LYNX THERAPEUTICS INC
Form 10-K/A
October 22, 2004

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

FORM 10-K/A

Amendment No. 3

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

For the fiscal year ended December 31, 2003

OR

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

Commission file number 0-22570

LYNX THERAPEUTICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3161073**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

25861 Industrial Blvd., Hayward, CA 94545
(Address of principal executive offices, including zip code)

(510) 670-9300
(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $.01 par value per share

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 and 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 x No o

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes o No x

State the aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter: $10,920,824.[1]

The number of shares of common stock of the Registrant outstanding as of March 9, 2004, was 6,199,245. The aggregate market value of the common stock of the Registrant held by non-affiliates of the Registrant, based upon the closing price of the common stock reported on the Nasdaq National Market on March 9, 2004, was $30,264,929.[2]

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[1] Based on a closing price of $3.79 per share on June 30, 2003 and 4,654,245 shares outstanding (as adjusted to reflect the Registrant s reverse stock split effected in January 2003). Excludes 1,772,761 shares of the Registrant s common stock held by executive officers, directors and stockholders whose ownership exceed 5% of the common stock outstanding at June 30, 2003.

[2] Based on a closing price of $6.30 per share on March 9, 2004 and 6,199,245 shares outstanding. Excludes 1,395,288 shares of the Registrant s common stock held by executive officers, directors and stockholders whose ownership exceed 5% of the common stock outstanding at March 9, 2004.

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DOCUMENTS INCORPORATED BY REFERENCE

EXPLANATORY NOTE

Lynx Therapeutics, Inc. is filing this Amendment No. 3 on Form 10-K/A to our Annual Report on Form 10-K, originally filed with the Securities and Exchange Commission on March 30, 2004, solely for the purpose of amending and restating certain portions of such Annual Report on Form 10-K. Each of the following sections of the Annual Report is amended and restated in its entirely, and current as of October 22, 2004:

Part I, Item 1. Business Business Risks We will need additional funds in the future, which may not be available to us ;

Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Reserves ;

Part II, Item 8. Consolidated Financial Statements and Supplementary Data Report of Ernst & Young LLP ;

Part II, Item 8. Consolidated Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Note 1. Summary of Significant Accounting Policies and Basis of Presentation Business and Basis of Presentation ; and

Part II, Item 8. Consolidated Financial Statements and Supplementary Data Notes to Consolidated Financial Statements Note 18. Liquidity .

In addition, we have filed the following exhibits herewith:

23.3 Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.

31.7 Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

31.8 Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

32.3 Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).

Except as specifically indicated herein, no other information included in the Annual Report on Form 10-K is amended by this Amendment No. 3 on Form 10-K/A.

LYNX THERAPEUTICS, INC.

FORM 10-K/A ANNUAL REPORT FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003

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PART I

Item 1. Business

Except for the historical information contained herein, this report contains certain information that is forward-looking in nature. Examples of forward-looking statements include statements regarding Lynx s future financial results, operating results, product successes, business strategies, projected costs, future products, competitive positions and plans and objectives of management for future operations. In some cases, you can identify forward-looking statements by terminology, such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, potential or continue or the negative of such terms and other comparable terminology. In addition, statements that refer to expectations or other characterizations of future events or circumstances are forward-looking statements. These statements involve known and unknown risks and uncertainties that may cause Lynx s or its industry s results, levels of activity, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that may cause or contribute to such differences include, among others, those discussed under the captions Item 1. Business Business Risks and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations. These and many other factors could affect the future financial and operating results of Lynx. Lynx undertakes no obligation to update any forward-looking statement to reflect events after the date of this report.

Lynx, MPSS , Megaclone , Megasort , Megatype , Protein ProFiler and the Lynx logo are some of Lynx Therapeutics, Inc. s trademarks and service marks.

In January 2003, we received stockholder approval for, and effected, a reverse stock split of our common stock at a ratio of 1-for-7 (the reverse stock split). As a result of the reverse stock split, each outstanding share of common stock automatically converted into one-seventh of a share of common stock, with the par value of each share of common stock remaining at one cent ($.01) per share. Accordingly, common stock share and per share amounts for all periods presented have been adjusted to reflect the impact of the reverse stock split.

Overview

We believe that Lynx Therapeutics, Inc. is a leader in the development and application of novel genomics analysis solutions. Our Massively Parallel Signature Sequencing, or MPSS, instruments analyze millions of DNA molecules in parallel, enabling genome structure characterization at what we believe to be an unprecedented level of resolution. As applied to gene expression analysis, MPSS provides comprehensive and quantitative digital information important to modern systems biology research in the pharmaceutical, biotechnology and agricultural industries. Gene expression refers to the number of genes and the extent a cell or tissue expresses those genes, and represents a way to move beyond DNA sequence data to understand the function of genes, the proteins that they encode and the role they play in health and disease. Systems biology is an approach in which researchers seek to gain a complete molecular understanding of biological systems in health and disease.

We believe that our MPSS generates a complete, accurate and quantitative analysis of the Transcriptome, which is the full complement of activated genes, messenger RNAs or transcripts in a particular tissue at a particular time, to enable systems biology. Transcriptome analysis provides information about all of the genes that are expressed in a biological sample. MPSS generates simultaneously, from a million or more Megaclone, our unique and proprietary cloning procedure, micro-beads, gene sequence information that uniquely identifies a sample s DNA molecules without the need for individual conventional sequencing reactions and produces a comprehensive quantitative profile of gene expression in cells or tissues. MPSS is capable of finding and identifying genes that are expressed at low levels in the cell, beyond the normal sensitivity levels of microarrays, which are small glass or silicon wafers with tens of thousands of DNA molecules arrayed on the surface for subsequent analysis and are the current leading tool for

gene expression analysis on the market. As a result, Lynx believes that MPSS provides a highly reproducible, quantitative digital readout for the activity of virtually every gene in a biological sample. Additionally, unlike microarrays, which are limited to the genes represented on them, MPSS does not require advance knowledge of genes or sequences and, therefore, has broad potential commercial applicability to humans, animals, plants and other commercially important organisms.

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Our current business model is primarily focused on providing genomics discovery services, such as gene expression analysis and genomic sequencing using MPSS. Our commercialization strategies, tactics and target customers for MPSS generally involve expanding our work with scientific thought leaders and genomics researchers and gaining additional customers in the pharmaceutical, biotechnology and agricultural industries.

Megaclone, our unique and proprietary cloning procedure, is the DNA cloning technology that underlies MPSS. Megaclone transforms a biological sample containing millions of DNA molecules into one made up of millions of micro-beads, which are microscopic beads of latex, each of which carries approximately 100,000 copies of one of the DNA molecules in the sample. We were incorporated in Delaware in February 1992. Please see a discussion of our plans under Item 1. Business Business Risks and Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources.

Industry Background

The publication of the human genome was a milestone in the history of genetics and genomics. Genetic differences between people and populations can have a significant biological impact, including a major influence on health. However, the remaining challenge for researchers in industry and academia alike is to explore the multitude of genomic variations and to discover, from the analysis of these differences, the functions of genes and their roles in health and disease. Researchers in industry and academia alike are exploring the multitude of genomic sequence and epigenetic variations of individuals and populations for a better understanding of the role of genes and gene expression in the human body, suggesting new ways to tackle disease and ultimately to the discovery of new diagnostics and therapies. It is this work, post genome-sequencing, that is expected to lead to commercial opportunities and ultimately to the discovery of new therapies and diagnostics for unmet medical needs and to provide the basis for the emerging fields of pharmacogenomics (the identification and assessment of genes that are predictive of the efficacy and/or toxicity of drug compounds or that may correlate drug responses to the genotype, or genetic makeup, of an individual), and individualized patient therapy (personalized medicine).

Many diseases result from a malfunction of the genetically programmed protective response to insults, such as trauma, infection, stress and/or inherited mutant genes and/or deleterious combinations of common variants of a number of genes. That malfunction may result in inadequate, misguided or exaggerated gene expression, unfolding a complex pathogenic process that may resolve itself, linger chronically or evolve with increasingly destructive effects in a manner quite removed from, and even independent of, the original insult. Complex traits often play a significant role in disease; these are due to interactions between the environment and common variants of many genetic factors sometimes including defective, mutant genes. By analyzing which genes are expressed in a cell or tissue, the level of expression can illustrate which physiological pathways are active in the cell and to what degree. By understanding when and where abnormal gene expression occurs and the changes in expression that a drug can cause, the physiological pathways implicated in disease and drug action can be pinpointed. This knowledge could be used to help discover drug targets, screen drug leads, predict a compound s toxic effects, anticipate pharmacological responses to drug leads and tailor clinical trials to the specific needs of subgroups within a population. By recognizing gene expression patterns, researchers, and ultimately physicians, may also be able to determine which treatments are likely to be effective for a specific condition and which may be ineffective or harmful.

Genomics approaches to therapeutics discovery seek to identify genes connected to the origin of a disease. Searches to identify such genes generally are laborious and involve a very large amount of conventional DNA sequencing to identify genes or gene fragments. This knowledge of genes is only a first step. While it may pave the way for the development of better diagnostics, it may not necessarily lead to a successful therapy. For example, while a particular gene, or absence of a gene, may predispose a person to a cancer, an entirely different set of genes is likely to govern the tumor and its metastases. Hence, in addition to understanding the cause of disease, it is important to understand entire networks of genes and their functions in both healthy and diseased states in order to identify the

optimal targets for therapy.

One current approach to genomics research is based on the study of gene expression and regulation of gene expression in cells in differing states or conditions. Gene expression in a cell consists of transcription, the process that converts the genetic information encoded in the double-stranded DNA of a gene into mRNA or transcripts , and translation, the process that converts the genetic information encoded in mRNA transcripts into a specific protein molecule. At any one time, any particular human cell expresses thousands of genes. A different number of

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copies of each mRNA transcript will be present in each biological sample depending upon the particular cell, its function and its environmental conditions at the time. Thus, a cell will contain, at any one time, tens of thousands of different transcripts, in various quantities, for a total on the order of one million or more transcripts.

Elucidating gene function involves not only determining which genes are expressed in a healthy or diseased tissue, but also requires determining which of the altered transcripts or transcript levels cause a disease rather than result from the disease. In general, only the most abundant transcripts are currently accessible using conventional methods. In addition, conventional methods are dependent on separating and cloning double-stranded DNA copies (cDNA) of each individual mRNA transcript, or cDNA, prior to analysis. Thus, by conventional methods, it is impractical to obtain a comprehensive, high-resolution analysis of gene expression across one million or more transcripts in cells of interest to the researcher.

Epigenomics is the genome-wide study of epigenetic effects that are distinct from changes to the primary DNA sequence (mutations). Cells are impacted by epigenetic structural changes that can lead to changes in control of gene expression, either gene silencing or gene activation. Epigenomics and genome structure play a major role in the regulation of gene expression and disease. Indeed, most cancers involve the epigenetic silencing of genes that normally control cell proliferation. Chemical modifications, such as methylation, and the patterns of protein binding are interdependent and ultimately determine in any given cell which genes will be expressed when and to what degree. For example, cancer cells often contain a variety of genome structure alterations, some subtle, some dramatic, that contribute to the onset and progression of disease through their influence on gene expression. The major forms of epigenetic modification occurring in human tumors are DNA methylation and histone deacetylation. Comprehensive knowledge of the structure and state of the genome, and quantifying the activity level of all genes offers great promise to the understanding of disease, as well as to the prospect for early detection through diagnostics and treatment through novel, precisely targeted therapeutics and personalized medicine.

Our Solution

We have developed a powerful genome analysis system, a high throughput DNA sequencing process, Massively Parallel Signature Sequencing (MPSS) technology, which permits the characterization of up to two million targeted DNA molecules in a single assay. Each of our MPSS machines has 10,000 times the capacity of any other commercially available DNA sequencing process at less than 1/100th the cost per DNA molecule analyzed. This capacity and the resulting economy enable a variety of biological analyses at previously unachievable levels of precision and completeness. Furthermore, our MPSS technology provides digital data based on actual DNA sequence information for many biological processes where imprecise analogue fluorescent readouts are the current standard such as expression profiling with DNA microarrays.

We believe that MPSS expression profiling generates a complete, accurate and quantitative analysis of the transcriptome to enable systems biology. Transcriptome analysis provides information about all the genes that are expressed in a biological sample. MPSS expression analysis generates simultaneously, from millions of Megaclone micro-beads, DNA sequence information that uniquely identifies a sample s transcripts without the need for individual conventional sequencing reactions and produces a comprehensive quantitative profile of gene expression in cells or tissues. MPSS analysis is capable of finding and identifying genes using a process involving the targeted capture of short DNA fragments derived from each message expressed in a cell, all within a single sample. This allows for detection and quantitation of virtually all genes that are expressed, particularly those at low levels in the cell that are beyond the normal sensitivity levels of microarrays. As a result, we believe that MPSS analysis provides a highly reproducible, quantitative digital readout for the activity of virtually every gene in a biological sample. Additionally, unlike microarrays, MPSS gene expression analysis does not require advance knowledge of genes or sequences and, therefore, has broad potential commercial applicability to humans, animals, plants and other commercially important organisms.

Our Commercialization Strategies, Tactics and Target Customers

Our commercialization strategies, tactics and target customers for MPSS gene expression analysis generally involve expanding our work with scientific thought leaders and genomics researchers and gaining additional customers in the pharmaceutical, biotechnology and agricultural industries. Additionally, our business development

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efforts include collaborating with IT and other companies that we believe can help design the software and other tools necessary to understand the large, complex MPSS-based data sets required to enable systems biology.

Expanding Our Genomics Discovery Services Business

Our current business model is primarily focused on providing MPSS genomics discovery services such as gene expression analysis and genomic sequencing to research institutions and pharmaceutical, biotechnology and agricultural companies.

Research Institutes

We believe that scientific thought leaders affiliated with research institutes can provide an immediate, significant and enduring source of revenue, both directly from their institutes and from access to labs doing genomics research in the larger scientific research community. More broadly, we believe that we will benefit by having MPSS data placed in the public domain by these researchers. The scientific thought leaders should provide public and very visible exposure and validation of MPSS through their commentary and publications in scientific journals.

Pharmaceutical, Biotechnology and Agricultural Companies

Pharmaceutical, biotechnology and agricultural customers are an integral component of our business development focus and commercialization efforts. With the assumed accessibility to data sets containing gene expression information for cells or tissues and sequence information for genomes for comparative purposes stemming from our work with scientific thought leaders and IT companies, we expect that pharmaceutical, biotechnology and agricultural companies will engage us to produce a comprehensive quantitative profile of gene expression in cells or tissues and genomic sequencing for their specific interests, such as in diseased, abnormal or induced states or conditions. In these arrangements, we could provide information content for each company s specific internal programs.

We believe that MPSS gene expression analysis can become the technology of choice to: (1) accelerate drug discovery by identifying and validating drug targets and identifying pathways and mode of action; (2) accelerate drug development through lead (which is a representative of a compound series with sufficient potential to progress to a drug development program) qualification and optimization (which is the synthetic modification of a biologically active compound to fulfill all of the necessary properties required for clinical usefulness) by improving the success rate of getting products into clinical testing and to the market by patient group stratification (which is the division or arrangement of patients into representative subject populations within the clinical trial) and toxicology; and (3) enable discovery of biomarkers (which is a biochemical feature that can be used to measure the progress of disease or the effects of treatment) for diagnostics and pharmacogenomics. We believe that most of the important drug targets cannot be reliably monitored by gene expression methods other than MPSS.

The revenue sources from genomics discovery service arrangements may include technology access and services fees from performing MPSS analyses and providing MPSS data. Additionally, Takara Bio Inc. has licensed from us the right to use our technologies to provide genomics discovery services and to manufacture and sell microarrays containing content identified by our technologies in specific geographic territories. In December 2002 and September 2003, Lynx sold to Takara two and three MPSS instruments, respectively, for Takara s use in providing genomics discovery services in their licensed territories.

Our Technologies and Applications

Massively Parallel Signature Sequencing Technology

Our MPSS technology addresses the need to generate sequence information from millions of DNA fragments. At this extremely large scale, our MPSS approach eliminates the need for individual sequencing reactions and the physical separation of DNA fragments required by conventional sequencing methods. MPSS uses proprietary instruments and reagents developed by us.

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MPSS enables the simultaneous identification of all the DNA molecules in a sample. MPSS uses flow cells, which are glass plates that are micromachined, or fabricated, to very precise, small dimensions, to create a grooved chamber for immobilizing microbeads in a planar microarray, which is a two-dimensional, dense ordered array of DNA samples. With MPSS, one million or more Megaclone micro-beads are fixed in a single layer array in a flow cell, so solvents and reagents can be washed over the micro-beads in each cycle of the process. Our proprietary protocols elicit from the Megaclone micro-beads sequence-dependent fluorescent responses, which are recorded by a charged coupled device, or CCD, camera after each cycle. The process produces short signature, or identifying, sequences, 20 or more nucleotides long, without requiring fragment separation and separate sequencing reactions as in conventional DNA sequencing approaches. We have developed proprietary instrumentation and software to automate the delivery of reagents and solutions used in our sequencing process and to compile, from the images obtained at each cycle, the signature sequences that result from each experiment.

We believe MPSS has the following advantages over conventional DNA sequencing methods:

it sequences DNA molecules on as many as one million or more Megaclone beads simultaneously;

it eliminates the need for individual sequencing reactions and gels;

it identifies each of the DNA molecules by a unique signature sequence;

it produces a comprehensive quantitative profile of gene expression in cells or tissues of interest; and

it identifies even the rarest expressed genes.

Lynx currently has 25 operational proprietary MPSS instruments.

Megaclone Technology

Megaclone, our unique and proprietary cloning procedure, underlies our MPSS technology. Megaclone transforms a biological sample containing millions of DNA molecules into one made up of millions of micro-beads, which are microscopic beads of latex, each of which carries approximately 100,000 copies of one of the DNA molecules in the sample. In contrast to conventional cloning, in which an individual DNA molecule is selected from a sample and amplified into many copies for analysis or identification, we can capture on one set of micro-beads clones of nearly all the DNA sequences that characterize a sample. Once attached to the micro-beads, these clones can be handled and subjected to experiments and analyses all at the same time. Megaclone thereby enables many analyses or characterizations to be conducted that would otherwise be too cumbersome or onerous to conduct using conventional procedures where each clone must be addressed individually.

Megaclone is a process that uses a proprietary library of approximately 16.7 million short synthetic DNA sequences, called tags, and their complementary anti-tags, to uniquely mark and process each DNA molecule in a sample. Each unique tag is a permanent identifier of the DNA molecule it is attached to, and all of the tagged molecules in a sample are amplified together to create multiple copies of the tagged molecules. We use another proprietary process to generate five-micron diameter micro-beads, each of which carries multiple copies of a short anti-tag DNA sequence complementary to one of the 16.7 million tags. Then, we collect the amplified tagged DNA molecules onto the micro-beads through hybridization of the tags to the complementary anti-tags. Each micro-bead carries on its surface enough complementary anti-tags to collect approximately 100,000 identical copies of the corresponding tagged DNA molecule.

By this process, each tagged target DNA molecule in the original sample is converted into a micro-bead carrying about 100,000 copies of the same sequence. Therefore, in a few steps, our Megaclone technology can transform a

complex mixture of more than a million individual DNA molecules into a usable format that provides the following benefits:

- substantially all the different DNA molecules present in a sample (typically more than one million) are represented in the final micro-bead collection;

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these million or more DNA molecules can be analyzed simultaneously in various applications; and

the need for storing and handling millions of individual DNA clones is eliminated.

Megaclone is the foundation for our genome-wide analytical applications, principally MPSS gene expression analysis and other MPSS genome functional assays under development.

Collaborations, Customers and Licensees

We have derived substantially all of our revenues from corporate collaborations, customer agreements and licensing arrangements. For the year ended December 31, 2003, revenues from Takara, DuPont, BASF, and Bayer CropScience accounted for 39%, 28%, 14% and 4%, respectively, of our total revenues. The following are summary descriptions of certain key collaborators, customers and licensees:

E.I. DuPont de Nemours and Company

In October 1998, Lynx entered into a research collaboration agreement with E.I. DuPont de Nemours and Company to apply our technologies on an exclusive basis to the study of certain crops and their protection. Under the terms of the agreement, we received payments over a five-year period that ended in the fourth quarter of 2003 for genomics discovery services, the achievement of specific technology milestones and the delivery of genomic maps of specified crops. We received an initial payment of $10.0 million for technology access at the execution of the agreement, and service fees of $12.0 million were received by us over a three-year period, which commenced in January 1999. The agreement was extended with us for a two-year period during which we received additional service fees of $8.0 million through the fourth quarter of 2003. In the fourth quarter of 1999, we achieved a technology milestone under the agreement that resulted in a $5.0 million payment from DuPont.

Through December 31, 2003, we received aggregate payments of $35.0 million from DuPont under the 1998 agreement.

In November 2003, we entered into a new five year services agreement with DuPont. Through this agreement, we will continue to provide MPSS services to enhance DuPont s discovery and development of new agricultural traits and products.

BASF AG

In October 1996, we entered into an agreement with BASF AG, as amended in October 1998, to provide BASF with nonexclusive access to certain of our genomics discovery services. In connection with certain technology development accomplishments, BASF paid us a technology access fee of $4.5 million in the fourth quarter of 1999. BASF s access to our genomics discovery services is for a minimum of two years and requires BASF to purchase services at a minimum rate of $4.0 million per year. At the end of the initial two-year service period in the fourth quarter of 2001, BASF exercised its right to carryover for an additional two-year period through the fourth quarter of 2003, a certain level of previously unrequested genomics discovery services. The agreement expired in September 2003.

Through December 31, 2003, we received aggregate payments of $19.0 million from BASF under the agreement.

Bayer CropScience (formerly Aventis CropScience GmbH)

In March 1999, Aventis Pharmaceuticals, formerly Hoechst Marion Roussel, Inc., obtained nonexclusive access to certain of our genomics discovery services for the benefit of its affiliate, Aventis CropScience, which is now Bayer

CropScience. We received an initial payment for genomics discovery services to be performed by us for Bayer CropScience. The service period was renewed in March 2000, extended in March 2002 for an additional five-year period, and amended in September 2002. Related to the five-year extension and subsequent amendment, Bayer CropScience and Lynx plan to jointly develop and commercialize a novel assay based on Lynx s proprietary bead-

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based technologies. Lynx and Bayer CropScience will own the assay technology jointly. We will manufacture and sell the services or products based on the assay technology and will pay related royalties to Bayer CropScience. Additionally, we will derive revenues from performing genomics discovery services for Bayer CropScience during the development and commercialization phase of the agreement. Lynx and Bayer CropScience currently collaborate to apply our technology for the purpose of identifying sequences that might be inserted in genetically modified plants. This is an evaluation project for understanding the possible Bayer CropScience product applicability and our commercial viability of this limited application.

Through December 31, 2003, we have received aggregate payments of $6.0 million from Bayer CropScience under these agreements.

Takara Bio Inc. (formerly Takara Shuzo Co., Ltd.)

In November 2000, we entered into a collaboration and license agreement with Takara Bio Inc. of Japan. The license, as amended in December 2002 and in July 2003, provided Takara with the right in Japan, Korea and China, including Taiwan, to use our proprietary Megaclone, Megasort and MPSS technologies exclusively until the expiration of the relevant Lynx patents to provide genomics discovery services and to manufacture and sell microarrays containing content identified by our technologies. Under the terms of the original license agreement, Takara has a nonexclusive license right to manufacture and sell such microarrays elsewhere throughout the world. In connection with the 2002 amendment to the collaboration, Takara was also granted a royalty-bearing, nonexclusive right to provide genomics discovery services to customers in France and Italy.

Under the terms of the collaboration agreement, as amended, we received payments from Takara for technology access fees, royalties on sales of microarrays and revenues from genomics discovery services, the sale to Takara of proprietary instruments and reagents used in applying our technologies and purchases of our common stock. In the event of improvements made by Takara that increase the efficiency of our technologies by a defined amount, we agreed with Takara to negotiate in good faith a limited reduction to the royalty rate applicable to the above royalties. In December 2002, we sold two MPSS instruments to Takara for Takara s use in providing genomics discovery services in licensed territories. As part of the 2002 amendment to the collaboration, Takara accelerated its technology access fee payments to us.

In both September and December 2002, in connection with the collaboration agreement, we issued and sold 291,545 shares of common stock, at a purchase price of $3.43 per share, to Takara in private placements pursuant to the terms and conditions of common stock purchase agreements. In October 2001, in connection with the collaboration agreement, we issued and sold 45,787 shares of common stock, at a purchase price of $21.84 per share, to Takara in a private placement pursuant to the terms and conditions of a common stock purchase agreement.

As part of the August 2003 amendment to the collaboration and license agreement with Takara, Takara made a payment of approximately $3.0 million dollars to us in exchange for which Takara was relieved of its obligation to make technology access fee payments to us totaling approximately $2.0 million dollars during 2003 and 2004 and royalties in respect of Takara s sales, and acquired three additional MPSS instruments for Takara s use in providing genomics discovery services in Takara s licensed territories. In addition, Takara will no longer be required to make future equity investments in us.

Through December 31, 2003, we have received aggregate payments of $14.7 million, net of foreign withholding taxes, from Takara under the collaboration agreement. The remaining commitment under this agreement is limited to providing a minimum level of reagents to Takara, at agreed prices, in order for Takara to perform MPSS in their licensed territories.

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Axaron Bioscience AG, formerly BASF-LYNX Bioscience AG

In 1996, Lynx and BASF established Axaron Bioscience AG, a joint venture company in Heidelberg, Germany. Axaron began operations in 1997 and is employing our technologies in its neuroscience, toxicology and microbiology research programs. Upon the establishment of Axaron, we contributed access to our technologies to Axaron in exchange for an initial 49% equity ownership in Axaron. BASF, by committing to provide research funding to Axaron of DM50 million (or approximately $32 million based on a December 2003 exchange rate) over a five-year period beginning in 1997, received an initial 51% equity ownership in Axaron. In 1998, BASF agreed to provide an additional $10.0 million in research funding to Axaron, of which $4.3 million was paid to us for technology assets related to a central nervous system program. In the period since the joint venture was established, management and employees increased their equity ownership in Axaron to 15%, thereby reducing the ownership of Lynx and BASF to 41.6% and 43.4%, respectively.

In June 2001, we extended our technology licensing agreement with Axaron. The license extends Axaron s right to use our proprietary MPSS and Megasort technologies nonexclusively in Axaron s neuroscience, toxicology and microbiology programs until December 31, 2007. The agreement also positions Axaron to apply our technologies to specific disorders in the neuroscience field. Under the terms of the agreement, we received a $5.0 million technology license fee from Axaron. We intend to furnish to Axaron, initially without charge and later for a fee, proprietary reagents and additional MPSS instruments for use in Axaron s research programs.

In 2001, Lynx and BASF agreed to continue their support of Axaron s growth, including an increase in the capital of Axaron. We made an additional investment of $4.5 million in Axaron, which maintained our ownership interest in Axaron at approximately 40%. Given our ownership share of Axaron and our ability to exercise significant influence over Axaron s operating and accounting policies, we have accounted for the investment under the equity method in accordance with Accounting Principles Board Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock.

Through December 31, 2003, we have received aggregate payments of $9.3 million from Axaron under all related agreements. We recorded revenue of $0.8 million in 2003, $0.8 million in 2002, and $0.4 million in 2001 from Axaron, as the technology license fee from Axaron is being recognized as revenue on a straight-line basis over the noncancelable term of the technology licensing agreement. We may receive additional payments from Axaron over the remaining term of the technology licensing agreement from the sale to Axaron of proprietary reagents and additional MPSS instruments for use in Axaron s research programs. We have no on-going financial commitment to Axaron.

Competition

Competition among entities attempting to identify the genes associated with specific diseases and to develop products based on such discoveries is intense. We face, and will continue to face, competition from pharmaceutical, biotechnology and agricultural companies, such as Affymetrix, Inc., Celera Genomics Group, Gene Logic, Inc., and Genome Therapeutics Corporation, academic and research institutions and government agencies, both in the United States and abroad. Several entities are attempting to identify and patent randomly sequenced genes and gene fragments, while others are pursuing a gene identification, characterization and product development strategy based on positional cloning. We are aware that certain entities are using a variety of gene expression analysis methodologies, including chip-based systems, to attempt to identify disease-related genes. In addition, numerous pharmaceutical companies are developing genomic research programs, either alone or in partnership with our competitors. Competition among such entities is intense and is expected to increase. In order to successfully compete against existing and future technologies, we will need to demonstrate to potential customers that our technologies and capabilities are superior to those of our competitors.

Many of our competitors have substantially greater capital resources, research and development staffs, facilities, manufacturing and marketing experience, distribution channels and human resources than we do. These competitors may discover, characterize or develop important genes, drug targets or drug leads, drug discovery technologies or drugs in advance of our customers or us or that are more effective than those developed by our collaborators and customers or us. They may also obtain regulatory approvals for their drugs more rapidly than our collaborators or customers will, any of which could have a material adverse effect on our business. Moreover, our competitors may

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obtain patent protection or other intellectual property rights that could limit our rights or our collaborators and customers abilities to use our technologies or commercialize therapeutic, diagnostic or agricultural products. We also face competition from these and other entities in gaining access to cells, tissues and nucleic acid samples for use in our discovery programs.

Intellectual Property

We are pursuing a strategy designed to obtain United States and foreign patent protection for our core technologies. Our long-term commercial success will be dependent in part on our ability to obtain commercially valuable patent claims and to protect our intellectual property portfolio. As of December 31, 2003, we owned or controlled 84 issued patents and 98 pending patent applications in the United States and foreign countries relating to our genomics and proteomics technologies.

In addition to acquiring patent protection for our core analysis technologies, as part of our business strategy, we may file for patent protection on sets of genes, both known and newly discovered, that have diagnostic or prognostic applications, novel genes that may serve as drug development targets, genetic maps and sets of genetic markers, such as SNPs, that are associated with traits or conditions of medical or economic importance. However, there is substantial uncertainty regarding the availability of such patent protection.

Patent law relating to the scope of claims in the technology field in which we operate is still evolving. The degree to which we will be able to protect our technology with patents, therefore, is uncertain. Others may independently develop similar or alternative technologies, duplicate any of our technologies and, if patents are licensed or issued to us, design around the patented technologies licensed to or developed by us. In addition, we could incur substantial costs in litigation if we are required to defend ourselves in patent suits brought by third parties or if we initiate such suits.

With respect to proprietary know-how that is not patentable and for processes for which patents are difficult to enforce, we rely on trade secret protection and confidentiality agreements to protect our interests. We intend to maintain several important aspects of our technology platform as trade secrets. While we require all employees, consultants, collaborators, customers and licensees to enter into confidentiality agreements, we cannot be certain that proprietary information will not be disclosed or that others will not independently develop substantially equivalent proprietary information.

Research and Development Expenditures

We have devoted our efforts primarily to research and development. Research and development expenses were $12.2 million for the year ended December 31, 2003, $20.8 million for the year ended December 31, 2002 and $24.7 million for the year ended December 31, 2001.

Scientific Advisor

Sydney Brenner, M.B., D.Phil., our principal scientific advisor, is a distinguished Professor at the Salk Institute of Biological Studies in La Jolla, California. From July 1996 to January 2001, Dr. Brenner served as Director and President of The Molecular Sciences Institute, a non-profit research institute in Berkeley, California. Until his retirement in 1996, Dr. Brenner was Honorary Professor of Genetic Medicine, University of Cambridge School of Clinical Medicine, Cambridge, England. Dr. Brenner is known for his work on genetic code and the information transfer from genes to proteins and for his pioneering research on the genetics and development of the nematode. Dr. Brenner is the principal inventor of Lynx s bead-based technologies. Dr. Brenner is a Fellow of the Royal Society (1995) and a Foreign Associate of the U.S. National Academy of Sciences (1977) and has received numerous awards

of recognition, including the Nobel Prize in Physiology or Medicine for 2002, the Albert Lasker Medical Research Award (2000 and 1991), the Genetics Society of America Medal (1987) and the Kyoto Prize (1990).

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Employees

As of December 31, 2003, we employed 90 full-time employees, of which 75 were engaged in production and research and development activities.

We believe we have been successful in attracting skilled and experienced scientific personnel; however, competition for such personnel is intense. None of our employees are covered by collective bargaining agreements, and management considers relations with our employees to be good.

Available Information

We maintain a site on the World Wide Web at www.lynxgen.com; however, information found on our website is not incorporated by reference into this report. We make available free of charge on or through our website our annual report of Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

We have not adopted a code of ethics because adoption of such a code is not yet required, however, we intend to adopt a code of ethics prior to our annual meeting for 2004 that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. We intend to post the text of our code of ethics on our website at www.lynxgen.com in connection with Investor Resources material and will include a copy of such code of ethics as an exhibit to our definitive proxy statement with respect to our annual meeting of stockholders. In addition, we intend to promptly disclose (1) the nature of any amendment to our code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions and (2) the nature of any waiver, including an implicit waiver, from a provision of our code of ethics that is granted to one of these specified officers, the name of such person who is granted the waiver and the date of the waiver on our website in the future.

Business Risks

Our business faces significant risks. These risks include those described below and may include additional risks of which we are not currently aware or which we currently do not believe are material. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could be materially adversely affected. These risks should be read in conjunction with the other information set forth in this report.

We have a history of net losses. We expect to continue to incur net losses, and we may not achieve or maintain profitability.

We have incurred net losses each year since our inception in 1992, including net losses of approximately $8.8 million for the year ended December 31, 2003, $15.5 million in 2002 and $16.7 million in 2001. As of December 31, 2003, we had an accumulated deficit of approximately $107.7 million. Net losses may continue for at least the next several years as we proceed with the commercialization and additional development of our technologies. The presence and size of these potential net losses will depend, in part, on the rate of growth, if any, in our revenues and on the level of our expenses. Our research and development expenditures and general and administrative costs have exceeded our revenues to date. Research and development expenses may increase due to spending for ongoing technology development and implementation, as well as new applications. We will need to generate significant additional revenues to achieve profitability. Even if we do increase our revenues and achieve profitability, we may not be able to sustain profitability.

Our ability to generate revenues and achieve profitability depends on many factors, including:

our ability to continue existing customer relationships and enter into additional corporate collaborations and agreements;

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our ability to expand the scope of our products and services into new areas of pharmaceutical, biotechnology and agricultural research;

our customers and collaborators abilities to develop diagnostic, therapeutic and other commercial products from the application of our technologies; and

the successful clinical testing, regulatory approval and commercialization of such products by our customers and collaborators.

The time required to reach profitability is highly uncertain. We may not achieve profitability on a sustained basis, if at all.

We will need additional funds in the future, which may not be available to us.

We have invested significant capital in our scientific and business development activities. Our future capital requirements will be substantial as we conduct our operations, and will depend on many factors including:

the progress and scope of our research and development projects;

payments received under our customer, license and collaborative agreements;

our ability to establish and maintain customer, license and collaborative arrangements;

the progress of the development and commercialization efforts under our customer, license and collaborative agreements;

the costs associated with obtaining access to biological samples and related information; and

the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims and other intellectual property rights.

We have experienced losses since our inception, including a net loss for the six months ended June 30, 2004. We expect to continue to incur net losses as we proceed with the commercialization and additional development of our technologies. The size of these losses will depend on the rate of growth, if any, in our revenues and on the level of our expenses. Our cash and cash equivalents have decreased from the $5.6 million, including $0.7 million of restricted cash, as of December 31, 2003. As of June 30, 2004, our cash and cash equivalents consisted of $2.0 million in unrestricted cash and investments and restricted cash of $0.3 million. We will require additional funding to continue our business activities through at least December 31, 2005. We are considering various options, which include securing additional equity financing, obtaining new collaborators and customers and other strategic actions. If we raise additional capital by issuing equity or convertible debt securities, our existing stockholders may experience substantial dilution. If we require additional financing, there can be no assurance that it will be available on satisfactory terms, or at all. If we are unable to secure additional financing on reasonable terms, or are unable to generate sufficient new sources of revenue through arrangements with customers, collaborators and licensees, we will be forced to take substantial restructuring actions, which may include significantly reducing our anticipated level of expenditures, the sale of some or all of our assets, or obtaining funds by entering into financing or collaborative agreements on unattractive terms, or we will not be able to fund operations.

Our technologies are new and unproven and may not allow our customers, collaborators or us to identify genes, proteins or targets for drug discovery.

You must evaluate us in light of the uncertainties and complexities affecting an early stage genomics company. Our technologies are new and unproven. The application of these technologies is in too early a stage to determine whether it can be successfully implemented. These technologies assume that information about gene expression and gene sequences may enable scientists to better understand complex biological processes and, therefore, provide us with increased commercial opportunities for our products. Our technologies also depend on the successful

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integration of independent technologies, each of which has its own development risks. Relatively few therapeutic products based on gene discoveries have been successfully developed and commercialized. Our technologies may not enable our customers, collaborators or us to identify genes, proteins or targets for drug discovery. To date, neither our customers nor we have identified any targets for drug discovery based on our technologies.

We are dependent on our customers and collaborators and will need to find additional customers and collaborators in the future to develop and commercialize diagnostic or therapeutic products.

Our strategy for the development and commercialization of our technologies and potential products includes entering into collaborations, customer agreements or licensing arrangements with pharmaceutical, biotechnology and agricultural companies and research institutes. We do not have the resources to develop or commercialize diagnostic or therapeutic products on our own. If we cannot negotiate additional collaborative arrangements or contracts on acceptable terms, or at all, or if such collaborations or relationships are not successful, we may never become profitable.

We have derived substantially all of our revenues from corporate collaborations, customer agreements and licensing arrangements. Revenues from such agreements depend upon continuation of the related relationships, our performance of genomics discovery services, the achievement of milestones and royalties derived from future products developed from our research and technologies. To date, we have received, and expect to continue to receive in the future, a significant portion of our revenues from a small number of collaborators, customers and licensees, as shown on the following table:

	Year Ended December 31,		
	2003	2002	2001
Takara Bio Inc.	39%	16%	12%
E.I. DuPont de Nemours and Company	28%	32%	37%
BASF AG	14%	11%	24%
Bayer CropScience	4%	14%	4%
Geron Corporation		15%	
Institute of Molecular and Cell Biology			12%

If we fail to perform genomics discovery services or successfully achieve milestones or our collaborators fail to develop successful products, we will not earn the revenues contemplated under such agreements. If our collaborators, customers or licensees do not renew existing agreements, we lose one of these collaborators, customers or licensees, we do not attract new collaborators, customers or licensees or we are unable to enter into new collaborative, customer or license agreements on commercially acceptable terms, our revenues may decrease, and our activities may fail to lead to commercialized products.

Our dependence on collaborations, agreements or licenses with third parties subjects us to a number of risks. We have limited or no control over the resources that such third parties may choose to devote to our joint efforts. Our collaborators, customers or licensees may breach or terminate their agreements with us or fail to perform their obligations thereunder. Further, our collaborators, customer or licensees may elect not to develop products arising out of our agreements or may fail to devote sufficient resources to the development, manufacture, marketing or sale of such products. While we do not currently compete directly with any of our customers and collaborators, some of our customers and collaborators could become our competitors in the future if they internally develop DNA analysis technologies or if they acquire other genomics companies and move into the genomics industry. We will not earn the

revenues contemplated under our customer and collaborative arrangements, if our customers and collaborators:

- do not develop commercially successful products using our technologies;
- develop competing products;
- preclude us from entering into collaborations with their competitors;
- fail to obtain necessary regulatory approvals; or
- terminate their agreements with us.

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We depend on a single supplier to manufacture flow cells used in our MPSS technology.

Flow cells are glass plates that are micromachined, or fabricated to very precise, small dimensions, to create a grooved chamber for immobilizing micro-beads in a planar microarray, which is a two-dimensional, dense ordered array of DNA samples. We use flow cells in our MPSS technology. We currently purchase the flow cells used in our MPSS technology from a single supplier, although the flow cells are potentially available from multiple suppliers. While we believe that alternative suppliers for flow cells exist, identifying and qualifying new suppliers could be an expensive and time-consuming process. Our reliance on outside vendors involves several risks, including:

- the inability to obtain an adequate supply of required components due to manufacturing capacity constraints, a discontinuance of a product by a third-party manufacturer or other supply constraints;
- reduced control over quality and pricing of components; and
- delays and long lead times in receiving materials from vendors.

We operate in an intensely competitive industry with rapidly evolving technologies, and our competitors may develop products and technologies that make ours obsolete.

The biotechnology industry is highly fragmented and is characterized by rapid technological change. In particular, the area of genomics research is a rapidly evolving field. Competition among entities attempting to identify genes and proteins associated with specific diseases and to develop products based on such discoveries is intense. Many of our competitors have substantially greater research and product development capabilities and financial, scientific and marketing resources than we do.

We face, and will continue to face, competition from pharmaceutical, biotechnology and agricultural companies, as well as academic research institutions, clinical reference laboratories and government agencies. Some of our competitors, such as Affymetrix, Inc., Celera Genomics Group, Gene Logic, Inc., and Genome Therapeutics Corporation may be:

- attempting to identify and patent randomly sequenced genes and gene fragments and proteins;
- pursuing a gene identification, characterization and product development strategy based on positional cloning, which uses disease inheritance patterns to isolate the genes that are linked to the transmission of disease from one generation to the next; and
- using a variety of different gene and protein expression analysis methodologies, including the use of chip-based systems, to attempt to identify disease-related genes and proteins.

In addition, numerous pharmaceutical, biotechnology and agricultural companies are developing genomics research programs, either alone or in partnership with our competitors. Our future success will depend on our ability to maintain a competitive position with respect to technological advances. Rapid technological development by others may make our technologies and future products obsolete.

Any products developed through our technologies will compete in highly competitive markets. Our competitors may be more effective at using their technologies to develop commercial products. Further, our competitors may obtain intellectual property rights that would limit the use of our technologies or the commercialization of diagnostic or therapeutic products using our technologies. As a result, our competitors products or technologies may render our technologies and products, and those of our collaborators, obsolete or noncompetitive.

If we fail to adequately protect our proprietary technologies, third parties may be able to use our technologies, which could prevent us from competing in the market.

Our success depends in part on our ability to obtain patents and maintain adequate protection of the intellectual property related to our technologies and products. The patent positions of biotechnology companies, including our patent position, are generally uncertain and involve complex legal and factual questions. We will be able to protect

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our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the U.S., and many companies have encountered significant problems in protecting and defending their proprietary rights in foreign jurisdictions. We have applied and will continue to apply for patents covering our technologies, processes and products, as and when we deem appropriate. However, third parties may challenge these applications, or these applications may fail to result in issued patents. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products. Furthermore, others may independently develop similar or alternative technologies or design around our patents. In addition, our patents may be challenged or invalidated or fail to provide us with any competitive advantage.

We also rely on trade secret protection for our confidential and proprietary information. However, trade secrets are difficult to protect. We protect our proprietary information and processes, in part, with confidentiality agreements with employees, collaborators and consultants. However, third parties may breach these agreements, we may not have adequate remedies for any such breach or our trade secrets may still otherwise become known by our competitors. In addition, our competitors may independently develop substantially equivalent proprietary information.

Litigation or third-party claims of intellectual property infringement could require us to spend substantial time and money and adversely affect our ability to develop and commercialize our technologies and products.

Our commercial success depends in part on our ability to avoid infringing patents and proprietary rights of third parties and not breaching any licenses that we have entered into with regard to our technologies. Other parties have filed, and in the future are likely to file, patent applications covering genes, gene fragments, proteins, the analysis of gene expression and protein expression and the manufacture and use of DNA chips or microarrays, which are tiny glass or silicon wafers on which tens of thousands of DNA molecules can be arrayed on the surface for subsequent analysis. We intend to continue to apply for patent protection for methods relating to gene expression and protein expression and for the individual disease genes and proteins and drug discovery targets we discover. If patents covering technologies required by our operations are issued to others, we may have to rely on licenses from third parties, which may not be available on commercially reasonable terms, or at all.

Third parties may accuse us of employing their proprietary technology without authorization. In addition, third parties may obtain patents that relate to our technologies and claim that use of such technologies infringes these patents. Regardless of their merit, such claims could require us to incur substantial costs, including the diversion of management and technical personnel, in defending ourselves against any such claims or enforcing our patents. In the event that a successful claim of infringement is brought against us, we may need to pay damages and obtain one or more licenses from third parties. We may not be able to obtain these licenses at a reasonable cost, or at all. Defense of any lawsuit or failure to obtain any of these licenses could adversely affect our ability to develop and commercialize our technologies and products and thus prevent us from achieving profitability.

We have limited experience in sales and marketing and thus may be unable to further commercialize our technologies and products.

Our ability to achieve profitability depends on attracting collaborators and customers for our technologies and products. There are a limited number of pharmaceutical, biotechnology and agricultural companies and research institutes that are potential collaborators and customers for our technologies and products. To market our technologies and products, we must develop a sales and marketing group with the appropriate technical expertise. We may not successfully build such a sales force. If our sales and marketing efforts fail to be successful, our technologies and products may fail to gain market acceptance.

Our sales cycle is lengthy, and we may spend considerable resources on unsuccessful sales efforts or may not be able to enter into agreements on the schedule we anticipate.

Our ability to obtain collaborators and customers for our technologies and products depends in significant part upon the perception that our technologies and products can help accelerate their drug discovery and genomics efforts. Our sales cycle is typically lengthy because we need to educate our potential collaborators and customers and sell

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the benefits of our products to a variety of constituencies within such companies. In addition, we may be required to negotiate agreements containing terms unique to each collaborator or customer. We may expend substantial funds and management effort without any assurance that we will successfully sell our technologies and products. Actual and proposed consolidations of pharmaceutical companies have negatively affected, and may in the future negatively affect, the timing and progress of our sales efforts.

The loss of key personnel or the inability to attract and retain additional personnel could impair the growth of our business.

We are highly dependent on the principal members of our management and scientific staff. The loss of any of these persons services might adversely impact the achievement of our objectives and the continuation of existing customer, collaborative and license agreements. In addition, recruiting and retaining qualified scientific personnel to perform future research and development work will be critical to our success. There is currently a shortage of skilled executives and employees with technical expertise, and this shortage is likely to continue. As a result, competition for skilled personnel is intense and turnover rates are high. Competition for experienced scientists from numerous companies, academic and other research institutions may limit our ability to attract and retain such personnel. We depend on our President and Chief Executive Officer, Kevin P. Corcoran, the loss of whose services could have a material adverse effect on our business. Although we have an employment agreement with Mr. Corcoran in place, currently we do not maintain key person insurance for him or any other key personnel.

We use hazardous chemicals and radioactive and biological materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly.

Our research and development processes involve the controlled use of hazardous materials, including chemicals and radioactive and biological materials. Our operations produce hazardous waste products. We cannot eliminate the risk of accidental contamination or discharge and any resultant injury from these materials. We may be sued for any injury or contamination that results from our use or the use by third parties of these materials, and our liability may exceed our insurance coverage and our total assets. Federal, state and local laws and regulations govern the use, manufacture, storage, handling and disposal of hazardous materials. Compliance with environmental laws and regulations may be expensive, and current or future environmental regulations may impair our research, development and production efforts.

Ethical, legal and social issues may limit the public acceptance of, and demand for, our technologies and products.

Our collaborators and customers may seek to develop diagnostic products based on genes or proteins. The prospect of broadly available gene-based diagnostic tests raises ethical, legal and social issues regarding the appropriate use of gene-based diagnostic testing and the resulting confidential information. It is possible that discrimination by third-party payors, based on the results of such testing, could lead to the increase of premiums by such payors to prohibitive levels, outright cancellation of insurance or unwillingness to provide coverage to individuals showing unfavorable gene or protein expression profiles. Similarly, employers could discriminate against employees with gene or protein expression profiles indicative of the potential for high disease-related costs and lost employment time. Finally, government authorities could, for social or other purposes, limit or prohibit the use of such tests under certain circumstances. These ethical, legal and social concerns about genetic testing and target identification may delay or prevent market acceptance of our technologies and products.

Although our technology does not depend on genetic engineering, genetic engineering plays a prominent role in our approach to product development. The subject of genetically modified food has received negative publicity, which has aroused public debate. Adverse publicity has resulted in greater regulation internationally and trade restrictions on

imports of genetically altered agricultural products. Claims that genetically engineered products are unsafe for consumption or pose a danger to the environment may influence public attitudes and prevent genetically engineered products from gaining public acceptance. The commercial success of our future products may depend, in part, on public acceptance of the use of genetically engineered products, including drugs and plant and animal products.

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If we develop products with our collaborators, and if product liability lawsuits are successfully brought against us, we could face substantial liabilities that exceed our resources.

We may be held liable, if any product we develop with our collaborators causes injury or is otherwise found unsuitable during product testing, manufacturing, marketing or sale. Although we have general liability and product liability insurance, this insurance may become prohibitively expensive or may not fully cover our potential liabilities. Inability to obtain sufficient insurance coverage at an acceptable cost or to otherwise protect us against potential product liability claims could prevent or inhibit our ability to commercialize products developed with our collaborators.

Healthcare reform and restrictions on reimbursements may limit our returns on diagnostic or therapeutic products that we may develop with our collaborators.

If we successfully validate targets for drug discovery, products that we develop with our collaborators based on those targets may include diagnostic or therapeutic products. The ability of our collaborators to commercialize such products may depend, in part, on the extent to which reimbursement for the cost of these products will be available from government health administration authorities, private health insurers and other organizations. In the U.S., third-party payors are increasingly challenging the price of medical products and services. The trend towards managed healthcare in the U.S., legislative healthcare reforms and the growth of organizations such as health maintenance organizations that may control or significantly influence the purchase of healthcare products and services, may result in lower prices for any products our collaborators may develop. Significant uncertainty exists as to the reimbursement status of newly approved healthcare products. If adequate third-party coverage is not available in the future, our collaborators may fail to maintain price levels sufficient to realize an appropriate return on their investment in research and product development.

Our facilities are located near known earthquake fault zones, and the occurrence of an earthquake or other catastrophic disaster could cause damage to our facilities and equipment, which could require us to cease or curtail operations.

Our facilities are located near known earthquake fault zones and are vulnerable to damage from earthquakes. We are also vulnerable to damage from other types of disasters, including fire, floods, power loss, communications failures and similar events. If any disaster were to occur, our ability to operate our business at our facilities would be seriously, or potentially completely, impaired. In addition, the unique nature of our research activities could cause significant delays in our programs and make it difficult for us to recover from a disaster. The insurance we maintain may not be adequate to cover our losses resulting from disasters or other business interruptions. Accordingly, an earthquake or other disaster could materially and adversely harm our ability to conduct business.

Our stock price may be extremely volatile.

We believe that the market price of our common stock will remain highly volatile and may fluctuate significantly due to a number of factors. The market prices for securities of many publicly-held, early-stage biotechnology companies have in the past been, and can in the future be expected to be, especially volatile. For example, during the two-year period from January 1, 2002 to December 31, 2003, the closing sales price of our common stock as quoted on the Nasdaq National Market and Nasdaq SmallCap Market fluctuated from a low of $1.61 to a high of $32.89 per share. In addition, the securities markets have from time to time experienced significant price and volume fluctuations that may be unrelated to the operating performance of particular companies. The following factors and events may have a significant and adverse impact on the market price of our common stock:

- fluctuations in our operating results;

announcements of technological innovations or new commercial products by us or our competitors;

release of reports by securities analysts;

developments or disputes concerning patent or proprietary rights;

developments in our relationships with current or future collaborators, customers or licensees; and

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general market conditions.

Many of these factors are beyond our control. These factors may cause a decrease in the market price of our common stock, regardless of our operating performance.

Our securities have been transferred from the Nasdaq National Market to the Nasdaq SmallCap Market, which has subjected us to various statutory requirements and may have adversely affected the liquidity of our common stock, and a failure by us to meet the listing maintenance standards of the Nasdaq SmallCap Market could result in delisting from the Nasdaq SmallCap Market.

Effective May 22, 2003, a Nasdaq Qualifications Panel terminated our Nasdaq National Market Listing and transferred our securities to the Nasdaq SmallCap Market. In order to maintain the listing of our securities on the Nasdaq SmallCap Market, we must be able to demonstrate compliance with all applicable listing maintenance requirements. In the event we are unable to do so, our securities will be delisted from the Nasdaq Stock Market.

With our securities listed on the Nasdaq SmallCap Market, we face a variety of legal and other consequences that will likely negatively affect our business including, without limitation, the following:

we may have lost our exemption from the provisions of Section 2115 of the California Corporations Code, which imposes aspects of California corporate law on certain non-California corporations operating within California. As a result, (i) our stockholders may be entitled to cumulative voting and (ii) we may be subject to more stringent stockholder approval requirements and more stockholder-favorable dissenters rights in connection with certain strategic transactions;

the state securities law exemptions available to us are more limited, and, as a result, future issuances of our securities may require time-consuming and costly registration statements and qualifications;

due to the application of different securities law exemptions and provisions, we have been required to amend our stock option plan, suspend our stock purchase plan and must comply with time-consuming and costly administrative procedures;

the coverage of Lynx by securities analysts may decrease or cease entirely; and

we may lose current or potential investors.

In addition, we are required to satisfy various listing maintenance standards for our common stock to be quoted on the Nasdaq SmallCap Market. If we fail to meet such standards, our common stock would likely be delisted from the Nasdaq SmallCap Market and trade on the over-the-counter bulletin board, commonly referred to as the pink sheets. This alternative is generally considered to be a less efficient market and would seriously impair the liquidity of our common stock and limit our potential to raise future capital through the sale of our common stock, which could materially harm our business.

Anti-takeover provisions in our charter documents and under Delaware law may make it more difficult to acquire us or to effect a change in our management, even though an acquisition or management change may be beneficial to our stockholders.

Under our certificate of incorporation, our board of directors has the authority, without further action by the holders of our common stock, to issue 2,000,000 additional shares of preferred stock from time to time in series and with preferences and rights as it may designate. These preferences and rights may be superior to those of the holders of our common stock. For example, the holders of preferred stock may be given a preference in payment upon our liquidation or for the payment or accumulation of dividends before any distributions are made to the holders of

common stock.

Any authorization or issuance of preferred stock, while providing desirable flexibility in connection with financings, possible acquisitions and other corporate purposes, could also have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock or making it more difficult to remove directors and effect a change in management. The preferred stock may have other rights, including economic rights senior to those of our common stock, and, as a result, an issuance of additional preferred stock could lower the market value

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of our common stock. Provisions of Delaware law may also discourage, delay or prevent someone from acquiring or merging with us.

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PART II

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

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. When used herein, the words believe, anticipate, expect, estimate and similar expressions are intended to identify such forward-looking statements. There can be no assurance that these statements will prove to be correct. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this section, as well as in Item 1. Business -Business Risks. We undertake no obligation to update any of the forward-looking statements contained herein to reflect any future events or developments.

Overview

We believe that Lynx Therapeutics, Inc. (Lynx or the Company) is a leader in the development and application of novel genomics analysis solutions. Our Massively Parallel Signature Sequencing, or MPSS, instruments analyze millions of DNA molecules in parallel, enabling genome structure characterization at what we believe to be an unprecedented level of resolution. As applied to gene expression analysis, MPSS provides comprehensive and quantitative digital gene expression information important to modern systems biology research in the pharmaceutical, biotechnology and agricultural industries. Gene expression refers to the number of genes and the extent a cell or tissue expresses those genes, and represents a way to move beyond DNA sequence data to understand the function of genes, the proteins that they encode and the role they play in health and disease. Systems biology is an approach in which researchers seek to gain a complete molecular understanding of biological systems in health and disease.

We have incurred net losses each year since our inception in 1992. As of December 31, 2003, we had an accumulated deficit of approximately $107.7 million, including a net loss of $8.8 million in 2003. Net losses may continue for at least the next several years as we proceed with the commercialization and additional development of our technologies. The presence and size of these potential net losses will depend, in part, on the rate of growth, if any, in our revenues and on the level of our expenses. Our cash and cash equivalents have decreased from $11.7 million as of December 31, 2002 to $5.6 million as of December 31, 2003, which includes restricted cash of $0.7 million. In March 2004, we raised an additional $4 million through the sale of common stock. We believe that with the funds raised in March 2004, we will have sufficient funding to meet our projected operating and capital requirements through at least December 31, 2004. In addition, we are considering various options to raise additional funds, which will be required to allow us to continue our business activities beyond 2004. These options include securing additional equity financing and obtaining new collaborators and customers. If we raise additional capital by issuing equity or convertible debt securities, our existing stockholders may experience substantial dilution. There can be no assurance that additional financing will be available on satisfactory terms, or at all. If we are unable to secure additional financing on reasonable terms, or are unable to generate sufficient new sources of revenue through arrangements with customers, collaborators and licensees, we will be forced to take substantial restructuring actions, which may include significantly reducing our anticipated level of expenditures, the sale of some or all of our assets, or obtaining funds by entering into financing or collaborative agreements on unattractive terms, or we will not be able to fund operations.

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To date, we have received, and expect to continue to receive in the future, a significant portion of our revenues from a small number of collaborators, customers and licensees, as shown on the following table.

	Year Ended December 31,		
	2003	2002	2001
Takara Bio Inc.	39%	16%	12%
E.I. DuPont de Nemours and Company	28%	32%	37%
BASF AG	14%	11%	24%
Bayer CropScience	4%	14%	4%
Geron Corporation		15%	
Institute of Molecular and Cell Biology			12%

Revenues in each quarterly and annual period have in the past, and could in the future, fluctuate due to: the timing and amount of any technology access fees and the period over which the revenue is recognized; the level of service fees, which is tied to the number and timing of biological samples received from our collaborators and customers, as well as our performance of the related genomics discovery services on the samples; the timing of achievement of milestones and the amount of related payments to us; and the number, type and timing of new, and the termination of existing, agreements with collaborators, customers and licensees.

Our operating costs and expenses include cost of service fees and other, research and development expenses and general and administrative expenses. Cost of services fees and other includes primarily the costs of direct labor, materials and supplies, outside expenses, equipment and overhead incurred by us in performing our genomics discovery services for, and the costs of reagents and instruments sold to, our collaborators, customers and licensees. Research and development expenses include the costs of personnel, materials and supplies, outside expenses, equipment and overhead incurred by us in our technology and application development and process improvement efforts. Research and development expenses may increase due to spending for ongoing technology development and implementation, as well as new applications, primarily for MPSS. General and administrative expenses include the costs of personnel, materials and supplies, outside expenses, equipment and overhead incurred by us primarily in our administrative, business development, legal and investor relations activities. General and administrative expenses may increase in support of our research and development, commercial and business development efforts.

We account for our investment in Axaron Bioscience AG, a company owned primarily by BASF AG and us, using the equity method. For the years ended December 31, 2003 and 2002, our pro-rata share of Axaron s losses was approximately $1.9 million and $2.5 million, respectively.

As of December 31, 2003, we employed 90 full-time employees, of which 75 were engaged in production and research and development activities. In January 2003, we implemented a reduction of approximately 25% of our total workforce, or 32 people. The groups affected primarily by this action included research and development personnel based at Lynx Therapeutics GmbH in Germany and our proteomics group in California. In March 2004, we implemented another reduction of approximately 15% of our total workforce, or 14 people which included positions in all functions of the Company s business. The workforce reductions were intended to further focus our financial and human resources on expanding the commercial use of MPSS.

Critical Accounting Estimates

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in our financial statements and accompanying notes. The items in our financial statements requiring significant estimates and judgments include determining the useful lives of fixed assets for depreciation and amortization calculations, assumptions for valuing options and warrants and estimated lives of license and collaborative agreements related to deferred revenue. Actual results could differ materially from these estimates.

Revenue Recognition

Technology access fees have generally resulted from upfront payments from collaborators, customers and licensees who are provided access to Lynx s technologies for specified periods. We receive service fees from

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collaborators and customers for genomics discovery services performed by us on the biological samples they send to Lynx. Collaborative research revenues are payments received under various agreements and include such items as milestone payments. Milestone payments are recognized as revenue pursuant to collaborative agreements upon the achievement of specified technology developments, representing the culmination of the earnings process. Other revenues include the proceeds from the sale of technology assets, the sale of proprietary instruments and reagents, and grant revenue.

Technology access and license fees are deferred and recognized as revenue on a straight-line basis over the noncancelable term of the agreement to which they relate. Payments for services and/or materials provided by Lynx are recognized as revenues when earned over the period in which the services are performed and/or materials are delivered, provided that no other consequential obligations, refunds or credits to be applied to future work exist. Revenues from the sale of technology assets are recognized upon the transfer of the assets to the purchaser. Revenues from the sales of instruments and reagents are recognized upon shipment to the customer.

Inventory

Inventory is stated at the lower of cost (which approximates first-in, first-out cost) or market. The balances at December 31, 2003 and December 31, 2002 were classified as raw materials and consisted primarily of reagents and other chemicals to be utilized while performing genomics discovery services, plus services in process.

Services in process include direct material, direct service labor, overhead and other direct costs. Market is net realizable value , which, for services in process, is the estimated selling price, less costs to complete the service. For raw materials, it is replacement cost or the cost of acquiring similar products from our vendors, as adjusted for our assessment of excess or obsolete materials. While cost is readily determinable, estimates of market value involve significant estimates and judgments about the future.

We initially record our inventory at cost and each quarter evaluate the difference, if any, between cost and market. The determination of the market value of inventories is primarily dependent on estimates of future demand for our services, which in turn is based on other market estimates such as technological change, competitor actions and estimates of future selling prices.

We record write-downs for the amount that cost of inventory exceeds our estimated market value. No adjustment is required when market value exceeds cost.

Inventory, including allocated services labor and overhead, used in providing genomics discovery services and for reagent sales is charged to cost of services fees and other as consumed. Reagents and chemicals purchased for internal development purposes are charged to research and development expense as incurred.

Investments in Equity Securities

As of December 31, 2003, we held an approximate 42% equity interest in Axaron Bioscience AG. In 2001, we made a capital investment in Axaron of approximately $4.5 million. We account for our equity investment in Axaron using the equity method in accordance with Accounting Principles Board No. Opinion 18, The Equity Method of Accounting for Investments in Common Stock because our ownership is greater than 20% and we have the ability to exercise significant influence over the operating, investing and financing decisions of Axaron. Under the equity method, we record our pro-rata share of Axaron s income or losses and adjust the basis of our investment accordingly.

Although we have the ability to exercise significant influence over the operations of Axaron, we may choose not to exercise such influence or may not have influence over certain operating matters. Consequently, Axaron s operating

results could differ significantly from our expectations and our pro-rata share of Axaron s income or losses that we record in the future could be material.

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Results of Operations

Year Ended December 31, 2003 and 2002

Revenues

Revenues for the year ended December 31, 2003 were $18.1 million, compared to revenues of $17.4 million for the year ended December 31, 2002. Revenues for 2003 included technology access fees and service fees of $15.8 million, license fees from Axaron, a related party, of $0.8 million and collaborative research and other revenues of $1.5 million, including $1.0 million related to the sale of three MPSS instruments to Takara. In addition to the $1.0 million related to the sale of the instruments, we received a cash payment of approximately $2.0 million from Takara related to an amendment of our existing collaboration with them. In the third quarter of 2003, we met the research and development obligations under the collaboration agreement, as amended, related to amounts that we have been paid by Takara, including those amounts that we had recorded previously as deferred revenue. Accordingly, we recognized such amounts, aggregating approximately $2.5 million, as revenue in the third quarter of 2003. Revenues for 2002 included technology access fees and services fees of $13.0 million, license fees of $0.8 million from Axaron, a related party, and $3.6 million of collaborative research and other revenue, primarily from the sale of certain of Lynx s technology assets to Geron Corporation and the sale of MPSS instruments to Takara.

Our revenues have historically fluctuated from quarter to quarter and year to year and may continue to fluctuate in future periods due primarily to our service fees, which are impacted principally by the timing and number of biological samples received from existing customers and collaborators, as well as our performance of related services on these samples. Additionally, the number, type and timing of new collaborations and agreements and the related demand for, and delivery of, our services or products will impact the level of future revenues.

Operating Costs and Expenses

Our total operating costs and expenses were $23.6 million for the year ended December 31, 2003, compared to $31.1 million for the year ended December 31, 2002.

Cost of services fees and other were $4.4 million for the year ended December 31, 2003, compared to $3.5 million for the year ended December 31, 2002, and reflect primarily the costs of providing our genomics discovery services and the cost of MPSS instruments sold to Takara.

Research and development expenses were $12.2 million 2003, compared to $20.8 million in 2002. The decrease in research and development expenses in 2003 reflects a decrease in materials consumed in research and development efforts and lower personnel expenses, primarily resulting from the workforce reductions that occurred in the first quarter of 2003 and the second quarter of 2002. Our research and development efforts in 2003 were directed primarily toward the expansion of the commercial applications of, and process improvements for, MPSS.

In January 2003, we discontinued our development work on our proteomics technology, Protein ProFiler, which was intended to provide high-resolution analysis of complex mixtures of proteins from cells or tissues. Proteomics is the study of the number of proteins and the extent to which they are expressed in cells or tissues. In April 2002, we discontinued our development effort on Megatype, a technology that was being developed to permit the comparison of collected genomes of two populations and enable the detection and recovery of DNA fragments with the single nucleotide polymorphisms, or SNPs, that distinguish these two populations. SNPs are single nucleotide variations, or differences occurring in a single subunit of DNA or RNA, in the genetic code that occur on average at every 1,000 bases along the three billion nucleotides in the human genome. The primary reason for discontinuing our development efforts on both Protein ProFiler and Megatype was to focus our financial and human resources on expanding the

commercial use of MPSS, which we believe will have the greatest commercial value to us.

We anticipate that our research and development expenses may increase due primarily to efforts directed toward the expansion of the commercial applications of, and process improvements for, MPSS. These research and development efforts assume that information about gene expression and gene sequences may enable scientists to

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better understand complex biological processes and, therefore, provide us with increased commercial opportunities for our MPSS. Relatively few therapeutic products based on gene discoveries have been successfully developed or commercialized. Because of these risks and uncertainties, we cannot predict when or whether we will successfully complete the development of MPSS and related technologies or the ultimate costs of such efforts.

General and administrative expenses were $6.8 million and $6.3 million for the years ended December 31, 2003 and 2002, respectively, and reflect primarily expenses for outside services in support of our commercial and business development efforts. General and administrative expenses may increase in support of our continuing commercial, business development and research and development activities.

In January 2003, we implemented a reduction of approximately 25% of our workforce, or 32 people. The groups affected primarily by this action included research and development personnel based at Lynx Therapeutics GmbH in Germany and in our proteomics group in California. The workforce reduction was intended to further focus our financial and human resources on expanding the commercial use of MPSS. We recorded a restructuring charge for workforce reduction of $0.3 million in the first quarter of 2003 related primarily to severance compensation expense for our former employees. In terms of compensation, benefits and employer taxes that would have been paid to, and on behalf of, such former employees had they remained employed by Lynx, we realized cost savings of approximately $2.0 million during 2003.

The restructuring charge for workforce reduction of $0.5 million in the second quarter of 2002 was comprised primarily of severance charges for former Lynx employees who were part of Lynx s workforce reduction of approximately 30% of our domestic workforce, or 45 people, in that period. The group affected primarily by this action was research and development personnel in California. The workforce reduction was intended to focus our financial and human resources on the expansion of the commercial applications of, and process improvements for, MPSS and our other genomics technologies, and the continued development of our proteomics technology. In terms of compensation, benefits and employer taxes that would have been paid to, and on behalf of, such former employees had they remained employed by Lynx, we realized cost savings of approximately $3.0 million during 2003.

Equity Share of Net Loss of Related Party

The equity share of the net loss of related party of $1.9 million and $2.5 million for the years ended December 31, 2003 and 2002, respectively, reflects Lynx s pro-rata share of the net loss of Axaron, a joint venture investee, for the same periods.

Interest Expense, Net

Net interest expense was $0.2 million for the year ended December 31, 2003, compared to $0.3 million for the year ended December 31, 2002. The decrease in net interest expense from 2002 to 2003 reflects primarily lower interest expense in 2003 incurred on equipment-related debt outstanding during both the 2003 and 2002 periods.

Other Income (Expense), Net

Other expense was $1.0 million in the year ended December 31, 2003, compared to other income of $0.9 million for the year ended December 31, 2002. The other expense amount for the 2003 period relates primarily to the loss recorded on the disposal of certain fixed assets no longer used in the operations of Lynx Therapeutics GmbH in Germany. The 2002 other income amount was related primarily to the gain on the sale of our equity investment in Inex Pharmaceuticals Corporation.

Income Tax Provision (Benefit)

The income tax provision was $0.2 million for the year ended December 31, 2003, compared to the income taxes benefit of $98,000 for the year ended December 31, 2002. The 2003 provision consisted primarily of foreign withholding tax on payments received from our licensee, Takara. The 2002 income tax benefit related primarily to a

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refund received for federal alternative minimum taxes paid in prior periods, offset by foreign withholding tax due on payments received from our licensee, Takara.

As of December 31, 2003, we had a federal net operating loss carryforward of approximately $85.5 million, which will expire at various dates from 2010 through 2023, if not utilized. We had a state net operating loss carryforward of approximately $10.7 million, which will expire in the years 2004 through 2013. Deferred tax assets related to carryforwards at December 31, 2003 include approximately $3.9 million associated with stock option activity for which any subsequently recognized tax benefits will be credited directly to stockholders equity.

As of December 31, 2003, we also had federal and California research and development and other tax credit carryforwards of approximately $3.4 million and $3.3 million, respectively. The federal research and development credit will expire at various dates from 2018 through 2023, if not utilized. The California research and development credits do not expire.

Utilization of our net operating loss may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss before utilization.

Years Ended December 31, 2002 and 2001

Revenues

We had total revenues of $17.4 million for the year ended December 31, 2002, compared to $19.3 million for the year ended December 31, 2001. Revenues for 2002 included technology access fees and service fees of $13.0 million, license fees of $0.8 million from Axaron, a related party, and $3.6 million of collaborative research and other revenue, primarily from the sale of certain of our technology assets to Geron Corporation and the sale of MPSS instruments to Takara. Revenues for 2001 included technology access fees and service fees of $18.4 million, license fees of $0.5 million from Axaron, a related party, and $0.4 million of collaborative research and other revenue.

Operating Costs and Expenses

Our total operating costs and expenses were $31.1 million for the year ended December 31, 2002, compared to $36.3 million for the year ended December 31, 2001.

Cost of services fees and other were $3.5 million for the year ended December 31, 2002, compared to $4.1 million for the year ended December 31, 2001, and reflect the costs of providing our genomics discovery services and, in 2002, the cost of the MPSS instruments sold to Takara.

Research and development expenses were $20.8 million in 2002 and $24.7 million in 2001. The decrease in research and development expenses in 2002 reflects a decrease in materials consumed in research and development efforts and lower personnel expenses, primarily resulting from the workforce reduction that occurred in the second quarter of 2002. Our efforts in 2002 were directed primarily toward the expansion of the commercial applications of, and process improvements for, our genomics technologies and the continued development of our proteomics technology.

Our research and development expenses of $20.8 million for 2002 were comprised of $4.4 million in research expenses related primarily to internal discovery projects and $16.4 million in development expenses, including $0.9 million for the Megatype technology and $1.6 million for the Protein ProFiler technology.

In April 2002, we discontinued our development effort on Megatype, a technology that was being developed to permit the comparison of collected genomes of two populations and enable the detection and recovery of DNA fragments with the single nucleotide polymorphisms, or SNPs, that distinguish these two populations. SNPs are single nucleotide variations, or differences occurring in a single subunit of DNA or RNA, in the genetic code that occur on average at every 1,000 bases along the three billion nucleotides in the human genome.

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General and administrative expenses were $6.3 million for the year ended December 31, 2002, compared to $7.5 million for the year ended December 31, 2001. The decrease in general and administrative expenses from the 2001 period to the 2002 period reflects lower personnel expenses and lower outside service costs.

The restructuring charge of $0.5 million in the year ended December 31, 2002, was comprised primarily of severance charges for former Lynx employees who were part of Lynx s workforce reduction of approximately 30% of our domestic workforce, or 45 people, in the second quarter of 2002.

Equity Share of Net Loss of Related Party

The equity share of loss of related party of $2.5 million for the year ended December 31, 2002 reflects Lynx s pro-rata share of the net loss of Axaron, a joint venture investee, for the same period. Lynx s pro-rata share of Axaron s losses was immaterial for 2001.

Interest Expense, Net

Net interest expense was $0.3 million in the year ended December 31, 2002, compared to $0.1 million for the year ended December 31, 2001. The 2002 net interest expense reflects primarily increased expense incurred on equipment-related debt outstanding in 2002 and a decrease in interest income due to the decline in interest rates during 2002 as compared to the 2001 period.

Other Income (Expense), Net

Other income was $0.9 million for the year ended December 31, 2002, compared to $0.5 million for the year ended December 31, 2001. The 2002 other income was related primarily to the gain on the sale of our equity investment in Inex Pharmaceuticals Corporation. In 2001, other income was due primarily to a gain of $1.1 million from the receipt of shares of common stock from Inex, as part of the proceeds related to the March 1998 sale of our former antisense program, and a realized gain of $1.1 million from the sale of previously held Inex shares, partially offset by an other-than-temporary write down in the value of previously held Inex shares of $1.6 million.

Income Tax Provision (Benefit)

The income tax benefit was $98,000 in the year ended December 31, 2002, compared to the provision for income taxes of $81,000 for the year ended December 31, 2001. The 2002 income tax benefit related primarily to a refund received for federal alternative minimum taxes paid in prior periods, offset by foreign withholding tax due on payments received from our licensee, Takara. The 2001 income tax provision consisted entirely of foreign withholding tax on a payment received from our licensee, Takara.

Liquidity and Capital Resources

Cash and cash equivalents at December 31, 2003 consisted of $5.6 million, including restricted cash of $0.7 million. Net cash used in operating activities was $10.5 million for the year ended December 31, 2003, as compared to $16.2 million for the same period in 2002. The change was due primarily to a lower net loss and the greater increase in accounts payable in 2003 than in 2002, partially offset by a greater decrease in deferred revenues and the impact of the difference between non-cash expenses, losses and gains in the 2003 period as compared to the 2002 period. The amount of net cash used in operating activities differed from the 2003 net loss due primarily to the decrease in deferred revenues, partially offset by the adjustment for non-cash items, primarily depreciation and amortization expenses and the impact of our pro rata share of the net loss of Axaron. For 2002, the amount of net cash used in operating activities differed from the net loss due primarily to decreases in deferred revenue and accounts

payable, offset partially by the net adjustment for non-cash items, primarily depreciation and amortization expenses and the impact of our pro rata share of the net loss of Axaron, and a decrease in inventory.

Net cash used in operating activities was $16.2 million for the year ended December 31, 2002, as compared to $15.4 million for fiscal year 2001. The change between 2002 and 2001 was due primarily to a higher decrease in deferred revenues and a decrease, rather than an increase, in accounts payable and other liabilities during 2002 as compared

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to 2001, partially offset by a lower net loss, excluding the impact of depreciation and amortization expenses and non-cash gains and losses. The amount of net cash used in operating activities differed from the 2001 net loss due primarily to the depreciation and amortization expenses, the amortization of deferred compensation and the write down of an equity investment, partially offset by a decrease in deferred revenue and a gain on the sale of the antisense business.

Net cash used in investing activities of $0.2 million for the year ended December 31, 2003 was due primarily to expenditures for capital equipment. Net cash provided by investing activities of $1.4 million for year ended December 31, 2002 was due primarily to proceeds from the sale of equity investments and repayment of notes receivable from employees, partially offset by expenditures for capital equipment. Net cash used in investing activities of $0.4 million for the year ended December 31, 2001, was due primarily to expenditures for capital equipment and leasehold improvements and our investment in Axaron, partially offset by proceeds from the sale of Inex securities and net maturities of short-term investments.

Net cash provided by financing activities of $4.5 million in 2003 related primarily to the issuance of common stock pursuant to a common stock purchase agreement between Lynx and certain investors in two private placements, partially offset by the repayment of principal under equipment-related debt. Net cash provided by financing activities in 2002 of $23.3 million was due primarily to the issuance of Lynx common stock in three private placements. Net cash provided by financing activities in 2001 of $11.1 million was due primarily to the issuance of Lynx common stock in two private placements, partially offset by the repayment of principal under equipment-related debt.

In March 2004, we completed a $4.0 million private placement of common stock and warrants to purchase common stock (the financing) resulting in proceeds of $3.9 million, net of commissions and expenses. The financing included the sale of 788,235 shares of newly issued shares of common stock at $5.10 per share and the issuance of warrants to purchase 181,295 shares of common stock at an exercise price of $6.25 per share.

In December 2003, we completed a private financing of common stock and warrants to purchase common stock. The financing included the sale of 800,000 newly issued shares of common stock, at a purchase price of $5.00 per share, resulting in gross proceeds of $4 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase up to 200,000 shares of common stock at an exercise price of $6.25 per share.

In September 2003, we completed a private financing of common stock and warrants to purchase common stock. The financing included the sale of 744,000 newly issued shares of common stock, at a purchase price of $4.03 per share, resulting in gross proceeds of $3 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase 186,000 shares of common stock at an exercise price of $9.91 per share.

In both September and December 2002, in connection with our collaboration agreement with Takara, we issued and sold 291,545 shares of common stock, at a purchase price of $3.43 per share, to Takara in private placements pursuant to the terms and conditions of common stock purchase agreements.

In April 2002, we completed a private placement of common stock and warrants to purchase common stock. The financing included the sale of 2.1 million newly issued shares of common stock, at a purchase price of $10.85 per share, resulting in gross proceeds of $22.6 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase up to 0.8 million shares of common stock at an exercise price of $13.58 per share. Additionally, Lynx issued a warrant to purchase up to an aggregate of 41,714 shares of common stock at an exercise price of $10.85 per share to Friedman, Billings, Ramsey & Co., Inc. (FBR), as partial consideration, in addition to other customary fees, for services rendered by FBR as sole

manager for the private equity financing.

In October 2001, in connection with our collaboration agreement with Takara, we issued and sold 45,787 shares of common stock, at a purchase price of $21.84 per share, to Takara in a private placement pursuant to the terms and conditions of a common stock purchase agreement.

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In May 2001, we completed a private placement of common stock and warrants to purchase common stock. The financing included the sale of 249,605 newly issued shares of common stock, at a purchase price of $44.59 per share, resulting in net proceeds of $10.5 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, we issued warrants to purchase up to 62,399 shares of common stock at an exercise price of $ 64.41 per share.

In October 2002, we entered into a loan and security agreement with a financial institution, Comerica Bank-California, for an equipment line of credit of up to $2.0 million with a draw-down period of one year. Under the initial advance, we drew down $1.6 million in November 2002 related to the purchase of equipment made in previous periods. We granted Comerica Bank-California a security interest in all items we financed under this agreement. The initial advance under the loan to finance the purchase of equipment made in previous periods has a term of 24 months from the date of advance and bears interest at a rate of 7.25%. In May 2003, we renegotiated the terms of the agreement, which now require that we maintain a minimum cash balance of restricted cash and cash equivalents in an account at Comerica Bank-California of at least 110% of the principal balance under loans outstanding under this agreement until Comerica Bank-California receives payment in full of all outstanding obligations. As of December 31, 2003, the balance of restricted cash was approximately $0.7 million. As of December 31, 2003, the principal balance under loans outstanding under this agreement was approximately $0.7 million. We believe that we are in compliance with all terms of the loan agreement.

In late 1998, we entered into a financing agreement with a financial institution, Transamerica Business Credit Corporation, under which we drew down $4.8 million during 1999 for the purchase of equipment and certain other capital expenditures. In September 2000, Lynx obtained additional financing of approximately $1.0 million under an amendment to the original financing agreement. We granted the lender a security interest in all items financed by it under this agreement. Each draw down under the loan has a term of 48 months from the date of the draw down. As of December 31, 2003, the principal balance under loans outstanding under this agreement was $0.4 million. The draw down period under the agreement expired on March 31, 2000.

Our contractual obligations for the next five years and thereafter are as follows:

	Payments Due by Period				
Contractual Obligations	**Less than 1 year**	**1-3 Years**	**4-5 Years**	**After 5 Years**	**Total**
			(in thousands)		
Operating leases	$2,742	$5,676	$5,848	$	$14,266
Equipment loans	1,093				1,093
Total contractual cash obligations	$3,835	$5,676	$5,848	$	$15,359

We plan to use available funds for ongoing commercial and research and development activities, working capital and other general corporate purposes and capital expenditures. We expect capital investments during 2004 will be less

than $2.0 million and will be comprised primarily of expenditures for capital equipment required in the normal course of business. We intend to invest our excess cash in investment-grade, interest-bearing securities.

We have obtained funding for our operations primarily through sales of preferred and common stock, payments received under contractual arrangements with customers, collaborators and licensees and interest income. Consequently, investors in our equity securities and our customers, collaborators and licensees are significant sources of liquidity for us. Therefore, our ability to maintain liquidity is dependent upon a number of uncertain factors, including but not limited to the following: our ability to advance and commercialize further our technologies; our ability to generate revenues through expanding existing collaborations, customer and licensee arrangements and obtaining significant new customers, collaborators and licensees; and the receptivity of capital markets toward our equity or debt securities. The cost, timing and amount of funds required for specific uses by us cannot be precisely determined at this time and will be based upon the progress and the scope of our commercial and research and development activities; payments received under customer, collaborative and license agreements; our ability to establish and maintain customer, collaborative and license agreements; costs of protecting intellectual property rights; legal and administrative costs; additional facilities capacity needs, and the availability of alternate methods of financing.

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We have incurred net losses each year since our inception in 1992. As of December 31, 2003, we had an accumulated deficit of $107.7 million, including a net loss of $8.8 million in 2003. Net losses may continue for at least the next several years as we proceed with the commercialization and additional development of our technologies. The presence and size of these potential net losses will depend, in part, on the rate of growth, if any, in our revenues and on the level of our expenses.

We have experienced losses since our inception, including a net loss for the six months ended June 30, 2004. We expect to continue to incur net losses as we proceed with the commercialization and additional development of our technologies. The size of these losses will depend on the rate of growth, if any, in our revenues and on the level of our expenses. Our cash and cash equivalents have decreased from the $5.6 million, including $0.7 million of restricted cash, as of December 31, 2003. As of June 30, 2004, our cash and cash equivalents consisted of $2.0 million in unrestricted cash and investments and restricted cash of $0.3 million. We will require additional funding to continue our business activities through at least December 31, 2005. As a result, the report of Ernst & Young LLP regarding our consolidated financial statements included in this annual report includes an explanatory paragraph concerning our ability to continue as a going concern. We are considering various options, which include securing additional equity financing, obtaining new collaborators and customers and other strategic actions. If we raise additional capital by issuing equity or convertible debt securities, our existing stockholders may experience substantial dilution. If we require additional financing, there can be no assurance that it will be available on satisfactory terms, or at all. If we are unable to secure additional financing on reasonable terms, or are unable to generate sufficient new sources of revenue through arrangements with customers, collaborators and licensees, we will be forced to take substantial restructuring actions, which may include significantly reducing our anticipated level of expenditures, the sale of some or all of our assets, or obtaining funds by entering into financing or collaborative agreements on unattractive terms, or we will not be able to fund operations.

Recent Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). The SFAS 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. The SFAS 150 is effective for all financial instruments created or modified after May 31, 2003, and to other instruments for periods beginning after June 15, 2003. The adoption of SFAS 150 did not have a material effect on our results of operations or financial position.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period ending after March 15, 2004. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. We do not believe the adoption of FIN 46 will have a material impact on our financial position or results of operations.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus regarding EITF Issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. The consensus addresses not only when and how an arrangement involving multiple deliverables should be divided into separate units of accounting, but also how the

arrangement s consideration should be allocated among separate units. The pronouncement is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF Issue 00-21 did not have a material effect on our results of operations or financial position.

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Item 8. Consolidated Financial Statements and Supplementary Data

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Report of Ernst & Young LLP, Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Lynx Therapeutics, Inc.

We have audited the accompanying consolidated balance sheets of Lynx Therapeutics, Inc. as of December 31, 2003 and 2002, and the related consolidated statements of operations, stockholders equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Lynx Therapeutics, Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements have been prepared assuming that Lynx Therapeutics, Inc. will continue as a going concern. As more fully described in Note 18, the Company has incurred losses since inception and expects that such losses will continue for the foreseeable future. Additionally, the Company anticipates requiring additional financial resources to fund its operations at least through December 31, 2005. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management s plans as to these matters are also described in Note 18. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the outcome of this uncertainty.

/s/ Ernst & Young LLP

Palo Alto, California
February 20, 2004, except for
paragraph 2 of Business and
Basis of Presentation in Note 1,
as to which the date is March 10, 2004
and Note 18, as to which the date
is October 18, 2004

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LYNX THERAPEUTICS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	December 31,	
	2003	**2002**
Assets		
Current assets:		
Cash and cash equivalents	$ 4,881	$ 11,735
Restricted cash	728	
Accounts receivable	402	836
Inventory	904	1,030
Other current assets	722	714
Total current assets	7,637	14,315
Property and equipment:		
Leasehold improvements	11,510	12,238
Laboratory and other equipment	21,667	22,972
	33,177	35,210
Less accumulated depreciation and amortization	(22,190)	(19,640)
Net property and equipment	10,987	15,570
Investment in related party		1,930
Other non-current assets	172	172
	$ 18,796	$ 31,987
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 1,070	$ 962
Accrued compensation	284	516
Deferred revenues	759	2,926
Equipment loans current portion	1,128	2,250
Other accrued liabilities	344	604
Total current liabilities	3,585	7,258
Deferred revenues	4,213	10,634
Equipment loans, less current portion		1,093

Other non-current liabilities	932	946
Commitments		
Stockholders equity:		
Preferred stock, $0.01 par value; 2,000,000 shares authorized; no shares issued and outstanding		
Common stock, $0.01 par value; 60,000,000 shares authorized; 6,199,245 and 4,646,784 shares issued and outstanding at December 31, 2003 and 2002, respectively	117,722	110,978
Deferred compensation		(9)
Accumulated other comprehensive income(loss)	17	
Accumulated deficit	(107,673)	(98,913)
Total stockholders equity	10,066	12,056
	$ 18,796	$ 31,987

See accompanying notes.

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LYNX THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)

	Year Ended December 31,		
	2003	**2002**	**2001**
Revenues:			
Technology access and services fees	$15,840	$ 13,026	$ 18,372
License fee from related party	760	759	453
Collaborative research and other	1,501	3,621	429
Total revenues	18,101	17,406	19,254
Operating costs and expenses:			
Cost of services fees and other	4,362	3,499	4,118
Research and development	12,178	20,813	24,660
General and administrative	6,773	6,271	7,503
Restructuring charge for workforce reduction	292	530	
Total operating costs and expenses	23,605	31,113	36,281
Loss from operations	(5,504)	(13,707)	(17,027)
Equity share of net loss of related party	(1,930)	(2,522)	
Interest income (expense), net	(158)	(282)	(86)
Other income (expense), net	(966)	882	464
Loss before income taxes	(8,558)	(15,629)	(16,649)
Income tax provision (benefit)	202	(98)	81
Net loss	$ (8,760)	$(15,531)	$(16,730)
Basic and diluted net loss per share	$ (1.80)	$ (4.50)	$ (9.18)
Shares used in per share computation	4,854	3,455	1,822

See accompanying notes.

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LYNX THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(in thousands, except share amounts)

	Common Stock		Notes Receivable from	Deferred	Accumulated Other Comprehensive Income	Accumulated	Total Stockholders
	Shares	Amount	Stockholders	Compensation	(Loss)	Deficit	Equity
Balance at January 1, 2001	1,634,317	75,851	(263)	(1,557)	(1,157)	(66,652)	6,222
Comprehensive loss:							
Net loss						(16,730)	(16,730)
Net unrealized gain on securities					2,296		2,296
Comprehensive loss							(14,434)
Employee stock purchase plan issuance	5,665	314					314
Exercise of stock options for cash and repayment of note receivable	31,122	458	13				471
Issuance of common stock in connection with private placements, net of issuance costs of $619	295,392	11,511					11,511
Amortization of deferred compensation, including forfeitures		(183)		813			630
Balance at December 31, 2001	1,966,496	87,951	(250)	(744)	1,139	(83,382)	4,714
Comprehensive loss:							
Net loss						(15,531)	(15,531)
Net unrealized loss on securities					(1,139)		(1,139)
Comprehensive loss							(16,670)
Employee stock purchase plan issuance	10,489	143					143
Exercise of stock options for cash and repayment of note receivable	1,011	3	250				253
	2,668,788	23,075					23,075

Issuance of common stock in connection with private placements, net of issuance costs of $1,700							
Amortization of deferred compensation, including forfeitures		(194)		735			541
Balance at December 31, 2002	4,646,784	$110,978	$	$ (9)	$	$ (98,913)	$ 12,056
Comprehensive loss:							
Net loss						(8,760)	(8,760)
Foreign currency translation adjustment					17		17
Comprehensive loss							(8,743)
Employee stock purchase plan issuance	7,461	13					13
Exercise of stock options for cash	1,000	2					2
Issuance of common stock in connection with private placements, net of issuance costs of $272,000	1,544,000	6,729					6,729
Amortization of deferred compensation, including forfeitures				9			9
Balance at December 31, 2003	6,199,245	$117,722	$	$	$ 17	$(107,673)	$ 10,066

See accompanying notes.

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LYNX THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2003	**2002**	**2001**
Cash flows from operating activities			
Net loss	$ (8,760)	$(15,531)	$(16,730)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization of fixed assets and leasehold improvements	3,328	5,357	5,020
Amortization of deferred compensation	9	541	630
Forgiveness of principal and interest on loans		181	224
Equity share of net loss of related party	1,930	2,522	
Gain on sale of antisense business		(1,009)	(2,113)
Non-cash portion of gain from sale of technology assets		(1,586)	
Loss on sale of equity investment		64	
Loss on write down of equity investment			1,605
Loss on disposal of fixed assets	689		
Changes in operating assets and liabilities			
Accounts receivable	434	316	387
Inventory	866	688	150
Other current assets	(8)	183	(495)
Accounts payable	108	(1,075)	397
Accrued liabilities	(492)	97	(519)
Deferred revenues	(8,588)	(6,814)	(4,312)
Other non-current liabilities	(14)	(157)	374
Currency translation adjustment	17		
Net cash provided by (used in) operating activities	(10,481)	(16,223)	(15,382)
Cash flows from investing activities			
Purchases of short-term investments		(3,261)	(3,808)
Maturities of short-term investments		3,261	12,153
Proceeds from sale of equity securities		3,702	3,072
Leasehold improvements and equipment purchases, net of retirements and sale to licensee	(435)	(2,701)	(7,427)
Proceeds from disposal of fixed assets	261		
Payments received on notes receivable from officers and employees		456	70
Investment in related party			(4,452)
Other assets		(11)	(40)
Net cash provided by (used in) investing activities	(174)	1,446	(432)
Cash flows from financing activities			

Issuance of common stock, net of repurchases	6,744	23,221	12,283
Proceeds from equipment loan		1,588	
Repayment of equipment loan	(2,215)	(1,496)	(1,145)
Net cash provided by financing activities	4,529	23,313	11,138
Net increase (decrease) in cash and cash equivalents	(6,126)	8,536	(4,676)
Cash and cash equivalents at beginning of year	11,735	3,199	7,875
Cash and cash equivalents at end of year	$ 5,609	$ 11,735	$ 3,199
Supplemental disclosures of cash flow information			
Income taxes paid	$ 202	$	$
Interest paid	$ 208	$ 308	$ 399
Inex stock received	$	$	$ 1,060
Geron stock received	$	$ 1,586	$
Transfer of instruments into inventory	$ 740	$	$

See accompanying notes

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies and Basis of Presentation

Business and Basis of Presentation

Lynx Therapeutics, Inc. (Lynx the Company or we) believes that it is a leader in the development and application of novel genomics analysis solutions. The Company s Massively Parallel Signature Sequencing, or MPSS, instruments analyze millions of DNA molecules in parallel, enabling genome structure characterization at what we believe to be an unprecedented level of resolution. As applied to gene expression analysis, MPSS provides comprehensive and quantitative digital gene expression information important to modern systems biology research in the pharmaceutical, biotechnology and agricultural industries. Gene expression refers to the number of genes and the extent a cell or tissue expresses those genes, and represents a way to move beyond DNA sequence data to understand the function of genes, the proteins that they encode and the role they play in health and disease. Systems biology is an approach in which researchers seek to gain a complete molecular understanding of biological systems in health and disease.

The Company s consolidated financial statements have been presented on a basis that contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has experienced operating losses since its inception of $107.7 million, including a net loss of $8.8 million for the year ended December 31, 2003. Net losses may continue for at least the next several years as we proceed with the commercialization and additional development of the Company s technologies. The presence and size of these potential net losses will depend, in part, on the rate of growth, if any, in the Company s revenues and on the level of its expenses. The Company s cash and cash equivalents have decreased from $11.7 million as of December 31, 2002. As of December 31, 2003, the Company s cash and cash equivalents were $5.6 million, which includes restricted cash of $0.7 million. On March 10, 2004, Lynx completed a $4.0 million private placement of common stock and warrants to purchase common stock (the financing) resulting in proceeds of $3.9 million, net of commissions and expenses. The financing included the sale of 788,235 shares of newly issued shares of common stock at $5.10 per share and the issuance of warrants to purchase 181,295 shares of common stock at an exercise price of $6.25 per share. Management believes that with the funds raised in March 2004, its current cash, cash equivalents and restricted cash, along with cash flows to be generated from customers, collaborators and licensees will be sufficient to enable the Company to meet its projected operating and capital requirements through at least December 31, 2004. The Company may seek additional financing, as needed through arrangements with customers, collaborators and licensees, and equity or debt offerings. There can be no assurance that additional financing, if required, will be available on satisfactory terms, or at all. If the Company is unable to secure additional financing on reasonable terms, or is unable to generate sufficient new sources of revenue through arrangements with customers, collaborators and licensees, the Company will be forced to take substantial restructuring actions, which may include significantly reducing its anticipated level of expenditures, the sale of some or all of its assets, or obtaining funds by entering into financing or collaborative agreements on unattractive terms, or the Company will not be able to fund operations. See Note 18 for an updated discussion regarding the Company s liquidity.

The consolidated financial statements of the Company include the accounts of the Company and its wholly-owned subsidiary, Lynx Therapeutics GmbH, formed under the laws of the Federal Republic of Germany. All significant intercompany balances and transactions have been eliminated. Certain amounts in prior periods have been reclassified to conform to the current year presentation.

Use of Estimates

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

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Foreign Currency Translation

Assets and liabilities of the Company s wholly-owned foreign subsidiary are translated from its local currency at exchange rates in effect at the balance sheet date, and revenues and expenses are translated at average exchange rates prevailing during the year. Any material resulting translation adjustments are reflected as a separate component of stockholders equity.

Concentration of Credit Risk and Other Concentrations

Financial instruments that potentially subject Lynx to concentration of credit risk consist principally of cash equivalents, short-term investments and trade receivables. The Company invests its excess cash in deposits with major banks and in money market and short-term debt securities of companies with strong credit ratings from a variety of industries. These securities generally mature within 365 days and, therefore, bear minimal interest-rate risk. The Company, by corporate policy, limits the amount of credit exposure to any one issuer and to any one type of investment.

Pharmaceutical companies and other research institutions account for a substantial portion of the Company s trade receivables. Accounts receivable are stated as amount billed to customers. The Company provides credit in the normal course of business to its customers and collateral for these receivables is generally not required. The Company monitors the creditworthiness of its customers to which it grants credit terms in the normal course of business. The Company has not experienced significant credit losses to date.

Lynx depends on a single supplier to manufacture flow cells used in its MPSS technology. Lynx currently purchases the flow cells from a single supplier, although the flow cells are potentially available from multiple suppliers. While Lynx believes that alternative suppliers for flow cells exist, identifying and qualifying new suppliers could be an expensive and time-consuming process. Lynx s reliance on outside vendors involves several risks, including the inability to obtain an adequate supply of required components due to manufacturing capacity constraints, a discontinuance of a product by a third-party manufacturer or other supply constraints, reduced control over quality and pricing of components and delays and long lead times in receiving materials from vendors.

Fair Value of Debt Obligations

The fair value of short-term and long-term obligations is estimated based on current interest rates available to Lynx for debt instruments with similar terms, degrees of risk and remaining maturities. The carrying values of these obligations approximate their fair values.

Cash, Cash Equivalents and Short-term Investments

The Company considers all investments in money market mutual funds, commercial paper and corporate bonds and notes with maturities at the date of purchase of 90 days or less as cash equivalents. Investments in debt securities with maturities beyond 90 days, but less than one year, and investments in publicly traded equity securities are considered to be short-term investments. The Company s investment policy stipulates that the investment portfolio be maintained with the objectives of preserving principal, maintaining liquidity and maximizing return.

The Company classifies its investments in money market mutual funds, commercial paper, equity securities and corporate bonds and notes as available-for-sale. Available-for-sale securities are carried at fair value based on quoted

market prices, with the unrealized gains and losses reported as a component of accumulated other comprehensive income. If a decline in the fair value of a short-term investment is below its cost for two consecutive quarters or if the decline is due to a significant adverse event, it is considered to be an other-than-temporary decline. Accordingly, the investment is written down to its estimated fair value. Other-than-temporary declines in fair value on short-term investments are charged against interest income.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Cash, Cash Equivalents and Short-term Investments (continued)

The cost of investments in commercial paper and corporate bonds and notes is adjusted for the amortization of premiums and accretion of discounts to maturity, which is included in interest income. The cost of securities sold, if any, is based on the specific identification method.

Inventory

Inventory is stated at the lower of cost (which approximates first-in, first out cost) or market. The balances at December 31, 2003 and December 31, 2002 were classified as raw materials and consisted primarily of reagents and other chemicals utilized while performing genomics discovery services. Inventory used in providing genomics discovery services and for reagent sales is charged to cost of services fees and other as consumed. Reagents and chemicals purchased for internal development purposes are charged to research and development expense as incurred.

Property and Equipment

Property and equipment are stated at original cost and are depreciated using the straight-line method over the estimated useful lives of the assets, which are generally three years. Leasehold improvements are amortized over the lesser of the useful life of the asset or the remaining term of the facility lease. Amortization of assets recorded under capital leases is included with depreciation expense.

Long-lived Assets

In accordance with Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144), the Company identifies and records impairment losses, as circumstances dictate, on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the discounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets. No such impairments have been identified with respect to the Company s long-lived assets, which consist primarily of property and equipment.

Revenue Recognition

Technology access fees have generally resulted from upfront payments from collaborators, customers and licensees who are provided access to Lynx s technologies for specified periods. Lynx receives service fees from collaborators and customers for genomics discovery services performed by the Company on the biological samples they send to Lynx. Collaborative research revenues are payments received under various agreements and include such items as milestone payments. Milestone payments are recognized as revenue pursuant to collaborative agreements upon the achievement of specified technology developments, representing the culmination of the earnings process. Other revenues include the proceeds from the sale of technology assets, the sale of proprietary instruments and reagents and grant revenue.

Technology access and license fees are deferred and recognized as revenue on a straight-line basis over the noncancelable term of the agreement to which they relate. Payments for services and/or materials provided by Lynx are recognized as revenues when earned over the period in which the services are performed and/or materials are delivered, provided that no other consequential obligations, refunds or credits to be applied to future work exist. Revenues from the sale of technology assets are recognized upon the transfer of the assets to the purchaser. Revenues

from the sales of instruments and reagents are recognized upon shipment to the customer.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Revenue Recognition (continued)

Revenue from significant collaborators, customers and licensees represented the following percentages of total revenue:

	Year Ended December 31,		
	2003	2002	2001
Takara Bio Inc.	39%	16%	12%
E.I. DuPont de Nemours and Company	28%	32%	37%
BASF AG	14%	11%	24%
Bayer CropScience	4%	14%	4%
Geron Corporation		15%	
Institute of Molecular and Cell Biology			12%

Net Loss Per Share

Basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase. Basic and diluted net loss per share amounts are the same in each year as the Company incurred a net loss for all periods presented.

The following table sets forth the computation of basic and diluted net loss per share (in thousands, except per share amounts):

	Year Ended December 31,		
	2003	2002	2001
Net loss	$(8,760)	$(15,531)	$(16,730)
Basic and diluted:			
Weighted-average shares of common stock outstanding	4,854	3,455	1,823
Less weighted-average shares subject to repurchase			(1)
Shares used in computing basic and diluted net loss per share	4,854	3,455	1,822

Basic and diluted net loss per share	$ (1.80)	$ (4.50)	$ (9.18)

Had Lynx been in a net income position, diluted earnings per share would have included the impact of outstanding shares subject to repurchase and the impact of dilutive outstanding options and warrants to purchase common stock. Excluded from the computation of basic and diluted net loss per share are approximately 1,887,000, 1,338,000 and 443,000 shares related to options and warrants to purchase common stock at December 31, 2003, 2002 and 2001, respectively, prior to the application of the treasury stock method. Such shares have been excluded because they are anti-dilutive for all periods presented.

Stock-Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company accounts for stock option grants in accordance with APB Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and related Interpretations. Under APB 25, because the exercise price of the Company s employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Stock-Based Compensation (continued)

All stock option awards to non-employees are accounted for at the fair value of the consideration received or the fair value of the equity instrument issued, as calculated using the Black-Scholes model, in accordance with SFAS 123 and Emerging Issues Task Force Consensus No. 96-18, Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. The option arrangements are subject to periodic remeasurement over their vesting terms. The Company recorded no compensation expense related to option grants to non-employees for the years ended December 31, 2003, 2002 and 2001.

Pro forma information regarding net loss and net loss per share required by Statement of Financial Accounting Standard No. 123, Accounting for Stock-based Compensation (SFAS 123), as amended by SFAS 148, is presented below and has been determined as if the Company had accounted for awards under its stock option and employee stock purchase plans using the fair value method:

	Year Ended December 31,		
	2003	2002	2001
	(in thousands, except per share amounts)		
Net loss, as reported	$ (8,760)	$(15,531)	$(16,730)
Add: Stock-based employee compensation, as reported	9	541	630
Deduct: Stock based employee compensation, as if fair value method applied to all awards	(2,457)	(4,765)	(5,976)
Net loss, pro forma as if fair value method applied to all awards	$(11,208)	$(19,755)	$(22,076)
Basic and diluted net loss per share, as reported	$ (1.80)	$ (4.50)	$ (9.18)
Basic and diluted net loss per share, pro forma as if fair value method applied to all awards	$ (2.31)	$ (5.72)	$ (12.12)

Segment Reporting

Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131), establishes standards for the way that public business enterprises report information about operating segments in financial statements. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company s business activities include the development and commercialization of technologies aimed at handling and/or analyzing the DNA molecules or fragments in biological

samples. Accordingly, the Company operates in only one business segment. All of the Company s assets and revenues are derived from this activity. Substantially all of the Company s long-lived assets are located in the United States. To date, revenues have been derived primarily from contracts with companies located in North America, Europe and Asia, as follows (revenue is attributed to geographic areas based on the location of the customers):

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Segment Reporting (continued)

	Year Ended December 31,		
	2003	2002	2001
		(in thousands)	
United States	$ 6,692	$ 8,906	$ 7,520
Europe			
Germany	4,058	5,570	6,346
France		35	696
United Kingdom	63		100
Norway		30	
Asia			
Japan	7,098	2,865	2,322
Singapore	150		2,270
Africa	40		
	$18,101	$17,406	$19,254

Income Taxes

Under Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes (SFAS 109), deferred tax assets and liabilities are determined based on the difference between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. SFAS 109 provides for the recognition of deferred tax assets if realization of such assets is more likely than not. Based upon the weight of available evidence, which includes the Company s historical operating performance and the reported cumulative net losses for the prior three years, the Company has provided a full valuation against its net deferred tax assets as of December 31, 2003 and 2002. The Company intends to evaluate the realizability of the deferred tax assets on a quarterly basis. See Note 10 to the Consolidated Financial Statements.

Investments in Equity Securities

As of December 31, 2003, Lynx held an approximate 42% equity interest in Axaron Bioscience AG. In 2001, Lynx made a capital investment in Axaron of approximately $4.5 million. Lynx accounts for its equity investment in Axaron using the equity method in accordance with Accounting Principles Board No. 18, The Equity Method of Accounting for Investments in Common Stock (APB 18), because Lynx s ownership is greater than 20% and Lynx has the ability to exercise significant influence over the operating, investing and financing decisions of Axaron. Under the equity method, Lynx records its pro-rata share of Axaron s income or losses and adjusts the basis of its investment accordingly. As of December 31, 2003, the Company s investment in Axaron was reduced to zero.

Recent Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150). SFAS 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. SFAS 150 is effective for all financial instruments created or modified after May 31, 2003, and to other instruments for periods beginning after June 15, 2003. The adoption of SFAS 150 did not have a material effect on the Company s results of operations or financial position.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

Recent Accounting Pronouncements (continued)

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities. In general, a variable interest entity is a corporation, partnership, trust, or any other legal structure used for business purposes that either (a) does not have equity investors with voting rights or (b) has equity investors that do not provide sufficient financial resources for the entity to support its activities. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period ending after March 15, 2004. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The Company does not believe the adoption of FIN 46 will have a material impact on its financial position or results of operations.

In November 2002, the Emerging Issues Task Force (EITF) reached a consensus regarding EITF Issue 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. The consensus addresses not only when and how an arrangement involving multiple deliverables should be divided into separate units of accounting, but also how the arrangement s consideration should be allocated among separate units. The pronouncement is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The adoption of EITF Issue 00-21 did not have a material effect on our results of operations or financial position.

2. Cash Equivalents and Short-term Investments

The following is a summary of available-for-sale securities:

	Available-for-Sale Securities			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(in thousands)			
December 31, 2003				
Money market mutual funds	$1,508	$	$	$1,508
December 31, 2002				
Money market mutual funds	$9,179	$	$	$9,179

As of December 31, 2003 and 2002, no securities were classified as short-term investments.

3. Investment in and Transactions with Related Parties

Axaron Bioscience AG

The Company holds an equity investment in Axaron Bioscience AG (Axaron) (See Note 4). As of December 31, 2003, Lynx held approximately a 42% ownership interest in Axaron and had the ability to exercise significant influence over Axaron s operating and accounting policies. Lynx has accounted for the investment under the equity method in accordance with APB Opinion No. 108. Under the equity method, the Company records its pro-rata share of the income or losses of Axaron. Axaron is engaged in employing Lynx s technologies in its neuroscience, toxicology and microbiology research programs. See Note 4 for further discussion of the joint venture.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. Investment in and Transactions with Related Parties (continued)

Summarized unaudited financial information of Axaron is as follows (in thousands):

	December 31,		
	2003	**2002**	**2001**
Condensed Balance Sheet Data:			
Current assets	$ 4,574	$ 7,459	$11,502
Noncurrent assets	5,198	5,727	5,665
Current liabilities	1,247	1,872	3,269
Stockholders equity	8,525	11,314	13,898
Condensed Statements of Operations Data:			
Net sales	4,226	2,539	9,486
Operating costs and expenses	8,987	8,911	9,525
Income or (loss) from continuing operations	(4,759)	(6,372)	(39)
Net income (loss)	(4,644)	(6,131)	65

In 2001, Lynx extended its technology licensing agreement with Axaron. The license extends Axaron s right to use Lynx s proprietary MPSS and Megasort technologies non-exclusively in Axaron s neuroscience, toxicology and microbiology programs until December 31, 2007. Lynx received from Axaron a $5.0 million technology license fee, which was recorded as deferred revenue and is being recognized on a straight-line basis over the noncancelable term of the agreement. The recorded revenue for year ended December 31, 2003, 2002 and 2001 was $760,000, $759,000 and $443,000, respectively. The Company performed genomics discovery services for Axaron in 2001, and recorded service revenue of $10,000. In 2001, Lynx made a capital investment in Axaron of approximately $4.5 million. For the year ended December 31, 2003 and 2002, Lynx s pro-rata share of Axaron s losses was approximately $1.9 million and $2.5 million, respectively. Lynx s pro-rata share of Axaron s earnings was immaterial for 2001.

The Company has also subleased certain offices in Germany to Axaron. During 2003, 2002 and 2001, the Company received an immaterial amount of sublease income from Axaron.

Other Transactions with Related Parties

For legal services and expenses during the calendar year ended December 31, 2003, Lynx paid approximately $322,000 to Cooley Godward LLP, Lynx s counsel, of which a director of Lynx, is a partner. At December 31, 2003 Lynx had an outstanding liability to Cooley Godward LLP of approximately $55,000.

For business development consulting services and expenses during the calendar year ended December 31, 2003, Lynx paid approximately $222,000 to L.E.K. Consulting LLC, of which a director of Lynx is President of its North American practice. At December 31, 2003 Lynx had an outstanding liability to L.E.K. of approximately $1,200.

For genomics discovery services performed during the calendar year ended December 31, 2003, Lynx received approximately $248,000 from the Institute for Systems Biology, of which a director of Lynx is President and Director.

In June 2001, Dr. Sydney Brenner, a director of the Company, entered into a consulting agreement with us. Pursuant to the agreement, Dr. Brenner performs consulting services of at least eight to 16 hours per month in consideration of his standard consulting fee. In 2003, Dr. Brenner received no consulting fees under this agreement.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Collaborators, Customers and Licensees

The following are summary descriptions of certain key collaborators, customers and licensees:

E.I. DuPont de Nemours and Company

In October 1998, Lynx entered into a research collaboration agreement with E.I. DuPont de Nemours and Company to apply Lynx s technologies on an exclusive basis to the study of certain crops and their protection. Under the terms of the agreement, Lynx received payments over a five-year period that ended in the fourth quarter of 2003 for genomics discovery services, the achievement of specific technology milestones and the delivery of genomic maps of specified crops. Lynx received an initial payment of $10.0 million for technology access at the execution of the agreement, and service fees of $12.0 million were received by Lynx over a three-year period, which commenced in January 1999. The agreement was extended with Lynx for a two-year period during which the Company received additional service fees of $8.0 million through the fourth quarter of 2003.

Through December 31, 2003, Lynx received aggregate payments of $35.0 million from DuPont under the 1998 agreement.

In late November 2003, Lynx entered into a new five year services agreement with DuPont. Through this agreement, we will continue to provide MPSS services to enhance DuPont s discovery and development of new agricultural traits and products.

BASF AG

In October 1996, Lynx entered into an agreement with BASF AG, as amended in October 1998, to provide BASF with nonexclusive access to certain of Lynx s genomics discovery services. In connection with certain technology development accomplishments, BASF paid Lynx a technology access fee of $4.5 million in the fourth quarter of 1999. BASF s access to Lynx s genomics discovery services is for a minimum of two years and requires BASF to purchase services at a minimum rate of $4.0 million per year. At the end of the initial two-year service period in the fourth quarter of 2001, BASF exercised its right to carryover for an additional two-year period through the fourth quarter of 2003, a certain level of previously unrequested genomics discovery services. The agreement expired in September 2003.

Through December 31, 2003, Lynx received aggregate payments of $19.0 million from BASF under the agreement.

Bayer CropScience (formerly Aventis CropScience GmbH)

In March 1999, Aventis Pharmaceuticals, formerly Hoechst Marion Roussel, Inc., obtained nonexclusive access to certain of Lynx s genomics discovery services for the benefit of its affiliate, Aventis CropScience, which is now Bayer CropScience. Lynx received an initial payment for genomics discovery services to be performed by Lynx for Bayer CropScience. The service period was renewed in March 2000, extended in March 2002 for an additional five-year period, and amended in September 2002. Related to the five-year extension and subsequent amendment, Bayer CropScience and Lynx plan to jointly develop and commercialize a novel assay based on Lynx s proprietary bead-based technologies. Lynx and Bayer CropScience will own the assay technology jointly. Lynx will manufacture and sell the services or products based on the assay technology and will pay related royalties to Bayer CropScience.

Additionally, Lynx will derive revenues from performing genomics discovery services for Bayer CropScience during the development and commercialization phase of the agreement. Lynx and Bayer CropScience currently collaborate to apply our technology for the purpose of identifying sequences that might be inserted in genetically modified plants. This is an evaluation project for understanding the possible Bayer CropScience product applicability and our commercial viability of this limited application.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Collaborators, Customers and Licensees (continued)

Takara Bio Inc. (formerly Takara Shuzo Co., Ltd.)

In November 2000, Lynx entered into a collaboration and license agreement with Takara Bio Inc. of Japan. The license, as amended in December 2002 and in July 2003, provided Takara with the right in Japan, Korea and China, including Taiwan, to use Lynx s proprietary Megaclone, Megasort and MPSS technologies exclusively until the expiration of the relevant Lynx patents to provide genomics discovery services and to manufacture and sell microarrays containing content identified by Lynx s technologies. Under the terms of the original license agreement, Takara has a nonexclusive license right to manufacture and sell such microarrays elsewhere throughout the world. In connection with the 2002 amendment to the collaboration, Takara was also granted a royalty-bearing, nonexclusive right to provide genomics discovery services to customers in France and Italy.

Under the terms of the collaboration agreement, as amended, Lynx received payments from Takara for technology access fees, royalties on sales of microarrays and revenues from genomics discovery services, the sale to Takara of proprietary instruments and reagents used in applying Lynx s technologies and purchases of Lynx common stock. In the event of improvements made by Takara that increase the efficiency of Lynx s technologies by a defined amount, Lynx and Takara have agreed to negotiate in good faith a limited reduction to the royalty rate applicable to the above royalties. In December 2002, Lynx sold two MPSS instruments to Takara for Takara s use in providing genomics discovery services in licensed territories. As part of the 2002 amendment to the collaboration, Takara accelerated its technology access fee payments to Lynx.

In both September and December 2002, in connection with the collaboration agreement, Lynx issued and sold 291,545 shares of common stock, at a purchase price of $3.43 per share, to Takara in private placements pursuant to the terms and conditions of common stock purchase agreements. In October 2001, in connection with the collaboration agreement, Lynx issued and sold 45,787 shares of common stock, at a purchase price of $21.84 per share, to Takara in a private placement pursuant to the terms and conditions of a common stock purchase agreement.

As part of a 2003 amendment to the collaboration and license agreement with Takara, Takara made a payment of approximately $3.0 million dollars to Lynx in exchange for which Takara was relieved of its obligation to make technology access fee payments to Lynx totaling approximately $2.0 million dollars during 2003 and 2004 and royalties in respect of Takara s sales, and acquired three additional MPSS instruments for Takara s use in providing genomics discovery services in Takara s licensed territories. In addition, Takara will no longer be required to make future equity investments in Lynx.

Through December 31, 2003, Lynx received aggregate payments of $14.7 million, net of foreign withholding taxes, from Takara under the collaboration agreement. The remaining commitment under this agreement is limited to providing a minimum level of reagents to Takara, at agreed prices, in order for Takara to perform MPSS in their licensed territories.

Axaron Bioscience AG, formerly BASF-LYNX Bioscience AG

In 1996, Lynx and BASF established Axaron Bioscience AG, a joint venture company in Heidelberg, Germany. Axaron began operations in 1997 and is employing Lynx s technologies in its neuroscience, toxicology and microbiology research programs. Upon the establishment of Axaron, Lynx contributed access to Lynx s technologies to Axaron in exchange for an initial 49% equity ownership in Axaron. BASF, by committing to provide research

funding to Axaron of DM50 million (or approximately $32.0 million based on a December 2003 exchange rate) over a five-year period beginning in 1997, received an initial 51% equity ownership in Axaron. In 1998, BASF agreed to provide an additional $10.0 million in research funding to Axaron, of which $4.3 million was paid to us for technology assets related to a central nervous system program. In the period since the joint venture was established, management and employees increased their equity ownership in Axaron to 15%, thereby reducing the ownership of Lynx and BASF to 41.6% and 43.4%, respectively.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

4. Collaborators, Customers and Licensees (continued)

In June 2001, Lynx extended its technology licensing agreement with Axaron. The license extends Axaron s right to use Lynx s proprietary MPSS and Megasort technologies nonexclusively in Axaron s neuroscience, toxicology and microbiology programs until December 31, 2007. The agreement also positions Axaron to apply Lynx s technologies to specific disorders in the neuroscience field. Under the terms of the agreement, Lynx received a $5.0 million technology license fee from Axaron. Lynx intends to furnish to Axaron, initially without charge and later for a fee, proprietary reagents and additional MPSS instruments for use in Axaron s research programs.

In 2001, Lynx and BASF agreed to continue their support of Axaron s growth, including an increase in the capital of Axaron. Lynx made an additional investment of $4.5 million in Axaron, which maintained its ownership interest in Axaron at approximately 42%. Given Lynx s ownership share of Axaron and its ability to exercise significant influence over Axaron s operating and accounting policies, Lynx has accounted for the investment under the equity method in accordance with Accounting Principles Board No. 18, The Equity Method of Accounting for Investments in Common Stock.

Through December 31, 2003, Lynx received aggregate payments of $9.3 million from Axaron under all related agreements. Lynx recorded revenue of $0.8 million in 2003, $0.8 million in 2002, and $0.4 million in 2001 from Axaron, as the technology license fee from Axaron is being recognized as revenue on a straight-line basis over the noncancelable term of the technology licensing agreement. Lynx may receive additional payments from Axaron over the remaining term of the technology licensing agreement from the sale to Axaron of proprietary reagents and additional MPSS instruments for use in Axaron s research programs.

5. Sale of the Antisense Business

In March 1998, Lynx sold its portfolio of phosphorothioate antisense patents and licenses and its therapeutic oligonucleotide manufacturing facility (collectively, the Antisense Business) to Inex Pharmaceuticals Corporation (Inex), a Canadian company. As partial consideration in this transaction, Lynx received $3.0 million in cash and 1.2 million shares of Inex common stock, in three equal installments of 400,000 shares in each of March 1998, March 2000 and March 2001.

Lynx recorded the installments of the Inex common stock received on March 31, 2001 and 2000, at fair value, in other income when received. The Company recognized other income of $1.1 million in 2001 and $3.1 million in 2000 related to the receipt of shares. During fiscal year 2001, the Company sold 763,000 shares of Inex common stock and recognized a gain of $1.0 million. The 2001 gains were offset by a loss of $1.6 million recorded in 2001 as a result of charges related to other-than-temporary declines in the fair value of Inex shares. In the first quarter of 2002, the Company sold its remaining 437,000 shares of Inex common stock and recognized a gain of approximately $1.0 million.

6. Sale of Technology Assets

In March 2002, Lynx sold its intellectual property rights under the N3 -P5 phosphoramidate patent estate to Geron Corporation (Geron) in exchange for $1.0 million in cash and 210,000 shares of Geron common stock. The agreement with Geron involves the sale of a family of patents covering process and compositional matter claims related to oligonucleotides containing phosphoramidate backbone linkages. The Company recognized proceeds of approximately $2.6 million from the sale of this technology to Geron, reflected in the statement of operations as

collaborative research and other revenue. The Company sold all of the Geron stock in April 2002, realizing a loss upon sale of approximately $64,000.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. Restructuring Charges

In January 2003, Lynx implemented a reduction of approximately 25% of its workforce, or 32 people. The Company recorded a workforce reduction charge of $0.3 million related primarily to severance compensation expense for former Lynx employees in the first quarter of 2003, which amounts had been paid entirely as of April 30, 2003.

In April 2002, Lynx implemented a reduction of approximately 30% of its domestic workforce, or 45 people. The Company recorded a workforce reduction charge of $0.5 million related primarily to severance compensation expense for former Lynx employees in the second quarter of 2002. The entire $0.5 million charge was paid during 2002.

8. License Agreements

Lynx has entered into various license agreements with companies and academic institutions. Such agreements generally require Lynx to pay annual or semiannual license fees and are generally cancelable upon 30 to 90 days notice. The expenses associated with licenses were approximately $139,000, $60,000 and $75,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

9. Notes Receivable from Officers

In 1999, the Company entered into loan agreements with certain officers of the Company. The aggregate loans totaled $360,000, were secured by second mortgages on real property, had interest accruable at rates of 4.83% to 6.02% per annum and were subject to early repayment under specified circumstances. The principal and interest on the loans were to be forgiven, based on the officer s continuous employment over a four-year period, on the anniversary dates of employment. The loans were either paid in full or forgiven in 2002 under the terms of the agreements.

In August 1998, Lynx entered into two loan agreements with an officer of the Company. Each loan was in the amount of $100,000, secured by a second mortgage on real property, with interest accruable at the rate of 5.57% per annum, and subject to early repayment under specified circumstances. The principal and interest on one loan were to be forgiven, based on the officer s continuous employment over a four-year period, in the following amounts: 50% on the second anniversary date of employment; and 25% on each of the third and fourth anniversary dates of employment. The second loan was to be repaid by the officer according to the following schedule: 50% of the principal on the third anniversary date of employment; and the remainder of the principal plus accrued interest on the fourth anniversary date of employment. The first loan was forgiven under the terms of the agreement, and the second loan was paid in full in 2002.

In April 1997, Lynx entered into a full-recourse loan agreement with an officer of the Company. A note receivable of $250,000 was issued under a stock purchase agreement for the purchase of 50,000 shares of common stock whereby all the shares issued under the agreement were pledged as collateral. The outstanding principal amount was due and payable in full in April 2002, subject to an obligation to repay under specified circumstances. Interest was payable upon the expiration or termination of the note and accrued at the rate of 6.49% per annum, and $81,125 in interest was forgiven in 2002. The loan s principal was paid in full in 2002.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Stockholders Equity

Common Stock

At December 31, 2003, Lynx had reserved shares of common stock for issuance upon the exercise of outstanding employee and non-employee stock options, upon the issuance of shares to be purchased pursuant to the employee stock purchase plan and upon the exercise of outstanding warrants as noted below:

Stock option grants outstanding	524,103
Shares available for future option grants	208,156
Employee stock purchase plan shares	75,010
Warrants	1,363,068
	2,170,337

In December 2003, we completed a private financing of common stock and warrants to purchase common stock. The financing included the sale of 800,000 newly issued shares of common stock, at a purchase price of $5.00 per share, resulting in gross proceeds of $4 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase up to 200,000 shares of common stock at an exercise price of $6.25 per share.

In September 2003, we completed a private financing of common stock and warrants to purchase common stock. The financing included the sale of 744,000 newly issued shares of common stock, at a purchase price of $4.03 per share, resulting in gross proceeds of $3 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase 186,000 shares of common stock at an exercise price of $9.91 per share.

In both September and December 2002, in connection with the collaboration agreement, Lynx issued and sold 291,545 shares of common stock, at a purchase price of $3.43 per share, to Takara in private placements pursuant to the terms and conditions of common stock purchase agreements.

In April 2002, Lynx completed a $22.6 million private placement of common stock and warrants to purchase common stock (the financing) resulting in proceeds of $20.9 million, net of commissions and expenses. The financing included the sale of 2.1 million newly issued shares of common stock at $10.85 per share and the issuance of warrants to purchase approximately 0.8 million shares of common stock at an exercise price of $13.58 per share. In connection with the financing, the Company issued a warrant to purchase up to an aggregate of 41,714 shares of the Company s common stock at an exercise price of $10.85 per share to Friedman, Billings, Ramsey & Co., Inc. (FBR), as partial consideration, in addition to other customary fees, for services rendered by FBR as sole manager for the private equity financing.

In October 2001, in connection with the collaboration agreement, Lynx issued and sold 45,787 shares of common stock, at a purchase price of $21.84 per share, to Takara in a private placement pursuant to the terms and conditions of

a common stock purchase agreement.

In May 2001, Lynx completed a private placement of common stock and warrants to purchase common stock. The financing included the sale of 249,605 newly issued shares of common stock at a purchase price of $44.59 per share, resulting in net proceeds of approximately $10.5 million, pursuant to a common stock purchase agreement between Lynx and certain investors. In connection with this transaction, Lynx issued warrants to purchase up to 101,082 shares of common stock at an exercise price of $39.76 per share.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Stockholders Equity (continued)

In November 1996, Lynx issued common stock and options in exchange for shares of Spectragen, Inc. common stock and options held by certain officers, employees and one consultant of Spectragen, pursuant to an agreement of merger between Lynx and Spectragen, and charged deferred compensation of approximately $1.4 million ratably to expense as the repurchase rights expired over the period of 1997 through 2002. At the same time, Lynx issued options to purchase shares of Lynx common stock in exchange for options to purchase shares of Spectragen common stock pursuant to the agreement of merger between the Company and Spectragen and charged deferred compensation of approximately $712,000 to expense over the respective vesting periods of the grants from 1997 through 2002.

In December 1997, Lynx s board of directors (the Board) approved the commencement of vesting of certain performance-based stock options that had been granted to certain employees prior to the merger between Spectragen and Lynx. In connection with this action, Lynx recognized deferred compensation of $4.1 million, which has been charged to expense over the five-year vesting period from December 1997 through November 2002.

1992 Stock Option Plan

In July 1992, the Board adopted, and the stockholders subsequently approved, the Company s 1992 Stock Option Plan (the 1992 Plan). In May 1996, the stockholders approved an amendment to the 1992 Plan extending the term of the 1992 Plan until March 2006. In May 2003, the stockholders approved an amendment to the 1992 Plan, authorizing the increase in the number of shares authorized for issuance under the 1992 Plan from a total of 871,052 shares to 1,071,052 shares.

Under the 1992 Plan, the exercise price of incentive stock options granted may not be less than 100% (110% in the case of options granted to a person who owns more than 10% of the total combined voting power of all classes of stock of the Company) of the fair market value of Lynx s common stock at the date of grant. Nonqualified options may be granted at not less than 85% of the fair market value of Lynx s common stock at the date of grant. Options generally vest over a five-year period from the date of grant and have a term of ten years (five years in the case of options granted to a person who owns more than 10% of the total combined voting power of all classes of stock of the Company).

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Stockholders Equity (continued)

The stock option activity under the 1992 Plan was as follows:

		Options Outstanding	
	Available for Grant	Number of Shares Subject to Options	Weighted Average Exercise Price
Balance at January 1, 2000	41,904	348,498	$ 92.61
Shares authorized	100,000		
Options granted	(97,115)	97,115	$ 54.90
Options exercised		(31,122)	$ 14.71
Options canceled	34,187	(34,248)	$ 77.48
Balance at December 31, 2001	78,976	380,243	$ 90.72
Shares authorized	85,714		
Options granted	(129,120)	129,120	$ 9.29
Options exercised		(1,011)	$ 2.50
Options canceled	139,986	(147,765)	$ 64.60
Balance at December 31, 2002	175,556	360,587	$ 72.51
Shares authorized	200,000		
Options granted	(242,750)	242,750	$ 2.17
Options exercised		(1,000)	$ 2.09
Options canceled	75,350	(78,234)	$ 77.10
Balance at December 31, 2003	208,156	524,103	$ 39.38

As of December 31, 2003, all options granted under the 1992 Plan were nonqualified options. There were 223,929, 180,384 and 167,786 options exercisable under the 1992 Plan at December 31, 2003, 2002 and 2001, respectively.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Stockholders Equity (continued)

The options outstanding at December 31, 2003 have been segregated into ranges for additional disclosure as follows:

	Options Outstanding			Options Exercisable	
Range of exercise prices	Options outstanding at December 31, 2003	Weighted-average remaining contractual life (in years)	Weighted-average exercise price	Options currently exercisable at December 31, 2003	Weighted-average exercise price
$2.09 - $2.09	231,000	9.22	$ 2.09	28,250	$ 2.09
$2.66 - $10.01	101,717	8.30	$ 8.26	37,190	$ 7.86
$10.78 - $56.98	60,298	4.16	$ 30.27	50,634	$ 27.27
$58.63 - $80.50	62,626	5.70	$ 71.36	51,944	$ 70.59
$80.92 - $243.25	53,805	5.75	$118.20	45,090	$114.39
$245.00 - $332.92	2,803	6.56	$276.37	1,913	$277.04
$339.50- $339.50	1,142	6.53	$339.50	780	$339.50
$341.25 - $341.25	856	6.51	$341.25	583	$341.25
$386.75 - $386.75	571	6.11	$386.75	428	$386.75
$537.25 - $537.25	9,285	6.15	$537.25	7,117	$537.25
$2.09 - $537.25	524,103	7.60	$ 39.38	223,929	$ 69.39

1998 Employee Stock Purchase Plan

In May 1998, the stockholders approved the adoption of the Company s 1998 Employee Stock Purchase Plan (the Purchase Plan). The Purchase Plan authorized the issuance of 103,369 shares of common stock pursuant to purchase rights granted to employees of the Company and is intended to be an employee stock purchase plan as defined in Section 423 of the Internal Revenue Code. As of December 31, 2003, a total of 28,359 shares of common stock had been issued to employees at an aggregate purchase price of $922,556 and a weighted-average purchase price of $32.53 per share pursuant to offerings under the Purchase Plan, and 75,010 shares remained available for future issuance. Pursuant to our transfer from the Nasdaq National Market to the Nasdaq SmallCap Market, we have suspended our Purchase Plan.

Pro Forma Information

Pro forma information regarding net loss and net loss per share is required by Statement of Financial Accounting Standard No. 123, Accounting for Stock-based Compensation (SFAS 123), as amended by SFAS 148, and has been determined as if the Company had accounted for its stock options granted subsequent to December 31, 1994 under the fair value method of SFAS 123. The weighted-average fair value of options granted in 2003, 2002 and 2001 was $1.53, $6.99 and $41.68 per share, respectively. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model for the single option approach with the following weighted-average assumptions: a risk-free interest rate of 2.84%, 2.98% and 4.35% for 2003, 2002 and 2001, respectively; a weighted-average expected life of five years for 2003, 2002 and 2001 grants; an expected dividend yield of zero for all three years; and a volatility factor of the expected market price of the Company s common stock of 88% for 2003, 106% for 2002 and 109% for 2001.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. Stockholders Equity (continued)

Under SFAS 123, the fair value for the Purchase Plan purchase rights was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for 2003, 2002 and 2001, respectively: risk-free interest rate of 2.93%, 2.98% and 2.2%; no dividend yields; volatility factor of the expected market price of the Company s common stock of 86%, 106% and 109%; and a weighted-average expected life of 0.50, 0.50 and 0.47 years. The weighted-average fair value of those purchase rights granted in 2003, 2002 and 2001, respectively, was $2.07, $17.74 and $58.00.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company s stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company s stock options.

Preferred Stock

Under Lynx s certificate of incorporation, the Board has the authority, without further action by the holders of Lynx s common stock, to issue 2,000,000 additional shares of preferred stock from time to time in series and with preferences and rights as it may designate. These preferences and rights may be superior to those of the holders of Lynx s common stock. For example, the holders of preferred stock may be given a preference in payment upon Lynx s liquidation or for the payment or accumulation of dividends before any distributions are made to the holders of common stock.

Any authorization or issuance of preferred stock, while providing desirable flexibility in connection with financings, possible acquisitions and other corporate purposes, could also have the effect of making it more difficult for a third party to acquire a majority of Lynx s outstanding voting stock or making it more difficult to remove directors and effect a change in management. The preferred stock may have other rights, including economic rights senior to those of Lynx s common stock, and, as a result, an issuance of additional preferred stock could lower the market value of Lynx s common stock. Provisions of Delaware law may also discourage, delay or prevent someone from acquiring or merging with Lynx.

11. Closure of German Operations

In 2003 the Company decided to cease operations at its subsidiary, Lynx GmbH, located in Heidelberg Germany since the Company determined that this operation was no longer critical to the Company s core strategic focus. In January 2003, Lynx implemented a workforce reduction of approximately 92% or 23 people based at Lynx Therapeutics, GmbH, and in December 2003, the GmbH facility was closed. The Company incurred a loss of $689,000 due to the closure consisting entirely of losses on the disposal of fixed assets. The net book value of the assets sold was $0.9 million. This was recorded in other income (expense), net in the statement of operations. Lynx may be required to pay up to EURO 50,000, or approximately $63,000, based on a December 31, 2003 exchange rate, for costs necessary to alter the facilities space to permit or enable another party to lease such space. Lynx is obliged to pay the remaining unamortized balance for tenant improvements financed by the landlord over the term of the lease of EURO 25,705 or approximately $32,300. The Company has recognized the expected payment amounts as of December 31, 2003.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. Income Taxes

The income tax provision of $202,000 for 2003 consisted primarily of foreign withholding tax on payments received from our licensee, Takara. The income tax benefit of $98,000 for 2002 related primarily to a refund received for federal alternative minimum taxes paid in prior periods, offset by foreign withholding tax due on payments received from Lynx s licensee. The provision for income taxes of $81,000 for 2001 relates entirely to foreign taxes.

In the accompanying statements of operations, Loss before provision for income taxes includes the following components for the years ended December 31, 2003, 2002 and 2001 (in thousands):

	Year Ended December 31,		
	2003	**2002**	**2001**
Domestic	$(6,394)	$(14,426)	$(15,705)
Foreign	(2,164)	(1,203)	(944)
	$(8,558)	$(15,629)	$(16,649)

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

	Year Ended December 31,		
	2003	**2002**	**2001**
Current:			
Federal	$		
State	1	(38)	
Alternative Minimum Taxes		(270)	
Foreign	201	210	81
Total Current	$202	$ (98)	$81
Deferred:			
Federal			
State			
Total Deferred			

Total provision (benefit)	$202	$ (98)	$81

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. Income Taxes (continued)

The reconciliation of income tax expense (benefit) attributed to continuing operations computed at the U.S. federal statutory rates to income tax expense (benefit) for the fiscal years ended December 31, 2003, 2002 and 2001 is as follows (in thousands):

	Year Ended December 31,		
	2003	2002	2001
Tax provision (benefit) at U.S. statutory rate	$(2,910)	$(5,314)	$(5,675)
Alternative minimum tax	1	(308)	
Foreign taxes	201	210	81
Loss for which no tax benefit is currently recognizable	2,910	5,314	5,675
	$ 202	$ (98)	$ 81

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company s deferred tax assets are as follows (in thousands):

	2003	2002
Deferred tax assets:		
Net operating loss carryforwards	$ 29,714	$ 21,400
Research and development tax credit carryforwards	5,559	4,540
Alternative minimum tax credit carryforwards		
Capitalized research and development expenditures	3,701	3,110
Deferred revenues	1,989	5,424
Reserves and accruals	497	570
Valuation allowance	(41,460)	(35,044)
Net deferred tax assets	$	$

Realization of deferred tax assets is dependent on future earnings, if any, the timing and amount of which are uncertain. Accordingly, a valuation allowance, in an amount equal to the net deferred tax assets as of December 31, 2003 and 2002 has been established to reflect these uncertainties. The change in the valuation allowance was a net increase of $6.4 million for the year ended December 31, 2003, a net decrease of $1.5 million and a net increase of $5.9 million for the years ended December 31, 2002 and 2001, respectively. Deferred tax assets related to carryforwards at December 31, 2003 include approximately $3.9 million associated with stock option activity for which any subsequently recognized tax benefits will be credited directly to stockholders equity.

As of December 31, 2003, the Company had a federal net operating loss carryforward of approximately $85.5 million, which will expire at various dates from 2010 through 2023, if not utilized. The Company had a state net operating loss carryforward of approximately $10.7 million, which will expire in the years 2004 through 2013.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

12. Income Taxes (continued)

As of December 31, 2003, the Company also had federal and California research and development and other tax credit carryforwards of approximately $3.4 million and $3.3 million, respectively. The federal research and development credits will expire at various dates from 2018 through 2023, if not utilized. The California research and development credits do not expire.

Utilization of the Company s net operating loss and credit carryforwards may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and credits before utilization.

13. Obligations Under Operating Leases

In February 1998, the Company entered into a noncancelable operating lease for facilities space of approximately 111,000 square-feet in two buildings in Hayward, California. Currently, Lynx s corporate headquarters, principal research and development facilities and production facilities are located in one of the two buildings. The remaining space will be developed and occupied in phases, depending on the Company s growth. The term of the lease commenced on December 15, 1998 and expires on December 14, 2008. Under the terms of the lease, the monthly rental payments were fixed for the first 24 months. Thereafter, the monthly rental payments increase and are subject to annual Consumer Price Index-based adjustments, with minimum and maximum limits. The Company is recognizing rent expense on a straight-line basis over the lease period. The Company leased approximately 37,000 square feet of additional space in one of the buildings for further expansion purposes. The Company has the option to extend the lease for an additional five-year period, subject to certain conditions, with payments to be determined at the time of the exercise of the option.

In June 1998, Lynx GmbH entered into a noncancelable operating lease for facilities space of approximately 6,300 square-feet in Heidelberg, Germany, to house its operations. The lease was terminated as of December 31, 2003. Upon termination, Lynx is obliged to pay the remaining unamortized balance of tenant improvements financed by the landlord over the term of the lease. Additionally, Lynx may be required to pay up to approximately EURO 50,000 (or approximately $63,000 based on a December 31, 2003 exchange rate) for the costs necessary to alter the facilities space to permit or enable another party to lease such space. Now that the lease is terminated, Lynx estimates that the total payments, including possible alteration costs, will be approximately $97,600.

The Company has also leased equipment under various operating lease agreements subject to minimum annual lease payments. Minimum annual rental commitments and sublease income under non-cancelable operating leases are as follows (in thousands):

Years Ending December 31,	Lease Commitments
2004	$ 2,742
2005	2,803
2006	2,873
2007	2,945

Thereafter	2,903
	$14,266

Rent expense for facilities and equipment under operating leases was $3,034,000, $2,752,000 and $2,854,000 for the years ended December 31, 2003, 2002 and 2001, respectively. Rental income for the facilities under sublease

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

13. Obligations Under Operating Leases (continued)

was approximately $760,000, $1,266,000 and $1,227,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

14. 401(k) Plan

In October 1992, Lynx adopted a 401(k) Plan covering all of its employees. Pursuant to the 401(k) Plan, employees may elect to reduce their current compensation by up to 25% (subject to an annual limit prescribed by the Internal Revenue Code) and have the amount of such reduction contributed to the 401(k) Plan. The 401(k) Plan permits, but does not require, additional contributions to the 401(k) Plan by Lynx on behalf of all participants in the 401(k) Plan. In the years ended December 31, 2003, 2002 and 2001, the Company contributed $64,400, $98,900 and $99,500, respectively.

15. Equipment Financing

In October 2002, Lynx entered into a loan and security agreement with a financial institution, Comerica Bank-California, for an equipment line of credit of up to $2.0 million with a draw-down period of one year. Under the initial advance, Lynx drew down $1.6 million in November 2002 related to the purchase of equipment made in previous periods. Lynx granted Comerica Bank-California a security interest in all items Lynx financed under this agreement. The initial advance under the loan to finance the purchase of equipment made in previous periods has a term of 24 months from the date of advance and bears interest at a rate of 7.25%. In May 2003, the Company renegotiated the terms of the agreement, which now require that the Company maintain a minimum cash balance of restricted cash and cash equivalents in an account at Comerica Bank-California of at least 110% of the principal balance under loans outstanding under this agreement until Comerica Bank-California receives payment in full of all outstanding obligations. As of December 31, 2003, the principal balance under loans outstanding under this agreement was $0.7 million. Accumulated depreciation relating to these assets as of December 31, 2003 and 2002, amounted to $0.3 million and $0.1 million, respectively.

In 1998, the Company entered into a financing agreement with a financial institution, TransAmerica Business Credit Corporation (TransAmerica), under which Lynx drew down $4.8 million during 1999 for the purchase of equipment and certain other capital expenditures. Lynx granted TransAmerica a security interest in all items financed by the Company under this agreement. Each draw down under the loan has a term of 48 months from the date of the draw down and bears interest at rates ranging from 10.9% to 11.8%. The original draw-down period under the agreement expired on March 31, 2000. In September 2000, Lynx obtained additional financing of $950,000 under an amendment to the original financing agreement. As of December 31, 2003, the principal balance under loans outstanding under this agreement was approximately $0.4 million. Accumulated depreciation relating to these assets amounted to $5.5 million and $5.5 million as of December 31, 2003 and 2002, respectively.

The carrying amounts of the Company s borrowings under its equipment financings approximate their fair values. The fair values are estimated using a discounted cash flow analysis based on the Company s current incremental borrowing rates for similar types of borrowing arrangements.

Equipment loans outstanding at December 31, 2003 will be fully repaid during 2004.

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LYNX THERAPEUTICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

16. Quarterly Results (Unaudited)

	Fiscal Year 2003 Quarter Ended			
	Mar. 31	**June 30**	**Sept. 30**	**Dec. 31**
	(in thousands, except per share data)			
Statement of Operations Data:				
Revenues	$ 3,264	$ 4,585	$8,272	$ 1,980
Income (loss) from operations	(3,102)	(1,881)	2,441	(2,962)
Net income (loss)	(3,972)	(2,857)	1,813	(3,744)
Basic net income (loss) per share	$ (0.85)	$ (0.61)	$ 0.39	$ (0.80)
Diluted net income (loss) per share	$ (0.85)	$ (0.61)	$ 0.38	$ (0.80)

	Fiscal Year 2002 Quarter Ended			
	Mar. 31	**June 30**	**Sept. 30**	**Dec. 31**
	(in thousands, except per share data)			
Statement of Operations Data:				
Revenues	$ 5,022	$ 2,853	$ 4,833	$ 4,698
Loss from operations	(3,898)	(4,927)	(2,086)	(2,796)
Net loss	(3,759)	(5,476)	(3,274)	(3,022)
Basic and diluted net loss per share	$ (1.91)	$ (1.61)	$ (0.80)	$ (0.69)

Net loss per share amounts have been restated to reflect the effect of a 1-for-7 reverse split of Lynx s common stock effected on January 15, 2003. Basic and diluted net loss per share is computed independently for each of the quarters presented. Therefore, the sum of the quarters may not be equal to the full year net loss per share amounts.

17. Subsequent Events (Unaudited)

In March 2004, we announced a reduction of approximately 15% of our total workforce, or 14 people. The reduction included positions in all functions of the Company s business. The workforce reduction was intended to further focus our financial and human resources on expanding the commercial use of MPSS.

On March 24, 2004 Lynx and Solexa Ltd. jointly acquired from Manteia SA the rights to proprietary technology assets for DNA colony generation.

18. Liquidity

We have experienced losses since our inception, including a net loss for the six months ended June 30, 2004. We expect to continue to incur net losses as we proceed with the commercialization and additional development of our technologies. The size of these losses will depend on the rate of growth, if any, in our revenues and on the level of our expenses. Our cash and cash equivalents have decreased from the $5.6 million, including $0.7 million of restricted cash, as of December 31, 2003. As of June 30, 2004, our cash and cash equivalents consisted of $2.0 million in

unrestricted cash and investments and restricted cash of $0.3 million. We will require additional funding to continue our business activities through at least December 31, 2005. We are considering various options, which include securing additional equity financing, obtaining new collaborators and customers and other strategic actions. If we raise additional capital by issuing equity or convertible debt securities, our existing stockholders may experience substantial dilution. If we require additional financing, there can be no assurance that it will be available

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on satisfactory terms, or at all. If we are unable to secure additional financing on reasonable terms, or are unable to generate sufficient new sources of revenue through arrangements with customers, collaborators and licensees, we will be forced to take substantial restructuring actions, which may include significantly reducing our anticipated level of expenditures, the sale of some or all of our assets, or obtaining funds by entering into financing or collaborative agreements on unattractive terms, or we will not be able to fund operations. The accompanying consolidated financial statements have been prepared assuming that we will continue as a going concern. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the matters discussed above.

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PART IV

Item 15. Exhibits, Financial Statements Schedules and Reports on Form 8-K

(a) **Financial Statements, Schedules and Exhibits**

(1) The following index, Report of Ernst & Young LLP, Independent Registered Public Accounting Firm, and financial statements set forth on pages 30 through 57 of this report are being filed as part of this report:

(i) Report of Ernst & Young LLP, Independent Registered Public Accounting Firm.

(ii) Consolidated Balance Sheets as of December 31, 2003 and 2002.

(iii) Consolidated Statements of Operations for the years ended December 31, 2003, 2002 and 2001.

(iv) Consolidated Statements of Stockholders Equity for the years ended December 31, 2003, 2002 and 2001.

(v) Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001.

(vi) Notes to Consolidated Financial Statements.

(2) All schedules are omitted because they are not required, are not applicable or the information is included in the consolidated financial statement or notes thereto.

(3) The following documents are being filed as part of this report:

Exhibit No.	Description of Document
2.1	Acquisition Agreement, dated as of February 4, 1998, by and between the Company and Inex Pharmaceuticals Corporation, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K filed on March 24, 1998.
3.1	Amended and Restated Certificate of Incorporation of the Company, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2000.
3.1.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Company, incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
3.2	Bylaws of the Company, as amended, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2000.
4.1	Form of Common Stock Certificate, incorporated by reference to Exhibit 4.2 of the Company s Statement Form 10 (File No. 0-22570), as amended (see the Statement Form 10).
10.1	Form of Indemnity Agreement entered into between the Company and its directors and officers, incorporated by reference to Exhibit 10.7 of the Company s Statement Form 10.
10.2**	

	The Company s 1992 Stock Option Plan (the Stock Option Plan), incorporated by reference to Exhibit 10.8 of the Company s Statement Form 10.
10.3**	Form of Incentive Stock Option Grant under the Stock Option Plan, incorporated by reference to Exhibit 10.9 of the Company s Statement Form 10.
10.4**	Form of Nonstatutory Stock Option Grant under the Stock Option Plan, incorporated by reference to Exhibit 10.10 of the Company s Statement Form 10.

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Exhibit No.	Description of Document
10.5	Agreement of Assignment and License of Intellectual Property Rights, dated June 30, 1992, by and between the Company and ABI, incorporated by reference to Exhibit 10.11 of the Company s Statement Form 10.
10.6	Amended and Restated Investor Rights Agreement, dated as of November 1, 1995, incorporated by reference to Exhibit 10.30 of the Company s Form 10-K for the period ended December 31, 1995.
10.7+	Technology Development and Services Agreement, dated as of October 2, 1995, by and among the Company, Hoechst Aktiengesellschaft and its subsidiary, Hoechst Marion Roussel, Inc., incorporated by reference to Exhibit 10.28 of the Company s Form 10-K for the period ended December 31, 1995.
10.7.1+	Amended and Restated First Amendment to Technology Development and Services Agreement, dated May 1, 1998, by and between the Company and Hoechst Marion Roussel, Inc., incorporated by reference to Exhibit 10.36 of the Company s Form 10-Q for the period ended June 30, 1998.
10.7.2+	Second Amendment to Technology Development and Services Agreement, dated March 1, 1999, by and among the Company, Hoechst Marion Roussel, Inc. and its affiliate Hoechst Schering AgrEvo GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.7.3+	Third Amendment to Technology Development and Services Agreement, dated December 20, 1999, by and among the Company, Aventis Pharmaceutical Inc. and its affiliate Aventis CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.7.4+	Fourth Amendment to Technology Development and Services Agreement, dated March 31, 2002, by and between the Company and Aventis CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended March 31, 2002.
10.7.5+	Fifth Amendment to Technology Development and Services Agreement, dated as of September 30, 2002, by and between the Company and Bayer CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.10	Lease, dated as of February 27, 1998, by and between the Company and SimFirst, L.P., Limited Partnership, incorporated by reference to Exhibit 10.35 of the Company s Form 10-Q for the period ended March 31, 1998.
10.11**	The Company s 1998 Employee Stock Purchase Plan (the Purchase Plan), incorporated by reference to Exhibit 99.1 of the Company s Form S-8 (File No. 333-59163).
10.12+	Research Collaboration Agreement, dated as of October 29, 1998, by and between the Company and E.I. Dupont de Nemours and Co., incorporated by reference to Exhibit 10.13 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.12.1+	Letter Amendment, dated March 1, 2002, to Research Collaboration Agreement by and between the Company and E.I. DuPont De Nemours and Co., incorporated by reference to the indicated exhibit of

	the Company s Form 10-Q for the period ended March 31, 2002.
10.13	Master Loan and Security Agreement, dated as of October 26, 1998, by and between the Company and Transamerica Business Credit Corporation, incorporated by reference to Exhibit 10.14 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.14	Promissory Note No. 7, dated as of September 29, 2000, issued by the Company to Transamerica Business Credit Corporation, incorporated by reference to Exhibit 10.15 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.

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Exhibit No.	Description of Document
10.15+	Collaboration Agreement, dated as of September 30, 1999, by and between the Company and Hoechst Schering AgrEvo GmbH, incorporated by reference to Exhibit 10.16
10.16**	Employment Agreement, dated as of October 18, 1999, by and between the Company and Norman John Wilkie Russell, Ph.D., incorporated by reference to Exhibit 10.13 of the Company s Form 10-Q for the period ended September 30, 1999.
10.17+	Collaboration Agreement, dated as of October 1, 2000, by and between the Company and Takara Shuzo Co., Ltd. incorporated by reference to Exhibit 10.18 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.17.1+	Amendment No. 1 to Collaboration Agreement, dated December 19, 2002, by and between the Company and Takara Bio Inc., incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
10.17.2+	Amendment No. 2 to Collaboration Agreement, dated June 30, 2003, by and between the Company and Takara Bio Inc., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2003.
10.18	Securities Purchase Agreement, dated as of May 24, 2001, by and among the Company and the investors listed therein, incorporated by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.19	Registration Rights Agreement, dated as of May 24, 2001, by and among the Company and the investors listed therein, incorporated by reference to Exhibit 10.2 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.20	Form of Warrant issued by the Company in favor of each investor thereto, incorporated by reference to Exhibit 10.3 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.21+	Joint Venture Agreement, dated as of June 29, 2001, by and between the Company and BASF Aktiengesellschaft, incorporated by reference to Exhibit 10.18 of the Company s Form 10-Q for the period ended June 30, 2001.
10.22+	First Amendment to Joint Venture Agreement, by and between the Company and BASF Aktiengesellschaft, dated as of August 14, 2001, incorporated by reference to Exhibit 10.22.2 of the Company s Form 10-Q for the period ended September 30, 2001.
10.23+	Technology License Agreement, dated as of June 1, 2001, by and between the Company and BASF-LYNX Bioscience AG, incorporated by reference to Exhibit 10.19 of the Company s Form 10-Q for the period ended June 30, 2001.
10.24	Common Stock Purchase Agreement, by and between the Company and Takara Shuzo Co., Ltd., dated as of October 1, 2001, incorporated by reference to Exhibit 10.24 of the Company s Form 10-Q for the period ended September 30, 2001.

10.25+	Purchase Agreement, dated as of March 5, 2002, by and between Geron Corporation and Lynx Therapeutics, Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K filed on March 18, 2002.
10.26+	Common Stock Purchase Agreement, dated as of March 5, 2002, by and between Geron Corporation and Lynx Therapeutics, Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on From 8-K filed on March 18, 2002.
10.27	Form of Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.

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Exhibit No.	Description of Document
10.28	Form of Registration Rights Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.
10.29	Form of Warrant issued by the Company in favor or each investor party to the Securities Purchase Agreement and Friedman, Billings, Ramsey & Co., Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.
10.30**	Employment Agreement, dated as of June 3, 2002, by and between the Company and Kevin P. Corcoran, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.31**	Employment Agreement, dated as of June 10, 2002, by and between the Company and Thomas J. Vasicek, Ph.D., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.32**	Letter Agreement, dated as of July 9, 2002, by and between the Company and Norman John Wilkie Russell, Ph.D., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.33	Common Stock Purchase Agreement, dated as of September 25, 2002, by and between the Company and Takara Shuzo Co., Ltd., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.34	Loan and Security Agreement, dated October 23, 2002, by and between the Company and Comerica Bank-California, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.35	Common Stock Purchase Agreement, dated as of December 26, 2002, by and between the Company and Takara Shuzo Co., Ltd., incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
10.39	Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on September 25, 2003.
10.40	Form of Warrant issued by the Company in favor of each investor, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on September 25, 2003.
10.41+	Services Agreement, by and between E.I. DuPont de Nemours and Company.
10.42	Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on January 2, 2004.
10.43	Form of Warrant issued by the Company in favor of each investor, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on January 2, 2004.

21.1	Subsidiaries of the Company.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
23.2	Consent of Ernst & Young AG, Independent Auditors.
23.3*	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney. Reference is made to the signature page.
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

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Exhibit No.	Description of Document
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.3	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.4	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.5	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.6	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.7*	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.8*	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1++	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
32.2++	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
32.3++*	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
++	This certification accompanies the Annual Report on Form 10-K to which it relates, pursuant to Section 906 of the Sarbanes Oxley Act of 2002, and is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Lynx Therapeutics, Inc. under the Securities Act or the Exchange Act (whether made before or after the date of the Annual Report on Form 10-K), irrespective of any general incorporation language contained in such filing.

* Being filed herewith; all other exhibits previously filed.

** Management contract or compensatory plan or arrangement.

(+) Portions of this agreement have been deleted pursuant to our request for confidential treatment.

(b) Reports on Form 8-K

A current report on Form 8-K was filed on November 13, 2003 in connection with the issuance of a press release dated November 13, 2003 announcing our financial results for the third quarter of 2003. The press release was furnished under Item 9.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) Securities Exchange Act of 1934, the Registrant has duly caused this report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized, on October 22, 2004.

LYNX THERAPEUTICS, INC.

By: /s/ Kevin P. Corcoran

Kevin P. Corcoran
President and Chief Executive Officer

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

Signature	Title	Date
/s/ Kevin P. Corcoran Kevin P. Corcoran	President, Chief Executive Officer and Director *(Principal Executive Officer)*	October 22, 2004
* Craig C. Taylor	Chairman of the Board	October 22, 2004
/s/ Kathy A. San Roman Kathy A. San Roman	Vice President Human Resources & Administration and Acting Chief Financial Officer *(Principal Financial and Accounting Officer)*	October 22, 2004
* Sydney Brenner	Director	October 22, 2004
* Leroy Hood	Director	October 22, 2004
* James C. Kitch	Director	October 22, 2004
*	Director	October 22, 2004

Marc D. Kozin		
*	Director	October 22, 2004
James V. Mitchell		
*	Director	October 22, 2004
David C. Uprichard		
*	Director	October 22, 2004
Richard P. Woychik		

*By: /s/ Kevin P. Corcoran

KEVIN P. CORCORAN
ATTORNEY-IN-FACT

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EXHIBIT INDEX

Exhibit No.	Description of Document
2.1	Acquisition Agreement, dated as of February 4, 1998, by and between the Company and Inex Pharmaceuticals Corporation, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K filed on March 24, 1998.
3.1	Amended and Restated Certificate of Incorporation of the Company, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2000.
3.1.1	Certificate of Amendment to Amended and Restated Certificate of Incorporation of the Company, incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
3.2	Bylaws of the Company, as amended, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2000.
4.1	Form of Common Stock Certificate, incorporated by reference to Exhibit 4.2 of the Company s Statement Form 10 (File No. 0-22570), as amended (see the Statement Form 10).
10.1	Form of Indemnity Agreement entered into between the Company and its directors and officers, incorporated by reference to Exhibit 10.7 of the Company s Statement Form 10.
10.2**	The Company s 1992 Stock Option Plan (the Stock Option Plan), incorporated by reference to Exhibit 10.8 of the Company s Statement Form 10.
10.3**	Form of Incentive Stock Option Grant under the Stock Option Plan, incorporated by reference to Exhibit 10.9 of the Company s Statement Form 10.
10.4**	Form of Nonstatutory Stock Option Grant under the Stock Option Plan, incorporated by reference to Exhibit 10.10 of the Company s Statement Form 10.

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10.5	Agreement of Assignment and License of Intellectual Property Rights, dated June 30, 1992, by and between the Company and ABI, incorporated by reference to Exhibit 10.11 of the Company s Statement Form 10.
10.6	Amended and Restated Investor Rights Agreement, dated as of November 1, 1995, incorporated by reference to Exhibit 10.30 of the Company s Form 10-K for the period ended December 31, 1995.
10.7+	Technology Development and Services Agreement, dated as of October 2, 1995, by and among the Company, Hoechst Aktiengesellschaft and its subsidiary, Hoechst Marion Roussel, Inc., incorporated by reference to Exhibit 10.28 of the Company s Form 10-K for the period ended December 31, 1995.
10.7.1+	Amended and Restated First Amendment to Technology Development and Services Agreement, dated May 1, 1998, by and between the Company and Hoechst Marion Roussel, Inc., incorporated by reference to Exhibit 10.36 of the Company s Form 10-Q for the period ended June 30, 1998.
10.7.2+	Second Amendment to Technology Development and Services Agreement, dated March 1, 1999, by and among the Company, Hoechst Marion Roussel, Inc. and its affiliate Hoechst Schering AgrEvo GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.7.3+	Third Amendment to Technology Development and Services Agreement, dated December 20, 1999, by and among the Company, Aventis Pharmaceutical Inc. and its affiliate Aventis CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.7.4+	Fourth Amendment to Technology Development and Services Agreement, dated March 31, 2002, by and between the Company and Aventis CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended March 31, 2002.
10.7.5+	Fifth Amendment to Technology Development and Services Agreement, dated as of September 30, 2002, by and between the Company and Bayer CropScience GmbH, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.10	Lease, dated as of February 27, 1998, by and between the Company and SimFirst, L.P., Limited Partnership, incorporated by reference to Exhibit 10.35 of the Company s Form 10-Q for the period ended March 31, 1998.
10.11**	The Company s 1998 Employee Stock Purchase Plan (the Purchase Plan), incorporated by reference to Exhibit 99.1 of the Company s Form S-8 (File No. 333-59163).
10.12+	Research Collaboration Agreement, dated as of October 29, 1998, by and between the Company and E.I. Dupont de Nemours and Co., incorporated by reference to Exhibit 10.13 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.12.1+	Letter Amendment, dated March 1, 2002, to Research Collaboration Agreement by and between the Company and E.I. DuPont De Nemours and Co., incorporated by reference to the indicated exhibit of

	the Company s Form 10-Q for the period ended March 31, 2002.
10.13	Master Loan and Security Agreement, dated as of October 26, 1998, by and between the Company and Transamerica Business Credit Corporation, incorporated by reference to Exhibit 10.14 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.14	Promissory Note No. 7, dated as of September 29, 2000, issued by the Company to Transamerica Business Credit Corporation, incorporated by reference to Exhibit 10.15 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.

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Exhibit No.	Description of Document
10.15+	Collaboration Agreement, dated as of September 30, 1999, by and between the Company and Hoechst Schering AgrEvo GmbH, incorporated by reference to Exhibit 10.16
10.16**	Employment Agreement, dated as of October 18, 1999, by and between the Company and Norman John Wilkie Russell, Ph.D., incorporated by reference to Exhibit 10.13 of the Company s Form 10-Q for the period ended September 30, 1999.
10.17+	Collaboration Agreement, dated as of October 1, 2000, by and between the Company and Takara Shuzo Co., Ltd. incorporated by reference to Exhibit 10.18 of the Company s Form 10-K/A filed on August 24, 2001 for the period ended December 31, 2001.
10.17.1+	Amendment No. 1 to Collaboration Agreement, dated December 19, 2002, by and between the Company and Takara Bio Inc., incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
10.17.2+	Amendment No. 2 to Collaboration Agreement, dated June 30, 2003, by and between the Company and Takara Bio Inc., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2003.
10.18	Securities Purchase Agreement, dated as of May 24, 2001, by and among the Company and the investors listed therein, incorporated by reference to Exhibit 10.1 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.19	Registration Rights Agreement, dated as of May 24, 2001, by and among the Company and the investors listed therein, incorporated by reference to Exhibit 10.2 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.20	Form of Warrant issued by the Company in favor of each investor thereto, incorporated by reference to Exhibit 10.3 of the Company s Current Report on Form 8-K, filed on June 4, 2001.
10.21+	Joint Venture Agreement, dated as of June 29, 2001, by and between the Company and BASF Aktiengesellschaft, incorporated by reference to Exhibit 10.18 of the Company s Form 10-Q for the period ended June 30, 2001.
10.22+	First Amendment to Joint Venture Agreement, by and between the Company and BASF Aktiengesellschaft, dated as of August 14, 2001, incorporated by reference to Exhibit 10.22.2 of the Company s Form 10-Q for the period ended September 30, 2001.
10.23+	Technology License Agreement, dated as of June 1, 2001, by and between the Company and BASF-LYNX Bioscience AG, incorporated by reference to Exhibit 10.19 of the Company s Form 10-Q for the period ended June 30, 2001.
10.24	Common Stock Purchase Agreement, by and between the Company and Takara Shuzo Co., Ltd., dated as of October 1, 2001, incorporated by reference to Exhibit 10.24 of the Company s Form 10-Q for the period ended September 30, 2001.

10.25+	Purchase Agreement, dated as of March 5, 2002, by and between Geron Corporation and Lynx Therapeutics, Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K filed on March 18, 2002.
10.26+	Common Stock Purchase Agreement, dated as of March 5, 2002, by and between Geron Corporation and Lynx Therapeutics, Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on From 8-K filed on March 18, 2002.
10.27	Form of Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.

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Exhibit No.	Description of Document
10.28	Form of Registration Rights Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.
10.29	Form of Warrant issued by the Company in favor or each investor party to the Securities Purchase Agreement and Friedman, Billings, Ramsey & Co., Inc., incorporated by reference to the indicated exhibit of the Company s Current Report on Form 8-K, as amended, filed on April 30, 2002.
10.30**	Employment Agreement, dated as of June 3, 2002, by and between the Company and Kevin P. Corcoran, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.31**	Employment Agreement, dated as of June 10, 2002, by and between the Company and Thomas J. Vasicek, Ph.D., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.32**	Letter Agreement, dated as of July 9, 2002, by and between the Company and Norman John Wilkie Russell, Ph.D., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended June 30, 2002.
10.33	Common Stock Purchase Agreement, dated as of September 25, 2002, by and between the Company and Takara Shuzo Co., Ltd., incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.34	Loan and Security Agreement, dated October 23, 2002, by and between the Company and Comerica Bank-California, incorporated by reference to the indicated exhibit of the Company s Form 10-Q for the period ended September 30, 2002.
10.35	Common Stock Purchase Agreement, dated as of December 26, 2002, by and between the Company and Takara Shuzo Co., Ltd., incorporated by reference to the indicated exhibit of the Company s Form 10-K for the period ended December 31, 2002.
10.39	Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on September 25, 2003.
10.40	Form of Warrant issued by the Company in favor of each investor, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on September 25, 2003.
10.41+	Services Agreement, by and between E.I. DuPont de Nemours and Company.
10.42	Securities Purchase Agreement by and among the Company and the investors listed therein, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on January 2, 2004.
10.43	Form of Warrant issued by the Company in favor of each investor, incorporated by reference to the indicated exhibit of the Company s Form 8-K filed on January 2, 2004.

21.1	Subsidiaries of the Company.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
23.2	Consent of Ernst & Young AG, Independent Auditors.
23.3*	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney. Reference is made to the signature page.
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.

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Exhibit No.	Description of Document
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.3	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.4	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.5	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.6	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.7*	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.8*	Certification required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1++	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
32.2++	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
32.3++*	Certification required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).
++	This certification accompanies the Annual Report on Form 10-K to which it relates, pursuant to Section 906 of the Sarbanes Oxley Act of 2002, and is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Lynx Therapeutics, Inc. under the Securities Act or the Exchange Act (whether made before or after the date of the Annual Report on Form 10-K), irrespective of any general incorporation language contained in such filing.

* Being filed herewith; all other exhibits previously filed.

** Management contract or compensatory plan or arrangement.

(+) Portions of this agreement have been deleted pursuant to our request for confidential treatment.