GENOME THERAPEUTICS CORP
Form 8-K/A
January 30, 2004

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 8-K/A

# CURRENT REPORT

**Pursuant to**

**Section 13 or 15(d) of**

**THE SECURITIES EXCHANGE ACT OF 1934**

**Date of Report (Date of Earliest Event Reported): January 30, 2004**

# GENOME THERAPEUTICS CORP.

**(Exact name of registrant as specified in its charter)**

| **Massachusetts** | **0-10824** | **04-2297484** |
|---|---|---|
| **(State or other jurisdiction of incorporation)** | **(Commission File Number)** | **(I.R.S. Employer Identification Number)** |

**100 Beaver Street**

**Waltham, Massachusetts 02453**

**(Address of principal executive offices, including zip code)**

**(781) 398-2300**

**(Registrant s telephone number, including area code)**

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**ITEM5. OTHER EVENTS**

On December 30, 2003, Genome Therapeutics Corp., a Massachusetts corporation ( Genome ), and GeneSoft Pharmaceuticals, Inc., a Delaware corporation ( Genesoft ), filed an amended joint proxy statement/prospectus on Form S-4/A (file no. 333-111171) relating to the merger of Genome and Genesoft. Set forth below is certain information regarding Genesoft and the proposed merger contained in the S-4/A.

The following is information regarding Genesoft.

**INFORMATION ABOUT GENESOFT**

**Genesoft s Business**

Genesoft is a specialty pharmaceutical company based in South San Francisco focused on the discovery and development of novel anti-infective agents. FACTIVE (gemifloxacin mesylate) is the company s lead product, an orally administered, broad-spectrum fluoroquinolone antibiotic recently approved by the FDA for the treatment of acute bacterial exacerbations of chronic bronchitis, or ABECB, and community-acquired pneumonia, or CAP, of mild to moderate severity. Under an agreement with LG Life Sciences, Genesoft exclusively licensed the rights to develop and commercialize FACTIVE in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino and Vatican City. By virtue of its *in vitro* potency, favorable pharmacokinetic profile, and clinical efficacy as demonstrated in clinical trials, Genesoft believes that FACTIVE is well positioned to become an important antibiotic for the treatment of respiratory tract infections. See FACTIVE Competitive Advantages below.

Genesoft is also developing two classes of novel mode of action antibiotics. The first, peptide deformylase, or PDF, inhibitors, represent a new class of molecules that target an essential bacterial enzyme and have antibacterial activities suitable for the potential treatment of respiratory tract infections. The second, DNA-Nanobinder compounds, target certain DNA sequences and have the potential to serve as biological warfare countermeasures.

*Infectious Diseases Market*

Bacterial infections comprise the sixth leading cause of death in the U.S. and anti-infectives, consisting of antibacterials, antivirals, and antifungals, are the third largest product segment in the pharmaceutical industry, accounting for more than $30 billion in annual sales worldwide in 2002. Antibacterials represent the largest segment of the anti-infective market, accounting for $20 billion of total worldwide anti-infective sales in 2002. The principal structural classes of antibiotics include beta-lactams, quinolones, macrolides, tetracyclines, aminoglycosides, glycopeptides and trimethoprim combinations. Penicillin, a member of the beta-lactam class, which also includes extended-spectrum penicillins, cephalosporins and carbapenems, was first developed in the 1940s. Nalidixic acid, the earliest member of the quinolone class, was discovered in the 1960s. Major advances were made in the 1970s with the development of new beta-lactams and in the 1980s with the development of new quinolones and macrolides.

Bacterial resistance to existing antibiotics has been increasing in recent years, leading to bacterial infection recurrences, treatment failures and higher costs. These factors have fueled a growing need for more effective products in existing antibiotic classes, as well as for products with new

mechanisms of action.

*Community Respiratory Diseases*

*Acute Bacterial Exacerbation of Chronic Bronchitis (ABECB).* Chronic bronchitis is a health problem associated with significant morbidity and mortality. It is estimated that chronic bronchitis affects up to 13 million individuals or approximately 4% to 6% of adults in the United States. Patients with chronic bronchitis are prone to frequent exacerbations, characterized by increased cough and other symptoms of respiratory distress. Longitudinal studies have estimated that 1 to 4 exacerbations occur each year in patients with chronic bronchitis, and such exacerbations are estimated to account for approximately 12 million physician visits per year in the U.S. Antibiotic therapy, the standard treatment for ABECB, is typically effective in reducing the course of illness for patients.

*Community-Acquired Pneumonia (CAP).* CAP is a common and serious illness in the United States. The 3 to 4 million reported cases per year of CAP result in approximately 10 million physician visits, 1 million hospitalizations, 64 million days of restricted activity, and 64,000 deaths annually, making CAP the seventh leading cause of death in the United States, and the most common cause of death due to infectious diseases. Antibiotics are the mainstay of treatment for most patients with pneumonia, and where possible, antibiotic treatment should be specific and individualized. However, since the responsible pathogen is not identified in a high proportion of patients with CAP, an empiric approach to treatment is usually necessary. Over the last decade, resistance to penicillin and macrolides has increased significantly, and in many cases, quinolones are now recommended as a first line of therapy due to their efficacy against a wide range of respiratory pathogens, including many resistant strains. The recent treatment guidelines from the Infectious Diseases Society of America recommend quinolones as a first line treatment for certain higher-risk patients with CAP.

*FACTIVE*

In April 2003, FACTIVE (gemifloxacin mesylate) was approved by the FDA for the treatment of ABECB and CAP of mild to moderate severity. In July 2003, FACTIVE was approved to treat CAP caused by susceptible strains of multi-drug resistant *Streptococcus pneumoniae*, or *S. pneumoniae*, a growing clinical concern. Multi-drug resistant *S. pneumoniae*, or MDRSP, is defined as *S. pneumoniae* resistant to two or more of the following antibiotics: penicillin, second-generation cephalosporins (such as cefuroxime), macrolides, tetracyclines, and trimethoprim/sulfamethoxazole. FACTIVE is the only antimicrobial currently approved for this indication.

FACTIVE has potent *in vitro* activity against a wide range of Gram-positive, Gram-negative and atypical pathogens, including key respiratory pathogens, such as *S. pneumoniae, Haemophilus influenzae,* and *Moraxella catarrhalis,* and is bactericidal at clinically achievable concentrations. FACTIVE targets two enzymes in bacteria and has minimum inhibitory concentrations, or MICs, as low as 0.03 µg/ml for *S. pneumoniae*. FACTIVE has been studied in nearly 7,000 patients and has a good overall safety and tolerability profile comparable to other currently marketed antibiotics.

FACTIVE has been the subject of over 200 publications. Among the research published are data indicating FACTIVE s ability to reduce the number of ABECB recurrences over a six-month period following treatment.

Within the antibiotic market, quinolones, a product class with close to $3 billion in annual sales in the U.S., have been gaining market share at the expense of older antibiotics, according to IMS Health. Genesoft expects this trend to continue as resistance to older antibiotic classes increases. Due to its microbiological activity and clinical efficacy, FACTIVE, a new branded quinolone, represents an alternative choice for the treatment of certain respiratory tract infections.

*Mechanism of Action*

FACTIVE acts by inhibiting bacterial DNA synthesis through the inhibition of both DNA gyrase and topoisomerase IV, two enzymes that are essential for bacterial growth and survival. *S. pneumoniae* showing mutations in both DNA gyrase and topoisomerase IV (double mutants) are resistant to most fluoroquinolones. Since FACTIVE has the ability to inhibit both target enzymes at therapeutically relevant drug levels, some of these *S. pneumoniae* double mutants remain susceptible to FACTIVE.

FACTIVE is also active against many strains of *S. pneumoniae* that are resistant to other classes of antibiotics. There is no known bacterial cross-resistance between FACTIVE and any other class of antimicrobials.

*Clinical Efficacy*

FACTIVE was studied for the treatment of acute bacterial exacerbation of chronic bronchitis in three pivotal, double-blind, randomized, active-controlled clinical trials using 320 mg once daily for 5 days. In these non-inferiority studies, a total of 826 patients received treatment with FACTIVE and 822 patients received treatment with active comparator, namely levofloxacin, clarithromycin, or amoxicillin/clavulanate. The primary

efficacy parameter was clinical response at follow-up. The results for the principal ABECB studies demonstrate that FACTIVE given once daily for 5 days was at least as effective as the comparators given for 7 days. The clinical success rates for each of these three trials were as follows:

| | | |
|---|---|---|
| FACTIVE | 5 days (320 mg): | 88.2% |
| Levofloxacin | 7 days (500 mg): | 85.1% |
| FACTIVE | 5 days (320 mg): | 86.0% |
| Clarithromycin | 7 days (500 mg bid): | 84.8% |
| FACTIVE | 5 days (320 mg): | 93.6% |
| Amoxicillin/clavulanate | 7 days (500 mg/125 mg, 3 times/day, or tid): | 93.2% |

FACTIVE was also studied for the treatment of community-acquired pneumonia in three double-blind, randomized, active-controlled clinical studies, one open, active-controlled study, and two uncontrolled studies. In total, 1,349 patients with CAP were treated with FACTIVE, including 1,037 patients treated for 7 days; 927 patients with CAP were treated with an active comparator. The primary efficacy parameter for each of these three trials was clinical response at follow-up. The results of these studies showed that FACTIVE was effective in the treatment of mild to moderate CAP. The clinical success rates for FACTIVE in studies with a fixed 7-day duration ranged from 89% to 92%.

In the pivotal CAP comparator study, a 7-day treatment regimen of FACTIVE 320 mg once daily was shown to be as effective as a 10-day treatment course of amoxicillin/clavulanate (500 mg/125 mg tid). The clinical success rates for the two treatment arms were:

| | | |
|---|---|---|
| FACTIVE | 7 days (320 mg): | 88.7% |
| Amoxicillin/clavulanate | 10 days (500 mg/125 mg tid): | 87.6% |

Clinical studies showed that FACTIVE was effective in the treatment of CAP due to penicillin-resistant *S. pneumoniae*, or PRSP. Of 11 patients with PRSP treated with FACTIVE for 7 days, 100% achieved both clinical and bacteriological success at follow-up.

FACTIVE is also effective in the treatment of CAP due to MDRSP. In clinical trials, of 22 patients with MDRSP treated with FACTIVE for 7 days, 19 (87%) achieved both clinical and bacteriological success at follow-up. FACTIVE is the first antibiotic approved to treat mild to moderate CAP caused by these multi-drug resistant organisms.

*Competitive Advantages*

The potential competitive advantages of FACTIVE include the following:

- FACTIVE is active against many bacterial isolates resistant to other classes of antibiotics, and is the only antibiotic approved to treat community-acquired pneumonia of mild to moderate severity due to multi-drug resistant *S. pneumoniae.*

- FACTIVE has a dual targeting mechanism of action in *S. pneumoniae*, which targets two enzymes essential for bacterial growth and survival at therapeutically relevant drug levels, and has low *in vitro* potential for resistance generation.

FACTIVE can be dosed once daily, with short courses of therapy for both ABECB (5 days) and CAP (7 days).

FACTIVE has patent protection into 2015 (with possible regulatory extension), longer than any currently marketed fluoroquinolones or other antibiotics widely used to treat respiratory tract infections.

*Safety and Tolerability*

FACTIVE has been studied extensively in nearly 7,000 patients and has a favorable safety profile. The incidence of adverse events reported for FACTIVE was low and comparable to comparator drugs, namely beta-lactam antibiotics, macrolides and other fluoroquinolones. Most adverse events were described as mild to moderate.

Although rash was more frequent among FACTIVE-treated patients in the total patient population than among those who received comparator drugs, in the adult population most at risk for CAP of mild to moderate severity and ABECB (patients over 40 years of age) and at the approved dosage (320 mg for 7 days or less), the rate of rash with FACTIVE was low and comparable to that seen with other antibiotics.

As a post-marketing study commitment, the FDA required that Genesoft conduct a prospective, randomized study comparing FACTIVE (5,000 patients) to an active comparator (2,500 patients) in patients with CAP or ABECB. This study will include patients of different ethnicities, to gain safety information in populations not substantially represented in the existing clinical trial program, specifically as it relates to rash. Patients will be evaluated for clinical and laboratory safety. This Phase IV trial is in the design stage and the FDA required, as a condition to its approval, that the trial be initiated by March 2004. We have requested permission from the FDA to commence the Phase IV trial at a later date that is consistent with the planned launch of FACTIVE. The FDA has indicated its willingness to grant this request. If our request is not granted, however, we will commence the Phase IV trial as soon as possible thereafter, which may not be before the end of March 2004. In connection with the approval of FACTIVE, the FDA has also required us to obtain data on the prescribing patterns and use of FACTIVE for the first three years after its initial marketing in the U.S. As part of this requirement, we will furnish periodic reports to the FDA on the number of prescriptions issued, including refills, and the diagnoses for which the prescriptions are dispensed.

*Additional Development Plans*

FACTIVE has also been the subject of additional clinical trials for acute bacterial sinusitis, or ABS. Two double-blind, randomized, active-controlled clinical studies were conducted to examine the efficacy of FACTIVE 320 mg once daily for 7 days in the treatment of patients with ABS. In these studies, 540 patients received FACTIVE and 536 patients received active comparator, namely trovafloxacin or cefuroxime. The primary efficacy parameter was clinical success at follow-up. The result of these clinical trials showed comparable clinical success for patients treated with FACTIVE and those treated with comparator drugs. In addition, a double-blind, randomized, active-controlled clinical study comparing a FACTIVE 7-day treatment regimen for ABS with a FACTIVE 5-day treatment regimen showed similar efficacy between the two treatment arms. Two open-label studies also support the efficacy of FACTIVE given for 5 days for the treatment of ABS. Genesoft anticipates pursuing this indication in the future.

An intravenous formulation of FACTIVE is also in development. Genesoft is currently evaluating plans for the completion of this intravenous formulation program.

*Product Pipeline*

Genesoft s current pharmaceutical programs reflect its commitment to the research and development of novel anti-infective therapeutics. The pipeline spans discovery research and preclinical development to early clinical trials and pre-launch activities.

*Peptide Deformylase Inhibitors*. In August 2002, Genesoft entered into a research and license agreement with British Biotech Pharmaceuticals Ltd., now Vernalis, to co-develop inhibitors of peptide deformylase, or PDF, a novel iron-binding enzyme essential for bacterial growth but not involved in human cytoplasmic protein synthesis. Genesoft believes that PDF inhibitors represent an excellent opportunity for the development of novel mode of action antibiotics. In September 2003, Genesoft assumed full responsibility for the development and commercialization of these compounds.

Preclinical studies of GSQ-83698, Genesoft s most advanced PDF inhibitor, indicated that the compound may have potential for the treatment of hospitalized patients suffering from CAP. An intravenous formulation of GSQ-83698 entered Phase I clinical trials in October 2002, and the drug was well tolerated and demonstrated good pharmacokinetic properties. GSQ-83698 has exhibited good *in vitro* activity against many of the important respiratory tract pathogens, but has limited activity against *H. influenzae*. Rather than devote additional resources to the clinical development of GSQ-83698, Genesoft has chosen to focus on the optimization of second-generation PDF inhibitors.

This second-generation research program has focused on developing orally available PDF compounds with the potential to target the broader community-based antibiotic market. Several compounds have been identified with improved properties, including good activity against *H. influenzae.* With continued success, Genesoft anticipates selecting a development candidate and initiating IND-enabling studies.

*Biowarfare Countermeasures/DNA-Nanobinder Program.* In an ongoing research effort supported by the Defense Advanced Research Projects Agency, or DARPA, Genesoft is developing DNA-Nanobinder compounds to target biological warfare agents, Gram-positive pathogens, and some parasitic organisms. DNA-Nanobinder compounds selectively target pathogen DNA and bind with high affinity to functionally important adenine/thymine, or A/T, rich DNA sequences, thereby inhibiting DNA and RNA synthesis. These compounds derive their spectrum of activity from the fact that most biowarfare threat agents contain A/T rich DNA sequences in essential elements of their genome. DNA-Nanobinder compounds are being investigated as a medical defense against anthrax, smallpox, and malaria. GSQ-7302, Genesoft s most advanced DNA-Nanobinder compound, has demonstrated *in vitro* activity against these pathogens, and efficacy in a small animal model for anthrax infection.

*Intellectual Property*

In October 2002, Genesoft exclusively licensed from LG Life Sciences the rights to develop and commercialize FACTIVE in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino and Vatican City. This license covers 11 issued U.S. patents and a broad portfolio of corresponding foreign patents and patent applications. The U.S. patents are currently set to expire at various dates, ranging from June 2015, in the case of the principal patents relating to FACTIVE, to September 2019. Genesoft has filed patent term extension applications, covering the regulatory review process, for the principal patents related to FACTIVE. If granted, these extensions would extend the exclusivity period through April 2017.

The patents that Genesoft licenses to FACTIVE under the agreement with LG Life Sciences include claims related to the chemical composition of FACTIVE, its use for the prophylaxis and treatment of bacterial infections, and methods of manufacturing FACTIVE. Genesoft also has the exclusive right to use FACTIVE trademarks, trade names, domain names and logos in conjunction with the use or sale of the product in the territories covered by the license.

Genesoft has exclusively licensed rights from Vernalis for the research, development, and commercialization of certain anti-infectives under Vernalis patent portfolio of 5 issued U.S. patents, 1 pending U.S. patent, 24 issued foreign patents, and 36 pending foreign patent applications. The patents that Genesoft licenses from Vernalis relate to metalloenzyme inhibitors (including peptide deformylase inhibitors), their uses, and their targets.

Genesoft s patent portfolio related to DNA-Nanobinder compounds and their applications as anti-infective therapeutics consists of one issued U.S. patent, 10 pending U.S. patent applications and 8 pending foreign patent applications. In addition, Genesoft licenses 14 issued U.S. patents, 10 pending U.S. patents, 10 issued foreign patents, and 36 pending foreign patent applications from the California Institute of Technology. Some of Genesoft s patents and patent applications related to DNA-Nanobinder compounds resulted from research funded by the U.S. government, and the government has a standard statutory nonexclusive government purpose license and march-in rights if, for example, Genesoft fails to actively develop the technology or public health concerns are implicated.

*Partnerships and Collaborations*

*LG Life Sciences.* In October of 2002, Genesoft entered into a partnership with LG Life Sciences to license exclusive commercialization rights to FACTIVE in the territories specified above under Intellectual Property. The term of the agreement coincides with FACTIVE s patent life which currently expires in 2015, but the patent could be extended for an additional two years. The arrangement included the payment to LG Life Sciences of an up-front fee of $5.5 million and the issuance to LG Life Sciences of approximately 14% of Genesoft s fully-diluted shares outstanding as of April 2003. The arrangement also provides for Genesoft s payment of royalties on future product sales. Genesoft is required to buy bulk drug requirements from LG Life Sciences (see below), and will pay LG Life Sciences a royalty on sales in the U.S. and the territories covered by the license in Europe. The gross margin on product sales, including royalty obligations, is projected to be approximately 75% during the first two years, and in the 65 to 70% range after those periods. Genesoft is responsible, at its expense and through consultation with LG Life Sciences, for the clinical and

commercial development of FACTIVE in the territories covered by the license. This arrangement requires a minimum sales commitment over a period of time, which if not met, could result in the technology being returned to LG Life Sciences. Genesoft is obligated to purchase from LG Life Sciences, and LG is obligated to supply to Genesoft, all of Genesoft s anticipated commercial requirements for FACTIVE bulk drug substance as further described in the Manufacturing section below. Upon delivery of the first shipment of FACTIVE, which is anticipated to occur prior to the end of the first quarter of 2004, Genesoft will be obligated to make a $2.5 million milestone payment to LG Life Sciences as well as a payment of $4.8 million for the purchase of the drug inventory. Upon the closing of the merger, the combined company will be obligated to make an $8 million milestone payment to LG Life Sciences. The arrangement also provides for potential additional milestone payments to LG Life Sciences of up to $22 million, primarily upon achieving sales targets.

*Vernalis.* In August of 2002, Genesoft entered into a strategic partnership with British Biotech Pharmaceuticals Ltd., now Vernalis, to co-develop GSQ-83698 and oral PDF inhibitors for the treatment of community-acquired infections. In 2002, Genesoft paid fees to Vernalis totaling $5 million in connection with the original agreement and issued 356,252 shares of Genesoft common stock upon the achievement of a milestone under the agreement. In September 2003, the companies entered into an agreement whereby Genesoft would assume sole responsibility for the development and commercialization of these compounds. Genesoft also obtained an exclusive worldwide license or sub-license, as applicable, to develop and commercialize three novel bacterial targets for purposes of the treatment of infections from Vernalis as part of this agreement. Genesoft is obligated to pursue the development of these targets and, if appropriate, to pursue the regulatory approval and commercialization of them. Under the agreement, Genesoft has obligations to make royalty payments to Vernalis on future product sales. Additionally, Genesoft may be required to make future milestone payments to Vernalis of up to $18.8 million.

*Defense Advanced Research Projects Agency.* In December 1998, Genesoft received a three-year, $12.3 million grant in the aggregate from DARPA to conduct research on the regulation of pathogen gene expression and to endeavor to develop oral therapeutics against bio-warfare threat agents, including anthrax, smallpox and malaria. This grant ended in June 2002. In November 2002, Genesoft entered into a $3.0 million contract with DARPA to continue the same research. This contract was amended in April 2003 to include the U.S. Army as a party and to provide for an additional $5.5 million to fund the research through early 2004.

*California Institute of Technology.* In September of 1998, Genesoft entered into a license agreement with CIT for the development of DNA-Nanobinders for human gene regulation, under which Genesoft obtained an exclusive worldwide license to a number of patents described above under Intellectual Property. As an up-front fee, Genesoft paid CIT $5,000 and issued CIT 42,750 shares of its common stock. Professor Peter Dervan, one of Genesoft s founders and a director of the company, leads the research effort related to this collaboration at CIT. Genesoft is obligated to pursue the development and commercialization of products based on the technology licensed from CIT. Genesoft is also obligated to pay royalties on possible future product sales and any costs relating to the preparation, filing, prosecution and maintenance of existing and new patents covered by the license agreement.

*Manufacturing*

Under the terms of Genesoft s licensing agreement with LG Life Sciences, LG Life Sciences agreed to supply all of Genesoft s anticipated commercial requirements for FACTIVE bulk drug substance and Genesoft agreed to purchase all of its requirements for the bulk drug substance from LG Life Sciences. LG Life Sciences is expected to supply the FACTIVE bulk drug substance from its manufacturing facility in South Korea. The LG Life Sciences facility is subject to on-going government regulation, including FDA regulations requiring compliance with current Good Manufacturing Practices, or cGMP. For 2004, the final drug product will be tableted and packaged for LG Life Sciences by SB Pharmco at its manufacturing facility in Puerto Rico. This arrangement with SB Pharmco is expected to conclude by the end of 2004. Genesoft is in discussions with a new secondary manufacturer to assume these responsibilities for subsequent periods.

**Facilities**

Genesoft subleases approximately 68,000 square feet of laboratory and administrative space at 7000 Shoreline Court, South San Francisco, California 94080. The yearly base rent for this facility is approximately $3,697,000. Genesoft s sublease for this facility expires on March 31, 2011. Genesoft has sub-subleased approximately 30,200 square feet of the facility through December 31, 2004. Genesoft receives approximately $1,700,000 in yearly base rent from the sub-sublease. Genesoft is considering additional subleases and other options for portions of this space.

**Legal Proceedings**

Genesoft is not aware of any actual, threatened or pending legal proceeding to which it is a party or to which any of its property is subject that could result in material adverse change in the business or financial condition of Genesoft.

**NOTE ON TRADEMARKS**

The following trademarks are the properties of the specified holders: FACTIVE® is the property of LG Life Sciences, Ltd., Nanobinder® is the property of Genesoft, Levaquin® is the property of Ortho-McNeil Pharmaceutical, Inc., Tequin® is the property of Bristol-Myers Squibb Company, Cipro® and Avelox® are both the property of Bayer Corporation, Biaxin® is the property of Abbott Laboratories, Zithromax® is the property of Pfizer Inc., Augmentin® is the property of GlaxoSmithKline, Ketek® is the property of Aventis Pharmaceuticals and Vanconin® is the property of Eli Lilly and Company. Unless otherwise indicated, trademarks or service marks appearing in this current report on Form 8-K are the property of their respective holders.

The following is selected Genesoft financial information and Genesoft management s discussion and analysis of financial condition and results of operations.

**GENESOFT SUMMARY SELECTED FINANCIAL DATA**

The following summary financial data should be read in conjunction with the Genesoft Management s Discussion and Analysis of Financial Condition and Results of Operations section included later in this current report on Form 8-K, and Genesoft s financial statements and related notes included later in this current report on Form 8-K. Genesoft has derived the statements of operations data for the years ended December 31, 2000, 2001 and 2002 from its audited financial statements which are included in this current report on Form 8-K. Genesoft has derived the statements of operations and balance sheet data as of and for the nine months ended September 30, 2002 and 2003 from its unaudited financial statements which are also included in this current report on Form 8-K. These unaudited statements include, in the opinion of management, all normal and recurring adjustments that are necessary for a fair statement of results in accordance with generally accepted accounting principles.

| | Year Ended December 31, | | | | | Nine Months Ended | |
|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | 2000 | 2001 | 2002 | Sept. 30, 2002 | Sept. 30 2003 |
| | (in thousands, except per share amounts) | | | | | (Unaudited) | |
| **Statement of Operations Data:** | | | | | | | |
| Total revenues | $ | $ 2,520 | $ 4,187 | $ 2,059 | $ 5,402 | $ | $ 3,072 |
| Net loss | (770) | (2,987) | (7,921) | (18,321) | (25,569) | (18,368) | (19,796) |
| Basic and diluted net loss per common share | $ (1.03) | $ (2.92) | $ (8.27) | $ (15.69) | $ (12.81) | $ (14.04) | $ (1.69) |
| Weighted average shares used in computing basic and diluted net loss per common share | 745 | 1,024 | 957 | 1,168 | 1,996 | 1,308 | 11,729 |

| | December 31, | | | | | Sept. 30, | Sept. 30 |
|---|---|---|---|---|---|---|---|
| | 1998 | 1999 | 2000 | 2001 | 2002 | 2002 | 2003 |
| | (in thousands) | | | | | (Unaudited) | |
| **Balance Sheet Data:** | | | | | | | |
| Cash and cash equivalents, short-term investments and restricted cash | $ 3,195 | $ 12,405 | $ 29,379 | $ 24,714 | $ 5,951 | $ 7,225 | $ 7,826 |
| Working capital (net capital deficiency) | 2,703 | 12,056 | 22,644 | 18,208 | (3,076) | 715 | (20,993) |
| Total assets | 3,406 | 14,037 | 35,918 | 40,162 | 19,432 | 20,539 | 25,799 |
| Total liabilities | 548 | 1,200 | 6,202 | 7,498 | 11,983 | 6,270 | 32,924 |
| Stockholders equity (net capital deficiency) | 2,858 | 12,837 | 29,716 | 32,664 | 7,448 | 14,269 | (7,125) |

**GENESOFT MANAGEMENT S DISCUSSION AND ANALYSIS**

**OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis should be read in conjunction with Genesoft s financial statements and notes thereto appearing elsewhere in this current report on Form 8-K. This discussion and analysis contains forward-looking statements about Genesoft within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements represent the judgment of the management of Genesoft regarding future events. Forward-looking statements typically are identified

by use of terms such as may, will, should, plan, expect, intend, anticipate, estimate, and similar words, although some forward-look statements are expressed differently. Genesoft does not plan to update these forward-looking statements. You should be aware that actual results could differ materially from those contained in the forward-looking statements due to a number of risks affecting the business of Genesoft.

Although Genesoft believes that its plans, intentions and expectations as reflected in or suggested by these forward-looking statements are reasonable, it can give no assurance that these plans, intentions or expectations will be achieved. Genesoft stockholders are cautioned that all forward-looking statements involve risks and uncertainties and actual results may differ materially from those discussed as a result of various risk factors described in the section entitled Risk Factors and elsewhere in this current report on Form 8-K.

Some of the important risk factors that could cause Genesoft s actual results to differ materially from those expressed in Genesoft s forward-looking statements include, but are not limited to:

- risks related to Genesoft s approved product, FACTIVE, such as (i) Genesoft s inability to obtain the financial resources and personnel to commercialize FACTIVE, (ii) competitors in the antibiotic market introducing superior products that are more effective, more cost-effective and marketed more effectively and (iii) Genesoft s business in the future could expose it to potential product liability risks;

- Genesoft s inability to successfully develop and obtain regulatory approval of products based on metalloenzyme inhibitors, including peptide deformylase (PDF) inhibitors, and DNA-Nanobinder technology;

- Genesoft s history of operating losses, and negative working capital which resulted in a going concern qualification to its December 31, 2002 financial statements, and Genesoft s need to raise future capital to support Genesoft s product development and research initiatives;

- intensified competition from pharmaceutical or biotechnology companies that may have greater resources and more experience than Genesoft;

- Genesoft s inability to obtain or enforce Genesoft s intellectual property rights;

- Genesoft s dependence on key personnel; and

- Genesoft s issued debt burden which totaled approximately $22.0 million at September 30, 2003.

**Overview**

Since its inception in 1997, Genesoft has devoted its efforts to the research and development of its licensed technology. To date, Genesoft has generated no revenues from product sales and has depended upon equity financings, interest on invested funds, research funding from the government and financing through debt to provide the capital required to pursue its intended business activities. Genesoft has a net accumulated deficit of $75.4 million through September 30, 2003. The accumulated deficit has resulted principally from Genesoft s efforts to develop drug candidates and the associated administrative costs required to support these efforts. Genesoft expects to incur significant additional operating losses over the next several years due to the costs associated with launching FACTIVE and its ongoing development and clinical efforts. Genesoft s potential for future profitability is dependent on its ability to successfully launch FACTIVE, its ability to effectively develop its metalloenzyme inhibitor compounds and its ability to license and develop new compounds.

**Major Research and Development Projects**

*FACTIVE*

Genesoft s ongoing regulatory activities related to FACTIVE (gemifloxacin mesylate), its lead product, comprised 28% of its total research and development expenditures for the fiscal year ended December 31, 2002 (including $5.5 million in licensing fees paid to LG Life Sciences), 3% of total research and development expenditures for the nine month period ended September 30, 2002, and 13% of total research and development expenditures for the nine month period ended September 30, 2003.

In October 2002, the company entered into a partnership with LG Life Sciences to develop and commercialize FACTIVE, a novel quinolone antibiotic, in North America, France, Germany, the United Kingdom, Luxembourg, Ireland, Italy, Spain, Portugal, Belgium, the Netherlands, Austria, Greece, Sweden, Denmark, Finland, Norway, Iceland, Switzerland, Andorra, Monaco, San Marino and Vatican City. The term of the agreement coincides with the compound s patent life which currently expires in 2015. The patent could be extended for an additional two years pursuant to Genesoft s request for an extension related to the regulatory process. The product was approved for sale in the United States in April 2003 for the treatment of acute bacterial exacerbation of chronic bronchitis and community-acquired pneumonia of mild to moderate severity. The arrangement with LG Life Sciences included up-front fees, milestone payments and royalties on sales. In addition, Genesoft issued LG Life Sciences common stock equivalent to 14% of the equity in Genesoft on a fully diluted basis as of the time of FDA approval. The bulk product will be manufactured by LG Life Sciences. Genesoft will purchase its requirements for the final drug product from LG Life Sciences for 2004, which final drug product will be tableted and packaged for LG Life Sciences by SB Pharmco at its manufacturing facility in Puerto Rico. This arrangement with SB Pharmco is expected to conclude by the end of 2004. Genesoft is in discussions with a new secondary manufacturer to assume these responsibilities for subsequent periods.

The successful commercialization of FACTIVE is subject to many risks and uncertainties, including an inability to successfully market the product due to competition from other competing drugs, inability to recruit and retain a successful sales management team and sales force, and the inability to raise the financial resources required to launch the drug. A failure to successfully commercialize FACTIVE would have a significant negative impact on Genesoft s operations, financial position and liquidity.

*Metalloenzyme Inhibitors (MEI), including PDF Inhibitors*

Genesoft s ongoing clinical trials and other research activities related to Genesoft s MEI program comprised 23% of Genesoft s total research and development expenditures for fiscal 2002 (including $5 million in in-license and milestone fees paid in August and October 2002 to British Biotech Pharmaceuticals Ltd. (now Vernalis)), 29% of total research and development expenditures for the nine month period ended September 30, 2002 and 25% of total research and development expenditures for the nine month period ended September 30, 2003.

In August 2002, Genesoft entered into a three-year joint collaboration with Vernalis to co-develop GSQ-83698, a novel PDF inhibitor which, based on human pharmacokinetic and tolerability information, may have potential to treat patients hospitalized with community-acquired pneumonia, or CAP. In addition, Genesoft commenced an optimization research project to deliver second-generation oral peptide deformylase development candidates for the treatment of respiratory tract infections, or RTI. In September 2003, Genesoft assumed full responsibility for the MEI program, including some additional limited research assets such as three novel metalloenzyme bacterial targets. The transfer of remaining Vernalis assets to Genesoft related to this program is nearly complete. Genesoft s license agreement with Vernalis provides Genesoft with exclusive rights to develop and market GSQ-83698 and any molecules that are developed from the oral PDF inhibitor program. Genesoft is obligated to pay a royalty on product sales and to make other milestone payments.

Rather than devote additional resources to the clinical development of GSQ-83698, Genesoft has chosen to focus on the optimization of second-generation orally available PDF compounds. Although GSQ-83698 has exhibited good *in vitro* activity against many of the important respiratory tract pathogens, it has limited activity against *H. influenzae.* The second-generation PDF compounds have demonstrated improved properties, including good activity against *H. influenzae.* With continued success, Genesoft anticipates selecting a development candidate and initiating IND-enabling studies.

The successful commercialization of the PDF inhibitor molecules is subject to many risks and uncertainties, including Genesoft s inability to realize the potential of Genesoft s initial discoveries due to scientific failures or lack of skilled personnel. In addition, Genesoft s success in achieving its goals depends, for example, upon whether Genesoft s compounds warrant clinical development, whether any such compounds demonstrate the required safety and efficacy in clinical trials in order to support a regulatory approval and whether Genesoft is able to successfully manufacture and commercialize the product. As a result of these many risks and uncertainties, Genesoft cannot predict when material cash inflows from Genesoft s MEI inhibitor project will commence, if ever. A failure to successfully commercialize Genesoft s PDF inhibitor compounds would have a significant negative impact on Genesoft s operations, financial position and liquidity.

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*Department of Defense Collaboration*

A second major research and development project of Genesoft s is the fulfillment of Genesoft s research obligations related to Genesoft s contract with the U.S. Department of Defense and related agencies.

The research and development expense to support this program was 34% of total research and development expenses in fiscal 2001, 18% of total research and development expenses in fiscal 2002, 27% of total research and development expenses for the nine months ended September 30, 2002 and 26% of total research and development expenses for the nine months ended September 30, 2003. Research and development expense to support this alliance was 29% of the total research and development expense from January 1, 1999 through September 30, 2003.

Genesoft has had substantial funding since 1999 from agencies within the U.S. Department of Defense to develop oral, small molecule treatments for bio-warfare threats, including smallpox, anthrax and malaria. In research, Genesoft has shown its compounds to be efficacious *in vitro* against smallpox, anthrax and malaria and *in vivo* against cowpox, anthrax and malaria.

In December 1998, Genesoft received a three-year, $12.3 million grant in the aggregate from DARPA to conduct research on the regulation of pathogen gene expression and to endeavor to develop oral therapeutics against bio-warfare threat agents, including anthrax, smallpox and malaria. This grant ended in June 2002. In November 2002, Genesoft entered into a $3.0 million contract with DARPA to continue the same research. This contract was amended in April 2003 to include the U.S. Army as a party and to provide for an additional $5.5 million to fund the research through early 2004. Genesoft is subject to the risk that this contract may be terminated prior to its specified expiration date or that the contract may not be renewed further.

Genesoft s ability to obtain the goals for this collaboration is subject to numerous risks, including Genesoft s inability to realize the potential of Genesoft s initial discoveries due to scientific failures or lack of skilled personnel. In addition, Genesoft s success in achieving its goals depends, for example, upon whether Genesoft s compounds warrant clinical development, whether any such compounds demonstrate the required safety and efficacy in clinical trials in order to support a regulatory approval and whether Genesoft is able to successfully manufacture and commercialize the product. Due to these uncertainties, Genesoft cannot be certain if Genesoft will obtain additional funding under this program. A failure to obtain additional funding and to advance Genesoft s program towards product approvals would have a significant negative impact on Genesoft s operations, financial position and liquidity.

*Internally Funded Research Program*

Genesoft conducts its own internally funded program which stems from technology that was licensed from California Institute of Technology, or CIT, called DNA-Nanobinder technology. The use of compounds generated from this technology has been explored in various therapeutic areas. However, a number of technical hurdles associated with the early development of this technology, including limited cellular uptake, binding specificity, and building block stability has slowed progress in some of the therapy areas. Genesoft s current focus has been to use the DNA-Nanobinder compounds in the discovery and research of potential drug candidates in the anti-infective area. In June 2002, Genesoft entered into a contract with Dow Pharmaceuticals for the development of a topical antibacterial to treat skin infections such as infected diabetic foot ulcers and secondarily infected traumatic lesions. Under this collaboration, a topical DNA-Nanobinder preparation was investigated. This program is currently on hold for financial reasons.

These research efforts represented 66% of total research and development expenditures in fiscal 2001, 31% of expenditures in fiscal 2002, 41% of expenditures during the nine month period ended September 30, 2002 and 36% of expenditures during the nine month period ended

September 30, 2003. These efforts comprised 47% of the total research and development expense from inception in August 1997 through September 30, 2003.

Genesoft s ability to obtain its goals for its internally funded research program is subject to numerous risks, including Genesoft s inability to make new discoveries due to scientific failures or lack of skilled personnel. Even if Genesoft succeeds in identifying novel lead series, Genesoft may not be successful in developing these discoveries further due to lack of resources and skilled personnel and the inability to find a strategic partner in an increasingly competitive environment for strategic alliances. Due to all of these uncertainties, Genesoft can provide no assurance that Genesoft will ever receive any material cash inflows from this program.

**Going Concern**

Genesoft has generated negative cash flows from operations since inception and has minimal capital resources at December 31, 2002. Genesoft has been able to fund its cash needs to date through the sale of its preferred and common stock and debt financings. The ability of Genesoft to manage its operating expenses to a level that can be financed by existing cash flows and its ability to obtain additional funding is therefore critical to Genesoft s ability to continue operating as a going concern. These conditions raise substantial doubt about Genesoft s ability to continue as a going concern. Genesoft s management intends to merge Genesoft with Genome (See Note 12 to its financial statements included elsewhere in this current report on Form 8-K) and obtain additional financing or enter into collaborative arrangements. The outcome of management s intentions is not presently determinable. As such, no adjustments have been made that might result from this situation.

Genesoft s continuation as a going concern is primarily dependent upon its ability to merge or obtain alternative sources of capital. In the event Genesoft is unable to secure alternative financing sources, it is likely that any of the following alternatives will be pursued: (1) pursue a co-promotion collaboration; or (2) pursue other available protective remedies.

**Critical Accounting Policies & Estimates**

Genesoft s management discussion and analysis of its financial condition and results of operations are based on its financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires Genesoft to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported revenues and expenses during the reporting periods. On an ongoing basis, Genesoft evaluates its estimates and judgments. Genesoft bases its estimates on historical experience and on various other factors that it believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While Genesoft s significant accounting policies are more fully described in Note 1 to its financial statements included elsewhere in this current report on Form 8-K, Genesoft believes that the following accounting policies relating to the fair value of common stock, the impairment of assets, revenue recognition and stock compensation are most critical to a full understanding and evaluation of its reported financial results.

*Fair Value of Common Stock*

Genesoft has issued various equity instruments including common stock, warrants and options as part of the various transactions it has entered into including those related to the FACTIVE license agreement with LG Life Sciences, the license agreement with Vernalis and option grants to consultants and employees. Genesoft must make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported revenues and expenses during the reporting periods related to the valuation of equity instruments issued in these transactions. Genesoft utilizes third party valuation experts and industry accepted valuation models to estimate the fair market value of these equity instruments; however, the methods utilized by these various valuation methodologies require the use of estimates and assumptions. On an ongoing basis, Genesoft evaluates its estimates and judgments.

*Impairment of Assets*

Genesoft is required to make judgments about the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying value of these assets may be impaired or not recoverable. In order to make such judgments, Genesoft is required to make assumptions about the value of these assets in the future including future prospects for earnings and cash flows. If impairment is indicated, Genesoft writes those assets down to their fair value that is generally determined based on discounted cash flows. Judgments and assumptions about the future are complex, subjective and can be affected by a variety of factors including industry and economic trends, Genesoft s market position and the competitive environment of the businesses in which Genesoft operates.

*Revenue Recognition*

Grant revenue is recognized as the costs stipulated under the grant contracts are incurred.

*Stock Compensation*

Genesoft accounts for employee stock options using the intrinsic-value method in accordance with Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, Financial Accounting Standards Board, or FASB, Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, an interpretation of APB No. 25, and related interpretations and have adopted the disclosure-only provisions of Statement of Financial Accounting Standards, or SFAS, No. 123, Accounting for Stock-Based Compensation, or SFAS No. 123.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. SFAS No. 148 amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. Genesoft has elected to continue to follow the intrinsic value method of accounting as prescribed by APB No. 25. The information regarding net loss as required by SFAS No. 123, presented in Note 1 to its financial statements, has been determined as if Genesoft had accounted for its employee stock options under the fair value method of that statement. The resulting effect on net loss pursuant to SFAS No. 123 is not likely to be representative of the effects on net loss pursuant to SFAS No. 123 in future years, since future years are likely to include additional grants and the irregular impact of future years vesting.

**Results of Operations**

*Nine Months Ended September 30, 2002 and September 30, 2003*

Genesoft s total revenues increased to $3.1 million for the nine months ended September 30, 2003 compared with no revenue for the period ended September 30, 2002. In November 2002, DARPA awarded Genesoft a new four month contract for $3 million. This was increased by $5.5 million for 12 months in April 2003. Genesoft believes that revenues from DARPA will remain relatively stable, if the contract is renewed in April 2004. Genesoft also believes that it will recognize product revenues as a result of its first product launch (FACTIVE) currently projected for September 2004.

Research and development expenses decreased $5.6 million (39%) to $8.9 million for the nine month period ended September 30, 2003 compared to $14.5 million for the nine month period ended September 30, 2002. The decrease was primarily due to a decrease of $1.3 million (51%) in salary expense to scientific management and staff due to reduction in staffing levels in order to control expenditures (which primarily impacted the MEI inhibitor program), a decrease of $2.0 million (45%) in facility related allocation due to the reduction in scientific headcount and a decrease of approximately $470,000 (24%) in consultants used in the internal programs. Additionally, in August 2002, Genesoft paid Vernalis $4 million in technology license fees. There was no comparable payment to Vernalis in 2003. The decrease was partially offset by an increase in research and development expenses due to increased regulatory related fees for FACTIVE of $1.0 million and a payable of $775,000 in research costs to Vernalis to reconcile program costs and FTE requirements per the contract. Genesoft believes that R&D expenses will remain relatively stable or be reduced as Genesoft tries to partner its MEI inhibitor program.

Marketing expenses increased to $2.1 million for the nine month period ended September 30, 2003 compared to no expenses in the period ended September 30, 2002. Genesoft licensed FACTIVE in October 2002, and started its marketing efforts when the product was approved in April 2003. Marketing expenses will continue to increase as Genesoft incurs expenses for the launch of FACTIVE in September 2004.

General and administrative expenses increased by $1.6 million (44%) to $5.2 million for the nine months ended September 30, 2003 compared to $3.6 million for the nine months ended September 30, 2002. The increase in general and administrative expense was primarily due to an increase of $1.5 million (136%) in facility related allocation due to the change in ratio of scientific to general and administrative staff and an increase of approximately $224,000 (26%) in travel and legal services due to increased activity in seeking alliances and potential strategic transactions. These increases were somewhat offset by a decrease in consulting expenses of approximately $319,000 (45%) as a result of reduced expenditures in the areas of business development and human resources. General and administrative expenses should remain relatively stable or be reduced as Genesoft continues to control its expenditures in this area.

Other income decreased by approximately $262,000 (82%) to $59,000 for the nine months ended September 30, 2003 compared to $321,000 for the nine months ended September 30, 2002. The decrease was as a result of lower interest income as a result of lower average cash balances for the period ended December 31, 2002 and lower interest rates earned on invested cash balances in that period. Other income should increase as Genesoft raises more funds through financings resulting in higher cash balances earning interest.

Other expense increased by $6.2 million (1170%) to $6.7 million for the nine months ended September 30, 2003 compared to approximately $530,000 for the nine months ended September 30, 2002. The increase was a result of the interest on the bridge loans which were entered into in December 2002 and April 2003. Interest expense accrued on the bridge loans was $5.5 million through September 30, 2003. Other expense should decrease as Genesoft either pays off or converts its loans in the upcoming months. This decrease is subject to the completion of the merger as planned.

*Twelve Months Ended December 31, 2002 compared with Twelve Months Ended December 31, 2001*

Genesoft s total revenues increased by $3.3 million (157%) to $5.4 million for the twelve months ended December 31, 2002 compared to $2.1 million for the comparable period ended December 31, 2001. This increase was due to additional funding from DARPA. In September 2002, DARPA awarded Genesoft additional grant funds of $3.5 million. Additionally, a new four month contract for $3 million was awarded in November 2002.

Research and development expenses increased by $10.1 million (62%) to $26.3 million for the twelve months ended December 31, 2002 compared to $16.2 million for twelve months ended December 31, 2001. The increase in research and development expenses was primarily due to $5 million in technology licensing and milestone fees paid to Vernalis for access to the Metalloenzyme Inhibitor technology platform; a $5.5 million license fee paid to LG Life Sciences for rights to FACTIVE, a quinolone antibiotic; increased lab supply and contract service expenses of approximately $741,000 (26%) due to toxicology and other analytical expenses related to the DARPA contract. These expenses were somewhat offset by a decrease of approximately $369,000 (10%) in salary expense to scientific management and staff due to reduction in staffing levels in order to control expenditures, which primarily impacted the internal DNA-Nanobinder related programs, as well as a reduction in rent and related facility expense of $1.5million (23%) as a result of subleasing additional space in its facility to a subtenant.

General and administrative expenses decreased by approximately $286,000 (6%) to $4.5 million for the twelve months ended December 31, 2002 compared to $4.8 million for the twelve months ended December 31, 2001. The decrease in general and administrative expenses was primarily due to approximately $233,000 (14%) decrease in administrative salaries and relocation expenses due to reduction in staffing levels and one time relocation charges in 2001 and a decrease of approximately $432,000 (28%) due to subleasing additional space in its facility. This was somewhat offset by an increase of approximately $333,000 (29%) in professional service fees such as legal and consulting fees due to increased activities in business development and human resources related to the licensing of FACTIVE from LG Life Sciences and analyzing other licensing and collaborative opportunities.

Other income decreased by approximately $688,000 (55%) to $564,000 in the twelve months ended December 31, 2002 compared to $1.3 million for the twelve months ended December 31, 2001. The decrease was due to lower interest income resulting from lower cash balances for the period ended December 31, 2002 and lower interest rates earned on invested cash balances.

Other expense increased by approximately $152,000 (27%) to $710,000 in the twelve months ended December 31, 2002 compared to approximately $558,000 for the twelve months ended December 31, 2001. The increase was primarily due to a full year of interest expense on Genesoft s equipment financing . In 2001, the first installment of $3.7 million was drawn in June 2001, followed by the second draw in August 2001 of approximately $512,000 and the last draw of approximately $ 464,000 in October 2001.

*Twelve Months Ended December 31, 2001 compared with Twelve Months Ended December 31, 2000*

Genesoft s total revenues decreased by $2.1 million (51%) to $2.1 million for the twelve months ended December 31, 2001 compared to $4.2 million for the comparable period ended December 31, 2000. This decrease was due to decreased funding from DARPA. Funds from the DARPA grant were depleted by May 2001 whereas in the comparable period ended December 31, 2000 Genesoft was fully funded for twelve months.

Research and development expenses increased by $4.8 million (42%) to $16.2 million in the twelve months ended December 31, 2001, from $11.4 million for the twelve months ended December 31, 2000. The increase in research and development expenses was primarily due to an increase of $1.3 million (54%) in salaries for scientific management and staff due to increased headcount primarily to support the DNA-Nanobinder antibacterial and mammalian programs, an increase of approximately $618,000 (42%) in professional service fees related to consultants used in the DNA-Nanobinder antibacterial and mammalian programs, an increase of $4.4 million (197%) in facility related expenses comprised primarily of an increase in rent expense due to the move to a new, larger facility and associated expenses, including depreciation expense due to the depreciation commencing on leasehold improvements related to the new facility, and other facility-related expenses such as utilities, repairs and maintenance, and office-related expenses. These expenses were somewhat offset by decreased lab supply and outside contract services expenses of $1.0 million (25%) as toxicology and scale up synthesis related to the DNA-Nanobinder antibacterial program were completed in the prior year.

General and administrative expenses increased $3.0 million (164%) to $4.8 million in the twelve months ended December 31, 2001, from $1.8 million for the twelve months ended December 31, 2000. The increase in general and administrative expenses was primarily due to approximately $857,000 (138%) increase in administrative salaries and relocation expenses due to increased headcount to build Genesoft s infrastructure; an increase of approximately $446,000 (162%) in professional service fees for consulting in the areas of business development and human resources; an increase of $1.2 million (367%) comprised primarily of an increase in rent expense due to the move to a new larger facility and associated expenses, including depreciation expense due to the depreciation on leasehold improvements for the new facility, and other facility-related expenses such as utilities, repairs and maintenance, and office-related expenses.

Other income increased approximately $20,000 (2%) to $1.25 million in the twelve months ended December 31, 2001 compared to $1.23 million for the twelve months ended December 31, 2000. This was primarily a result of interest income being stable between years as the cash balances and interest rates were relatively unchanged during the two years.

Other expense increased approximately $504,000 (927%) to $558,000 in the twelve months ended December 31, 2001 from approximately $54,000 for the twelve months ended December 31, 2000. The increase was primarily due to an increase in interest expense as a result of equipment and leasehold related financing transactions in 2001.

**Income Taxes**

At December 31, 2002, Genesoft had net operating loss carry-forwards for federal income taxes of $10.0 million. If not utilized, federal net operating loss carry-forwards will begin to expire in 2007. Genesoft s utilization of the net operating loss and tax credit carry-forwards may be subject to annual limitations pursuant to Section 382 of the Internal Revenue Code, and similar state provisions, as a result of changes in its ownership structure. The annual limitations may result in the expiration of net operating losses and credits prior to utilization.

At December 31, 2001 and 2002, Genesoft had deferred tax assets representing the benefit of net operating loss carryforwards and certain start-up costs capitalized for tax purposes. Genesoft did not record a benefit for the deferred tax assets because realization of the benefit was uncertain and, accordingly, a valuation allowance is provided to offset the deferred tax assets.

**Liquidity and Capital Resources**

Genesoft s primary sources of cash have been through government grants and contracts, borrowings under equipment lending facilities and proceeds from the sale of equity and debt securities.

As of September 30, 2003, Genesoft had cash, cash equivalents and short-term and long-term marketable securities of approximately $7,826,000, of which $3,697,000 was restricted.

In June of 2000 and August of 2001, Genesoft completed private placements of its series C and series D convertible preferred stock, respectively. The series C involved the issuance of 4,890,000 shares at $5.00 per share raising $24,405,000 in net proceeds. The series D involved the issuance of 5,450,000 shares at $4.00 per share raising $20,650,000 in net proceeds. Each share of preferred stock was convertible, at the option of the holder, into one share of common stock. In December 2002, in connection with Genesoft s raising of funds from a bridge loan (see further discussion below), all convertible preferred stock was converted to common stock.

Genesoft s operating activities used cash of approximately $6,992,000, $16,647,000 , $22,006,000, $16,153,000 and $13,342,000 for the years ended December 31, 2000, 2001 and 2002 and the nine months ended September 30, 2002 and 2003, respectively. Cash used in Genesoft s operating activities for the fiscal year ended 2000 was primarily due to its net loss and increases in accounts receivable and prepaid expenses. These uses of cash were partially offset by increases in accounts payable, other assets, accrued bonus and other accrued liabilities as well as non-cash expenses, such as, depreciation and amortization, interest expense and accounting charges for stock issuances to consultants. Cash used in Genesoft s operating activities for the fiscal year ended 2001 was primarily due to its net loss and decreases in accounts payable, accrued patent expenses and accrued leasehold improvements. These uses of cash were partially offset by decreases in accounts receivable, other assets, accrued bonus and other accrued liabilities, increases in deferred rent payable as well as non-cash expenses, such as, depreciation and amortization, interest expense and accounting charges for stock issuances to consultants. Cash used in Genesoft s operating activities for the fiscal year ended 2002 was primarily due to its net loss and increases in accounts receivable and other assets. These uses of cash were partially offset by increases in accounts payable, other accrued liabilities, deferred rent payable and decreases in prepaid expenses as well as non-cash expenses, such as, depreciation and amortization, interest expense and accounting charges for stock issuances to consultants and collaborators. Additionally, Genesoft realized gains on its short-term investments as well as disposal of equipment. Cash used in its operating activities for the nine months ended September 30, 2002 was primarily due to its net loss and increases in accounts receivable, other assets and decreases in its accounts payable. These uses of cash were partially offset by increases in other accrued liabilities, deferred rent payable and decreases in prepaid expenses as well as non-cash expenses, such as, depreciation and amortization, interest expense. Additionally, Genesoft realized gains on its short-term investments as well as disposal of equipment. Cash used in Genesoft s operating activities for the nine months ended September 30, 2003 was primarily due to its net loss and increases in accounts receivable and decreases in its accounts payable. These uses of cash were partially offset by increases in bridge loans, other accrued liabilities, deferred rent payable and decreases in prepaid expenses and other assets as well as non-cash expenses, such as, depreciation and amortization, interest expense and stock issued to consultants and collaborators. Additionally, Genesoft realized gains on its short-term investments.

Genesoft s investing activities (used)/provided cash of approximately ($12,946,000), ($15,905,000), $16,320,000, $14,614,000 and $369,000 for the years ended December 31, 2000, 2001, 2002 and the nine months ended September 30, 2002 and 2003, respectively. Cash used by Genesoft s investing activities for fiscal year 2000 was primarily due to purchases of marketable securities and property and equipment and the issuance of a standby letter of credit to its landlord for the building deposit, which is secured by a restricted cash account. Cash used by Genesoft s investing activities for fiscal year 2001 was primarily due to purchases of marketable securities and property and equipment. The uses were partially offset by the conversion of marketable securities to cash and cash equivalents. Cash provided by Genesoft s investing activities for the fiscal year 2002, was primarily through the conversion of marketable securities to cash and cash equivalents, proceeds received from the sale of property and equipment. These uses were partially offset by the purchases of marketable securities and property and equipment. Cash provided by Genesoft s investing activities for the nine months ended September 30 and September 30, 2002, respectively, was primarily through the conversion of marketable securities to cash and cash equivalents, proceeds received from the sale of property and equipment. These uses were partially offset by the purchases of marketable securities and property and equipment. Cash provided by Genesoft s investing activities for the nine months ended September 30, 2003, was primarily through the conversion of marketable securities to cash and cash equivalents. These uses were partially offset by the purchases of marketable securities and property and equipment.

Capital expenditures totaled $2,386,000, $12,174,000, $209,000, $151,000 and $7,000 for the years ended December 31, 2000, 2001, 2002 and the nine months ended September 30, 2002 and 2003, respectively, consisting primarily of the investment in leasehold improvements and purchases of laboratory and computer equipment. Genesoft currently estimates that it will not acquire any new equipment or make additions to leasehold improvements prior to the consummation of the proposed merger with Genome. Genesoft s capital expenditures will mainly result from the replacement of any defective equipment.

Genesoft s financing activities provided cash of approximately $26,206,000, $24,016,000, $3,435,000 and $15,222,000 for the years ended December 31, 2000, 2001, 2002 and the nine months ended September 30, 2003, respectively. For the nine months ended September 30, 2002, Genesoft s financing activities used cash of $1,427,000. For the fiscal year ended 2000, Genesoft s cash was provided primarily from proceeds received from the sale of convertible preferred stock totaling $24.4 million in net proceeds, proceeds received from entering into an additional loan agreement for $1.9 million, as well as proceeds received from issuances of stock from employee early exercise of options through its employee option plan. These proceeds from financing activities were partially offset by payments of obligations of $323,000 and the repurchase of unvested stock from terminated employees. For the fiscal year ended 2001, Genesoft s cash was provided primarily from proceeds received from the sale of convertible preferred stock totaling $20.6 million in net proceeds, proceeds received from entering into an additional loan agreement for $4.7 million, as well as proceeds received from issuances of stock from employee early exercise of options through the employee option plan. These proceeds from financing activities were partially offset by payments of obligations of $1,279,000 and the repurchase of unvested stock from terminated employees. For the fiscal year ended 2002, Genesoft s cash was provided primarily from proceeds received from entering into a bridge loan and additional loan agreements for $6.5 million, as well as proceeds received from issuances of stock from employee early exercise of options through the employee option plan. These proceeds from financing activities were partially offset by payments of obligations of $3,032,000 and the repurchase of unvested stock from terminated employees. For the nine months ended September 30, 2002, Genesoft s cash was used by payments of obligations of $1,409,000 and the repurchase of unvested stock from terminated employees. The use was partially offset by issuances of stock from the employee early exercise of options through the employee option plan. For the nine months ended September 30, 2003, Genesoft s cash was provided primarily from proceeds received from entering into a bridge loan for $18.8 million as well as proceeds received from the issuances of stock from employee early exercise of options through the employee option plan. These proceeds from financing activities were partially offset by payments of obligations of $3,625,000 and the repurchase of unvested stock from terminated employees.

*Contractual obligations*

In December of 2002 and April of 2003, Genesoft entered into convertible bridge loan agreements with various existing and new investors in the aggregate principal amount of $22,300,000. The December bridge loan was in the original principal amount of approximately $5 million, had an interest rate of 6% per annum, carries a liquidation preference of $7.5 million and required the conversion of all existing Genesoft preferred stock to common stock. The April bridge loan was in the original principal amount of approximately $17.3 million and had an initial interest rate of 17% per annum which increased to 4% per month on August 15, 2003 since the loan was not repaid by that date. The December bridge loan is convertible, at the option of the holders, into common stock of Genesoft upon the closing of a financing transaction at the price per share paid in that financing transaction. The April bridge loan is

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convertible, at the option of the holders, into common stock of Genesoft at any time after December 15, 2003 at a price of $5.00 per share. In connection with the signing of the merger agreement with Genome, the December and April bridge loans were amended to provide that interest would accrue on the loans at a rate of 5% per annum from and after December 10, 2003, in the case of the December bridge loans, and from and after December 15, 2003, in the case of the April bridge loans. The maturity date of the December bridge loans was amended to be the later of December 10, 2005 and 60 days following the termination or expiration of the merger agreement. The maturity date of the April bridge loans was amended to be the later of December 15, 2005 and 60 days following the termination or expiration of the merger agreement. Upon the closing of the merger, the December and April bridge loans will be exchanged for convertible promissory notes of Genome. See the section entitled The Merger and Related Transactions Other Material Agreements Relating to the Merger Note Amendment and Exchange Agreement in the joint proxy statement/prospectus on Form S-4/A (file no. 333-111171) for more detail.

In connection with the December and April bridge loans, Genesoft issued warrants to purchase 5,000,678 of its shares of common stock at an exercise price of $0.01 per share and 360,593 of its common stock at an exercise price of $12 per share. These warrants and the conversion feature on the bridge loans were valued, using the Black-Scholes option pricing model, at $1.2 million which is being amortized to interest expense over the term of the notes.

Genesoft has two loan agreements under which it has financed the purchase of office and laboratory equipment and leasehold improvements. Genesoft has borrowed approximately $6,600,000 in the aggregate from financial institutions, of which approximately $1,889,000 remains outstanding at September 30, 2003. This amount is repayable over the next 15 months, with $1,518,000 repayable over the next 12 months. At the closing of the merger with Genome, the combined company will be required to pay off one of these loans under which $1,019,306 is currently outstanding. In connection with these financing arrangements, Genesoft issued warrants to purchase 40,702 shares of common stock at an exercise price of $13.47 per share. These warrants were valued, using the Black-Scholes option pricing model, at $408,000 which is being amortized to interest expense over the term of the agreement.

In December 2002, Genesoft issued a promissory note to LG Life Sciences for $3,000,000 which represented the balance due on the up-front in-license fee of $5,500,000. The note, which had a maturity date of April 29, 2003, was unsecured and had an interest rate of 10% per annum compounded quarterly. In December 2002, Genesoft prepaid $125,000 of the outstanding balance and in April 2003 Genesoft paid back the entire remaining amount due under the note.

The future minimum payments under the operating leases (gross) and financing arrangements, by year, are as follows:

| | Operating Leases | Notes Payable and Bridge Loan |
|---|---|---|
| Three months ending December 31, 2003 | $ 533,925 | $ 24,714,412 |
| Year ending December 31, | | |
| 2004 | 2,198,940 | 1,714,354 |
| 2005 | 4,075,654 | 5,918,301 |
| 2006 | 4,218,296 | |
| 2007 | 4,365,944 | |
| Thereafter | 13,384,023 | |
| | $ 28,776,782 | 32,347,067 |
| Less interest | | (6,897,842) |
| Less discount | | (731,631) |

| | |
|---|---|
| | 24,717,595 |
| Less current portion | (19,689,234) |
| Long-term portion | $ 5,028,361 |

Genesoft plans to continue to invest in the launch of FACTIVE as well as its internal research programs, primarily the MEI inhibitors. Pursuant to its partnership with LG Life Sciences, upon delivery of the first shipment of FACTIVE, which is anticipated to occur prior to the end of first quarter of 2004, Genesoft will be obligated to make a $2.5 million milestone payment to LG Life Sciences as well as a payment of $4.8 million for the purchase of the drug inventory. Upon the closing of the merger, the combined company will be obligated to make an $8 million milestone payment to LG Life Sciences.

On November 17, 2003, Genome loaned to Genesoft $6.2 million in connection with the signing of the merger. This loan, along with Genesoft s existing capital resources are expected to fund Genesoft s operations through the closing of the merger. If, however, the closing of the merger is delayed or if Genesoft s liabilities increase, there can be no assurance that these funds will be sufficient. For further detail on the terms of this loan, see the section entitled The Merger and Related Transactions Other Material Agreements Relating to the Merger Bridge Loan in the joint proxy statement/prospectus on Form S-4/A (file no. 333-111171).

In the future, Genesoft, as part of the combined company following the merger, will need to raise additional capital in order to continue to fund its programs. Additional financing may not be available when needed or, if available, it may not be on terms acceptable to the combined company. Any additional capital that the combined company raises by issuing equity or convertible debt securities will dilute the ownership of existing stockholders of Genesoft in the combined company.

**Quantitative and Qualitative Disclosures about Market Risk**

The primary objective of Genesosft s investment activities is to preserve its capital for the purpose of funding operations while at the same time maximizing the income Genesoft receives from its investments without significantly increasing risk. To achieve these objectives, Genesoft s investment policy allows it to maintain a portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, money market funds and corporate debt securities. Genesoft s cash and cash equivalents through September 30, 2003 included liquid money market accounts. Genesoft s short-term investments included readily marketable debt securities. Due to the short-term nature of these instruments, a 1% movement in market interest rates would not have a significant impact on the total value of Genesoft s portfolio as of September 30, 2003.

The following is information regarding the company following the merger and information regarding ownership of Genesoft.

## MANAGEMENT OF THE COMBINED COMPANY AFTER THE MERGER

### Directors

The board of the combined company will consist of Luke Evnin, Robert J. Hennessey, Vernon R. Loucks, Jr., Steven Rauscher, William S. Reardon, Norbert G. Riedel, William Rutter, David B. Singer and David K. Stone. David B. Singer will serve as Chairman of the board of directors.

### Committees of the Board of Directors

The board of directors will have an audit committee and a stock option and compensation committee, each consisting of at least three independent directors, and a nominating committee, consisting of two independent directors. Each committee will perform the functions traditionally performed by such committee.

### Compensation of Directors

Directors of the combined company will be subject to the existing compensation structure for Genome s current directors. Each non-employee director of the combined company will receive his annual retainer, currently set at $10,000, for the fiscal year, and a non-employee chairman of each sub-committee will also receive an additional retainer, currently set at $4,000, for the fiscal year, each in the form of a stock option grant that provides the right to purchase share of Genome common stock at a 70% discount to the fair market value. These grants will vest quarterly over a year from the date of grant. The grant size (number of options) will be determined by dividing the annual retainer fee by 70% of the fair market value of the Genome common stock on the date of grant. In addition, upon their initial election to the board, non-employee directors will also be granted options to receive an aggregate 17,000 shares of Genome common stock that will vest equally over three years with an exercise price equal to the fair market value at date of grant. As a long term incentive in connection with their re-election to the board, directors will, upon their re-election to the board, also be granted options to receive an aggregate of 8,500 shares of Genome common stock that will vest equally over three years with an exercise price equal to the fair market value at date of grant. Upon a change of control if, within two years following the change of control, a director is either not nominated to serve as a director or is not elected by the shareholders to serve as a director, all of such director s unvested options will become exercisable upon such director ceasing to be a director of Genome and all of the director s options will remain exercisable until the earlier of two years from the date such director ceases to be a director of Genome and the final exercise date of the option. In addition, each director will have the option to receive all of his board meeting fees and sub-committee fees, currently set at $2,000 and $1,250, respectively, per meeting, in the form of cash or a stock option grant on the same terms described above for the annual retainer. Meeting fees will be reduced by fifty percent if the director attends a meeting via teleconference.

### Management

The management of the combined company will consist of the following: Steven Rauscher as Chief Executive Officer and President, Stephen Cohen as Senior Vice President and Chief Financial Officer and Martin Williams as Senior Vice President of Corporate Development and Marketing.

**GENESOFT MANAGEMENT**

The following directors of Genesoft will become directors of Genome following the closing of the merger:

| Name | Age | Position |
|---|---|---|
| David B. Singer | 41 | Chairman |
| Luke Evnin, Ph.D. | 40 | Director |
| Vernon R. Loucks, Jr. | 69 | Director |
| William Rutter, Ph.D. | 76 | Director |

*David B. Singer* joined Genesoft as founding President and Chief Executive Officer in September of 1998. Mr. Singer previously served as founding President and Chief Executive Officer of both Affymetrix, Inc., a company focused on developing state-of-the-art technology for acquiring, analyzing and managing complex genetic information for use in biomedical research, and Corcept Therapeutics, Inc. Prior to Genesoft, Mr. Singer was Senior Vice President and Chief Financial Officer of Heartport, Inc. He is a member of the board of directors at Affymetrix (NASDAQ: AFFX), Corcept and Physician Dynamics, Inc. Mr. Singer received his B.A. in History from Yale College and his M.B.A. from The Graduate School of Business at Stanford University. He is a Henry Crown Fellow of the Aspen Institute and Sterling Fellow of Yale University.

*Luke Evnin, Ph.D.,* is a Managing Director of MPM Asset Management LLC, a venture capital firm. Prior to joining MPM in 1998, Dr. Evnin was a general partner at Accel Partners, focusing on investing in a broad range of life sciences companies. From October 1998 to July 2002, Dr. Evnin served as a director of Sonic Innovations. Dr. Evnin received his A.B. degree from Princeton University and his Ph.D. in Molecular Biology from the University of California, San Francisco. Dr. Evnin also serves on the boards of several private companies.

*Vernon R. Loucks, Jr.* is the Chief Executive Officer of Segway LLC, a company providing solutions to short distance travel, since January 2003. Mr. Loucks served as Chairman of Baxter International Inc., and held the position of Chief Executive Officer from May 1980 to January 2000. He is a director of Affymetrix, Inc., Anheuser-Busch Companies, Inc., Capital and Limited (Singapore) and Emerson Electric Co. He is a member of The Business Council and is the former chairman and co-founder of the Healthcare Leadership Council. Mr. Loucks is a trustee of Rush-Presbyterian/St. Luke s Medical Center in Chicago, and has served as a director of the Harvard Business School Board of Directors and as Senior Fellow of the Yale Corporation. Mr. Loucks holds a B.A. degree in History from Yale College and a M.B.A. from the Harvard Graduate School of Business Administration. He is a veteran of the U.S. Marine Corps. Mr. Loucks also serves on the board of a private equity firm.

*William Rutter, Ph.D.*, is Professor Emeritus of Biochemistry at the University of California, San Francisco. Dr. Rutter is Chairman, Chief Executive Officer and principal shareholder of Synergenics LLC, a company that provides financial resources, facilities, financial, legal support and strategic advice to start-up biotech companies, since July 2002. Dr. Rutter was a founder of Chiron and served as the company s Chief Executive Officer and Chairman of the Board. Dr. Rutter also was a consultant to Chiron from February 2000 until May 2002. He continues to serve as a Director of Chiron. Dr. Rutter services as a director of Ciba-Geigy, Ltd. and subsequently Novartis from 1995 until April 1999. From January 2000 to present, Dr. Rutter has served as a director of Sangamo Biosciences, Inc. From 1969 to 1982, Dr. Rutter was Chairman of the Department of Biochemistry and Biophysics at the University of California, San Francisco. Dr. Rutter received his B.A. from Harvard University and his Ph.D. from the University of Illinois. Dr. Rutter has received numerous awards for his scientific work and is a member of the National Academy of Sciences and the American Academy of Arts and Sciences. Dr. Rutter also serves on the boards of other privately-held biotechnology companies.

**Interests of Directors and Executive Officers of Genome in the Merger**

Genome s stockholders should be aware that some Genome executive officers and directors may have interests in the merger that may be different from, or in addition to, their interests as stockholders of Genome in considering the recommendation of the Genome board of directors that Genome s stockholders vote in favor of the proposals (i) to approve the issuance of a total of 28,571,405 shares of Genome common stock pursuant to the merger agreement and the issuance of shares of Genome common stock upon the potential conversion of the convertible notes of Genome, in an aggregate principal amount of $22,309,647, to be exchanged for Genesoft promissory notes in connection with the merger, (ii) to approve the Amendment to Genome s Articles of Organization to increase the number of shares of Genome common stock the company is authorized to issue from 50,000,000 to 175,000,000 shares of common stock, and (iii) subject to approval of proposal (i) above, to authorize the Genome board of directors, in the three month period commencing with the date of the approval of this proposal, to issue up to 20,000,000 shares of Genome common stock in order to raise capital to finance the combined company, subject to the terms and conditions described in this joint proxy statement/prospectus.

*Governance Structure and Management Positions*

The merger agreement provides for the initial composition of the board of directors of the combined company and the executive officer positions for the combined company, and specified members of Genome s existing board of directors and its executive officers will retain their positions in the combined company. See Management of the Combined Company After the Merger.

*Severance and Other Arrangements*

Genome has amended the employment agreements with Steven Rauscher, Stephen Cohen and Martin Williams, its executive officers.

As amended, the employment agreements with Messrs. Rauscher, Cohen and Williams provide that, in the event employment is terminated by Genome other than for cause, or by the executive for good reason, within twenty-four months following the consummation of the merger, then the executive will receive continuation of base salary and benefits coverage for 18 months, in the case of Mr. Rauscher, and 12 months, in the case of Messrs. Cohen and Williams. In such event, all of the executive s unvested options and non-exercisable restricted shares will vest and become exercisable. All of the executive s options will remain exercisable until the earlier of two years from the date of termination of the executive s employment and the final exercise date of the option.

For purposes of the employment agreements, termination for cause means the executive s termination by Genome as a result of executive s (i) material failure to perform (other than by reason of disability), or material negligence in the performance of, the executive s duties and responsibilities to Genome; (ii) material breach of the executive s employment agreement or any other agreement between the executive and Genome; (iii) commission of a felony or other crime involving an act of moral turpitude; or (iv) material act of dishonesty or breach of trust resulting or intended to result, directly or indirectly, in a personal gain or enrichment at the expense of Genome.

For purposes of the employment agreements, an executive may terminate his employment with Genome for good reason following the occurrence, after the consummation of the merger, of any one or more of the following events without his consent: any change in the executive s position with Genome that results in a material diminution in the executive s position, authority or duties as such position, authority or duties existed immediately prior to the merger or Genome takes any action that would require the executive to have his principal place of work changed to any location outside a thirty-five mile radius of the City of Boston.

Genome has also amended the terms of the stock options granted to its directors. For those directors of Genome that will not be continuing as directors following the merger, all of such directors unvested options will become exercisable upon the consummation of the merger and all of his options will remain exercisable until the earlier of two years from the date of the closing of the merger and the final exercise date of the option. With respect to the non-employee directors of Genome that will continue to be directors following the merger, if, within two years following the merger, a director is either not nominated to serve as a director or is not elected by the shareholders to serve as a director, all of such director s unvested options will become exercisable upon such director ceasing to be a director of Genome and all of the director s options will remain exercisable until the earlier of two years from the date such director ceases to be a director of Genome and the final exercise date of the option.

**Interests of Directors and Executive Officers of Genesoft in the Merger**

In considering the recommendation of Genesoft s board of directors that Genesoft s stockholders vote in favor of approval of the merger agreement, Genesoft stockholders should be aware that some Genesoft executive officers and directors may have interests in the merger that may be different from, or in addition to, their interests as stockholders of Genesoft. Genesoft s board of directors was aware of these interests during its deliberations on the merits of the merger and in making its recommendation to Genesoft s stockholders that they vote for the merger.

*Governance Structure and Management Positions*

The merger agreement provides for the initial composition of the board of directors of the combined company and the executive officer positions for the combined company, and specified members of Genesoft s board of directors will serve on the board of directors of the combined company. See Management of the Combined Company After the Merger.

*Indemnification; Directors and Officers Insurance*

Under the merger agreement, Genome has agreed to indemnify all directors and officers of Genesoft to the same extent such persons are indemnified by Genesoft prior to the merger for all acts or omissions occurring at or prior to the merger by such individuals in such capacities. Genome has also agreed to provide, for six years after the merger, directors and officers liability

insurance in respect of acts or omissions occurring prior to the merger covering each person currently covered by the directors and officers liability insurance policy of Genesoft on terms and in amounts no less favorable than those of the policies of Genome, provided that Genome will not be required to pay an annual premium for the insurance in excess of approximately $54,000. Genome has agreed to maintain charter and by-law provisions with respect to indemnification and advancement of expenses that are at least as favorable to the intended beneficiaries as those contained in the charter and by-laws of Genesoft as in effect on the date the merger agreement was signed.

*Severance and Other Arrangements*

In January 2003, the board of directors of Genesoft approved a severance plan for, and the grant of options to, employees and officers of Genesoft in anticipation of a possible merger or other sale of Genesoft.

Under the terms of Mr. Singer s agreements with Genesoft, he will be entitled to receive severance payments and to have the vesting of his options accelerated. Due to the fact that Mr. Singer will not be offered a position as an employee of the combined company following the merger, immediately prior to the merger, Genesoft will pay to Mr. Singer a cash severance payment equal to $472,500. In addition, upon consummation of the merger, options held by Mr. Singer to purchase a number of shares of Genesoft common stock ranging from approximately 531,000 to 709,000, depending upon the market value of Genome s shares at the time of the closing, will become vested and exercisable.

Following the merger, in connection with Mr. Singer s service as chairman of board of directors of Genome, Genome has agreed to provide Mr. Singer an office and the services of an assistant that is an employee of Genome until December 31, 2004.

Upon the closing of the merger, Gary Patou, the President of Genesoft, will become an employee of Genome through January 1, 2005 and serve as a consultant through January 1, 2006. Under the terms of Mr. Patou s employment agreement, Dr. Patou is entitled to a salary at a rate of $315,000 per year. During his employment, Dr. Patou will also be entitled to continue to receive a housing allowance of $6,000 per month. While serving as a consultant to Genome, Dr. Patou has agreed to provide up to eight hours of consulting services per month and will be paid at a rate of $2,500 per day. If Dr. Patou continues as an employee of Genome through January 1, 2005, or if Genome terminates Dr. Patou s employment without cause prior to January 1, 2005, Genome will pay to Dr. Patou a severance payment of $449,000, plus the forgiveness of a $315,000 loan. At such time, all of Dr. Patou s Genesoft options then in effect would become vested and exercisable in full.

*Amendment and Exchange of Genesoft Promissory Notes*

As described more fully in Genome s amended joint proxy statement/prospectus on Form S-4/A (file no. 333-111171), Mr. Singer, Mr. Rutter (including trusts and family members of Mr. Rutter) and certain investment funds affiliated with Dr. Evnin and MPM Capital Management each hold promissory notes of Genesoft, the principal amount of which will be converted into convertible promissory notes of Genome at the time of the merger. The interest and other amounts payable under the Genesoft notes will be converted into shares of Genome common stock at the time of the merger. Mr. Singer holds $100,000 of these Genesoft promissory notes, Mr. Rutter (including trusts and family members of Mr. Rutter) holds $1,300,000 of these Genesoft promissory notes and investment funds affiliated with Dr. Evnin and MPM Capital Management hold $5,750,000 of these Genesoft promissory notes. Each of Messrs. Singer, Rutter and Evnin are directors of Genesoft and are anticipated to serve as directors of Genome following the merger.

**GENESOFT PRINCIPAL AND MANAGEMENT STOCKHOLDERS**

The following table sets forth information regarding the beneficial ownership of Genesoft common stock as of November 30, 2003 by:

- each person known by Genesoft to own beneficially 5% or more of the Genesoft stock;
- each director of Genesoft;
- each executive officer of Genesoft; and
- all of the directors and executive officers of Genesoft as a group.

The percentages shown are based on 12,378,931 shares of Genesoft common stock outstanding as of November 30, 2003. Unless otherwise indicated, the address for each stockholder is c/o GeneSoft Pharmaceuticals, Inc., 7300 Shoreline Court, South San Francisco, California 94080. Unless otherwise indicated, each person or entity named in the table has sole voting power and investment power (or shares such power with his or her spouse) with respect to all shares of capital stock listed as owned by such person or entity.

| Name and Address of Beneficial Owner | Amount and Nature of Beneficial Ownership | Percent of Class |
|---|---|---|
| David B. Singer | 1,229,778(1) | 9.3 % |
| Gary Patou | 811,790(2) | 6.2 % |
| Peter B. Dervan | 618,096(3) | 5.0 % |
| Vernon R. Loucks | 195,938(4) | 1.6 % |
| Luke B. Evnin | 5,594,802(5) | 35.2 % |
| William J. Rutter | 818,095(6) | 6.4 % |
| Edward M. Scolnick | 17,812(7) | 0.1 % |
| LG Life Sciences | 2,856,368(8) | 23.1 % |
| Entities affiliated with MPM Capital | 5,594,802(5) | 35.2 % |
| Novartis Forschungsttiftung | 1,647,344(9) | 12.1 % |
| SunAmerica Investments, Inc. | 1,440,330(10) | 10.4 % |
| Entities affiliated with Maverick Capital, Ltd. | 1,728,393(11) | 12.3 % |
| All directors and executive officers as a group (7 persons) | 9,286,311(12) | 51.5% |

(1) Includes 14,250 shares of common stock held by the Singer-Kapp Family 2000 Trust and 200,000 shares of common stock held by the Singer-Kapp Long-Term Trust. Includes 826,965 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of options.

(2) Includes 811,790 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of options.

(3) The address of this stockholder is 1200 E. California Boulevard, MS 164-30, Pasadena, CA 91125.

(4) The address of this stockholder is 1101 Skokie Boulevard, Suite 240, Northbrook, Illinois 60062.

(5) Includes 1,779,496 shares of common stock held by BB BioVentures L.P.; 23,659 shares of common stock held by MPM Asset Management Investors 1998 LLC; and 254,372 shares of common stock held by MPM BioVentures Parallel Fund, L.P. Includes 2,477,964 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by BB BioVentures, L.P.; 32,343 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by MPM Asset Management Investors 1998 LLC; and 302,190 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by MPM BioVentures Parallel Fund, L.P. Includes 706,340 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by BB BioVentures L.P.; 9,219 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by MPM Asset Management Investors 1998 LLC; and 86,139 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by MPM BioVentures Parallel Fund, L.P. Dr. Evnin has shared voting and dispositive power over shares held by BB BioVentures L.P., MGM Asset Management Investors 1998 LLC and MPM BioVentures Parallel Fund, L.P. The address of this stockholder is 601 Gateway Boulevard, Suite 360, South San Francisco, California 94080.

(6) Includes 356,251 shares of common stock held by the William J. Rutter Revocable Trust U/A/D 4/11/02. Includes 310,416 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by the William J. Rutter Revocable Trust U/A/D 4/11/02. Includes 133,616 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by the William J. Rutter Revocable Trust U/A/D 4/11/02. Includes 17,812 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of options. The address of this stockholder is One Market Street, Suite 1475, San Francisco, CA 94105.

(7) Includes 17,812 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of options. The address of this stockholder is 770 Sunneytown Pike, WP26-25, West Point, Pennsylvania 19486.

(8) The address of this stockholder is LG Twin Tower, 20, Yoido-dong, Youngdungpo-gu, Seoul, Korea.

(9) Includes 1,020,833 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants. Includes 267,232 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes. The address of this stockholder is WSJ-200.220, Lichstrasse 354056, Basel, Switzerland.

(10) Includes 104,166 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants. Includes 1,336,164 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes. The address of this stockholder is 1 SunAmerica Center, Los Angeles, California 90067.

(11) Includes 76,437 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by Maverick Fund LDC; 34,520 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by Maverick Fund USA, Ltd; 14,041 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of warrants held by Maverick Fund II, Ltd. Includes 980,477 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by Maverick Fund LDC; 442,804 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by Maverick Fund, Ltd.; and 180,114 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes held by Maverick Fund II, Ltd. The address of this stockholder is 300 Crescent Court, Suite 1850, Dallas, TX 75201.

(12) Includes 1,674,379 shares of common stock that may be acquired within 60 days of November 30, 2003 upon exercise of options. Includes 3,122,913 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of warrants. Includes 935,314 shares of common stock that may be acquired within 60 days of November 30, 2003 upon conversion of promissory notes.

Outstanding promissory notes of Genesoft totaling an aggregate principal amount of $22,309,647, which include the promissory notes referred to in the footnotes above, will be exchanged for convertible promissory notes of Genome at the closing of the merger. Such Genome convertible promissory notes will bear interest at 5% per annum and have a maturity date of five years from the closing date and will be convertible at any time at the option of the holder into shares of Genome common stock at a 10% premium to the average trading price of Genome common stock for the five trading days immediately preceding the date of the closing of the merger. For more information on this exchange, please refer to the section entitled Note Amendment and Exchange Agreement in the joint proxy statement/prospectus on Form S-4/A (file no. 333-111171). The shares issuable upon the conversion of such Genome convertible promissory notes are not included in the table above.

The following is unaudited pro forma condensed combined financial information.

**UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION**

The following unaudited pro forma condensed combined financial statements combine the historical consolidated balance sheets and statements of operations of Genome and Genesoft, giving effect to the merger using the purchase method of accounting under accounting principles generally accepted in the United States and the assumptions and adjustments described below. The unaudited pro forma condensed combined financial statements are presented for illustrative purposes only to aid you in your analysis of the financial aspects of the merger, and do not purport to be indicative of the consolidated financial position and results of operations for future periods or the results that actually would have been realized had Genome and Genesoft been a consolidated company during the specified periods.

The unaudited pro forma condensed combined financial statements are based on the respective audited and unaudited historical consolidated financial statements and the notes thereto of Genome and Genesoft.

The pro forma adjustments were based upon available information and certain assumptions described in the notes to the unaudited pro forma condensed combined financial statements that Genome s management believes are reasonable under the circumstances. The pro forma adjustments are based on the information available at the date of this current report on Form 8-K and a preliminary determination of the purchase price allocation and are subject to change based on completion of the transaction, and such changes may be material. The closing of the merger is contingent on Genome raising at least $32 million to finance the combined companies (unless waived by both parties). These unaudited pro forma condensed combined financial statements do not include any adjustment to record the expected proceeds from this offering or the dilutive effect of the issuance of shares related to this offering.

The unaudited pro forma condensed combined financial statements and accompanying notes should be read in conjunction with the historical consolidated financial statements and notes thereto of Genome included in its Annual Report on Form 10-K for the year ended December 31, 2002, and its quarterly report on Form 10-Q for the nine months ended September 27, 2003, incorporated by reference in the joint proxy statement/prospectus on Form S-4, and the separate historical financial statements and notes thereto of Genesoft for the year ended December 31, 2002 and the nine months ended September 30, 2003 included in this current report on Form 8-K.

The unaudited pro forma condensed consolidated balance sheet is as of September 27, 2003 as it relates to Genome and is as of September 30, 2003 as it relates to Genesoft. The unaudited pro forma condensed consolidated statements of operations for the year ended December 31, 2002 and for the nine months ended September 27, 2003 assume that the merger occurred as of January 1, 2002. For the interim period, Genome s nine months ended September 27, 2003 was combined with Genesoft s nine months ended September 30, 2003.

Under the purchase method of accounting, the total estimated purchase price, calculated as described in Note 1 to these unaudited pro forma condensed combined financial statements, is allocated to the net tangible and intangible assets to be acquired in connection with the merger, based on their estimated fair values. A preliminary valuation and purchase price allocation was conducted to determine the fair value of these assets at the transaction date. This preliminary valuation and purchase price allocation is the basis for the estimates of fair value reflected in these unaudited pro forma condensed combined financial statements.

The unaudited pro forma condensed combined financial information has been prepared based upon available information and certain assumptions described in the accompanying notes and the estimated fair value of assets to be acquired and liabilities to be assumed from Genesoft. The unaudited pro forma condensed combined financial statements do not include any adjustments for liabilities resulting from

integration plans.

**Unaudited Pro Forma Condensed Consolidated**

**Statements of Operations**

**Nine Months Ended September 27, 2003**

**(in thousands, except per share amounts)**

| | Genome | Genesoft | Pro Forma Adjustments | Pro Forma Combined |
|---|---|---|---|---|
| Total Revenues | $ 7,318 | $ 3,072 | $ | $ 10,390 |
| Costs and Expenses: | | | | |
| Cost of revenues | 1,902 | | | 1,902 |
| Research and development | 17,541 | 8,896 | 4,514 (2b) | 30,951 |
| Restructuring charge | 4,733 | | | 4,733 |
| Convertible debt retirement expense | 5,540 | | | 5,540 |
| Selling, general and administrative | 5,463 | 7,306 | 1,246 (2a) | 14,015 |
| Total costs and expenses | 35,179 | 16,202 | 5,760 | 57,141 |
| Loss from operations | (27,861) | (13,130) | (5,760) | (46,751) |
| Other Income (Expense): | | | | |
| Other income | 460 | 59 | | 519 |
| Other expense | (1,054) | (6,725) | | (7,779) |
| Net other income (expense) | (594) | (6,666) | | (7,260) |
| Net loss | $ (28,455) | $ (19,796) | $(5,760) | $ (54,011) |
| Net Loss per Common Share: | | | | |
| Basic and diluted | $ (1.16) | $ (1.69) | $ | $ (1.08) |
| Weighted Average Shares Used in Computing Net Loss per Share: | | | | |
| Basic and diluted | 24,581 | 11,729 | | 50,057 |

See accompanying notes to pro forma condensed combined financial statements.

**Unaudited Pro Forma Condensed Consolidated**

**Statements of Operations**

**Year Ended December 31, 2002**

**(in thousands, except per share amounts)**

| | Genome | Genesoft | Pro Forma Adjustments | Pro Forma Combined |
|---|---|---|---|---|
| Total Revenues: | $ 22,987 | $ 5,402 | $ | $ 28,389 |
| Costs and Expenses: | | | | |
| Cost of services | 15,020 | | | 15,020 |
| Research and development | 32,435 | 26,283 | 6,018 (2b) | 64,736 |
| Selling, general and administrative | 9,382 | 4,542 | 1,661 (2a) | 15,585 |
| Total costs and expenses | 56,837 | 30,825 | 7,679 | 95,341 |
| Loss from operations | (33,850) | (25,423) | (7,679) | (66,952) |
| Other Income (Expense): | | | | |
| Other income | 1,769 | 564 | | 2,333 |
| Other expense | (1,936) | (710) | | (2,646) |
| Net other income (expense) | (167) | (146) | | (313) |
| Net loss | $ (34,017) | $ (25,569) | $ (7,679) | $ (67,265) |
| Net Loss per Common Share: | | | | |
| Basic and diluted | $ (1.48) | $ (12.81) | $ | $ (1.39) |
| Weighted Average Shares Used in Computing Net Loss per Share: | | | | |
| Basic and diluted | 22,921 | 1,996 | | 48,397 |

See accompanying notes to pro forma condensed combined financial statements.

**Unaudited Pro Forma Condensed Consolidated**

**Balance Statement**

**September 27, 2003**

**(in thousands)**

| | Genome | Genesoft | Pro Forma Adjustments | Pro Forma Combined |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current Assets: | | | | |
| Cash and cash equivalents | $ 14,270 | $ 4,129 | $ (9,697)(2c),(2e) | $ 8,702 |
| Marketable securities (held-to-maturity) | 9,832 | | | 9,832 |
| Marketable securities (available-for-sale) | 983 | | | 983 |
| Interest receivable | 240 | | | 240 |
| Accounts receivable | 179 | 1,131 | | 1,310 |
| Unbilled costs and fees | 129 | | | 129 |
| Prepaid expenses and other current assets | 350 | 51 | | 401 |
| Total current assets | 25,983 | 5,311 | (9,697) | 21,597 |
| Property and equipment, net | 3,907 | 10,170 | | 14,077 |
| Long-term marketable securities (held-to-maturity) | 701 | | | 701 |
| Restricted cash | | 3,697 | | 3,697 |
| Intangible assets | | 6,575 | 73,797 (2i) | 80,372 |
| Goodwill | | | 19,278 (2i) | 19,278 |
| Other assets | 148 | 46 | | 194 |
| Total Assets | $ 30,739 | $ 25,799 | $ 83,378 | $ 139,916 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | | | |
| Current Liabilities: | | | | |
| Current maturities of long-term obligations | $ 1,167 | $ 19,689 | $ (1,697)(2c) | $ 19,159 |
| Accounts payable | 247 | 1,168 | | 1,415 |
| Clinical trial expense accrual and other accrued liabilities | 8,544 | 5,447 | 4,000 (2d) | 17,991 |
| Deferred revenue | 852 | | | 852 |
| Total Current Liabilities | 10,810 | 26,304 | 2,303 | 39,417 |
| Long-term obligations, net of current maturities | 583 | 6,620 | | 7,203 |
| Shareholders Equity: | | | | |
| Common stock, par value | 2,617 | 1 | 2,547 (2f) | 5,165 |
| Additional paid-in capital | 170,797 | 68,238 | 19,605 (2g) | 258,640 |
| Accumulated deficit | (154,231) | (75,364) | 63,587 (2h) | (166,008) |
| Other shareholders equity | 163 | | (4,664) | (4,501) |
| Total Shareholders Equity | 19,346 | (7,125) | 81,075 | 93,296 |
| Total Liabilities and Shareholders Equity | $ 30,739 | $ 25,799 | $ 83,378 | $ 139,916 |

See accompanying notes to pro forma condensed combined financial statements.

**Notes to Unaudited Pro Forma Condensed Combined Financial Statements**

***Note 1 Description of Merger and Purchase Price***

On November 17, 2003, Genome entered into a definitive agreement to acquire Genesoft in a transaction to be accounted for as a purchase under accounting principles generally accepted in the United States. Under the terms of the merger agreement, Genome will issue an aggregate of 28,571,405 shares of its common stock, options and warrants to purchase Genome common shares to existing shareholders, promissory note holders and holders of stock options and warrants of Genesoft. The exact amount of common stock, stock options, and warrants to be issued by Genome will be determined at the closing date of the merger based on a common exchange ratio as determined by:

deducting the shares of Genome common stock to be issued to the holders of Genesoft s promissory notes as payment of accrued interest and related amounts from the total of 28,571,405 shares of Genome common stock issuable in the merger and

dividing that remaining amount of Genome shares by the fully-diluted number of shares of Genesoft common stock outstanding on the closing date (assuming conversion or exercise of all Genesoft options and warrants).

The exact exchange ratio between Genesoft and Genome common stock will depend on the closing date of the merger, which will determine how much interest has accrued on the Genesoft promissory notes, as well as the price at which the accrued interest and other related amounts of the Genesoft promissory note holders are converted into Genome common stock. The interest and other related amounts will be converted into Genome common stock at a price of $2.84 per share, unless the issuance price per share of Genome common stock expected to be issued in the capital raising transaction to raise a minimum of $32 million to finance the combined company, which is a condition to the merger agreement (unless waived by both parties), is less than $2.84, in which case that lesser per share price will become the conversion price. As noted above, these unaudited pro forma condensed combined financial statements do not include the proceeds from this offering or the dilutive effect of the shares that would be issued. Had these shares been included in unaudited condensed combined pro forma financials, pro forma earnings per share would have been approximately $1.13 and $0.88 for the year ended December 31, 2002 and nine months ended September 30, 2003, respectively, assuming 11 million shares were sold at $3.05 per share less closing costs.

Each holder of a stock option or warrant to purchase shares of Genesoft common stock that does not terminate by its terms prior to the merger will receive an option or warrant to purchase a number of shares of Genome common stock equal to the product of the number of Genesoft shares for which such option or warrant was exercisable multiplied by the common exchange ratio and with an exercise price equal to the exercise price per share of such option in effect immediately prior to the merger divided by the common exchange ratio.

Coincident with the signing of the merger agreement, Genome made a bridge loan of $6.2 million to Genesoft pursuant to a promissory note issued by Genesoft, which is repayable within 60 days of an event of default (as defined in the note) or termination of the merger agreement, unless the merger agreement is terminated by Genesoft due to a failure of Genome to obtain the stockholder vote necessary to approve the merger, in which case it is repayable within 180 days of termination.

The estimated total purchase price of the merger is calculated as follows (in thousands):

| | |
|---|---|
| Issuance of 25,479,517 shares of Genome common stock to existing Genesoft common shareholders, promissory note holders and warrant holders | $ 75,664 |
| Fair value of 3,043,547 options issued in exchange for Genesoft stock options | 8,381 |
| Payment to LG Life Sciences related to FACTIVE license | 8,000 |
| Bridge loan and related accrued interest to be forgiven at closing | 6,265 |
| Fair value of 48,341 warrants issued in exchange for Genesoft warrants | 81 |
| Estimated direct transaction costs incurred by Genome | 4,000 |
| | 102,391 |
| Less: Amount related to unvested stock options allocated to deferred compensation | (4,664) |
| Total Estimated Purchase Price | $ 97,727 |

The fair value of the Genome shares used in determining the purchase price was $2.97 per share based on the average closing price of Genome s stock from the two days before through two days after November 18, 2003, the date of the public announcement of the merger. The fair value of the options and warrants to be assumed by Genome in connection with the merger is determined based on a stock price of $2.97 per share using the Black-Scholes method with the following assumptions: risk free interest rate of 3.8%, volatility of 84% and no expected dividend. The options have an expected life of four years, which is based on historical Genome experience. The warrants expire in October 2007 and June 2011.

Deferred compensation reflects the estimated intrinsic value of approximately 1.7 million shares of unvested stock options that will be outstanding as of February 2, 2004.

The preliminary allocation of the purchase price is as follows (in thousands):

| | |
|---|---|
| Current assets | $ 5,311 |
| Property, plant and equipment, net | 10,170 |
| In-process research and development | 11,777 |
| Intangible assets | 80,372 |
| Goodwill | 19,278 |
| Other assets | 46 |
| Restricted cash | 3,697 |
| Current liabilities | (26,304) |
| Long-term liabilities | (6,620) |
| Total | $ 97,727 |

The final determination of the purchase price allocation will be based on the fair values of the assets, including the fair value of in-process research and development and other intangibles, and the fair value of liabilities assumed at the date of the closing of the merger. The purchase price will remain preliminary until Genome is able to finalize its valuation of significant intangible assets acquired, including in-process research and development, and adjust the fair value of other assets and liabilities acquired. The final determination of the purchase price allocation is expected to be completed as soon as practicable after the date of the closing of the merger. Once the merger is complete, the final amounts allocated to assets and liabilities acquired could differ significantly from the amounts presented in the unaudited pro forma condensed

consolidated financial information above.

The valuation of the purchased intangible assets of $80.4 million was based on the result of a valuation using the income approach and applying a risk adjusted discount rate of between 15% to 22%. The valuation of purchased intangible assets include Genesoft s lead product and developed technology, FACTIVE, valued at

$72.7 million, an orally administered, broad-spectrum fluoroquinolone antibiotic which was approved by the FDA for the treatment of acute bacterial exacerbation of chronic bronchitis (ABECB) and community-acquired pneumonia (CAP) of mild to moderate severity. The valuation of purchased intangible assets also includes the value of a manufacturing and supply agreement for FACTIVE with a third party of $5.2 million. The valuation of purchased intangible assets also includes a Biowarfare Countermeasures / DNA-Nanobinder research program, valued at $2.5 million, supported by the U.S. Department of Defense to develop oral, small molecule treatments for bio-warfare threats, including smallpox, anthrax and malaria. FACTIVE is currently expected to be launched by September 2004 with cash flows from product sales anticipated to begin in the fourth quarter of 2004. The valuation of the Biowarfare Countermeasures / DNA-Nanobinder research program assumes that funding from the U.S government or other sources would be available to support this research program through 2006 . However, there is no guarantee that funding to support this program would be available beyond early 2004.

The valuation of the in-process research and development of $11.8 million represents a peptide deformylase inhibitor research program (PDF) for the development of GSQ-83698 and oral PDF inhibitors, licensed from British Biotech (now Vernalis) for the treatment of community-acquired infections. In-process research and development also includes three novel metalloenzyme bacterial targets from Vernalis that the combined company may elect to initiate a drug discovery program to develop therapeutics directed against these targets.

Goodwill of $19.3 million represents the excess of the purchase price over the fair market value of the tangible and identifiable intangible assets. The unaudited pro forma condensed combined consolidated statements of operations do not reflect the amortization of goodwill acquired in the proposed merger consistent with the guidance in Financial Accounting Standards Board (FASB) Statement No, 142, *Goodwill and Other Intangible Assets.*

***Note 2 Pro Forma Adjustments***

The pro forma adjustments included in the unaudited pro forma condensed combined financial statements are as follows:

(a) An adjustment has been made to reflect the amortization of deferred compensation related to the intrinsic value of the unvested portion of stock options issued by Genome to holders of Genesoft stock options at the close of the merger. Deferred compensation will be amortized over the remaining vesting period of these options. Amounts adjusted for the year ended December 31, 2002 and nine months ended September 27, 2003 were $1,661,000 and $1,246,000, respectively.

(b) An adjustment to reflect amortization expense on estimated intangible assets based on an estimated useful life of 15 years for FACTIVE and the related manufacturing and supply agreement, and an estimated useful life of 3 years for the Biowarfare Countermeasures / DNA-Nanobinder research program. Amounts adjusted for the year ended December 31, 2002 and nine months ended September 27, 2003 were $6,018,000 and $4,514,000, respectively.

(c) An adjustment has been made for payment of $1,697,000 by Genome to certain promissory note holders of Genesoft at the closing date of the merger.

(d) An adjustment has been made to accrue estimated merger costs of $4,000,000 expected to be incurred by Genome in connection with the merger, consisting primarily of financial advisory and legal and accounting fees.

(e) An adjustment has been made to reflect a payment of $8,000,000 by Genome to LG Life Sciences at the closing of the merger under Genesoft s License Agreement with LG Life Sciences for FACTIVE.

(f) An adjustment to eliminate the par value of Genesoft historical common stock of $1,000 has been made in consideration of the merger offset by the par value of $2,548,000 of new Genome securities issued in consideration of the merger.

(g) The reduction in pro forma combined additional paid-in-capital is as follows (in thousands):

| | |
|---|---|
| Elimination of Genesoft additional paid-in capital | $ (68,238) |
| Value of new Genome securities issued in consideration of the merger (including options and warrants of $8,453 and a bridge loan of $6,287) | 90,391 |
| Less par value assigned to common stock | (2,548) |
| | $ 19,605 |

(h) The reduction in pro forma combined accumulated deficit is as follows (in thousands):

| | |
|---|---|
| Elimination of Genesoft s historical accumulated deficit | $ 75,364 |
| Charge for in-process research and development | (11,777) |
| | $ 63,587 |

(i) An adjustment has been made to reflect the estimated valuation of the purchased intangible assets of $80.4 million less the historical value of Genesoft s intangible assets of $6.6 million and goodwill of $19.3 million, as further explained above.

The following are the financial statements of Genesoft.

**GeneSoft Pharmaceuticals, Inc.**

**(a development stage company)**

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**Report of Ernst & Young LLP, Independent Auditors**

The Board of Directors and Stockholders

GeneSoft Pharmaceuticals, Inc.

We have audited the accompanying balance sheets of GeneSoft Pharmaceuticals, Inc. (a development stage company) as of December 31, 2002 and 2001, and the related statements of operations, stockholders equity (net capital deficiency), and cash flows for the years then ended and for the period from August 12, 1997 (inception) through December 31, 2002. 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 auditing standards generally accepted in the 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 financial statements referred to above present fairly, in all material respects, the financial position of GeneSoft Pharmaceuticals, Inc. (a development stage company) at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended and for the period from August 12, 1997 (inception) through December 31, 2002, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that GeneSoft Pharmaceuticals, Inc. (a development stage company) will continue as a going concern. As more fully described in Note 1, the Company has incurred recurring operating losses and has a working capital deficiency. These conditions raise substantial doubt about the Company s ability to continue as a going concern. Management s plans in regard to these matters are also described in Note 1. 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.

Palo Alto, California

April 28, 2003, except for Note 12

as to which the date is

November 17, 2003

**GeneSoft Pharmaceuticals, Inc.**

**(a development stage company)**

**Balance Sheets**

| | December 31, | | September 30, |
|---|---|---|---|
| | 2002 | 2001 | 2003 |
| **Assets** | | | *(Unaudited)* |
| Current assets: | | | |
| Cash and cash equivalents | $ 1,880,794 | $ 4,132,162 | $ 4,129,274 |
| Short-term investments | 373,437 | 16,885,099 | |
| Grants receivable | 713,437 | 109,950 | 1,130,850 |
| Tenant allowance receivable | | | |
| Prepaid expenses and other current assets | 141,334 | 368,676 | 50,851 |
| Total current assets | 3,109,002 | 21,495,887 | 5,310,975 |
| Restricted cash | 3,696,840 | 3,696,840 | 3,696,840 |
| Property and equipment, net | 12,290,802 | 14,969,544 | 10,170,004 |
| Intangible and other assets | 335,000 | | 6,621,236 |
| Total assets | $ 19,431,644 | $ 40,162,271 | $ 25,799,055 |
| **Liabilities and stockholders equity** | | | |
| Current liabilities: | | | |
| Accounts payable | $ 1,554,167 | $ 1,134,372 | $ 1,167,845 |
| Other accrued liabilities | 770,314 | 362,292 | 5,447,333 |
| Accrued leasehold improvements | | | |
| Accrued bonus | | | |
| Accrued patent expenses | | | |
| Current portion of lease commitments, promissory notes, and bridge loan | 3,860,021 | 1,790,931 | 19,689,234 |
| Total current liabilities | 6,184,502 | 3,287,595 | 26,304,412 |
| Long-term liabilities: | | | |
| Long-term portion of commitments, promissory notes, and bridge loan | 4,511,510 | 3,428,970 | 5,028,361 |
| Deferred rent payable | 927,498 | 421,590 | 1,231,455 |
| Security deposit | 359,775 | 359,775 | 359,775 |
| Total long-term liabilities | 5,798,783 | 4,210,335 | 6,619,591 |
| Commitments | | | |
| Stockholders equity: | | | |
| Preferred stock, $0.0001 par value: 24,975,000 shares are authorized at September 30, 2003 (unaudited) and December 31, 2002, 31,025,000 shares are authorized at December 31, 2001: | | | |
| Series A convertible preferred stock: 5,425,000 shares designated at September 30, 2003 (unaudited), December 31, 2002 and December 31, 2001. None issued and outstanding at September 30, 2003 (unaudited) and December 31, 2002, and December 31, 2001 | | 5,350,417 | |
| Series B convertible preferred stock: 6,000,000 shares designated at September 30, 2003 (unaudited), December 31, 2002, and December 31, 2001. None issued and outstanding at September 30, 2003 (unaudited) and 5,420,000 outstanding at December 31, 2002, and 4,527,400 shares issued and outstanding at December 31, 2001 | | 11,190,814 | |
| Series C convertible preferred stock: 6,600,000 shares designated at September 30, 2003 (unaudited) and December 31, 2002, 4,890,000 shares designated at December 31, 2001. None issued and outstanding at September 30, 2003 (unaudited) and December 31, 2002, and 4,890,000 shares issued and outstanding at December 31, 2001 | | 24,814,092 | |
| Series D convertible preferred stock: 5,950,000 shares designated at September 30, 2003 (unaudited) and December 31, 2002, 13,000,000 shares designated at December 31, 2001. None | | 20,649,701 | |

| | | | |
|---|---|---|---|
| issued and outstanding at September 30, 2003 (unaudited) and December 31, 2002, and 5,450,000 shares issued and outstanding at December 31, 2001 | | | |
| Series 1 convertible preferred stock: 1,000,000 shares designated in 2002, none outstanding at December 31, 2002 and September 30, 2003 (unaudited) | | | |
| Common stock, $0.0001 par value: 43,450,000 shares are authorized at September 30, 2003 (unaudited) and December 31, 2002, 45,000,000 shares are authorized at December 31, 2001. 12,378,931, 10,808,540, and 1,504,047 shares issued and outstanding at September 30, 2003 (unaudited), December 31, 2002, and December 31, 2001, respectively | 63,016,056 | 420,789 | 68,238,679 |
| Other accumulated comprehensive income | | 237,193 | 194 |
| Deficit accumulated during the development stage | (55,567,697) | (29,998,665) | (75,363,821) |
| Total stockholders equity (net capital deficiency) | 7,448,359 | 32,664,341 | (7,124,948) |
| Total liabilities and stockholders equity (net capital deficiency) | $ 19,431,644 | $ 40,162,271 | $ 25,799,055 |

See accompanying notes.

**GeneSoft Pharmaceuticals, Inc.**

**(a development stage company)**

**Statements of Operations**

| | Year ended December 31, | | | Period from August 12, 1997 (inception) through December 31, | Nine months ended September 30, | | Period from August 12, 1997 (inception) through September 30, |
|---|---|---|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 2002 | 2003 | 2002 | 2003 |
| | | | | | (Unaudited) | | (Unaudited) |
| Grant revenue | $ 5,401,895 | $ 2,059,176 | $ 4,186,751 | $ 14,167,895 | $ 3,072,350 | $ | $ 17,240,245 |
| Operating expenses: | | | | | | | |
| Research and development | 26,283,501 | 16,245,449 | 11,454,934 | 59,536,123 | 8,895,882 | 14,534,786 | 68,432,005 |
| Marketing | | | | | 2,059,396 | | 2,059,396 |
| General and administrative | 4,541,718 | 4,828,042 | 1,825,410 | 12,276,734 | 5,246,839 | 3,623,601 | 17,523,573 |
| Total operating expenses | 30,825,219 | 21,073,491 | 13,280,344 | 71,812,857 | 16,202,117 | 18,158,387 | 88,014,974 |
| Operating loss | (25,423,324) | (19,014,315) | (9,093,593) | (57,644,962) | (13,129,767) | (18,158,387) | (70,744,729) |
| Other income | 564,099 | 1,251,633 | 1,226,872 | 3,436,073 | 59,097 | 321,135 | 3,495,170 |
| Other expense | (709,807) | (557,970) | (54,309) | (1,358,808) | (6,725,454) | (530,291) | (8,084,262) |
| Net loss | $ (25,569,032) | $ (18,320,652) | $ (7,921,030) | $ (55,567,697) | $ (19,796,124) | $ (18,367,543) | $ (75,363,821) |
| Basic and diluted net loss per share | $ (12.81) | $ (15.69) | $ (8.27) | | $ (1.69) | $ (14.04) | |
| Weighted-average shares used in calculating basic and diluted net loss per share | 1,996,472 | 1,167,611 | 957,311 | | 11,728,821 | 1,307,881 | |

**GeneSoft Pharmaceuticals, Inc.**

**(a development stage company)**

**Statements of Stockholders Equity (Net Capital Deficiency)**

**Period from August 12, 1997 (inception) through September 30, 2003**

| | Series A Convertible Preferred Stock | | Series B Convertible Preferred Stock | | Series C Convertible Preferred Stock | | Series D Convertible Preferred Stock | | Series 1 Convertible Preferred Stock | | Common Stock | | Other Accumulated Comprehensive Income (Loss) | Deficit Accumulated During the Development Stage | Total Stockholders Equity (Net Capital Deficiency) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | Shares | Amount | | | |
| Issuance of common stock to founders in October 1997 at $0.0048 per share for cash | | $ | | $ | | $ | | $ | | $ | 730,317 | $ 3,500 | $ | $ | $ 3,500 |
| Issuance of common stock in September 1998 at $0.14 per share for license to technology | | | | | | | | | | | 42,750 | 6,000 | | | 6,000 |
| Issuance of common stock in November 1998 at $0.0048 per share for cash | | | | | | | | | | | 42,750 | 204 | | | 204 |
| Issuance of Series A convertible preferred stock at $1.00 per share to investors in October 1998 through December 1998 for cash, net of issuance costs of $69,583 | 3,537,500 | 3,467,917 | | | | | | | | | | | | | |