	
Common stock, par value $0.01 per share, 200,000,000 shares authorized, 59,910,253 and 59,906,500 shares issued and outstanding at March 31, 2001 and December 31, 2000, respectively	
Additional paid-in capital	344,
Deferred stock-based compensation	(4,
Notes receivable for common stock	(18,
Accumulated deficit	(19,
Accumulated other comprehensive loss	(57,
Total shareholders' equity	245,
Total liabilities, redeemable preferred stock and shareholders' equity	$ 625,

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

4

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	THREE MONTHS ENDED MARCH 31,	
	2001	2000
Revenues:		
Product revenue	$ 75,268	$ 73,640
Fees and royalty revenues	2,455	6,059
Total revenues	77,723	79,699
Operating expenses:		
Cost of product sold	40,898	41,998

Research and development	12,924	11,824
Sales, marketing and business development	5,857	5,665
General and administrative	6,482	5,542
Amortization of intangible assets	2,397	2,672
Other expense/(income)	848	(299)
Total operating expenses	69,406	67,402
Operating income	8,317	12,297
Non operating (income)/expenses:		
Investment income	--	(15,046)
Interest expense	2,607	2,660
Interest income	(3,117)	(560)
Total non operating income	(510)	(12,946)
Income before provision for income taxes	8,827	25,243
Provision for income taxes	2,550	8,700
Net income	$ 6,277	$ 16,543
Net income available to holders of common stock.	$ 4,458	$ 14,724
Earnings per common share:		
Basic	$ 0.07	$ 0.29
Diluted	$ 0.07	$ 0.28
Weighted average common shares:		
Basic	59,908,089	50,000,000
Diluted	61,458,775	51,816,735

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

5

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

	THREE MONTHS ENDED MARCH 31,	
	2001	2000
Cash flows from operating activities:		
Net income	$ 6,277	$ 16,543
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,990	8,952
Amortization of deferred stock-based		

compensation	593	--
Gain on sale of marketable securities	--	(15,046)
Decrease (increase) in operating assets:		
Trade accounts receivable	436	1,999
Inventories	(4,313)	(884)
Other assets	4,252	(238)
Decrease in operating liabilities:		
Accounts payable and accrued expenses	(7,867)	(2,145)
Other liabilities	(3,701)	(5,740)
Net cash provided by operating activities	4,667	3,441
Cash flows from investing activities:		
Purchases of property, plant and equipment	(4,706)	(3,639)
Proceeds from the sale of marketable securities	--	15,928
Net cash (used in) provided by investing activities	(4,706)	12,289
Cash flows from financing activities:		
Proceeds from exercise of stock options	37	--
Net payments on notes payable of foreign affiliate	(121)	--
Net cash used in financing activities	(84)	--
Effect of exchange rate changes on cash	(3,086)	(1,198)
Net (decrease)/increase in cash and cash equivalents	(3,209)	14,532
Cash and cash equivalents-- beginning of period	200,591	39,331
Cash and cash equivalents-- end of period	$ 197,382	$ 53,863

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

GENENCOR INTERNATIONAL, INC. AND SUBSIDIARIES

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

1 -- BASIS OF PRESENTATION

The condensed consolidated unaudited financial statements should be read in conjunction with the Company's audited consolidated financial statements and related footnotes for the year ended December 31, 2000, as included in the Company's Report on Form 10-K. These interim financial statements have been prepared in conformity with the rules and regulations of the U.S. Securities and Exchange Commission. Certain disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations pertaining to interim financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for fair presentation of the interim financial statements have been included therein. The results of operations of any interim period are not necessarily indicative of the results of operations for the full year.

2 -- EARNINGS PER SHARE

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 common shareholders, undeclared and unpaid dividends on redeemable preferred stock of $1,819 were deducted from net income for each quarter presented.

Diluted earnings per share reflects the potential dilution that could occur if dilutive securities and other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the net income available to common shareholders of the Company. As a result of stock options outstanding under the Company's Stock Option and Stock Appreciation Right Plan, there were dilutive securities for the three months ended March 31, 2001 and 2000. The weighted-average impact of these has been reflected in the calculation of diluted earnings per share for the respective periods presented.

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

	2001	2000
Net income	$ 6,277	$ 16,543
Less: Accrued dividends on preferred stock	(1,819)	(1,819)
Net income available to holders of common stock	$ 4,458	$ 14,724
Weighted average common shares:		
Basic	59,908,089	50,000,000
Effect of stock options	1,550,686	1,816,735
Diluted	61,458,775	51,816,735
Earnings per common share:		
Basic	$ 0.07	$ 0.29
Diluted	$ 0.07	$ 0.28

3 -- FEES AND ROYALTY REVENUES

In January 2000, the Company, in settlement of certain patent infringement claims with one of its customers, received $3.5 million for payment of back royalties.

4 -- INVENTORIES

Inventories consist of the following:

	MARCH 31, 2001	DECEM 2
Raw materials	$ 8,492	$
Work-in-progress	8,437	
Finished goods	32,797	
Inventories	$ 49,726	$

5 -- SHAREHOLDERS' EQUITY

Accumulated other comprehensive loss consists of the following:

	FOREIGN CURRENCY TRANSLATION ADJUSTMENT	MARKETABLE SECURITIES VALUATION ADJUSTMENT
Balances, December 31, 2000	$ (48,360)	$ 228
Current period change	(9,351)	274
Balances, March 31, 2001	$ (57,711)	$ 502

The change in the marketable securities valuation adjustment for the three months ended March 31, 2001, of $274 ($435 pre-tax) relates to unrealized holding gains on the Company's available-for-sale securities.

6 -- INVESTMENT INCOME

There was no investment income during the three months ended March 31, 2001. During the three months ended March 31, 2000, the Company realized a gain on the sale of marketable securities in the amount of $15,046. This amount is included in investment income as part of total non operating income for the period.

7 -- SUBSEQUENT EVENTS

Subsequent to March 31, 2001 the Company's existing $48 million revolving credit agreement with a syndicate of banks was amended and the committed amounts increased to $60 million. The amended facility grants the Company $40 million of three year committed borrowings and $20 million of one year committed borrowings, which may be renewed each year.

8

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

The following discussion of our financial condition and results of operations should be read in conjunction with the consolidated financial statements and the notes to those statements included in our 2000 Annual Report on Form 10-K, and the condensed consolidated unaudited financial statements included elsewhere in this report. This discussion may contain forward-looking statements that involve certain risks and uncertainties. Our actual results could differ materially from those anticipated by forward-looking information due to many factors, including those identified below and in our 2000 Annual Report on Form 10-K.

OVERVIEW

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

We manufacture our products through our eight manufacturing facilities located in the United States, Finland, Belgium, China and Argentina. We conduct our sales and marketing activities through our direct sales organizations in the United States, the Netherlands, Singapore, Japan and Argentina. In 2000 we derived approximately 51% of our revenues from our foreign operations. For the three months ended March 31, 2001, we have derived approximately 50% of our revenues from our foreign operations.

SUMMARY OF RESULTS

For the three months ended March 31, 2001, net income available for common shareholders decreased to $4.5 million, or $0.07 per diluted share, from $14.7 million, or $0.28 per diluted share for the three months ended March 31, 2000. Two non-recurring transactions favorably impacted net income for the quarter ended March 31, 2000. We recognized a gain of $15.0 million, $9.2 million tax-effected, from the sale of marketable equity securities and also successfully settled patent infringement issues with one of our customers, which resulted in back royalties of $3.5 million, $2.1 million tax-effected.

RECENT DEVELOPMENTS

During the first quarter of 2001, we established a cooperative agreement with the Mayo Clinic for the development of a celiac disease model in conjunction with the January 2001 announcement of a key milestone in our transgenic mouse program. We have the first known in-vivo model that contains the genetically linked DQ2 and DR3 genes. This human HLA gene locus is most commonly associated with autoimmune diseases, such as multiple sclerosis, type 1 diabetes and celiac disease. Our cooperative agreement with the Mayo Clinic aims to build an in-vivo celiac disease model with this mouse. We expect this to be the first in a series of disease-specific HLA mouse models.

In January 2001, we signed a five-year, $70 million, exclusive supply agreement with Cargill's U.S. wet corn milling facilities. Cargill has been a strategic partner of Genencor for more than 10 years.

In March 2001, we signed an agreement with DuPont to expand their multi-year research and development collaboration in the area of metabolic pathway engineering. We will continue to develop advanced bioprocessing technology for the manufacture of a critical monomer for the synthesis of high-performance

polyester from glucose. Under the terms of this agreement, we will receive research and development funding, potential milestone payments, and upon commercialization, royalties on product sales.

RESULTS OF OPERATIONS

Comparison of the Three Months Ended March 31, 2001 and 2000

Revenues. Total revenues in 2001 decreased $2.0 million to $77.7 million in 2001 from 2000, due mainly to a decrease in fees and royalty revenues.

Product Revenues. Product revenues for the three months ended March 31, 2001 increased $1.7 million, or 2%, to $75.3 million from the three months ended March 31, 2000. Excluding the impact of the stronger U.S. dollar against foreign currencies, primarily the Euro, product revenues for the three months ended March 31, 2001 would have increased by approximately 5%, to $77.2 million. For the three months ended March 31, 2001, unit volume/mix grew 7%, while average prices fell 2%. Volume increased primarily due to increased protease enzyme sales to a major customer and increased sales volume with our textile and grain processing customers.

Regionally, North American product revenues for the three months ended March 31, 2001 increased $1.5 million, or 4%, to $36.0 million from the three months ended March 31, 2000, driven primarily by sales to our cleaning customers. European product revenues for the three months ended March 31, 2001 declined $0.6 million, or 2%, to $26.5 million from the three months ended March 31, 2000, due primarily to lower cleaning sales and the impact of currency exchange rates. Our product revenues in Latin America for the three months ended March 31, 2001 were consistent with the three months ended March 31, 2000. Product revenues in Asia increased $0.7 million, or 9%, to $8.4 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 due mainly to growth in China, Korea, and Taiwan.

Fees and Royalty Revenues. Fees and royalty revenues decreased $3.6 million, or 59%, to $2.5 million for the three months ended March 31, 2001 from the three months ended March 31, 2000, due primarily to a decrease in royalties.

Funded research revenues for the three months ended March 31, 2001 were $2.2 million compared to $2.5 million for the three months ended March 31, 2000. Revenues generated by research funding result from collaborative agreements with various parties, including the U.S. Government, whereby we perform research activities and receive revenues that partially reimburse us for expenses incurred. Under such agreements, we retain a proprietary interest in the products and technology developed. Our funded research revenue as it relates to U.S. Government collaborations increased $0.1 million to $0.8 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 primarily due to funding provided by the National Renewable Energy Laboratory to develop an enzymatic process to convert biomass into bioethanol. This increase was partially offset by a decrease in U.S. Government funded research revenues for the three months ended March 31, 2001 due to the successful completion during September 2000 of a program partially funded by the Advanced Technology Program/National Institute of Standards and Technology. Funded research revenues provided by customers decreased $0.4 million, or 22%, to $1.4 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 primarily due to a decrease in funding received under a collaborative agreement with a major customer.

Royalties decreased $3.6 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 due primarily to the successful resolution of a patent infringement issue with a customer, for which back

royalties of $3.5 million were received during the first quarter of 2000. These one-time royalties pertain to previous sales, using patented technology, made by the customer to third parties.

Operating Expenses

Cost of Product Sold. Cost of product sold decreased $1.1 million, or 3%, to $40.9 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 even though our expanded sales volume/mix increased costs $1.3 million. This reduction in cost of product sold was driven primarily by reductions due to the impact of the stronger U.S. dollar against foreign currencies of $1.1 million, the sale of lower cost inventories of approximately $0.7 million, and a decrease in long-term incentive compensation expense of $0.2 million.

Gross Profit and Margins from Product Sold. Gross profit from product sold increased $2.8 million, or 9%, to $34.4 million for the three months ended March 31, 2001 from the three months ended March 31, 2000. This overall increase was caused by significant product revenue related factors including a 7% increase in volume/mix being processed through our plants, partially offset by an average price decline of 2%. These product revenue related factors were combined with a decrease in cost of product sold due to reductions in our manufacturing costs. This net increase in gross profit was partially offset by a $0.8 million decrease due to the impact of the stronger U.S. dollar against foreign currencies, primarily the Euro. As a result of these factors, gross margin on product revenue increased to 45.7% for the three months ended March 31, 2001 from 42.9% for the three months ended March 31, 2000.

Research and Development. Research and development expenses primarily consist of the personnel related, consulting, and facilities costs incurred in connection with our research activities conducted in Palo Alto, California, and Leiden, the Netherlands. These expenses increased $1.1 million, or 9%, to $12.9 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 as we increased our investment in technology and product development for new markets and hired additional internal staff to support our health care and other initiatives. As a part of total research and development expenses, estimated expenses related to research collaborations partially funded by customers decreased $1.9 million, or 50%, to $1.9 million for the three months ended March 31, 2001 from the three months ended March 31, 2000.

Sales, Marketing and Business Development. Sales, marketing and business development expenses primarily consist of the personnel related and marketing costs incurred by our global sales force. These expenses increased $0.2 million, or 4%, to $5.9 million for the three months ended March 31, 2001 from the three months ended March 31, 2000.

General and Administrative. General and administrative expenses include the costs of our corporate executive, finance, information technology, legal, human resources, and communications functions. In total, these expenses increased $1.0 million, or 18%, to $6.5 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 due primarily to increased salaries and benefits of $0.6 million and increased advertising and promotions costs of approximately $0.2 million.

Amortization of Intangible Assets. We amortize our intangible assets, consisting of patents, licenses, technology and goodwill, on a straight-line basis over their estimated useful lives. Amortization expense decreased $0.3 million, or 11%, to $2.4 million for the three months ended March 31, 2001 from

the three months ended March 31, 2000 due primarily to the 2000 release of an income tax valuation allowance that was reallocated to goodwill.

Other Expense and Income. Other expense and income relates primarily to foreign currency exchange gains and losses on transactions denominated in other than the functional currency of the entity in which the transaction occurred. Other expense for the three months ended March 31, 2001 was $0.8 million, as compared with other income of $0.3 million for the three months ended March 31, 2000. This $1.1 million increase in expense was due mainly to an increase in foreign currency transaction losses during the three months ended March 31, 2001.

Deferred Compensation. We measure deferred compensation for options granted to employees as the difference between the grant price and the estimated fair value of our common stock on the date we granted the options. In connection with the grant of stock options to employees during 2000, amortization of deferred compensation expense for the three months ended March 31, 2001 was $0.6 million. These amounts were reported in our statement of operations as follows (in millions):

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

Non Operating Expense and Income

Investment Income. Investment income represents gains from the sale of marketable equity securities. During the three months ended March 31, 2000, we realized a $15.0 million gain on the sale of marketable equity securities.

Interest Income. Interest income increased $2.5 million to $3.1 million for the three months ended March 31, 2001 from the three months ended March 31, 2000 due mainly to earnings on proceeds from our initial public offering.

Income Taxes. Several factors affected our effective income tax rate for the three months ended March 31, 2001, including the statutory income tax rate in foreign jurisdictions, amortization of certain intangible assets and other items which are not deductible for tax purposes, and research and experimentation tax credits. The effective income tax rate for the three months ended March 31, 2001 was 29% compared with 34% for the three months ended March 31, 2000. The effective rate for the three months ended March 31, 2000 included the effect of two one-time events. During the first quarter of 2000, we realized $15.0 million of pre-tax gains from the sale of marketable equity securities and a $3.5 million pre-tax gain from the settlement of certain patent infringement issues, both in the United States and tax effected at a marginal rate of 38.6%. During both periods we were subject to a tax ruling in the Netherlands that reduces the local effective income tax rate from 35.0% to 17.5%. This ruling will expire at the end of 2005.

LIQUIDITY AND CAPITAL RESOURCES

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

We believe that our current cash and cash equivalent balances plus funds to be provided from our current year operating activities will satisfy our funding needs over the next twelve months. We believe that the proceeds from our initial public offering in July 2000, including those received from the underwriters' exercise of their over-allotment option in August 2000, plus funds to be provided from our operating activities will adequately fund our anticipated long-term needs thereafter. Factors that could negatively impact our cash position include, but are not limited to, future levels of product, fees and royalty revenues, expense levels, capital expenditures, acquisitions, and foreign currency exchange rate fluctuations.

As of March 31, 2001, cash and cash equivalents totaled $197.4 million, including $132.7 million of net proceeds from our initial public offering, which we invested in short-term instruments including commercial paper, U.S. treasury bills, institutional money market funds and bank deposits.

Cash provided by operations was $4.7 million and $3.4 million for the three months ended March 31, 2001 and 2000, respectively. The increase of $1.3 million in 2001 from 2000 was generated principally by operating earnings, net of non-cash items such as depreciation and amortization, and changes in operating assets and liabilities.

Cash used by investing activities was $4.7 million for the three months ended March 31, 2001. Cash provided by investing activities was $12.3 million for the three months ended March 31, 2000. This difference of $17.0 million was driven primarily by proceeds of $15.9 million received from the sale of marketable equity securities during the three months ended March 31, 2000. Spending in each of these quarters was driven by capital expenditures, which totaled $4.7 million in 2001 compared with $3.6 million in 2000. A significant portion of this spending included process improvement projects at our manufacturing and research and development facilities and information technology enhancements.

Cash used by financing activities of $0.1 million during the three months ended March 31, 2001 resulted from reductions in our outstanding borrowings on our foreign credit facilities partially offset by cash received from the exercise of stock options during the quarter. There were no dividends paid to our common shareholders for the three months ended March 31, 2001 and 2000. We currently intend to retain future earnings to finance the expansion of our business. Any future determination to pay cash dividends will be at the discretion of our board of directors and will depend upon our financial condition, results of operations, capital requirements, general business conditions and other factors that the board of directors may deem relevant, including covenants in our debt instruments that may limit our ability to declare and pay cash dividends on our capital stock. Covenants in our senior note agreement restrict the payment of dividends or other distributions in cash or other property to the extent the payment puts us in default of these covenants. Such covenants include, but are not limited to, maintaining a debt to total capitalization of no greater than 55% and a maximum ratio of debt to EBITDA of 3.5:1.

As of March 31, 2001 we had a $48 million revolving credit agreement with a syndicate of banks, which is available for general corporate purposes. The facility grants us $32 million of three year committed borrowings and $16 million of one year committed borrowings, which may be renewed each year. The combined facility carries a facility fee of 0.28% on the amount of unborrowed

principal and contains various financial covenants including a debt to total capitalization requirement. As of March 31, 2001 there were no borrowings under this facility. Subsequent to March 31, 2001 the facility was amended and the committed amounts increased to $60 million. The amended facility grants the Company $40 million of three year committed borrowings and $20 million of one year committed borrowings, which may be renewed each year.

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

MARKET RISK

Foreign currency risk and interest rate risk are the primary sources of our market risk. To date, foreign operations, mainly denominated in Euros, account for approximately 50% of our 2001 revenues. We believe that we mitigate this risk by locating our manufacturing facilities so that the costs are denominated in the same currency as our product revenues. We manage the foreign currency exposures that remain through the use of foreign currency forward contracts, currency options and off-setting currency loans where deemed appropriate. We do not use these instruments for speculative purposes.

As of March 31, 2001, cash and cash equivalents totaled $197.4 million. Of this amount, $35 million was denominated in Euros. The remainder or $162.4 million was primarily denominated in U.S. Dollars. Other than the first installment due in March 2002 under our 6.82% senior notes discussed under the heading "Liquidity and Capital Resources," short-term debt outstanding at March 31, 2001 was not significant. To the extent U.S. Dollar and Euro interest rates fluctuate either up or down, the return on the cash investments will also fluctuate. To the extent such Euro cash investments remain outstanding, we will be subject to the risks of future foreign exchange fluctuations and its impact on the translation of these cash investments into U.S. Dollars.

Our subsidiary based in the Netherlands, which adopted the Euro as its functional currency, has U.S. Dollar and Japanese Yen denominated revenues. We use forward currency contracts and option contracts from time to time as deemed appropriate to hedge these anticipated revenues. At March 31, 2001, there were no forward contracts or option contracts outstanding.

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 effect the interest earned on our cash equivalents, short-term investments, and long-term investments.

Foreign currency Exposure

We conduct business throughout the world. To date, we have derived approximately 50% of our 2001 revenues and approximately 93% of our 2001 operating income from foreign operations. Economic conditions in countries where we conduct business and changing foreign currency exchange rates affect our financial position and results of operations. We are exposed to changes in exchange rates in Europe, Latin America, and Asia. The Euro presents our most significant foreign currency exposure risk. Changes in foreign currency exchange rates, especially the strengthening of the U.S. dollar, may have an adverse

effect on our financial position and results of operations as they are expressed in U.S. dollars.

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

13

Risk Factors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

substantial debt, expose us to contingent liabilities and result in amortization expenses related to goodwill and other intangible assets and could negatively impact our profitability.

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

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

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

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

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

A large portion of our expenses, including expenses for facilities, equipment and personnel, are relatively fixed. Accordingly, if product revenue declines or does not grow as we anticipate or non-product revenue declines due to the expiration or termination of strategic alliance agreements or the failure to obtain new agreements or grants, we may not be able to correspondingly reduce

our operating expenses in any particular quarter. Our quarterly revenue and operating results have fluctuated in the past and are likely to do so in the future. If our operating results in some quarters fail to meet the expectations of stock market analysts and investors, our stock price would likely decline. Some of the factors that could cause our revenue and operating results to fluctuate include:

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

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

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

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

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

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

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

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

time.

If a third party successfully claims an intellectual property right to technology we use, it may force us to discontinue an important product or product line, alter our products and processes, pay license fees, pay damages for past infringement or cease certain activities. Under these circumstances, we may attempt to obtain a license to this intellectual property; however, we may not be able to do so on commercially reasonable terms, or at all.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
NONE

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES
NONE

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
NONE

ITEM 5. OTHER INFORMATION
NONE

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a. EXHIBITS
SEE INDEX TO EXHIBITS

b. REPORTS ON FORM 8-K
NONE

16

SIGNATURES

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

GENENCOR INTERNATIONAL, INC.

May 15, 2001

Date

By: /s/ Raymond J. Land

Raymond J. Land
Senior Vice President and Chief Financial Officer

May 15, 2001

Date

By: /s/ Darryl L. Canfield

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

17

INDEX TO EXHIBITS

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

Not applicable.

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

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

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

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

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

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

(d) Line of Credit Offering Letter for a $30,000,000 Line of Credit between the Company and The Chase Manhattan Bank, dated May 4, 2000 is incorporated herein by reference to Exhibit 4.3 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on June 26, 2000.

(e) $10 million Promissory Note by the Company in favor of Gist-Brocades International B.V., dated June 2, 1995 is incorporated herein by reference to Exhibit 4.4 to Amendment No. 1 to the Company's Registration Statement on Form S-1 (Registration No. 333-36452) filed on June 26, 2000.

(10) Material Contracts

*(10.1) Enzyme Supply Agreement by and between the Company and Cargill, Incorporated dated as of January 5, 2001

(11) Statement re computation of per share earnings

Computation can be clearly determined from Note 2 to the financial statements included herein under Item 1.

(15) Letter re unaudited interim financial information

Not applicable.

(18) Letter re change in accounting principles

Not applicable.

(19) Report furnished to security holders

Not applicable.

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

Not applicable.

(23) Consents of experts and counsel

Not applicable.

(24) Power of Attorney

Not applicable.

(99) Additional Exhibits

Not applicable

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* Exhibit filed with this Report