

GENENTECH INC
Form 10-Q
May 02, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark
One)

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

For the quarterly period ended March 31, 2006

or

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

For the transition period from _____ to _____ .

Commission File Number: 1-9813

GENENTECH, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or
organization)

94-2347624

(I.R.S. Employer Identification Number)

1 DNA Way, South San Francisco, California 94080-4990

(Address of principal executive offices and Zip Code)

(650) 225-1000

(Registrant's telephone number, including area code)

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

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

Edgar Filing: GENENTECH INC - Form 10-Q

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

<u>Class</u>	<u>Number of Shares Outstanding</u>
Common Stock \$0.02 par value	1,053,627,146 Outstanding at April 26, 2006

GENENTECH, INC.
TABLE OF CONTENTS

	<u>Page No.</u>
<u>PART I—FINANCIAL INFORMATION</u>	
Item 1.	<u>Financial Statements</u>
	<u>Condensed Consolidated Statements of Income— for the three months ended March 31, 2006 and 2005</u> 3
	<u>Condensed Consolidated Statements of Cash Flows— for the three months ended March 31, 2006 and 2005</u> 4
	<u>Condensed Consolidated Balance Sheets— March 31, 2006 and December 31, 2005</u> 5
	<u>Notes to Condensed Consolidated Financial Statements</u> 6-15
	<u>Report of Independent Registered Public Accounting Firm</u> 16
Item 2.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u> 17-36
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u> 37
Item 4.	<u>Controls and Procedures</u> 37
<u>PART II—OTHER INFORMATION</u>	
Item 1.	<u>Legal Proceedings</u> 38
Item 1A.	<u>Risk Factors</u> 38-49
Item 2.	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u> 50
Item 6.	<u>Exhibits</u> 50
	<u>SIGNATURES</u> 51

In this report, “Genentech,” “we,” “us” and “our” refer to Genentech, Inc.; “Common Stock” refers to Genentech’s Common Stock, par value \$0.02 per share, “Special Common Stock” refers to Genentech’s callable puttable Common Stock, par value \$0.02 per share, all of which was redeemed by Roche Holdings, Inc. (or “Roche”) on June 30, 1999.

We own or have rights to various copyrights, trademarks and trade names used in our business including the following: Activase® (alteplase, recombinant) tissue-plasminogen activator; Avastin® (bevacizumab) anti-VEGF antibody; Cathflo® Activase® (alteplase for catheter clearance); Herceptin® (trastuzumab) anti-HER2 antibody; Lucentis™ (ranibizumab, rhuFab V2) anti-VEGF antibody fragment; Nutropin® (somatropin (rDNA origin) for injection) growth hormone; Nutropin AQ® and Nutropin AQ Pen® (somatropin (rDNA origin) for injection) liquid

formulation growth hormone; Nutropin Depot® (somatropin (rDNA origin) for injectable suspension) encapsulated sustained-release growth hormone; Omnitarg™ (pertuzumab) HER dimerization inhibitor; Protropin® (somatrem for injection) growth hormone; Pulmozyme® (dornase alfa, recombinant) inhalation solution; Raptiva® (efalizumab) anti-CD11a antibody; and TNKase® (tenecteplase) single-bolus thrombolytic agent. Rituxan® (rituximab) anti-CD20 antibody is a registered trademark of Biogen Idec Inc.; Tarceva® (erlotinib) is a trademark of OSI Pharmaceuticals, Inc.; and Xolair® (omalizumab) anti-IgE antibody is a trademark of Novartis AG. This report also includes other trademarks, service marks and trade names of other companies.

PART I—FINANCIAL INFORMATION**Item 1. Financial Statements**

GENENTECH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In millions, except per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2006	2005
Revenues		
Product sales (including amounts from related parties: 2006-\$59; 2005-\$54)	\$ 1,644	\$ 1,186
Royalties (including amounts from a related party: 2006-\$167; 2005-\$104)	286	232
Contract revenue (including amounts from related parties: 2006-\$28; 2005-\$26)	56	44
Total operating revenues	1,986	1,462
Costs and expenses		
Cost of sales (including amounts for related parties: 2006 and 2005-\$50)	262	256
Research and development (including amounts for related parties: 2006-\$53; 2005-\$44) (including contract related: 2006-\$36; 2005-\$27)	374	243
Marketing, general and administrative	441	310
Collaboration profit sharing (including amounts for a related party: 2006-\$43; 2005-\$24)	226	176
Recurring charges related to redemption	26	35
Special items: litigation-related	13	11
Total costs and expenses	1,342	1,031
Operating income	644	431
Other income (expense):		
Interest and other income, net	53	18
Interest expense	(19)	(3)
Total other income, net	34	15
Income before taxes	678	446
Income tax provision	257	162
Net income	\$ 421	\$ 284
Earnings per share		
Basic	\$ 0.40	\$ 0.27
Diluted	\$ 0.39	\$ 0.27
Shares used to compute basic earnings per share	1,054	1,047
Shares used to compute diluted earnings per share	1,075	1,067

GENENTECH, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Three Months Ended March 31,	
	2006	2005
Cash flows from operating activities		
Net income	\$ 421	\$ 284
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	96	88
Employee stock-based compensation	74	-
Deferred income taxes	(50)	(21)
Deferred revenue	10	(9)
Litigation-related liabilities	13	13
Tax benefit from employee stock options	-	51
Excess tax benefit from stock-based compensation arrangements	(49)	-
Gain on sales of securities available-for-sale and other	(3)	(1)
Write-down of securities available-for-sale and other	-	4
Changes in assets and liabilities:		
Receivables and other current assets	(96)	(103)
Inventories	(86)	25
Investments in trading securities	(7)	(1)
Accounts payable, other accrued liabilities, and other long-term liabilities	139	55
Net cash provided by operating activities	462	385
Cash flows from investing activities		
Purchases of securities available-for-sale	(454)	(72)
Proceeds from sales and maturities of securities available-for-sale	193	162
Capital expenditures	(253)	(144)
Change in other assets	(13)	(8)
Net cash used in investing activities	(527)	(62)
Cash flows from financing activities		
Stock issuances under employee stock plans	89	106
Stock repurchases	(227)	(156)
Excess tax benefit from stock-based compensation arrangements	49	-
Net cash used in financing activities	(89)	(50)
Net (decrease) increase in cash and cash equivalents	(154)	273
Cash and cash equivalents at beginning of period	1,225	270
Cash and cash equivalents at end of period	\$ 1,071	\$ 543
Supplemental cash flow data		
Non-cash investing and financing activities		
Capitalization of construction in progress related to financing lease transaction	\$ 27	\$ 44

Exchange of note receivable for a prepaid royalty and other long-term asset	-	29
---	---	----

See Notes to Condensed Consolidated Financial Statements.

GENENTECH, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions)
(Unaudited)

	March 31, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	\$ 1,071	\$ 1,225
Short-term investments	1,213	1,140
Accounts receivable—product sales (net of allowances: 2006-\$93; 2005-\$83; including amounts from related parties: 2006-\$24; 2005-\$4)	615	554
Accounts receivable—royalties (including amounts from related party: 2006-\$199; 2005-\$173)	332	297
Accounts receivable—other (net of allowances: 2006-\$1; 2005-\$1; including amounts from related parties: 2006-\$129; 2005-\$132)	187	199
Inventories	804	703
Prepaid expenses and other current assets	311	268
Total current assets	4,533	4,386
Long-term marketable debt and equity securities	1,658	1,449
Property, plant and equipment, net	3,565	3,349
Goodwill	1,315	1,315
Other intangible assets	548	574
Restricted cash and investments	735	735
Other long-term assets	358	339
Total assets	\$ 12,712	\$ 12,147
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable (including amounts to related parties: 2006-\$3; 2005-\$1)	\$ 328	\$ 339
Deferred revenue	45	44
Taxes payable	318	62
Other accrued liabilities (including amounts to related parties: 2006-\$148; 2005-\$132)	1,059	1,215
Total current liabilities	1,750	1,660
Long-term debt	2,103	2,083
Deferred revenue	229	220
Litigation-related and other long-term liabilities	736	714
Total liabilities	4,818	4,677
Commitments and contingencies		
Stockholders' equity		
Common stock	21	21
Additional paid-in capital	9,468	9,263
Accumulated other comprehensive income	255	253
Accumulated deficit, since June 30, 1999	(1,850)	(2,067)

Total stockholders' equity		7,894		7,470
Total liabilities and stockholders' equity	\$	12,712	\$	12,147

See Notes to Condensed Consolidated Financial Statements.

-5-

GENENTECH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

We prepared the Condensed Consolidated Financial Statements following the requirements of the Securities and Exchange Commission for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by accounting principles generally accepted in the United States of America (or “GAAP”) can be condensed or omitted. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Consolidated Financial Statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2005. In the opinion of management, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of our financial position and operating results.

Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those expected for the full year or any future period.

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of Genentech and all wholly owned subsidiaries. Material intercompany accounts and transactions have been eliminated.

Use of Estimates and Reclassifications

The preparation of financial statements in conformity with GAAP requires management to make judgments, assumptions and estimates that affect the amounts reported in our Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates.

Certain reclassifications of prior period amounts have been made to our Condensed Consolidated Financial Statements to conform to the current period presentation.

Earnings Per Share

Basic earnings per share (or “EPS”) are computed based on the weighted-average number of shares of our Common Stock outstanding. Diluted EPS are computed based on the weighted-average number of shares of our Common Stock and other dilutive securities.

The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations (*in millions*):

Three Months