CHIRON CORP
Form 10-K
March 06, 2002

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

/x/ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the fiscal year ended December 31, 2001

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**
For the transition period from _____ to _____

Commission File Number: 0-12798

CHIRON CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**94-2754624**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4560 Horton Street,
Emeryville, California 94608
(Address of principal executive offices) (Zip code)

(Registrant's telephone number, including area code) **(510) 655-8730**

(Former name, former address and former fiscal year, if changed since last report) **Not Applicable**

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

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.01 Par Value
Warrant to Purchase Common Stock, $0.01 Par Value

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been

subject to such filing requirements for the past 90 days. Yes: /x/ No: / /

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

The aggregate market value of voting stock held by nonaffiliates of the Registrant as of January 31, 2002 was $4.7 billion. The number of shares outstanding of each of the Registrant's classes of common stock as of January 31, 2002:

Title of Class	Number of shares
Common Stock, $0.01 par value	189,509,955

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement to be filed in connection with the solicitation of proxies for the Annual Meeting of Stockholders to be held on May 16, 2002 are incorporated by reference into Part III of this Report.

PART I

ITEM 1. BUSINESS

Our Policy on Forward-Looking Statements

This 10-K contains forward-looking statements concerning plans, objectives, goals, strategies, future events or performance, and all other statements which are not statements of historical fact. These statements contain words such as, but not limited to, "believes," "anticipates," "expects," "estimates," "projects," "will," "may" and "might." The forward-looking statements contained in this 10-K reflect our current beliefs and expectations on the date of this 10-K. Actual results, performance or outcomes may differ from what is expressed in the forward-looking statements. We have discussed the important factors, which we believe could cause actual results to differ from what is expressed in the forward-looking statements, in Part II, Item 7. of this 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations," under the caption "Factors That May Affect Future Results." We are not obligated to publicly announce any revisions to these forward-looking statements to reflect a change in facts or circumstances.

Company Summary

Chiron Corporation is a global pharmaceutical company that leverages a diverse business model to develop and commercialize high-value products that make a difference in people's lives. We apply our advanced understanding of the biology of cancer and infectious disease to develop products from our platforms in proteins, small molecules and vaccines. We commercialize our products through three business units: biopharmaceuticals, vaccines and blood testing.

Focus on Cancer and Infectious Disease

Chiron is focused on developing products for cancer and infectious disease. We continue to build upon our cancer franchise, which has three dimensions; immune system modulators, monoclonal antibodies and novel anti-cancer agents. In the infectious disease area, we have a range of products spanning all three of our business units.

Biopharmaceuticals

Chiron Biopharmaceuticals discovers, develops, manufactures and markets a range of therapeutic products. Our products include:

Betaseron® (inteferon beta-1b), for multiple sclerosis;

TOBI® (tobramycin solution for inhalation) for lung infections in cystic fibrosis patients;

Proleukin® (aldesleukin) for cancer; and

PDGF, the active ingredient in Regranex® Gel.

Vaccines

Chiron Vaccines, the fifth largest vaccines business in the world, currently offers more than 30 vaccines for adults and children. We provide a range of vaccines, including:

Menjugate , a conjugated vaccine against meningococcal meningitis caused by the bacterium N. meningitidis serogroup C;

Fluad , an innovative adjuvanted influenza vaccine;

Encepur , a preservative-free vaccine against tick-borne encephalitis; and

Rabipur®/RabAvert®, a cell culture vaccine against rabies.

Blood Testing

Chiron Blood Testing provides products used by the blood banking industry. With our collaborator, Gen-Probe Incorporated, we are developing and commercializing nucleic acid testing blood screening assays, including the Procleix HIV-1/HCV Assay. Through our joint business with Ortho-Clinical Diagnostics, Inc., a Johnson & Johnson company, we develop and market a line of immunodiagnostic screening and supplemental tests for infectious diseases.

Intellectual Property

Chiron has a large portfolio of intellectual property, with material positions in HIV and hepatitis C virus. Chiron has entered into numerous collaborations and licensing agreements with major companies, particularly in the areas of blood screening and diagnostics.

Corporate History and Headquarters Information

We were incorporated in California in 1981 and merged into a Delaware corporation in November 1986. Our principal executive offices are located at 4560 Horton Street, Emeryville, California 94608, and our main telephone number is (510) 655-8730.

Product Descriptions

Biopharmaceuticals

Chiron manufactures Betaseron® (interferon beta-1b) for sale outside of Europe by Berlex Laboratories, Inc. and its parent company, Schering AG of Germany. Betaseron® is approved for relapsing/remitting multiple sclerosis in over 60 countries, including the U.S. and the European Union, and for secondary progressive multiple sclerosis in approximately 40 countries, including the European Union, Canada, Australia and New Zealand. Multiple sclerosis is an autoimmune disease in which the patient's immune system attacks and destroys an element of the patient's own central nervous system. The active ingredient in Betaseron® is a modified form of a beta interferon produced naturally by the human body. Interferons help to regulate the immune system, and Betaseron® is thought to help slow down the immune system's attack on nerve tissue. While the ways in which Betaseron® actually affects multiple sclerosis are not clearly understood, it has been demonstrated clinically that Betaseron® may decrease the nerve damage associated with multiple sclerosis. It has been shown to reduce the overall frequency of multiple sclerosis relapses, which are also called exacerbations or attacks, as well as the number of moderate and severe relapses. We also receive royalties from the sale of an identical product in Europe, Betaferon®, which is manufactured by Boehringer Ingelheim and marketed by

Schering in Europe to treat patients with relapsing remitting and secondary progressive multiple sclerosis.

TOBI® is a stable, premixed, proprietary formulation of the antibiotic tobramycin for delivery by inhalation using a nebulizer. TOBI® has been tested and approved for cystic fibrosis patients with *Pseudomonas aeruginosa* lung infections. Cystic fibrosis is caused by a genetic mutation which prevents cells from building a special protein required for normal movement of sodium and chloride (salt) in and out of cells lining the lungs and other organs. This abnormal movement causes secretion of thick, sticky mucus. This mucus is not cleared from the airways and, as a result, bacteria begin to grow, causing infection. Respiratory infections are treated with antibiotics, often in aerosol form. The medicated aerosol fights infection, relieves constriction of the airways and reduces systemic toxicity associated with the antibiotic agent. *Pseudomonas aeurginosa* is the most common bacterium causing lung infections in people with cystic fibrosis. Appropriate treatment of these chronic lung infections is a major contributor to the extended life span of patients with cystic fibrosis and to improved quality of life. The TOBI® formulation is well tolerated by patients, thereby leading to increased patient compliance and more effective elimination of infection compared to other antibiotic aerosols. Antibiotic therapy rarely eradicates bacteria in the respiratory tract of patients with cystic fibrosis. However, treatment with TOBI® decreases the bacterial

load, reduces the associated inflammatory response, and improves overall lung function. TOBI® is the first inhaled antibiotic solution to be approved by the U.S. Food and Drug Administration and has been sold in the U.S. since January 1998. TOBI® is approved for sale in the U.S., Canada, Switzerland, Finland, Israel, Argentina, Australia, New Zealand and Brazil. TOBI® also has cleared the mutual recognition process required for marketing the drug in the European Union. Under this mutual recognition process, TOBI® has received marketing authorizations from all European Union member countries.

Chiron manufactures and markets Proleukin®, a recombinant form of interleukin-2. Interleukin-2 is a protein produced naturally in the body in very small quantities. Interleukin-2 stimulates the immune system to increase the production and function of immune cells. While the precise anti-tumor mechanism of Proleukin® is unknown, research has demonstrated that Proleukin® induces the proliferation of immune cells, including natural killer and cytotoxic T cells that can recognize and mobilize against tumor-specific antigens on the surface of malignant cells. We market Proleukin® directly or through distributors in the U.S. and over 50 other countries in North America, Europe, Asia and South America to treat metastatic renal cell carcinoma (a type of kidney cancer), and in the U.S. and Canada to treat metastatic melanoma (a form of skin cancer).

Chiron manufactures PDGF, the active ingredient in Regranex® Gel. PDGF was developed with Ortho-McNeil Pharmaceutical, Inc. through a collaboration in growth factor research that began in 1984. Ortho-McNeil Pharmaceutical markets Regranex® in the U.S. to treat diabetic foot ulcers. Regranex® works by enhancing the body's natural wound healing processes. It stimulates the migration of cells to the site of the ulcer, encouraging the patient's body to grow new tissue that helps heal these open wounds. Regranex® was the first product demonstrated to assist in the healing of diabetic foot ulcers. Regranex® also has been approved for marketing in Canada, Europe, Asia and other regions of the world.

Sales of Betaseron®, which include product sales to Berlex Laboratories and Schering and royalties earned on Schering's European sales of Betaferon®, accounted for approximately 12% (9% product sales and 3% royalties), 12% (8% product sales and 4% royalties) and 13% (9% product sales and 4% royalties) of total revenues in 2001, 2000 and 1999, respectively. Sales of TOBI® accounted for approximately 11% and 3% of our consolidated total revenues in 2001 and 2000, respectively. Sales of Proleukin® accounted for approximately 8%, 12% and 15% of our consolidated total revenues in 2001, 2000 and 1999, respectively. No other biopharmaceutical product accounted for 10% or more of our consolidated total revenues in any of the last three fiscal years.

Vaccines

In 2000, Chiron commenced sales of Menjugate , a conjugate vaccine against meningococcal meningitis caused by the bacterium N. meningitidis serogroup C. Invasive infection with the bacteria N. meningitidis can lead to meningitis and septicemia (blood poisoning). Meningococcal meningitis, which can be caused by multiple serogroups (A, B, C, Y and others), is associated with a high mortality rate. In March 2000, the Medicines Control Agency approved Menjugate for sale in the United Kingdom. The National Health Service in the United Kingdom accepted our tender to supply Menjugate in 2000 and 2001. We are also selling Menjugate in Canada, Ireland, Spain and Hungary. We have received approval to market Menjugate elsewhere in the European Union through the mutual recognition procedure.

Chiron also developed and markets Fluad , an adjuvanted flu vaccine, which uses our recently developed MF-59, an adjuvant which improves the body's immunologic reaction. This gives older patients long-lasting protection from influenza and its complications. Fluad currently is marketed in Italy, Germany, Austria and Spain (under a different trade name). We have gained approval to market Fluad in 12 countries of the European Union through the European mutual recognition procedure.

In 2000, we entered into a co-promotion and co-marketing agreement with Aventis Pasteur MSD related to Menjugate and Fluad . Under the agreement, Aventis Pasteur will assist Chiron in marketing and sales efforts (co-promotion) related to Menjugate in the United Kingdom and Ireland. Aventis

Pasteur will distribute, market and sell (co-market) Menjugate under its own label in the rest of Europe. Aventis Pasteur will similarly co-market and co-promote Fluad in Europe.

In Italy, we manufacture and market vaccines for:

- meningococcus
- haemophilus influenza type b
- influenza
- measles
- mumps
- rubella
- hepatitis A
- polio (oral vaccine)

Also in Italy, under license, we market vaccines for:

- pneumococcal disease
- diptheria
- tetanus
- pertussis
- haemophilus influenza type b
- hepatitis B (recombinant vaccine)

In Germany, we manufacture and market vaccines for:

diphtheria

tetanus

pertussis

influenza

rabies

tick-borne encephalitis

cholera

Also in Germany, under distribution agreements with other manufacturers, we market vaccines for:

hepatitis A

measles

mumps

rubella

typhoid fever

pneumococcal disease

haemophilus influenza type b

polio (inactivated vaccine)

acellular pertussis

hepatitis B (recombinant vaccine)

In India, we manufacture, through Chiron Behring Vaccines Limited, a vaccine against rabies.

We market most of our manufactured vaccines in other European countries and in the Middle East, the Far East, Africa and South America, and to international health agencies such as the World Health Organization. We market our rabies vaccine in the U.S.

In addition to revenues from the sale of the vaccines described above, Chiron receives royalties from the sale of certain vaccines from Merck and Company, Inc. and SmithKline Beecham Biologics (now part of GlaxoSmithKline plc), based upon technology developed by Chiron. Merck's hepatitis B virus vaccine, based on Chiron technology, was the first genetically engineered vaccine licensed by the U.S. Food and Drug Administration for human use.

Sales of Menjugate accounted for approximately 9% and 12% of our consolidated total revenues in 2001 and 2000, respectively. No other single vaccine product or class of vaccine product accounted for 10% or more of our consolidated total revenues in any of the last three fiscal years.

Blood Testing

Our blood testing business consists of two separate collaborations: an alliance with Gen-Probe Incorporated and a joint business with Ortho-Clinical Diagnostics, Inc.

Our collaboration with Gen-Probe is focused on developing and commercializing nucleic acid testing products using transcription-mediated amplification technology to screen donated blood in blood banks and plasma in the plasma industry for viral infection. Compared to immunodiagnostic testing, testing directly for the presence of viral nucleic acids improves the sensitivity of the test and enables infection to be detected earlier than currently approved technologies. Under the terms of the collaboration agreement, Gen-Probe performs certain product development and assay and instrument manufacturing functions, while Chiron and Gen-Probe jointly participate in new assay and instrument research and development. Chiron sells the collaboration's products under the Procleix brand name, and Gen-Probe receives a percentage of our sales revenues. The Chiron/Gen-Probe collaboration's first product is a combined test for HIV and hepatitis C virus using a semi-automated instrument system. The Procleix system has been used to screen blood under an Investigational New Drug application in the U.S. since 1999. On February 27, 2002, the U.S. Food and Drug Administration approved the Procleix HIV-1/HCV Assay. The nucleic acid amplification test is designed to detect the presence of all known HIV-1 subtypes and hepatitis C virus genotypes in whole blood and plasma during the very early stages of infection, when such agents would not be detected by immunodiagnostic screening technologies. The Procleix system is also approved for use in France, Germany, Australia, Portugal, Spain, Singapore, Italy, Austria, Switzerland and New Zealand, and is under evaluation in other European, South American and Asian countries.

Our joint business with Ortho-Clinical Diagnostics was formed in 1989, to develop and sell immunodiagnostic tests to detect human immunodeficiency and hepatitis viruses in blood. The joint business sells a full line of tests for hepatitis viruses and retroviruses and provides supplemental tests and microplate-based instrument systems to automate test performance and data collection. We manufacture, and perform research on, viral antigens for further manufacture by Ortho-Clinical Diagnostics into testing assays and supplemental hepatitis tests. Ortho-Clinical Diagnostics manufactures and sells assays and instrument systems. Chiron and Ortho-Clinical Diagnostics share equally in the pretax operating earnings generated by the joint business. The joint business holds the immunodiagnostic rights to our hepatitis and retrovirus technology and receives royalties from the sale of hepatitis C virus and HIV tests by Abbott

Laboratories, Inc. and from sales of hepatitis C virus tests by Bio-Rad Laboratories, Inc. and certain other licensees.

No single blood testing product or class of blood testing products accounted for 10% or more of our consolidated total revenues in any of the last three fiscal years.

Research and Development

As a global pharmaceutical company, our focus on cancer and infectious disease starts with the discovery process, using our three product platforms therapeutic proteins, small molecules and vaccines and continues into the clinic and eventually into one of our three business units. In addition to our research and development activities, technologies that are developed in collaborations with third parties, as well as technologies licensed from outside parties, also are sources of potential products for our business units.

Products or product candidates that are inappropriate for our commercial organization are out-licensed to other companies. This portfolio of intellectual property is, and will continue to be, an important part of our business model.

Therapeutic Proteins

Proteins produced naturally by the human body play a variety of roles in controlling disease. When administered as therapeutic agents, certain proteins or specific antibodies can enhance the patient's natural ability to fight disease. However, traditional methods of isolating or

producing proteins can be expensive, particularly in the quantities needed for pharmaceutical use. Through genetic engineering, certain proteins can be produced in relatively large quantities at reasonable cost.

Chiron and our collaborators have a number of recombinant proteins in clinical development. Proleukin®, already approved for marketing as a treatment for certain forms of kidney and skin cancer, is being clinically evaluated for other uses. These uses include treatment, in combination with antiviral drugs, of patients with HIV infection, treatment of acute myelogenous leukemia and treatment for non-Hodgkin's lymphoma in conjunction with an approved antibody therapeutic. Fibroblast Growth Factor, a growth factor that can stimulate the formation of new blood vessels, is in clinical studies for use as a treatment for peripheral artery disease. Tifacogin (recombinant Tissue Factor Pathway Inhibitor), a coagulation inhibitor, was developed in collaboration with Pharmacia & Upjohn, Inc. Chiron and Pharmacia & Upjohn conducted clinical studies on the use of tifacogin as a treatment for patients with severe sepsis. The results from the trial indicated that tifacogin did not meet the primary endpoint of reducing 28-day all-cause mortality. We are undertaking a full review of the data from the Phase 3 trial, and we will make future development decisions about tifacogin after we have completed the analysis of the data. In 2000, Chiron and Cephalon, Inc. discontinued their joint collaboration to develop Myotrophin® (mecasermin) Insulin-like Growth Factor-I to treat amyotrophic lateral sclerosis (also known as ALS or Lou Gehrig's disease).

Small Molecule Drug Discovery

Our small molecule drug discovery program combines multiple disciplines. These disciplines include combinatorial and computational chemistry, robotic screening and selection and molecular biology, to screen, identify and refine compounds which may be used as drugs for treating medical conditions or disorders. In addition to drug discovery against specific disease targets of interest to us, we occasionally enter into collaboration agreements with third parties under which we use our proprietary technologies to identify drug candidates for others. We have identified certain compounds that may be of interest to us. We will further optimize and test those compounds before moving them into clinical development.

Angiozyme® is a synthetic ribozyme designed as an angiogenesis inhibitor for cancer. Angiozyme® is under development in a collaboration led by Ribozyme Pharmaceuticals, Inc. Several phase 2 solid tumor studies are currently underway.

We are working to develop and register a product combining TOBI® and a new inhalation device. In December 2001, we entered into a collaboration with Inhale Therapeutics Systems, Inc. to develop this device. Our goal is to improve convenience and to reduce the time to deliver TOBI® to the cystic fibrosis patient's lungs. In addition to TOBI®, we are conducting clinical research on PA-1806, a novel, patented drug candidate that was licensed from Bristol-Myers Squibb Company in 1998. In the laboratory, PA-1806 has demonstrated activity against gram-negative lung bacteria, a broad subset of serious lung infections. Chiron intends to initiate preclinical programs on other inhaled antibiotics.

Vaccines

We are developing a new generation of vaccines to prevent disease utilizing genetic engineering and other techniques of modern biotechnology, including vaccines based on recombinant antigens. We are currently conducting preclinical studies on vaccines for a number of diseases, including hepatitis C virus and HIV. We are also developing novel adjuvants. Adjuvants are compounds that amplify the immune response generated by vaccine antigens. One of our adjuvants, MF-59, is a component of Fluad , our novel flu vaccine. In addition, we are conducting preclinical investigations of alternative delivery systems for vaccines that may be used in lieu of injection, such as inhaled or oral vaccines.

We are investigating the potential use of vaccines for therapeutic purposes, in which antigens are used to stimulate an immune response against established infections and cancer. Our therapeutic vaccine for treatment of chronic hepatitis B virus is in clinical development. We have also started a phase 1 clinical study of a vaccine for the H. pylori infection.

Chiron participates in the development of a range of hepatitis and retrovirus assays for *in-vitro* clinical diagnostics use for the joint business with Ortho-Clinical Diagnostics, Inc.

Chiron and Gen-Probe Incorporated are working toward widening the menu from HIV-1 and hepatitis C virus to include other transfusion transmitted viruses, such as hepatitis B, hepatitis A and the Parvo B19.

The Chiron/Gen-Probe collaboration also has two instrument systems in development, both of which are designed for use with HIV-1 and hepatitis C virus nucleic acid tests for whole blood and plasma. Gen-Probe is continuing development of the Procleix Fully Automated System.

Research and Development Expenses and Related Revenues

Research and development expense for the years ended December 31, 2001, 2000 and 1999 for Chiron-sponsored research, including payments to collaboration partners, was $344.4 million, $298.8 million and $303.4 million, respectively. Under contracts where we recognize revenue based upon work performed, the related research and development activities amounted to $9.1 million, $6.0 million and $49.7 million in 2001, 2000 and 1999, respectively. We recorded these revenues in "Collaborative agreement revenues" in the Consolidated Statements of Operations. Generally, collaborative agreement revenues include fees for research services as they are performed or completed and milestone payments upon attainment of specified benchmarks.

Commercialization

Technologies arising out of Chiron's research and development efforts are commercialized in various ways:

We market and distribute certain products, either directly or through distributors. See "Sales and Marketing" below.

We develop other products in collaboration with third parties. Under collaboration agreements, marketing rights may be assigned to us or to the collaborator or shared by both parties. In the event marketing rights are assigned to the collaborator, we generally retain the right to manufacture and supply key raw materials.

We license other technologies to third parties, with the licensee assuming responsibility for further development. We receive royalties on sales of the resulting product. Agreements under which we currently derive revenues for technologies licensed to third parties include:

an agreement with Bayer Corporation relating to, among other things, use of Chiron's hepatitis C virus and HIV technologies for nucleic acid amplification *in vitro* diagnostics;

an agreement with Merck and Company, Inc. relating to hepatitis B virus vaccines;

an agreement with GlaxoSmithKline plc relating to recombinant vaccine manufacturing technology;

agreements with Novo Nordisk AS relating to technology used in the manufacture of recombinant human insulin and glucagon;

a license to Abbott Laboratories, Inc. under our hepatitis C virus patents for use in nucleic acid amplification in clinical diagnostics, excluding blood screening; and

licenses to F. Hoffmann La-Roche Limited and Roche Molecular Systems, Inc. under our hepatitis C virus and HIV patents for use in nucleic acid amplification in *in vitro* diagnostics and in blood screening.

Sales and Marketing

We maintain several specialized marketing and sales forces that concentrate on individual classes of customers and markets.

Our biopharmaceutical marketing and sales organization for the U.S. is headquartered in Emeryville, California, and has European offices in Amsterdam, The Netherlands and London, England. We focus our sales efforts on specialist physicians, principally oncologists and pulmonologists, who are based in hospitals and large clinics. Generally, we sell products to wholesalers, distributors, clinics and hospital pharmacies.

Our vaccine international marketing organization and our marketing and sales organization for the German market are based in Marburg, Germany. Marketing and sales structures for the Italian market are headquartered in Siena, Italy. We focus our direct sales efforts on pediatricians and general practitioners. We also sell products to the public sector through tenders (a bid solicitation process) and to private sector pharmacies directly and through wholesalers and distributors.

Our blood testing marketing, sales and distribution organization for nucleic acid testing products is based in Emeryville, California and has representatives around the world. We sell products to the public sector through tenders and to private sector blood banks and hospitals directly and through distributors.

Patents

Patents are very important to our business. We have a policy of seeking patents on inventions arising from our research and development activities. The time and expense required to develop and obtain regulatory approval to market human healthcare products is significant. Without the protection of patents or trade secrets, competitors may be able to use our inventions to manufacture and market competitive products without being required to undertake the lengthy and expensive development efforts made by Chiron. We also receive significant revenue through the licensing of these patents to third parties. We have a substantial number of granted patents and pending patent applications in the U.S. and other important markets. Additionally, we have licensed a number of patents and patent applications from third parties. Additional information is provided below on the central patents held or licensed by Chiron that cover our key products. The existence of such patents does not mean they are valid or can be enforced against competitive products. We are often engaged in litigation to determine the scope and validity of these patents. We also seek term extensions for patents, which are available in certain countries based on delays in the grant of regulatory approvals for the sale of products covered by these patents. For these reasons the expiration dates provided below are not definitive.

To a lesser extent, trade secrets and confidential information are important to our commercial success. Although we seek to protect trade secrets and confidential information, others may obtain access to such information or develop the same or similar information independently. Also, third parties may obtain patent protection that precludes us from using our trade secrets or confidential information.

Biopharmaceuticals

The central patents that cover Betaseron® and Betaferon® in the U.S. and Europe cover the gene and serine-17 interferon-beta protein used in manufacturing the product. The U.S. patents expire in 2005 and 2007. The European patents expire between 2003 and 2009, depending on the country.

The central TOBI® patents include claims that cover the TOBI® product formulation and methods of treating *pseudomonas aeruginosa* infections with the TOBI® product. The U.S. and European patents expire in 2014 and 2015, respectively.

The central patents that cover Proleukin® in the U.S. and Europe cover the gene expressed in manufacturing the product, the serine-125 Interleukin-2 mutein in the product and the 95% pure form of recombinant Interleukin-2. The U.S. patents expire in 2006 and 2012. The European patents expire between 2003 and 2006.

Chiron and its collaborator are assignees or licensees of a number of U.S. and European patents that cover PDGF, the active ingredient in Regranex® Gel. These patents begin to expire in 2005.

Vaccines

Fluad®, our adjuvanted flu vaccine, contains the proprietary adjuvant MF-59. The U.S. and German patents containing claims directed to MF-59 expire in 2018 and 2010, respectively.

Blood Testing

Procleix HIV-1/HCV assay is covered by numerous patents held by Chiron in the U.S. and worldwide. These patents contain claims directed to methods of hybridization, methods for determining the presence of the hepatitis C virus in a sample and to probes/primers utilized in such a process. The U.S. patents expire in 2015 and 2016. The European patents expire in 2008. Procleix is also covered by several patents held by Gen-Probe Incorporated and licensed to Chiron.

The hepatitis C virus immunoassay diagnostic products sold by our joint business with Ortho-Clinical Diagnostics, Inc. are covered by numerous patents in the U.S. and worldwide. These patents contain claims

directed to hepatitis C virus immunoassay methods, kits and hepatitis C virus polypeptides. In the U.S., these patents expire between 2011 and 2017. In Europe, the patent expires in 2011.

Trademarks

Registered trademarks of Chiron and our subsidiaries:

Proleukin®

Rabavert®

TOBI®

Trademarks of Chiron and our subsidiaries:

Menjugate	ELVS
Fluad	Polioral
Begrivac	Triacelluvax
Encepur	Procleix

Registered trademark owned by Chiron and SkyePharma plc:

DepoCyt®

The following registered trademarks are owned by the indicated companies:

Betaseron® and Betaferon® (Schering AG)

Myotrophin® (Cephalon, Inc.)

Regranex® (Johnson & Johnson)

Apligraf® (Novartis AG)

Dermagraf® (Advanced Tissue Sciences, Inc.)

PRISM® (Abbott Laboratories, Inc.)

Copaxone® (Teva Pharmaceutical Industries, Ltd.)

Avonex® (Biogen, Inc.)

Aredia® (Novartis AG)

Amplicor® (F. Hoffmann La-Roche Limited)

Novantrone® (Immunex Corporation)

Tigris® (Gen-Probe Incorporated)

Angiozyme® (Ribozyme Pharmaceuticals, Inc.)

Seasonality

Sales of certain of our products, particularly the flu vaccine, are seasonal, with higher sales in the third and fourth quarters of the year.

Major Revenue Sources

We have a joint immunodiagnostics business with Ortho-Clinical Diagnostics, Inc. See "Products-Blood Testing" above. The Ortho-Clinical Diagnostics joint business, together with certain other

arrangements with Johnson & Johnson and its affiliates, contributed 11%, 13% and 14% of total revenues in 2001, 2000 and 1999, respectively.

We have a supply agreement with Berlex Laboratories, Inc. and its parent company, Schering AG of Germany. Revenues recognized under this agreement, together with certain other arrangements with Berlex Laboratories and Schering, contributed 12% to our total revenues in both 2001 and 2000 and 13% to our total revenues in 1999.

In 2000, the National Health Service accepted our tender to supply Menjugate for a universal vaccination program in the United Kingdom. This arrangement contributed 3% and 10% to total revenues in 2001 and 2000, respectively. Revenues from Aventis Pasteur MSD related to the sales of vaccines contributed 9% and 10% to total revenues in 2001 and 2000, respectively.

We have a strategic alliance with Novartis AG, including a series of arrangements with Novartis. See "Relationship with Novartis" below. These arrangements contributed 2% of total revenues in both 2001 and 2000 and 8% of total revenues in 1999.

Competition

We operate in a highly competitive environment, and we expect competition to increase. Competitors include large pharmaceutical, chemical and blood testing companies, and biotechnology companies. Some of these competitors, particularly large pharmaceutical and blood testing companies, have greater resources than Chiron. Chiron and our competitors apply rapidly evolving technologies and new developments that frequently result in price competition and product obsolescence. Substantial consolidation is underway in the global healthcare industry and is expected to produce greater efficiencies and even more intense competition. To compete effectively, we invest heavily in research and development, maintain specialized sales forces that concentrate on individual classes of customers and spend significant amounts on advertising, promotion and selling.

Important biotechnology research is performed in universities and nonprofit research organizations. These entities are becoming more active in seeking patent protection and licensing revenues for their discoveries. The competition among large pharmaceutical companies and smaller biotechnology companies to acquire technologies from these entities also is intensifying. We actively collaborate with such entities in

research, and have and will continue to license their technologies for further development. However, these institutions also compete with us to recruit scientific personnel and to establish proprietary positions in technology.

Biopharmaceuticals

Betaseron®, as a treatment for multiple sclerosis, competes with Avonex®, a recombinant beta interferon sold by Biogen, Inc. and with Copaxone® from Teva Pharmaceutical Industries, Ltd. Novantrone® from Immunex Corporation was approved and launched to treat secondary progressive multiple sclerosis in March 2000. Betaferon®, sold in Europe by Schering AG also faces competition from Serono, which sells Rebif®, another form of beta interferon that is used for, among other purposes, the treatment of multiple sclerosis. Other companies have treatments for multiple sclerosis in clinical development.

TOBI® is the first inhaled antibiotic solution to be approved by the U.S. Food and Drug Administration. However, the use of oral and intravenous antibiotics to treat pseudomonal and other bacterial infections is well-established. In cystic fibrosis patients with pseudomonal lung infections, tobramycin is the most commonly used intravenous antibiotic. The advantage of inhalation is that it permits higher antibiotic concentrations in the lung and reduces side effects by limiting systemic exposure. Competitive medical therapies include generic antibiotics, anti-inflammatory drugs, oral replacement enzymes to maintain nutrition and mucolytics to clear pulmonary secretions.

Proleukin® is the only product approved by the U.S. Food and Drug Administration to treat metastatic renal cell carcinoma and one of two approved treatments for metastatic melanoma. However, there are numerous products that are used to treat both cancers on an off-label basis, including alpha interferons sold by F. Hoffmann La-Roche Limited and Schering-Plough Corporation. Other competitors include Eli Lilly and Company, Bristol-Myers Squibb Company and Celgene Corporation. We estimate that about 90% of Proleukin® sales are from metastatic renal cell carcinoma and metastatic melanoma.

Regranex® was the first product approved by the U.S. Food and Drug Administration to treat diabetic foot ulcers. Regranex® indirectly competes with Dermagraft®, a product from Advanced Tissue Sciences, Inc. & Smith and Nephew, and Apligraf®, a product from Novartis AG which was approved by the U.S. Food and Drug Administration to treat venous leg ulcers. Apligraf® is also in clinical trials to treat diabetic foot ulcers.

Vaccines

Four large companies hold the greatest share of the worldwide vaccine market: Merck and Company, Inc., GlaxoSmithKline plc, Wyeth Lederle Vaccines & Pediatrics (a division of American Home Products Corporation), and Aventis Pasteur MSD. Aventis Pasteur has a strategic alliance with Merck in Europe. All four of these companies, and other biotechnology companies, have substantial research and development programs.

The competitive factors in vaccines are price, the introduction of new products, including vaccines against diseases for which no vaccine was previously available, and new combination vaccines that combine existing vaccines for several diseases into a single product. Public health authorities, medical practitioners and patients frequently favor combination vaccines, particularly in pediatric vaccines, because they eliminate the need for multiple injections and may increase overall compliance with recommended vaccination schedules. As new combination vaccines are introduced, older combinations and single products often become obsolete. We may be limited in our ability to develop and market certain combination vaccines if one of the vaccines, which would otherwise be included in the combination, is covered by valid and enforceable patent or other proprietary rights held by third parties.

Specifically, Menjugate faces competition from vaccines produced by two other companies, both of which participated in the National Health Services' tender in the United Kingdom. These companies are also competing for future meningococcus vaccine business.

Blood Testing

We are the sole manufacturer of hepatitis C virus antigens for use in immunodiagnostic assays of the Ortho-Clinical Diagnostics, Inc. joint business. We also manufacture hepatitis C virus antigens for Abbott Laboratories, Inc.'s immunodiagnostic assays. In the immunodiagnostic blood testing market, the Ortho-Clinical Diagnostics joint business competes with Abbott Laboratories. The joint business anticipates increased competitive pressures from Abbott Laboratories with the introduction of the Abbott Laboratories PRISM® instrument system. The joint business is also developing immunodiagnostic instruments and assays to detect hepatitis, retrovirus and other agents in clinical diagnostic applications. Many other companies, including F. Hoffmann La-Roche Limited and Bayer Corporation, have substantial positions in the market segment.

The Procleix system for the detection of HIV-1 and hepatitis C virus has received approval in France, Germany, Australia, Portugal, Spain, Singapore, Italy, Austria, Switzerland and New Zealand. On February 27, 2002, the U.S. Food and Drug Administration approved the Procleix HIV-1/HCV Assay. The Chiron/Gen-Probe product line is expected to compete primarily with polymerase chain reaction based products supplied by F. Hoffmann La-Roche or developed in-house by customers and, in some markets, the hepatitis C virus antigen test under development by the Ortho-Clinical Diagnostics joint business. The commercial market for nucleic acid testing products in the blood banking and plasma

industries is developing very rapidly as regulatory agencies began in 1999 to develop policies and mandates that require this new technology to be implemented as an additional measure to improve blood safety.

Government Regulation

Regulation by governmental authorities in the U.S. and other important markets is a significant factor in the manufacture and sale of Chiron's products and in our research and development activities.

Biopharmaceuticals and Vaccines

In the U.S., Chiron's therapeutic and vaccine products (both commercial and investigational) are primarily regulated under federal law and are subject to rigorous U.S. Food and Drug Administration approval procedures. No product can be marketed in the U.S. until an appropriate application is approved by the U.S. Food and Drug Administration. The U.S. Food and Drug Administration applies the approval procedures on a product-by-product basis and typically requires, among other things, an extensive three-phase human clinical testing program. In phase 1, studies are conducted with a relatively small number of subjects to assess the safety of the product. In phase 2, the product is evaluated in a larger group of subjects to begin to assess efficacy and appropriate dosing. Phase 3 studies are conducted in the target population with a number of subjects that is large enough to provide sufficient data to establish statistically the safety and efficacy of the product. The U.S. Food and Drug Administration limits its product approval to treat specified medical conditions or disorders. Further studies would be required to market the product for other uses. The U.S. Food and Drug Administration must inspect and approve all facilities used to manufacture, fill, test and distribute biologic products. If any change in manufacturing facilities or processes occurs after U.S. Food and Drug Administration approval, additional regulatory review and possibly additional clinical studies may be required.

Licensing procedures in Europe are comparable to those in the U.S. In 1995, the European Union established a centralized procedure for licensing of products derived from the use of high technology/biotechnology processes. This procedure leads to the grant of a single license for the entire European Union. Effective January 1, 1998, the European Union has also adopted a decentralized procedure under which a license granted in one member state is mutually recognized by the other member states, leading to a grant of licenses in member states recognizing the original license. This procedure is replacing independent national licensing of products in the European Union. In addition, each product must receive individual country pricing approvals before it can be marketed in that country.

Blood Testing

In the U.S., blood testing products, whether based upon immunodiagnostic or nucleic acid testing technologies, may only be used pursuant to the terms of approval of specific license applications in which the product's safety and effectiveness must be demonstrated based upon well controlled studies. Upon approval of the license application, the product may be marketed for the specific uses, which were identified in the approval. Facilities, processes and operations used for the manufacture, testing, storage and distribution of Chiron's blood testing products in the U.S. are subject to U.S. Food and Drug Administration approval and periodic inspection.

In Europe, our blood testing products are currently regulated by local country regulation. However, in June 2000, the In Vitro Diagnostic Medical Devices Directive was approved in the European Union. During the transition period that ends in December 2003, manufacturers and distributors of *in vitro* diagnostic devices can sell these products under the current local country regulations or under the provisions of the Directive. Our blood testing products are currently registered and sold according to local country legislation but will comply in 2003 with the provisions of the Directive.

For all our products, the time and expense needed to complete the required clinical studies, prepare and submit the required applications and supporting documentation and respond to inquiries generated by regulatory review can far exceed the time and expense of the research initially required to create the product. These factors largely determine the speed with which a successful research program is translated into a marketed product.

Compliance with Environmental Laws

We do not expect expenses for compliance with environmental laws to have a material impact upon our capital expenditures, earnings or competitive position.

Employees

On December 31, 2001, Chiron and its subsidiaries had 3,736 employees.

Relationship With Novartis AG

In January 1995, we established an alliance with Novartis, a life sciences company headquartered in Basel, Switzerland. As of February 1, 2002, Novartis owns 42% of our outstanding common stock.

We have entered into a series of agreements with Novartis which provide, among other things and subject to certain conditions and exceptions:

Novartis will not increase its ownership interest in Chiron above 55% unless it acquires all of Chiron's outstanding capital stock in a "buy-out" transaction. Novartis may exceed this amount and increase its ownership interest up to 79.9% in a transaction approved by a majority of the independent members of Chiron's Board of Directors.

Novartis has the right to nominate three members to Chiron's eleven member Board of Directors (effective May 16, 2001, the Board was reduced to ten members). The number of directors that Novartis may nominate declines if Novartis' ownership interest in Chiron is less than 30%.

Novartis provided certain funding to Chiron for research on certain adult and pediatric vaccines, Insulin-like Growth Factor-I, Factor VIII and Herpes Simplex Virus-thymidine kinase. Funding under this agreement ended December 31, 2001. In exchange for providing this funding, Novartis has certain co-promotion rights for certain vaccines and an interest in certain royalties on sales of certain products resulting from the funded research.

Novartis will guarantee certain indebtedness on behalf of Chiron through January 1, 2008.

Chiron may require Novartis to purchase shares of Chiron's common stock directly from Chiron at fair market value, up to a maximum subscription amount (initially $500.0 million, subject to adjustment based on other purchases made by Novartis under related agreements or otherwise).

Novartis has an option to purchase newly issued shares of Chiron's common stock directly from Chiron at fair market value, subject to the standstill restrictions described above.

Chiron and Novartis will cooperate in research, development, manufacturing and marketing of biotechnology products on an arm's-length basis while remaining independent to pursue their respective corporate strategies and opportunities.

ITEM 2. PROPERTIES

Emeryville Campus

Our principal executive offices are located in Emeryville, California. As of December 31, 2001, our campus consists of 26 buildings, of which 16 are leased and 10 are owned. Our Emeryville facilities include research and development, manufacturing and administrative facilities for our biopharmaceutical, vaccine and blood testing businesses.

In February 2001, our Board of Directors approved a capital expansion project, which includes the construction of a parking structure and a research and development facility (including a supporting central utility facility) in Emeryville, California. Chiron will own the parking structure. We began construction on the parking structure in June 2001. Related to the research and development facility, we are evaluating

various financing alternatives. We expect to begin construction on the research and development facility in the second half of 2002.

Other Facilities

We also own and lease manufacturing facilities in Vacaville, California used principally for our biopharmaceutical business. The owned facility has available capacity due to lower than expected demand for certain of our products and improved production yields from other facilities. As a result, we have entered into contract manufacturing agreements to utilize this available capacity (see the Biopharmaceuticals section in Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" below).

In December 1999, we sold our Amsterdam facility and are leasing back office and warehouse space for some operational and administrative activities.

We have the following facilities for our biopharmaceutical operations:

- research and development and administrative facilities in Seattle, Washington (leased);
- sales and marketing and administrative facilities in Skokie, Illinois (leased);
- manufacturing and distribution facilities in Annandale, New Jersey (leased);
- several sales offices in Europe and Canada (leased); and
- a sales and marketing and administrative facility in Cranford, United Kingdom (owned).

We have vaccine research and development, manufacturing and administrative facilities for our vaccines business in Siena, Italy; Marburg, Germany; Mumbai, India; and Ankleshwar, India. We also have manufacturing facilities in Rosia, Italy. The Siena, Mumbai, Ankleshwar and Rosia facilities are owned, and the Marburg facilities are leased.

We leased research and development facilities in San Diego, California in connection with our gene therapy activities. We sold this business in January 2001, and the purchaser assumed all facility leases.

We owned research and development, manufacturing and administrative facilities in Claremont, California. We used the facilities principally for our former ophthalmic products business, which we sold to Bausch & Lomb Incorporated in December 1997. Bausch & Lomb occupied a significant portion of the facilities under a three-year lease, which expired in December 2000. We sold the last warehouse on the Claremont campus in April 2001.

We lease a number of other facilities in North America, Europe and Asia, primarily for sales and service offices.

We believe that our current facilities are in good operating condition and are adequate for our current needs; however, we are expanding to meet future requirements. We continually evaluate future requirements for our facilities.

ITEM 3. LEGAL PROCEEDINGS

Bayer Corporation

In January 2002, Bayer Corporation filed a complaint in the United States District Court for the District of Delaware against Chiron relating to the Stock Purchase Agreement dated September 17, 1998 between Chiron, Bayer Corporation and Chiron Diagnostics Corporation. Bayer Corporation alleges that Chiron violated certain representations and warranties made in the Stock Purchase Agreement and additionally seeks damages for alleged misrepresentation and fraud made in connection with the sale of

Chiron Diagnostics Corporation. Based on these allegations, Bayer Corporation seeks both compensatory and punitive damages. It is not known when nor on what basis this matter will be resolved.

Citizens for Consumer Justice, et al.

In December 2001, Citizens for Consumer Justice and 13 other named plaintiffs filed a class action lawsuit in the United States District Court for the District of Massachusetts against 29 biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products, including DepoCyt®, which are reimbursed by Medicare. Plaintiffs allege that defendants violated federal antitrust and racketeering laws by devising and implementing a fraudulent pricing scheme against Medicare and Medicare beneficiaries. Plaintiffs seek a declaratory judgment that defendants violated the Social Security Act, as well as unspecified equitable remedies. It is not known when nor on what basis this matter will be resolved.

Cystic Fibrosis Pharmacy

In May 2000, PathoGenesis Corporation initiated an action against Cystic Fibrosis Pharmacy, Inc. in the United States District Court For The Middle District Of Florida, Orlando Division. PathoGenesis Corporation asserted that Cystic Fibrosis Pharmacy's advertising and sale of an inhaled antibiotic infringes PathoGenesis Corporation's U.S. Patent No. 5,508,269 (the " '269 patent"). PathoGenesis Corporation sought injunctive relief and damages. Cystic Fibrosis Pharmacy filed a counterclaim seeking a declaratory judgment of invalidity regarding the '269 patent. In September 2000, the court entered a consent order enjoining Cystic Fibrosis Pharmacy from advertising, compounding or selling the aerosol formulation alleged to infringe the '269 patent or use any imitation of the TOBI® trademark until further order of the court. On February 1, 2001, the dispute was settled by agreement of the parties. Among the settlement provisions, Cystic Fibrosis Pharmacy acknowledged the validity and enforceability of the '269 patent, agreed not to infringe the '269 patent, and agreed to certain restrictions on future advertising. A Consent Order and Final Judgment setting forth these terms of settlement was entered by the court on April 11, 2001.

Dade Behring Marburg GmbH and Dade Behring S.p.A.

In January 2001, Dade Behring Marburg GmbH and Dade Behring S.p.A. (collectively, "Dade Behring") filed suit in the Court of Milan, Italy against Chiron seeking a pan European declaration that Dade Behring's Enzygnost® HIV 1 /2 plus immunoassay kit does not infringe Chiron's European Patent No. 0 181 150 (the " '150 patent") relating to HIV technology, and to nullify the Italian portion of the '150 patent. In April 2001, Chiron filed a counterclaim seeking a declaration of infringement of the Italian portion of the '150 patent by the Enzygnost® HIV 1 /2 plus kit and related damages. It is not known when nor on what basis this matter will be resolved.

In May 2001, Chiron filed a petition for a preliminary injunction in the German Federal Court ("Landgericht") in Dusseldorf, asserting that the manufacture and sale of Dade's Enzygnost® HIV 1 /2 plus immunoassay kit infringes the '150 patent. In October 2001, the Court ruled that, due to a procedural insufficiency irrelevant to the validity of the patent, Chiron's petition would not be granted. Chiron did not appeal, and the matter is therefore concluded.

Federal Express

On September 3, 1999, Federal Express Corporation filed suit in the Supreme Court of the State of New York, County of Orange against Perseptive Biosystems, Inc., Perkin-Elmer Corporation, PE Biosystems Group and PE Corporation (together, the "PE Defendants") and Chiron. The Federal Express Corporation complaint related to a fire that allegedly destroyed a Federal Express Corporation aircraft and the majority of its cargo in September 1996. The matter was removed to the United States

District Court for the Southern District of New York. In March 2000, the Federal court, on its own motion, dismissed the matter for lack of subject matter jurisdiction. Federal Express Corporation appealed the dismissal, arguing for remand to state court. Defendants filed cross-appeals. In December 2000, the Second Circuit Court of Appeals dismissed those cross-appeals for lack of jurisdiction, and remanded the matter to the Supreme Court of the State of New York, County of Orange. It is not known when nor on what basis this litigation will be concluded.

F. Hoffmann La-Roche A.G.

Chiron was involved in certain previously reported litigation in the U.S. and several other countries with F. Hoffmann-LaRoche AG and related foreign entities (collectively "Roche") concerning infringement and/or validity of certain patents related to hepatitis C virus and HIV technology. In October 2000, Chiron and Roche resolved all litigation regarding hepatitis C virus and HIV nucleic acid technology. Among the settlement provisions, Chiron granted Roche licenses to manufacture and sell hepatitis C virus and HIV nucleic acid clinical diagnostic tests. In May 2001, Chiron further granted Roche licenses to manufacture and sell hepatitis C virus and HIV nucleic acid tests for blood screening.

These licensing agreements, however, did not resolve disputes regarding hepatitis C virus immunoassay technology. In connection therewith, Chiron initiated an action in July 2000 against Roche Diagnostics GmbH in the German Federal Court ("Landgericht") in Dusseldorf, asserting that Roche's manufacture and sale of hepatitis C virus immunoassay products infringe Chiron's German Patent Nos. DD 298 527 (the " '527 patent"), DD 298 524 (the " '524 patent"), DD 287 104 (the " '104 patent"), DD 297 446 (the " '446 patent") (collectively, the "German patents") and Chiron's European Patent No. EP 0 450 931 (the " '931 patent"). The Landgericht subsequently separated the matter into five individual actions, and then stayed oral hearings on the '931 patent and German patents pending results of the nullity proceedings described below.

In July 2000, Chiron initiated an action against Roche Diagnostics GmbH and related foreign entities in the German Administrative Court ("Verwaltungsgericht") in Karlsruhe, asserting that Roche's manufacture and sale of hepatitis C virus immunoassay products in various European countries infringe the '931 patent. Over Roche's objections, the action was referred to the District Court of Mannheim in March 2001. Following an oral hearing on January 18, 2002, Chiron voluntarily withdrew its application with respect to certain jurisdictions and the Court dismissed the case as to the remaining countries finding that it lacked jurisdiction to entertain Chiron's application for cross-border relief with the facts presented. The Court made no finding with regard to validity or infringement of the '931 patent.

In December 2000, Roche initiated two nullity actions against three of Chiron's German patents (the '104, '524 and '527 patents), and the '931 patent in the German Federal Patent Court ("Bundespatentgericht"). In January 2001, the Bundespatentgericht divided these two nullity actions into four separate actions. The Bundespatentgericht has indicated that oral hearings on the nullity actions will not occur before August 2002.

It is not known when nor on what basis the remaining matters will be resolved.

The October 2000 settlement also did not resolve disputes between Chiron and Dr. Daniel Bradley. In January 1998, Chiron initiated an action against Roche and Dr. Daniel Bradley in the United States District Court for the Northern District of California. With respect to Dr. Daniel Bradley, the action asserted that Dr. Daniel Bradley breached a 1990 settlement agreement with Chiron, that Roche wrongfully induced this breach, and that Dr. Daniel Bradley committed slander of title with respect to Chiron's hepatitis C virus technology. In October 2001, Dr. Daniel Bradley and Chiron entered into a consent judgment declaring (1) that Dr. Bradley was not an inventor of the disputed patents or of patents related thereto; (2) that he was properly not named as an inventor of Chiron's hepatitis C virus patents; and (3) that he has no ownership interest in said patents. Chiron and Dr. Bradley entered a confidential settlement agreement on October 25, 2001, which fully resolves Chiron's action against Dr. Bradley.

Gen-Probe Incorporated

In February 2001, Gen-Probe Incorporated filed a demand for arbitration alleging Chiron breached certain of the terms of their June 1998 collaboration agreement regarding nucleic acid tests used for blood screening. Gen-Probe Incorporated seeks various declarations of the parties' rights under the agreement and compensatory damages. Chiron denied Gen-Probe Incorporated's claims and asserted certain cross claims against Gen-Probe Incorporated. In August 2001, the arbitrator entered summary judgment in Chiron's favor on several of the issues in dispute. In October 2001, the arbitrator denied Gen-Probe Incorporated's motion for summary judgment. In December 2001, the dispute was settled by agreement of the parties.

German Red Cross Donation Service and Working Society of Physicians

In October 2001, the German Red Cross Donation Service and Working Society of Physicians brought a complaint against Chiron and Roche before the Commission of the European Communities (the "Commission"). These matters generally allege that Chiron and Roche have engaged in certain anticompetitive actions that violate Articles 81 and 82 of the Treaty Establishing the European Community (the "EC Treaty") in connection with HIV and hepatitis C virus nucleic acid tests in blood screening. Chiron filed its response with the Commission in January 2002. In February 2002, the Sanquin Blood Services Foundation in the Netherlands also filed a complaint against Chiron and Roche before the Commission. The Sanquin complaint was filed in support of the German complaint, and similarly alleges that Chiron and Roche violate Articles 81 and 82 of the EC Treaty in connection with HIV and hepatitis C virus nucleic acid tests in blood screening. Chiron has been informed that blood banking entities from Finland, Luxembourg and United Kingdom have filed similar complaints. It is not known when nor on what basis this matter will be resolved.

Innogenetics N.V.

In November 2000, Innogenetics N.V. brought a complaint against Chiron and Ortho-Clinical Diagnostics Systems, Inc. before the Commission. Innogenetics N.V. alleges that Chiron and Ortho violate Articles 81 and 82 of the Treaty relating to competitive practices. Pursuant to the complaint, the Commission has sought information from Chiron and Ortho-Clinical Diagnostics Systems, Inc. related to hepatitis C virus and HIV licensing practices in the European Union. It is not known when nor on what basis this matter will be resolved.

Lipton et al.

On February 18, 2000, the United States District Court for the Western District of Washington dismissed with prejudice all eight consolidated putative class action lawsuits that had been filed in March and April 1999 against PathoGenesis Corporation, its chief executive officer and its chief financial officer. The eight consolidated lawsuits alleged claims on behalf of all purchasers of PathoGenesis Corporation common stock during the period January 15, 1999 to March 22, 1999. Plaintiffs claimed that PathoGenesis Corporation and its officers violated certain provisions of the federal securities laws by making statements in early 1999 regarding PathoGenesis Corporation's 1998 financial results. The court's order dismissed the consolidated cases and bars plaintiffs from filing another lawsuit on the matter. In October 2001, the United States Court of Appeals for the Ninth Circuit heard oral argument based on plaintiffs' appeal of the dismissal order. It is not known when nor on what basis this matter will be resolved.

Medicare, Medi-Cal Investigations

Chiron is responding to two subpoenas from the Office of the Inspector General of the United States Department of Health and Human Services. Chiron believes the subpoenas were issued in connection with a pending, but as yet unserved, *qui tam* lawsuit against Chiron and a number of pharmaceutical companies

in the United States. With respect to Chiron, the subpoenas relate to pricing to Medicare and state Medicaid programs of certain generic oncology drugs sold by Cetus-Ben Venue Therapeutics, a joint venture between Chiron and Ben Venue Laboratories. Chiron sold its interest in that joint venture in 1996.

Chiron is also responding to a subpoena served on September 18, 2000, by the Office of the Attorney General of the State of California Department of Justice. Chiron believes that the subpoena was issued in connection with a pending, but as yet unserved, *qui tam* lawsuit against Chiron and a number of other pharmaceutical companies. With respect to Chiron, the subpoena seeks information related to pricing to the Medi-Cal program of certain generic oncology drugs sold by Cetus-Ben Venue Therapeutics. It is not known when nor on what basis these matters will be concluded.

Sorin Biomedica/Snia

In June 1994, Sorin Biomedica S.p.A. filed a lawsuit with the Court of Milan, Italy against Chiron and Ortho Diagnostic Systems S.p.A. seeking a declaration of nullity and non-infringement of the Italian counterpart to Chiron's European Patent 0 318 216 (the " '216 patent") claiming hepatitis C virus immunodiagnostic technology. Chiron denied Sorin Biomedica's allegations and filed a counterclaim seeking a declaration of infringement. In February 1997, the Court enjoined Sorin Biomedica from manufacturing or selling hepatitis C virus immunoassay kits in Italy. After Sorin Biomedica made further objections, the Court ruled in October 1999 that certain '216 patent claims were valid and that Sorin Biomedica's hepatitis C virus immunoassay infringed the '216 patent. In June 2000 the European Patent Office Technical Board Of Appeals upheld the validity of the '216 patent in an amended form which deleted claims that Chiron alleged to have been infringed by Sorin Biomedica. In December 2000, Snia S.p.A., Sorin Biomedica's parent company, filed an appeal in the Court of Milan asking the Court to declare the Italian portion of the '216 patent null and void and to award Snia damages. On March 14, 2001, Chiron denied Snia's allegations and

asked the Court to dismiss the case.

In January 2002, Chiron filed a complaint against Snia in the Court of Milan asserting that Snia's manufacture and sale of certain hepatitis C virus immunodiagnostics infringe Chiron's '931 patent. Chiron seeks a declaration of infringement based on the '931 patent, as well as damages. It is not known when nor on what basis these matters will be resolved.

State of Montana ex rel., *Mike McGrath, Attorney General*

In February 2002, the State of Montana through its Attorney General filed a complaint in the First Judicial District Court in Lewis and Clark County against 18 biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products, including DepoCyt®, that are reimbursed by Medicare and Medicaid. The Attorney General alleges that the Defendants violated Montana state and common laws on unfair trade practices and consumer protection, deceptive trade practices, Medicaid fraud, breach of contract and false claims, and seeks both compensatory and punitive damages. It is not known when nor on what basis this matter will be resolved.

Washington Research Foundation

In March 2001, the Washington Research Foundation filed a demand for arbitration with the American Arbitration Association alleging Chiron breached the terms of a February 1989 license agreement regarding patents claiming recombinant yeast expression production technology jointly held by Washington Research Foundation and Genentech, Inc., and that the license agreement was therefore terminated. Washington Research Foundation sought either a judgment declaring the license agreement terminated and royalty damages accrued up to the alleged termination date, or in the case that the license agreement was held not to have terminated, royalty damages accrued up to the judgment date. In April 2001, Chiron responded to the arbitration demand, denying that it was in breach of the license, and Chiron also filed suit against Washington Research Foundation and Genentech, Inc. in the United States

District Court for the Northern District of California seeking to have the underlying Washington Research Foundation and Genentech, Inc. U.S. patents declared invalid. In February 2002, the dispute was settled by agreement of the parties.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were brought to a vote of Chiron's stockholders in the quarter ended December 31, 2001.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company, who serve at the discretion of the Board of Directors, are as follows, in alphabetical order:

Name	Age	Title
Rajen K. Dalal	48	Vice President; President, Chiron Blood Testing
William G. Green	57	Senior Vice President, General Counsel and Secretary
Peder K. Jensen	47	Vice President; Head of Development
John A. Lambert	49	Vice President; President, Chiron Vaccines
Séan P. Lance	54	Chairman of the Board; President and Chief Executive Officer
Linda W. Short	56	Vice President, Corporate Resources
David V. Smith	42	Vice President, Finance and Principal Accounting Officer
James R. Sulat	51	Vice President, Chief Financial Officer
Craig A. Wheeler	41	Vice President; President, Chiron BioPharmaceuticals

Mr. Dalal joined Chiron in December 1991 as Vice President, Corporate Development. In 1998, he was appointed President of Chiron Blood Testing. From 1983 until joining Chiron, he was employed by the international consulting firm of McKinsey & Company, where he performed general management consulting in the firm's pharmaceuticals, medical devices and diagnostics industries practice. In January 2001,

Mr. Dalal was appointed to the Department of Health and Human Services' Advisory Committee on Blood Safety and Availability, which advises, assists and counsels the Secretary of Health and Human Services on implications for blood safety and availability in areas such as blood banking, transfusion medicine, bioethics and blood testing. In February 2002, Mr. Dalal joined the Board of Directors for Sagres Discovery. Mr. Dalal resigned from his positions with Chiron to be effective as of March 11, 2002.

Mr. Green joined Chiron as Vice President and General Counsel in October 1990, having served as Secretary or Assistant Secretary since Chiron's inception in 1981. In February 1992, he became Senior Vice President, General Counsel and Secretary. From 1981 to 1990, he was a partner in the San Francisco law firm of Brobeck, Phleger & Harrison.

Dr. Jensen joined Chiron as Vice President and Head of Development in August 1999, responsible for managing all aspects of Chiron's product development, including pre-clinical, clinical, project management, regulatory and medical affairs. Most recently, Dr. Jensen was development director, chief medical officer and a member of the board of British Biotech plc, and President of British Biotech, Inc., responsible for all aspects of drug development including chemical, pharmaceutical and clinical development, quality control and assurance, manufacturing and regulatory affairs. Dr. Jensen served as a non-executive director of British Biotech plc until January 31, 2001. From 1991 to 1998, Dr. Jensen was a Vice President at Schering-Plough Research Institute, where he managed a number of worldwide drug development projects, including the submission of several New Drug Applications, Abbreviated New Drug Applications, Investigational New Drug applications and a number of European applications. Before joining Schering-Plough, Dr. Jensen worked in various clinical positions at Ciba-Geigy Limited.

Mr. Lambert joined Chiron as Vice President; President of Chiron Vaccines in March 2001. Based in Europe, Mr. Lambert is responsible for the commercial operations of Chiron's global vaccines business. Prior to joining Chiron, Mr. Lambert headed John Lambert Associates, a company that provided consulting and coaching at the chief executive level to organizations both in the United Kingdom and internationally. From 1998 to 2000, Mr. Lambert was the President of Aventis Pasteur MSD, where he

headed the vaccines venture formed between Pasteur Mérieux Connaught (now Aventis Pasteur) and Merck and Company, Inc. following four years as that company's Vice President of Operations. From 1987 to 1994, Mr. Lambert held various positions with the Pasteur Mérieux Connaught Group, in increasing levels of responsibility, including Managing Director, Mérieux UK Ltd. Mr. Lambert also is the President of the European Vaccine Manufacturers. Mr. Lambert is a non-executive director of a U.K. Stock Exchange listed company, S.R. Pharma PLC in London, which conducts research in the fields of cancer and allergy. He is a Fellow of the Institute of Financial Accountants. Mr. Lambert also heads his own company, J.G. Solutions Ltd. in the United Kingdom.

Mr. Lance joined Chiron as President and Chief Executive Officer in May 1998, and became Chairman of the Board in May 1999. Mr. Lance joined Chiron from Glaxo Wellcome plc where he spent more than 12 years in positions of national and global management responsibility including positions as Chief Operating Officer and Chief Executive designate of Glaxo Wellcome plc. Mr. Lance began his pharmaceutical industry career in the Republic of South Africa at the Noristan Group of Companies, Ltd. in 1967. Mr. Lance has assumed leadership roles in a variety of national and international pharmaceutical associations, and is a past president of the International Federation of Pharmaceutical Manufacturers Associations. Mr. Lance currently serves on the Board of Directors for the California Healthcare Institute, Global Alliance for TB Drug Development, Bay Area Bioscience and iKnowMed.

Ms. Short joined Chiron in November 1997 as Vice President, Human Resources. In May 1999, she was promoted to Vice President, Corporate Resources with increased responsibilities, overseeing human resources, facilities planning, information management, organizational learning, payroll and benefits, compensation and stock administration. Prior to joining Chiron, she was the Director of Human Resources of Industrial Indemnity from 1994 to 1997. From 1983 to 1994, Ms. Short held various managerial positions with the Bank of America.

Mr. Smith joined Chiron as Vice President, Controller in February 1999 and was designated Chiron's principal accounting officer. In February 2002, Mr. Smith was appointed Vice President, Finance. Prior to joining Chiron, Mr. Smith served as the Vice President, Finance and Chief Financial Officer of Anergen, Inc. from 1997 until he joined Chiron. From 1988 to 1997, Mr. Smith held various financial management positions with Genentech, Inc., in both the United States and Europe, most recently as Director of Accounting.

Mr. Sulat joined Chiron as Vice President, Chief Financial Officer in April 1998. He was the Chief Financial Officer of Stanford Health Services, the clinical healthcare delivery arm of the Stanford University Medical Center, from 1993 to October 1997. In November 1997, Stanford Health Services merged with the hospital facilities of the University of California, San Francisco, and Mr. Sulat served as the Treasurer of the merged entity, UCSF Stanford Health Care, until joining Chiron. Mr. Sulat is also a director of Vans, Inc., a shoe manufacturer, and several private companies.

Mr. Wheeler joined Chiron in August 2001 as Vice President; President of Chiron Biopharmaceuticals, responsible for the commercial operations of Chiron's biopharmaceuticals business. Prior to joining Chiron, Mr. Wheeler was a senior member of The Boston Consulting Group's health care practice and a key contributor to the firm's practice in hospital strategy, disease management, and pharmaceutical capabilities. Based in Boston, he joined the firm in 1988. Before joining The Boston Consulting Group, Mr. Wheeler worked for Merck's MSDRL research unit, where he served as a senior engineer in process development. He recently served as the leader of The Boston Consulting Group's Scientist's Network. In partnership with the Rockefeller Foundation, he has joined the Global Alliance for TB Drug Development, a public-private partnership to develop new anti-tuberculosis drugs.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded in the NASDAQ National Market System under the symbol CHIR. As of December 31, 2001, there were 4,757 holders of record of Chiron common stock and no remaining holders of record of Cetus Corporation common stock or Viagene, Inc. common stock, corporations we acquired in 1991 and 1995, respectively. We have declared no cash dividends since our inception and do not expect to pay any dividends in the foreseeable future. Pursuant to an agreement with Novartis, it is required that Novartis approve our declaration and payment of dividends. See "Relationship with Novartis" above. The quarterly high and low closing sales prices (rounded to the nearest one-hundredth) of our common stock for 2001 and 2000 are shown below.

	2001		2000	
	High	Low	High	Low
First Quarter	$ 48.05	$ 37.06	$ 67.56	$ 39.44
Second Quarter	55.28	40.69	49.75	34.13
Third Quarter	52.26	41.44	59.13	41.25
Fourth Quarter	56.80	42.26	50.44	37.63

ITEM 6. SELECTED FINANCIAL DATA

	Year Ended December 31,				
	2001	2000	1999	1998	1997
	(In thousands, except per share data)				
Total revenues	$ 1,140,667	$ 972,119	$ 762,646	$ 736,673	$ 574,599
Income from continuing operations	174,758	16,102	128,404	75,998	25,782
Basic earnings per share from continuing operations	0.92	0.09	0.71	0.43	0.15
Diluted earnings per share from continuing operations	0.90	0.08	0.69	0.42	0.14
Total assets	2,873,452	2,458,076	2,444,778	2,524,264	1,768,478
Long-term debt	408,917	3,039	96,958	338,158	397,217

Factors that affected the comparability of information between 2001 and 2000 were (i) issuance of zero coupon Liquid Yield Option Notes in June 2001 for proceeds of $401.8 million, (ii) a full-year of TOBI® sales of $123.1 million and (iii) a full year of amortization expense on goodwill and other acquired intangible assets of $38.4 million recognized in 2001 as a result of our acquisition of PathoGenesis Corporation in the fourth quarter 2000. In 2000, we recognized TOBI® sales of $27.8 million (including $2.2 million from the last seven days in September 2000) and amortization expense on goodwill and other acquired intangible assets of $9.6 million. We have described the issuance of the Liquid Yield Option Notes in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Sources and Uses of Cash Financing activities" below. We have described the acquisition of PathoGenesis in both Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Biopharmaceuticals Product sales" and "Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Other Amortization expense" below.

Factors that affected the comparability of information between 2000 and 1999 were (i) shipments of $101.5 million of Menjugate for a universal vaccination program in the United Kingdom, which began in the second quarter 2000 and (ii) our acquisition of PathoGenesis for $720.7 million in cash in the fourth

quarter 2000, including the $171.6 million write-off of purchased in-process technologies. We described the universal vaccination program in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Vaccines Product sales" of the Form 10-K filed for the fiscal year ended December 31, 2000. We described the acquisition of PathoGenesis in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Other Write-off of purchased in-process technologies" of the Form 10-K filed for the fiscal year ended December 31, 2000.

A factor that affected the comparability of information between 1998 and 1997 was our acquisition of the remaining 51% interest in, and subsequent consolidation of, Chiron Behring GmbH & Co. for $54.8 million in cash in the second quarter 1998. Chiron Behring contributed revenues of $119.2 million and a loss from continuing operations before income taxes of $6.7 million to our consolidated operating results in 1998. We described this transaction in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Sources and Uses of Cash" of the Form 10-K filed for the fiscal year ended January 3, 1999.

See Note 16, "Segment Information," of Notes to Consolidated Financial Statements for operating results by operating segment.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We are a global pharmaceutical company that participates in three healthcare markets: biopharmaceuticals, vaccines and blood testing. The biopharmaceuticals segment consists of therapeutic products and services, with an emphasis on the treatment of cancer and infectious disease, using the development and acquisition of technologies related to therapeutic proteins and small molecules. The biopharmaceuticals segment also includes collaborations with Berlex Laboratories, Inc. and its parent company, Schering AG of Germany, related to Betaseron®, and Ortho-McNeil Pharmaceutical, Inc., a Johnson & Johnson company, related to PDGF. The vaccines segment consists principally of adult and pediatric vaccines for viral infections including flu, rabies and tick-borne encephalitis, and bacterial infections, including meningococcus C and haemophilius influenzae type B. We sell these vaccines primarily in Germany, Italy, the United Kingdom, Canada and other international markets. Our vaccines segment is also involved in the development of novel vaccines and vaccination technology. The blood testing segment consists of an alliance with Gen-Probe Incorporated and our one-half interest in the pretax operating earnings of our joint business with Ortho-Clinical Diagnostics, Inc., a Johnson & Johnson company. Our alliance with Gen-Probe is focused on commercializing and selling nucleic acid testing products using transcription-mediated amplification technology to screen donated blood and plasma products for viral infection. Our joint business with Ortho-Clinical Diagnostics sells a line of immunodiagnostic tests to detect hepatitis viruses and retroviruses and provides supplemental tests and microplate-based instrument systems to automate test performance and data collection. We view certain other revenues and expenses as not belonging to any one segment. As a result, we have aggregated these items into an "Other" segment.

The preparation of financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to investments; inventories; derivatives; intangible assets; product discounts, rebates and returns; bad debts; collaborative, royalty and license arrangements; restructuring; pension and other post-retirement benefits; income taxes; and litigation and other contingencies. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form our basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Investments We invest in debt and equity securities. The price of these securities is subject to significant volatility. We record an impairment charge when we believe that an investment has experienced a decline in value that is other than temporary. Generally, we believe that an investment is impaired if its market value has been below its carrying value for each trading day in a six-month period. Changes in the market price of these securities may impact our profitability.

Inventories We maintain inventory reserves primarily for product lot failures, recalls and obsolescence. The manufacturing processes for many of our products are complex. Slight deviations anywhere in the manufacturing process may result in unacceptable changes in the products that may result in lot failures or recalls and, therefore, additional inventory reserves. In addition, we operate in a highly competitive environment, with rapidly changing technologies. New technology frequently results in product obsolescence. As a result, we may be required to record additional inventory reserves.

Derivatives We use various derivatives to reduce foreign exchange and equity securities risks. We maintain our derivatives with major financial institutions. We manage the risk of counterparty default on our derivatives through the use of credit standards, counterparty diversification and monitoring of counterparty financial conditions. An adverse change in the financial condition of our counterparties could deem our derivatives ineffective, resulting in a premature charge to operations. On the date that we enter into derivative contracts, we designate them as either (1) a hedge of the fair value of a recognized asset or liability or an unrecognized firm commitment (fair value hedge); (2) a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge); or (3) a hedge of a net investment in a foreign operation (net investment hedge). Currently, we utilize fair value and cash flow hedges. Changes in the fair value of derivatives are recorded each period in earnings or comprehensive income, depending on whether the derivative is designated as a hedge and, if it is, depending on the type of hedge. For fair value hedges, changes in the fair value of the derivative are generally offset in the income statement by changes in the fair value of the item being hedged. For cash flow hedges, we report changes in the fair value of the derivative in other comprehensive income to the extent of effectiveness. Also related to cash flow hedges, we reclassify any amounts recorded in other comprehensive income to earnings in the period in which the derivative matures and the underlying asset or liability is sold. We deem all time value changes as ineffective and recognize them immediately in earnings.

Product returns For existing and acquired products, we maintain accruals for product returns based on historical return information. For new products, we estimate our accruals for product returns based on the specific terms for product returns and our projected sales figures for those products. If actual product returns are greater than our estimates, additional product return accruals may be required.

Bad debts We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Collaborative, royalty and license arrangements We defer and recognize up-front refundable fees as revenues upon the later of when they become nonrefundable or when performance obligations are completed. In situations where we have no continuing performance obligations, we recognize up-front nonrefundable fees as revenues when receivable. In situations where continuing performance obligations exist, we defer and amortize up-front nonrefundable fees over the performance period. The terms of such arrangements may cause our operating results to vary considerably from period to period. Specific to royalty revenues, we estimate royalty revenues based on product sales information provided by the third party or previous period actual product sales. In the subsequent quarter, we record an adjustment equal to the difference between those royalty revenues recorded in the previous quarter and the contractual percentage of the third party's actual product sales for that period.

Income taxes We record valuation allowances to reduce deferred tax assets to the amounts that are more likely than not to be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for valuation allowances. If we determined that we would be able to realize our deferred tax assets in the future in excess of our net deferred tax assets, adjustments to the deferred tax assets would increase income in the period that we made such determination. Likewise, if we determined that we would not be able to realize all or part of our net deferred tax assets in the future, adjustments would be charged to income in the period that we made such determination.

Litigation and other contingencies We maintain accruals for litigation and other contingencies when we believe a loss to be probable and reasonably estimated, as required by Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." We base our accruals on information available at the time of such determination. Information may become available to us after that time, for which additional accruals may be required.

The accounting policies of our reportable segments are the same as those described in Note 1, "The Company and Summary of Significant Accounting Policies," in the Notes to Consolidated Financial Statements.

On February 20, 2002, we acquired Matrix Pharmaceutical, Inc., a company that develops drugs (including tezacitabine) to treat cancer. We will account for the acquisition as an asset purchase and include Matrix Pharmaceutical's operating results in our consolidated operating results beginning on March 1, 2002. Matrix Pharmaceutical's operating results for the remaining business days in February 2002 were not significant to our consolidated operating results. Matrix Pharmaceutical will be part of our biopharmaceuticals segment.

On September 21, 2000, we acquired PathoGenesis Corporation, a company that developed and marketed drugs to treat infectious diseases, particularly serious lung infections. We accounted for the acquisition under the purchase method of accounting and included PathoGenesis' operating results, including the seven business days from September 21 to 30, 2000, in our consolidated operating results beginning on October 1, 2000. PathoGenesis' operating results for the seven business days in September 2000 were not significant to our consolidated operating results. PathoGenesis is part of our biopharmaceuticals segment.

On December 29, 1997, we completed the sale of Chiron Vision, our ophthalmics business to Bausch & Lomb Incorporated, and on November 30, 1998, we completed the sale of Chiron Diagnostics, our *in vitro* diagnostics business, to Bayer Corporation. Our Consolidated Statements of Operations reflect the after-tax results of Chiron Vision and Chiron Diagnostics as discontinued operations.

Certain minor arithmetical variances between the narrative and the consolidated financial statements may arise due to rounding.

Results of Operations

Biopharmaceuticals

Product sales Biopharmaceutical product sales were $337.9 million, $239.8 million and $187.6 million in 2001, 2000 and 1999, respectively. Biopharmaceutical product sales in 2001 consisted principally of Betaseron®, TOBI®, Proleukin® and PDGF. Biopharmaceutical product sales in 2000 and 1999 consisted principally of Betaseron®, Proleukin® and PDGF.

Betaseron® We manufacture Betaseron® for sale outside of Europe by Berlex Laboratories, Inc. and its parent company, Schering AG of Germany. Betaseron® is approved for relapsing/remitting multiple sclerosis in over 60 countries, including the U.S. and the European Union, and for secondary progressive multiple sclerosis in approximately 40 countries, including the European Union, Canada, Australia and New Zealand. We recognize a portion of revenue for product sales of Betaseron® upon shipment to Berlex Laboratories and Schering, and the remainder based on a contractual percentage of sales by Berlex Laboratories and Schering. We also earn royalties on Schering's European sales of Betaferon®, which we record in royalty and license fee revenues for the biopharmaceuticals segment.

Betaseron® product sales were $96.4 million, $82.1 million and $66.0 million in 2001, 2000 and 1999, respectively. The increases in Betaseron® product sales in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily related to fluctuations in Berlex Laboratories and Schering's inventory levels and increased underlying sales to end users in the U.S. and other countries driven by increased

utilization of beta interferon therapy for multiple sclerosis. As discussed in "Royalties and license fee revenues" below, Betaferon® royalties also increased in 2001 as compared with 2000, and in 2000 as compared with 1999. The increase in Betaseron® product sales in 2000 as compared with 1999 also included the effects of the second quarter 1999 conclusion of certain promotional pricing campaigns. Inventory levels may continue to fluctuate as Berlex Laboratories changes its distribution structure in the U.S.

Pursuant to the agreement with Schering, we will begin to supply Betaferon® to Schering in the fourth quarter 2002 for the European market. This will result in a shift of revenue recognized under this agreement to product sales, with a commensurate decrease in royalty revenues, in 2003.

TOBI® We obtained TOBI® as part of our acquisition of PathoGenesis Corporation on September 21, 2000. We sell TOBI® directly in the U.S. and certain international markets. The U.S. Food and Drug Administration approved TOBI® for cystic fibrosis lung infections in December 1997. PathoGenesis launched TOBI® in the U.S. in January 1998. TOBI® was approved in Canada in February 1999. TOBI® cleared the mutual recognition process required for marketing in the European Union in August 2000 and was subsequently launched in several European countries. We recognized TOBI® sales of $123.1 million and $27.8 million (including $2.2 million from the last seven days in September 2000) in 2001 and 2000, respectively. Sales of TOBI® by Chiron and PathoGenesis were $86.0 million and $60.1 million in 2000 and 1999, respectively. The growth was due to (i) increased TOBI® use in the U.S. and Canada by patients with cystic fibrosis and (ii) increased TOBI® sales related to the launch in various European countries. We continue to pursue the use of TOBI® to treat other serious lung infections and to seek approval in other countries. Wholesaler inventory management practices and foreign exchange rate fluctuations may influence future TOBI® sales.

Proleukin® Proleukin® is approved in over 50 countries for the treatment of metastatic (stage 4) renal cell carcinoma and in Canada and the U.S. for the treatment of metastatic (stage 4) melanoma, for which it became the first approved therapy in more than 20 years when the U.S. Food and Drug Administration approved it in 1998. Sales of Proleukin® were $93.3 million, $112.7 million and $111.8 million in 2001, 2000 and 1999, respectively. Proleukin® product sales in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily were affected by (i) fluctuations in wholesaler inventory management practices, (ii) the increasing cost sensitivity from reimbursement authorities, particularly in Europe, and (iii) a weaker exchange rate of the Euro as compared with the U.S. dollar. We expect these factors to continue into 2002.

PDGF We manufacture PDGF for Ortho-McNeil Pharmaceutical, Inc., a Johnson & Johnson company. PDGF is the active ingredient in Regranex® Gel, a treatment for diabetic foot ulcers. The U.S. Food and Drug Administration approved Regranex® Gel in December 1997. Ortho-McNeil Pharmaceutical launched it in early 1998. Regranex® Gel was approved to treat diabetic foot ulcers in Canada in December 1998 and Europe in March 1999. Net sales of PDGF to Ortho-McNeil Pharmaceutical were $11.3 million and $10.9 million in 2001 and 2000, respectively. There were no commercial sales of PDGF to Ortho-McNeil Pharmaceutical from the first quarter 1999 through the first quarter 2000, as our 1998 sales had filled Ortho-McNeil Pharmaceutical's inventory requirements. The increase in PDGF product sales in 2000 as compared with 1999 primarily was due to the resumption of commercial sales to Ortho-McNeil Pharmaceutical. In addition, net sales of PDGF in 2000 included a decrease in the product returns allowance of $3.7 million primarily due to additional historical return information provided by Johnson & Johnson. Historically, our sales of PDGF have fluctuated based upon the inventory management practices of Ortho-McNeil Pharmaceutical.

The balance of product sales recognized in our biopharmaceuticals segment consisted of various other products, which individually were not material.

We expect competitive pressures related to many of our biopharmaceutical products to continue into the foreseeable future, primarily as a result of the introduction of competing products into the market, as listed in Part I, Item 1., "Business Competition" above.

Collaborative agreement revenues We recognize collaborative agreement revenues for fees received as we perform research services and achieve specified milestones. Our biopharmaceuticals segment recognized collaborative agreement revenues of $25.0 million, $17.6 million and $20.0 million in 2001, 2000 and 1999, respectively.

Novartis Under the terms of a November 1995 agreement with Novartis AG, we granted Novartis a license to utilize our combinatorial chemistry techniques. In exchange for this license, Novartis paid us $26.0 million over a five-year period. In addition, this agreement provided for research funding by Novartis, and certain up-front milestone and royalty payments, as well as product commercialization rights for both parties. This agreement expired in the fourth quarter 2000. In 2000 and 1999, we recognized collaborative agreement revenues of $3.3 million and $4.2 million, respectively.

In November 1996, Chiron and Novartis entered into a consent order with the Federal Trade Commission. We granted a royalty-bearing license to Rhone-Poulenc Rorer, Inc. under certain of our patents related to the Herpes Simplex Virus-thymidine kinase gene in the field of gene therapy. Chiron and Novartis entered into a separate agreement which provided, among other things, for certain cross licenses between Chiron and Novartis, and under which Novartis paid us $60.0 million over five years. In connection with this agreement, we recognized collaborative agreement revenues of $10.0 million in 2001, 2000 and 1999. This agreement expired in the fourth quarter 2001.

Our "Other" segment also earns collaborative agreement revenues under a third Novartis agreement. See "Other Collaborative agreement revenues" below.

*S*BIO* In the second quarter 2000, we invested in a Singapore-based venture, S*BIO Pte Ltd, to research and develop therapeutic, diagnostic, vaccine and antibody products (see "Liquidity and Capital Resources Sources and uses of cash Investing activities" below). We also granted S*BIO certain rights to our gene expression and combinatorial chemistry technology. Under this arrangement, we will receive approximately $22.0 million over two years for technology transfer. We recognized collaborative agreement revenues of $12.1 million and $2.8 million in 2001 and 2000, respectively, under this arrangement.

Medivir In 1999, Medivir AB licensed certain of our combinatorial chemistry technology in the research and development of pharmaceuticals for human use. Revenue recognized under this agreement was $2.0 million in 1999.

The balance of collaborative agreement revenues recognized in our biopharmaceuticals segment consisted of various other agreements, which individually were not material.

Collaborative agreement revenues tend to fluctuate based on the amount of research services performed, the status of projects under collaboration and the achievement of milestones. Due to the nature of our collaborative agreement revenues, results in any one period are not necessarily indicative of results to be achieved in the future. In addition, the collaboration agreements typically provide for certain milestone payments and various royalties on future product sales if the collaborative partners commercialize a product using our technology. However, we have no assurance that the collaborative partners will meet their development objectives or commercialize a product using our technology. Also, our ability to generate additional collaborative agreement revenues may depend, in part, on our ability to initiate and maintain relationships with potential and current collaborative partners. We have no assurance that new relationships will be established or that current collaborative agreement revenues will not decline.

Royalty and license fee revenues Our biopharmaceuticals segment earns royalties on third party sales of several products, including Betaferon® and recombinant insulin and glucagon products. Our biopharmaceuticals segment also earns license fees for technologies, such as hepatitis C virus patents, used

by third parties to develop therapeutic products. The biopharmaceuticals segment recognized royalty and license fee revenues of $59.8 million, $50.9 million and $52.4 million in 2001, 2000 and 1999, respectively.

Betaferon® We earn royalties on Schering AG's European sales of Betaferon®. In 2001, 2000 and 1999, we recognized $38.9 million, $35.7 million and $29.7 million, respectively, under this arrangement. As discussed in "Product sales Betaseron®" above, the increases in Betaferon® in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily related to increased utilization of beta interferon therapy for multiple sclerosis, offset by a weaker exchange rate of the Euro as compared with the U.S. dollar. Betaferon® is the only product that is approved in Europe for the treatment of both relapsing/remitting and secondary progressive multiple sclerosis. As discussed in "Product sales Betaseron®" above, we will begin to supply Betaferon® to Schering in the fourth quarter 2002 for the European market. This will result in a shift of revenue recognized under this agreement to product sales, with a commensurate decrease in royalty revenues, in 2003.

Novo Nordisk We estimate recombinant insulin and glucagon royalty revenues based on previous period actual recombinant insulin and glucagon product sales by Novo Nordisk AS. We recognized $6.9 million, $6.1 million and $11.2 million in 2001, 2000 and 1999, respectively, under this arrangement. The decrease in 2000 as compared with 1999 primarily related to a $5.0 million positive adjustment related to a royalty audit recovery in 1999.

DepoCyt® In the fourth quarter 2000, we recognized a license fee of $3.5 million upon the resumption of phase 4 clinical trials for DepoCyt® in December 2000. In the second quarter 1999, we recognized a license fee of $9.7 million upon the grant of a European and Canadian DepoCyt® license to SkyePharma plc in April 1999.

Glaxo In March 2000, we granted Glaxo Group Limited (now part of GlaxoSmithKline plc) rights under certain of our hepatitis C virus patents, for which we recognized a license fee in the first quarter 2000.

Japan Tobacco In January 2001, we granted Japan Tobacco, Inc. rights under certain of our hepatitis C virus patents. The agreement provides for the payment of a license fee, which we received and recognized as revenue in the first quarter 2001.

Zarix In January 2001, we granted Zarix Incorporated rights under our recombinant protein technology, for which we recognized a license and technology transfer fee in the second quarter 2001.

Bristol-Myers Squibb In July 2001, we granted Bristol-Myers Squibb Company rights under certain of our hepatitis C virus patents, for which we recognized a license fee in the third quarter 2001.

Schering In October 2001, we granted Schering AG rights relating to the technology used in the manufacturing of Hirudin, for which we recognized a license fee in the fourth quarter 2001.

The balance of royalty and license fee revenues recognized in our biopharmaceuticals segment consisted of various other agreements, which individually were not material.

Royalty and license fee revenues may fluctuate based on the nature of the related agreements and the timing of receipt of license fees. Results in any one period are not necessarily indicative of results to be achieved in the future. Also, the license agreements typically provide for certain milestone payments and various royalties on future product sales if the licensees commercialize a product using our technology. However, we have no assurance that the licensees will meet their development objectives or commercialize a product using our technology. In addition, our ability to generate additional royalty and license fee revenues may depend, in part, on our ability to market and capitalize on our technologies. We have no assurance that we will be able to do so or that future royalty and license fee revenues will not decline.

Other revenues Our biopharmaceuticals segment recognized other revenues of $19.7 million, $16.4 million and $14.9 million in 2001, 2000 and 1999, respectively.

Contract manufacturing revenues Our biopharmaceuticals segment recognized contract manufacturing revenues of $16.1 million in 2001 and $13.3 million for both 2000 and 1999, respectively. The increase resulted from the level of activity and the timing of contract manufacturing activities.

Other In the fourth quarter 2001, we recognized $2.0 million related to a royalty audit recovery.

The balance of other revenues recognized in our biopharmaceuticals segment consisted of various other arrangements, which individually were not material.

Other revenues recognized in our biopharmaceuticals segment may fluctuate due to the nature of the revenues recognized and the timing of events giving rise to these revenues. We cannot guarantee that we will be successful in obtaining additional revenues or that these revenues will not decline.

Gross profit Biopharmaceutical gross profit as a percentage of net product sales was 71%, 70% and 68% in 2001, 2000 and 1999, respectively. The increase in biopharmaceutical gross profit margins in 2001 as compared with 2000 primarily related to a more favorable mix of biopharmaceutical product sales, including TOBI®, offset by a decrease in gross profit margins caused by the timing of Betaseron® shipments. The increase in biopharmaceutical gross profit margins in 2000 as compared with 1999 primarily related to a favorable mix of biopharmaceutical product sales.

We are obligated to pay royalties on sales of certain therapeutic products in the U.S. and in Europe to the former limited partners of Cetus Healthcare Limited Partnership (see Note 12, "Commitments and Contingencies," in the Notes to Consolidated Financial Statements). One of these agreements expired on December 31, 2001. As a result, we expect gross profit margins in 2002 to be slightly higher than 2001. However, biopharmaceutical gross profit percentages may fluctuate significantly in future periods as the biopharmaceutical product and customer mixes change.

Research and development Our biopharmaceuticals segment recognized research and development expenses of $265.9 million, $221.8 million and $214.1 million in 2001, 2000 and 1999, respectively. The increase in research and development spending in 2001 as compared with 2000 was due to the furtherance of our clinical trials related to tifacogin (recombinant Tissue Factor Pathway Inhibitor) for severe sepsis, Proleukin® for HIV and progress in various other development platforms, including those obtained as part of the acquisition of PathoGenesis Corporation on September 21, 2000. In December 2001, we entered into a collaboration agreement with Inhale Therapeutic Systems, Inc. related to, among other things, the development of an inhaled TOBI® product for the treatment of *pseudomonas aeruginosa* in cystic fibrosis patients. The increases were offset by the conclusion of phase 2 clinical trials for Fibroblast Growth Factor for coronary and peripheral artery diseases and a reduction in gene therapy activities with the sale of the San Diego facility in January 2001 (see "Gain (loss) on sale of assets" below).

The increase in 2000 as compared with 1999 was due to the furtherance of clinical trials related to Proleukin® for HIV and tifacogin for severe sepsis, offset by the timing of various other clinical trials, including Fibroblast Growth Factor for coronary and peripheral artery diseases. In addition, the acquisition of PathoGenesis contributed research and development expenses of approximately $9.0 million in 2000.

Research and development expenses may fluctuate from period to period depending upon the stage of certain projects and the level of pre-clinical and clinical trial-related activities.

Selling, general and administrative Our biopharmaceuticals segment recognized selling, general and administrative expenses of $79.8 million, $50.1 million and $50.0 million in 2001, 2000 and 1999, respectively. The increase in selling, general and administrative expenses in 2001 as compared with 2000 primarily was due to the acquisition of PathoGenesis Corporation, and increased sales and marketing costs related to the relaunch of DepoCyt® in the first quarter 2001. Selling, general and administrative expenses

in 2000 also were affected by our worldwide implementation of an integrated information system in April 1999, offset by a change in the method of allocating certain legal costs to segments. Beginning in 2000, we allocated certain legal costs to the "Other" segment, whereas in 1999, we allocated these certain legal costs to all segments.

Vaccines

Product sales We sell pediatric and adult vaccines in Germany, Italy, the United Kingdom, Canada and other international markets. Certain of our vaccine products, particularly our flu vaccine, are seasonal and typically have higher sales in the second half of the year. In addition, we expect Menjugate sales to continue to fluctuate as public health authorities potentially adopt broad vaccination programs. Vaccine product sales were $365.8 million, $344.5 million and $208.7 million in 2001, 2000 and 1999, respectively.

The fluctuations in product sales in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily were due to sales of Menjugate , our conjugate vaccine against meningococcal meningitis caused by the bacterium N. meningitidis serogroup C. Menjugate sales commenced in 2000 and amounted to $105.6 million and $114.9 million in 2001 and 2000, respectively. During 2001, shipments to the United Kingdom continued and shipments to Canada commenced, which offset the significant shipments that occurred during 2000. In 2000, we shipped $101.5 million of Menjugate to the National Health Service under a tender to begin a universal vaccination program in the United Kingdom. We are exploring opportunities for additional Menjugate sales in other countries.

Sales of all other vaccine products were $260.2 million, $229.6 million and $208.7 million in 2001, 2000 and 1999, respectively. Contributing to the increase in 2001 other vaccine product sales as compared with 2000 was an increase in (i) tick-borne encephalitis vaccine sales, attributed to regulatory problems of certain of our competitors, (ii) influenza vaccine sales, as we were the first to the German market this season and (iii) rabies vaccine sales, due to greater market penetration.

Contributing to the increase in 2000 other vaccine product sales as compared with 1999 was an increase in flu vaccine sales, attributed to (i) increasing demand, (ii) manufacturing problems of certain of our competitors and (iii) the launch of Fluad , our adjuvanted influenza vaccine, in Germany and Austria. In May 2000, we received approval in certain western European countries to market Fluad . The 2000 increase also was attributable to the re-launch of our tick-borne encephalitis vaccine. In the first half of 1999, our tick-borne encephalitis vaccine inventory failed to meet manufacturing specifications for purity and a portion of inventory was written off.

We expect competitive pressures related to many of our vaccine products to continue into the future, primarily as a result of the introduction of competing products into the market, including, but not limited to, new combination vaccines, as listed in Part I, Item 1., "Business Competition" above.

Royalty and license fee revenues Our vaccines segment earns royalties on third party sales of and license fees on several products. The vaccines segment recognized royalty and license fee revenues of $16.5 million, $29.0 million and $30.5 million in 2001, 2000 and 1999, respectively.

SmithKline Beecham An agreement with SmithKline Beecham (now part of GlaxoSmithKline plc) provides for royalties on sales of certain vaccine products. Under this agreement, we recognized $6.1 million, $7.0 million and $7.3 million of such royalties in 2001, 2000 and 1999, respectively. The decreases in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily were due to a decrease in GlaxoSmithKline sales due to competitive vaccine products.

Other In 2001, 2000 and 1999, we recognized $10.4 million, $19.0 million and $23.2 million, respectively, of royalty revenues primarily on third party sales of hepatitis B virus vaccine products. The decrease in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily related to a decrease in sales of hepatitis B virus vaccine products due to competitive multivalent hepatitis B virus

vaccine products. In addition, certain terms of one of the hepatitis B virus arrangements expired in the third quarter 2001. The decrease in 2000 as compared with 1999 also related to a hepatitis A virus royalty arrangement, which expired in 1999, and, to a lesser extent, a rabies royalty arrangement, which expired in the second quarter 1999.

The balance of royalty and license fee revenues recognized in our vaccines segment in 2000 consisted of another agreement, which was not material.

Royalty and license fee revenues may fluctuate based on the nature of the related agreements and the timing of receipt of license fees. Results in any one period are not necessarily indicative of results to be achieved in the future. In addition, our ability to generate additional royalty and license fee revenues may depend, in part, on our ability to market and capitalize on our technologies. We have no assurance that we will be able to do so or that future royalty and license fee revenues will not decline.

Other revenues Our vaccines segment recognized other revenues of $20.9 million, $21.7 million and $27.3 million in 2001, 2000 and 1999, respectively.

Commission revenues We earn commission revenues on sales of hepatitis B virus vaccine products. Previously, we also earned commission revenues on sales of immunoglobulin products. The immunoglobulin arrangement expired on December 31, 2000. Commission revenues were $2.6 million, $7.7 million and $13.9 million in 2001, 2000 and 1999, respectively. The decrease in commission revenues in 2001 as compared with 2000, and in 2000 as compared with 1999, primarily related to a decrease in sales of hepatitis B virus vaccine products due to competitive multivalent hepatitis B virus vaccine products.

National Institutes of Health In the second quarter 2000, we entered into an agreement with the U.S. National Institutes of Health to advance our HIV vaccine program into human clinical trials. Under this arrangement, we could receive $23.2 million over five years. Under a supplemental arrangement, we may perform other work related to the National Institutes of Health's HIV vaccine program on a contract-by-contract basis. We recognized $9.9 million and $2.0 million in 2001 and 2000, respectively, under this arrangement.

The balance of other revenues recognized in our vaccines segment consisted of various other arrangements, which individually were not material.

Other revenues recognized in our vaccines segment may fluctuate due to the nature of the revenues recognized and the timing of events giving rise to these revenues. We cannot guarantee that we will be successful in obtaining additional revenues or that these revenues will not decline.

Gross profit Vaccines gross profit as a percentage of net product sales was 63%, 65% and 52% in 2001, 2000 and 1999, respectively. The decrease in vaccine gross profit margins in 2001 as compared with 2000 primarily related to sales of Menjugate , including the fourth quarter 2001 commencement of royalties based on Menjugate sales paid to Novartis AG under the December 1995 Limited Liability Company Agreement (see Note 8, "Related Party Transactions," in the Notes to Consolidated Financial Statements), offset by a favorable mix of other vaccine product sales. The increase in vaccine gross profit margins in 2000 as compared with 1999 primarily related to (i) sales of Menjugate , (ii) manufacturing efficiencies resulting from increased production and (iii) a favorable mix of other vaccine product sales. We recorded a significantly higher gross profit on 2000 Menjugate sales, because a significant portion of Menjugate production occurred in 1999. As we had not received approval to market Menjugate at the end of fiscal year 1999, we expensed manufacturing costs to research and development.

Vaccines gross profit percentages may fluctuate significantly in future periods as the vaccines product and customer mixes change.

Research and development Our vaccines segment recognized research and development expenses of $61.7 million, $62.3 million and $72.5 million in 2001, 2000 and 1999, respectively.

The decrease in research and development spending in 2001 as compared with 2000 primarily was due to the timing of clinical trials related to our various vaccine programs, partially offset by some spending under our collaboration agreement with Rhein Biotech N.V. and GreenCross Vaccine Corporation. In April 2001, we entered into a collaboration agreement with Rhein Biotech and GreenCross Vaccine to research and develop certain pediatric combination vaccine products for sale outside of Europe and North America. Under the collaboration agreement, we share the research and development expenses, which actually began in the first quarter 2001, with Rhein Biotech and GreenCross Vaccine. The collaboration agreement also requires capital commitments from Chiron, Rhein Biotech and GreenCross Vaccine (see "Liquidity and Capital Resources Sources and uses of cash" below).

The decrease in research and development spending in 2000 as compared with 1999 primarily was due to receipt of approval for sales of Menjugate in March 2000, as discussed in "Gross profit" above, offset by increased spending due to the furtherance of clinical trials related to our various vaccine programs.

Research and development expenses may fluctuate from period to period depending upon the stage of certain projects and the level of pre-clinical and clinical trial-related activities.

Selling, general and administrative Our vaccines segment recognized selling, general and administrative expenses of $78.2 million, $76.1 million and $79.5 million in 2001, 2000 and 1999, respectively. The increase in selling, general and administrative expenses in 2001 as compared with 2000 primarily was due to commissions recognized under a co-marketing and co-promotion agreement with Aventis Pasteur MSD related to Menjugate and Fluad . Under the Aventis Pasteur agreement, Aventis Pasteur distributes, markets and sells (co-markets) Menjugate under its own label in Europe, excluding the United Kingdom and Ireland. Aventis Pasteur also assists us in marketing and sales efforts (co-promotion) related to Menjugate in the United Kingdom and Ireland. Aventis Pasteur similarly co-markets and co-promotes Fluad in Europe. Co-promotion commissions to Aventis Pasteur amounted to $6.6 million and $2.0 million in 2001 and 2000, respectively.

The decrease in selling, general and administrative expenses in 2000 as compared with 1999 was due to (i) a change in the method of allocating certain legal costs to segments, as discussed previously, offset by an increase in selling, general and administrative expenses due to (ii) the re-launch of our tick-borne encephalitis vaccine product in the first quarter 2000 and (iii) the worldwide implementation of our integrated information system in April 1999.

Amortization expense Our vaccines segment recognized amortization expense of $8.3 million, $8.1 million and $9.6 million in 2001, 2000 and 1999, respectively. In the second quarter 1998, we acquired the remaining 51% interest in Chiron Behring from Hoechst AG and accounted for the acquisition under the purchase method of accounting. We allocated a portion of the purchase price to acquired intangible assets and goodwill. Acquired intangible assets included the fair value of trademarks, patents and customer lists, which we are amortizing on a straight-line basis over 6 to 20 years. Acquired intangible assets also included the assembled workforce, which we were amortizing on a straight-line basis over 20 years. We were amortizing goodwill on a straight-line basis over 20 years. As circumstances dictate, we evaluate the useful life and value of each intangible asset, which may result in future adjustments to the amortization periods or book values.

As discussed in "New Accounting Standards" below, we implemented Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. This statement requires, among other things, that the assembled workforce be reclassified to goodwill and that goodwill (including assembled workforce) no longer be amortized, but instead be tested for impairment at least annually in accordance with this Statement. The goodwill and assembled workforce amortization expense was $2.4 million, $2.5 million and $2.8 million in 2001, 2000 and 1999, respectively.

Blood testing

Product sales Our blood testing segment recognized product sales of $68.7 million, $43.1 million and $25.4 million in 2001, 2000 and 1999, respectively.

Nucleic acid testing Under a collaboration agreement with Gen-Probe Incorporated, we are jointly participating in new assay and instrument research and development. Currently, Gen-Probe is the only manufacturer of nucleic acid testing products using transcription-mediated amplification technology. Worldwide product sales related to tests and instruments were $48.4 million, $22.4 million and $7.0 million in 2001, 2000 and 1999, respectively.

Chiron sells directly in the U.S., Australia and various European markets.We also have contracts with various agencies and distributors worldwide. In addition, evaluation studies are being conducted to consider the adoption of nucleic acid testing for blood screening in additional countries. We recognize product revenues based on the details of each contract.

In the U.S., we recognized revenues from sales of nucleic acid tests under an Investigational New Drug application beginning in the second quarter 1999. In the third quarter 2000, we assumed primary account responsibility for a key U.S. customer, which resulted in increased product sales. In the third quarter 2001, all of our U.S. customers renewed their agreements, most with moderate price increases, for nucleic acid testing products. On February 27, 2002, the U.S. Food and Drug Administration approved the Procleix HIV-1/ HCV Assay. We expect that commercial pricing for sales of the Procleix HIV-1/ HCV Assay to our U.S. customers will result in a significant increase in revenue recognized in 2002 from such sales.

Outside the U.S., the French government adopted nucleic acid testing for blood screening effective July 2001. As a result, we began recognizing revenues from the commercial sales of assays and instruments and the provision of services.

In Australia, we signed, and began recognizing revenue under, an exclusive contract with the Australian Red Cross Blood Service to provide blood testing products for nucleic acid testing screening in the fourth quarter 1999.

Ortho-Clinical Diagnostics Under the Ortho-Clinical Diagnostics, Inc. contract, we manufacture bulk reagents and antigens for immunodiagnostic products. We recognized product sales under this contract of $20.3 million, $20.7 million and $18.4 million in 2001, 2000 and 1999, respectively. The fluctuations between 2001 and 2000, as well as 2000 and 1999, primarily were due to the timing of manufacturing services.

Under a June 2001 agreement among Chiron, Ortho-Clinical Diagnostics, Inc. and Bayer Corporation, Chiron will manufacture bulk antigens for Ortho-Clinical Diagnostics, Inc. for inclusion in products to be sold by Bayer.

We expect competitive pressures related to our blood testing products to continue into the future, primarily as a result of the introduction of competing products into the market, as listed in Part I, Item 1. "Business-Competition" above.

Equity in earnings of unconsolidated joint businesses Our share of earnings from our joint business with Ortho-Clinical Diagnostics, Inc. was $84.5 million, $84.2 million and $78.1 million in 2001, 2000 and 1999, respectively. The increase in 2000 as compared with 1999 primarily was due to increased profitability of Ortho-Clinical Diagnostics' foreign affiliates.

Collaborative agreement revenues We recognize collaborative agreement revenues for fees received as we perform research services and achieve specified milestones. Our blood testing segment recognized total collaborative agreement revenues of $11.2 million, $11.7 million and $9.9 million in 2001, 2000 and 1999, respectively. Under the Ortho-Clinical Diagnostics, Inc. contract, we conduct research and

development services related to immunodiagnostic products. Our blood testing segment recognized collaborative agreement revenues related to immunodiagnostic products of $11.1 million, $10.1 million and $8.3 million in 2001, 2000 and 1999, respectively. The fluctuations between 2001 and 2000, and 2000 and 1999, primarily were due to the timing of research services.

The balance of collaborative agreement revenues recognized in our blood testing segment, not related to the Ortho-Clinical Diagnostics contract, consisted of various other agreements, which individually were not material.

Collaborative agreement revenues tend to fluctuate based on the amount of research services performed, the status of projects under collaboration and the achievement of milestones. Due to the nature of our collaborative agreement revenues, results in any one period are not necessarily indicative of results to be achieved in the future. Our ability to generate additional collaborative agreement revenues may depend, in part, on our ability to initiate and maintain relationships with potential and current collaborative partners. We have no assurance that new relationships will be established or that current collaborative agreement revenues will not decline.

Royalty and license fee revenues Our blood testing segment earns royalties on third party utilization of our hepatitis C virus and HIV patents for use in blood screening, as well as third party sales of hepatitis C virus and HIV immunodiagnostic and probe diagnostic products. The blood testing segment recognized royalty and license fee revenues of $20.6 million in 2001.

F. Hoffmann La-Roche settlement In October 2000, we entered into three license agreements with F. Hoffmann La-Roche Limited and several of its affiliated companies related to the settlement of certain litigation in the U.S. and certain other countries for the use of our hepatitis C virus and HIV intellectual property. Two agreements relate to *in vitro* diagnostic products. See "Other Royalty and license fee revenues" below. The third agreement for blood screening was superseded in May 2001 by two new agreements, one for each of hepatitis C virus and HIV. Revenues under these agreements were $18.1 million in 2001. Our blood testing segment did not recognize any royalty and license fee revenues

during 2000 under these agreements. Royalties will continue under these new agreements through the lives of the hepatitis C virus and HIV patents covering F. Hoffmannn La-Roche's nucleic acid testing products. Currently, the applicable issued hepatitis C virus patents begin to expire in 2015 for the U.S. and in 2008 for Europe. Currently, the applicable issued HIV patent in Europe expires in 2005. If and when a patent is issued under pending U.S. applications, the HIV patent life in the U.S. will be seventeen years from the date of issuance.

Bayer In June 2001, Chiron and Ortho-Clinical Diagnostics, Inc. entered into an agreement with Bayer Corporation. Under this agreement, Bayer will manufacture and sell certain of Ortho-Clinical Diagnostics' hepatitis C virus and HIV immunodiagnostic products for use on Bayer's instrument platforms. Bayer paid us a license fee of $45.3 million, which we deferred (due to our continuing manufacturing obligations) and began recognizing as revenue in the third quarter 2001. We will recognize the remaining amount ratably through 2010.

Royalty and license fee revenues may fluctuate based on the nature of the related agreements and the timing of receipt of license fees. Results in any one period are not necessarily indicative of results to be achieved in the future. In addition, our ability to generate additional royalty and license fee revenues may depend, in part, on our ability to market and capitalize on our technologies. We have no assurance that we will be able to do so or that future royalty and license fee revenues will not decline.

Gross profit Blood testing gross profit as a percentage of net product sales was 28%, 30% and 8% in 2001, 2000 and 1999, respectively. The decrease in blood testing gross profit margins in 2001 as compared with 2000 primarily related to payments to Gen-Probe Incorporated upon resolution of certain contractual disputes in the fourth quarter 2001, as discussed in Part I, Item 1. "Legal Proceedings" above. This decrease was offset by proportionately higher sales of nucleic acid testing products in 2001 as compared

with 2000. In July 2000, we began recognizing nucleic acid testing product sales for one of our key U.S. customers, which previously were recorded as collaborative agreement revenues. In addition, all of our U.S. customers renewed their agreements during the third quarter 2001, most with moderate price increases, for nucleic acid testing products.

The increase in blood testing gross profit margins in 2000 as compared with 1999 primarily was related to a favorable mix of blood testing product sales. As discussed above, we began recognizing nucleic acid testing product sales for one of our key U.S. customers, which previously were recorded as collaborative agreement revenues, in July 2000. Secondly, our remaining U.S. customers renewed their agreements during the third quarter 2000, which resulted in price increases for nucleic acid testing products. In addition, we recognized nucleic acid testing product sales in 2000 related to Australia.

Blood testing gross profit percentages may fluctuate significantly in future periods as the blood testing product and customer mixes change.

Research and development Our blood testing segment recognized research and development expenses of $17.2 million, $14.9 million and $10.0 million in 2001, 2000 and 1999, respectively. The increase in research and development spending in 2001 as compared with 2000 was due to an increase in development costs related to nucleic acid testing technology, as Chiron and Gen-Probe Incorporated completed submission of data to the U.S. Food and Drug Administration for the Procleix instruments and assays in January 2001 (see "Product sales" above). The increase in research and development spending in 2000 as compared with 1999 was due to an increase in development costs related to nucleic acid testing technology.

Research and development expenses may fluctuate from period to period depending upon the stage of certain projects and the level of pre-clinical and clinical trial-related activities.

Selling, general and administrative Our blood testing segment recognized selling, general and administrative expenses of $29.3 million, $21.5 million and $16.6 million in 2001, 2000 and 1999, respectively. The increase in selling, general and administrative expenses in 2001 as compared with 2000 primarily was due to sales and marketing activities associated with the nucleic acid testing business. The increase in selling, general and administrative expenses in 2000 as compared with 1999 primarily was also due to an increase in selling, general and administrative expenses associated with nucleic acid testing technology and, to a lesser extent, our worldwide implementation of an integrated information system in April 1999, partially offset by a change in the method of allocating certain legal costs to segments, as discussed previously. We expect continued growth in selling, general and administrative expenses related to nucleic acid testing technology as we expand our sales opportunities for additional nucleic acid testing adoptions in other countries.

Other

Collaborative agreement revenues We recognize collaborative agreement revenues for fees received as we perform research services and achieve specified milestones. Our other segment recognized collaborative agreement revenues of $9.1 million, $3.0 million and

$46.2 million in 2001, 2000 and 1999, respectively, under an agreement with Novartis AG. Under the December 1995 Limited Liability Company agreement (see Note 8, "Related Party Transactions," in the Notes to Consolidated Financial Statements), Novartis agreed to provide, at our request, research funding for certain projects. The funded projects consisted of certain adult and pediatric vaccines, Insulin-like Growth Factor-I, Factor VIII and Herpes Simplex Virus-thymidine kinase. There were two amendments in the past three years. In December 1999, Chiron and Novartis amended this agreement to increase the maximum amount of funding provided by Novartis from $250.0 million to $265.0 million. Based upon a December 2000 amendment, Novartis agreed to fund through December 31, 2001, at our request and subject to certain annual and aggregate limits, up to 100% of the development costs incurred between January 1, 1995 and December 31, 2000 on these projects. This agreement expired on December 31, 2001.

Collaborative agreement revenues tend to fluctuate based on the amount of research services performed, the status of projects under collaboration and the achievement of milestones. Due to the nature of our collaborative agreement revenues, results in any one period are not necessarily indicative of results to be achieved in the future. Our ability to generate additional collaborative agreement revenues may depend, in part, on our ability to initiate and maintain relationships with potential and current collaborative partners. We have no assurance that new relationships will be established or that current collaborative agreement revenues will not decline.

Royalty and license fee revenues Our other segment earns royalties on third party sales of and license fees on several products. Our other segment recognized royalty and license fee revenues of $101.3 million, $110.6 million and $60.0 million in 2001, 2000 and 1999, respectively.

Hepatitis C Virus and HIV Our other segment earns royalties and license fees related to the use of our hepatitis C virus and HIV patents by various third parties. Our other segment's royalty and license fee revenues related to the use of these products consisted of the following:

	Year Ended December 31,		
	2001	2000	1999
		(in thousands)	
Royalty revenues	$ 60,651	$ 11,119	$ 5,088
License fee revenues	38,333	73,167	39,167
	$ 98,984	$ 84,286	$ 44,255

F. Hoffmann La-Roche settlement In October 2000, we entered into three license agreements with F. Hoffmann La-Roche Limited related to the settlement of litigation in the U.S. and certain other countries for use of our hepatitis C virus and HIV nucleic acid testing intellectual property for use in clinical diagnostics.

Under the hepatitis C virus agreement, we received $85.0 million, of which we recognized $40.0 million in the fourth quarter 2000. We deferred the remaining $45.0 million, which becomes nonrefundable through 2005. In the first quarter 2001, we began recognizing portions of the $45.0 million based upon the greater of (i) the scheduled quarterly minimum non-refundable amount or (ii) the actual earned credits as royalties on future sales related to F. Hoffmann La-Roche's use of our hepatitis C virus patent in its *in vitro* diagnostic products. The agreement also provides for royalties on future sales related to F. Hoffmann La-Roche's use of our hepatitis C virus patent in its *in vitro*diagnostic products, which commenced in the first quarter 2001.

Under the HIV agreement, we received $10.0 million in the fourth quarter 2000, which we deferred, and received $10.0 million in the first quarter 2001. These amounts included a refundable license fee and royalties for past sales related to F. Hoffmann La-Roche's use of our HIV patent in its *in vitro* diagnostic products in Europe. These amounts became nonrefundable in January 2001 when the European Patent Office Board of Technical Appeals upheld our HIV patent. As a result, we recognized the entire $20.0 million as revenue in the first quarter 2001. The agreement also provides for royalties on future sales related to F. Hoffmann La-Roche's use of our HIV patent in its *in vitro* diagnostic products, which also commenced in the first quarter 2001 when the European Patent Office Board of Technical Appeals upheld our HIV patent. We will recognize additional revenue of $10.0 million under this arrangement when and if patents on HIV are issued to us in the U.S.

Such royalties will continue through the lives of the hepatitis C virus and HIV patents covering F. Hoffmann La-Roche's nucleic acid testing products. Currently, the applicable issued hepatitis C virus patents expire in 2015 for the U.S. and in 2008 for Europe. Currently, the

applicable issued HIV patent in Europe expires in 2005. If and when a patent is issued from pending U.S. applications, the HIV patent life in the U.S. will be seventeen years from the date of issuance.

See "Blood testing Royalties and license fee revenues" above for a discussion of the third agreement entered into with F. Hoffmann La-Roche in October 2000 and two additional agreements entered into with F. Hoffmann La-Roche in May 2001, which superseded the October 2000 agreement.

Bayer In connection with the sale of Chiron Diagnostics to Bayer Corporation, we granted Bayer rights under HIV and hepatitis C virus patents for use in nucleic acid diagnostic tests (excluding blood screening). In exchange for these rights, Bayer paid us a license fee of $100.0 million, which became nonrefundable in decreasing amounts over a period of three years. We recognized license fee revenues in 2001, 2000, and 1999, which represented the portions of the $100.0 million payment that became nonrefundable during those periods. We recognized the remaining revenue in the fourth quarter 2001. In addition, the cross-license agreement provides for royalties to us on HIV and hepatitis C virus products sold by Bayer, which increased in 2001 as compared with 2000, and were consistent in 2000 and 1999.

Organon Teknika In January 2001, we granted Organon Teknika BV rights under certain of our HIV patents. The agreement provides for royalties on future sales by Organon Teknika of assays for the detection of nucleic acid sequences for use in *in vitro* diagnostic (excluding blood screening) products, which commenced in the first quarter 2001.

Abbott Laboratories In 1999, we entered into a cross-license agreement with Abbott Laboratories, Inc., under which we granted Abbott Laboratories rights under our hepatitis C virus patents. In exchange for these rights, Abbott Laboratories paid us a license fee, which became nonrefundable and was recognized as revenue in the second quarter 2000. In addition, the cross-license agreement provides for payment of royalties to us on hepatitis C virus products sold by Abbott Laboratories.

The balance of royalty and license fee revenues for 2001 in the table above consisted of various other agreements, which individually were not material.

F. Hoffmann La-Roche PCR agreement Under a July 1991 agreement between F. Hoffmann La-Roche Limited and Cetus Corporation (a company acquired by Chiron), we received royalties on sales of polymerase chain reaction products and services sold by F. Hoffmannn La-Roche and its licensees. In 2001, 2000 and 1999, we recognized $2.4 million, $26.3 million and $15.7 million, respectively, under this agreement. F. Hoffmannn La-Roche's royalty obligations, with certain limited exceptions for future products, expired in the fourth quarter 2000. However, we estimated royalties on polymerase chain reaction product sales based on previous period actual sales. In the following quarter, we recorded an adjustment equal to the difference between those estimated royalty revenues recorded in the previous quarter and the contractual percentage of actual polymerase chain reaction product sales for that period. As a result, we recorded the adjustment for the final fourth quarter 2000 royalties in the first quarter 2001. In addition, we recorded a similar positive adjustment of $3.3 million in 2000.

Royalty and license fee revenues may fluctuate based on the nature of the related agreements and the timing of receipt of license fees. Results in any one period are not necessarily indicative of results to be achieved in the future. In addition, our ability to generate additional royalty and license fee revenues may depend, in part, on our ability to market and capitalize on our technologies. We have no assurance that we will be able to do so or that future royalty and license fee revenues will not decline.

Research and development In 1999, our other segment recognized research and development expenses of $6.8 million. Research and development spending in our other segment fluctuates based on the timing of license and collaboration agreements. The research and development spending in 1999 included a $5.0 million license fee related to our Fibroblast Growth Factor patent and license agreement with Scios, Inc. Under this agreement, in 1999, we also advanced Scios an additional $7.5 million in exchange for a promissory note, which may be forgiven if certain conditions are met. We may pay an additional $12.0 million in licensing fees if certain development objectives are met.

Selling, general and administrative In 2001, 2000 and 1999, our other segment recognized selling, general and administrative expenses of $65.3 million, $72.0 million and $34.8 million, respectively. The decrease in selling, general and administrative expenses in 2001 as compared with 2000 primarily was due to lower patent litigation costs upon substantial conclusion of the F. Hoffmann La-Roche Limited litigation in October 2000 and lower payroll taxes related to stock option exercises during a period of lower average Chiron stock prices. In March 2000, we posted an all-time high in our stock price. The fourth quarter 2000 also included costs associated with the integration of

PathoGenesis Corporation. The increase in selling, general and administrative expenses in 2000 as compared with 1999 was due to (i) costs associated with the integration of PathoGenesis, (ii) increased payroll related expenses and patent litigation costs, (iii) our worldwide implementation of an integrated information system in April 1999 and (iv) a change in the method of allocating certain legal costs to segments, as discussed previously.

Write-off of purchased in-process technologies The write-off of purchased in-process technologies was $171.6 million in 2000.

On September 21, 2000, we acquired PathoGenesis Corporation and accounted for the acquisition under the purchase method of accounting. We allocated a portion of the purchase price to purchased in-process technologies for $171.6 million. We wrote this off entirely in the fourth quarter 2000. The write-off of purchased in-process technologies represented the fair value at the acquisition date, calculated utilizing the income approach, of the portion of certain in-process research and development projects that were not reliant upon core technology. Core technology represents technology that has been utilized in approved or commercialized products. We did not include certain research and development projects deemed too early in terms of completion metrics and any future yet-to-be-defined technologies in the calculation of in-process technologies. We do not anticipate that there will be any alternative future use for the in-process technologies that were written off. In valuing the purchased in-process technologies, we used probability-of-success-adjusted cash flows and a 15% discount rate. We assumed cash inflows from any one in-process product to commence between 2002 and 2008. Based on current information, we believe that the revenue projections underlying the purchase price allocation are substantially accurate. As with all pharmaceutical products, the probability of commercial success for any one research and development project is highly uncertain.

Amortization expense Our other segment recognized amortization expense of $38.4 million and $9.6 million in 2001 and 2000, respectively. As discussed above, we acquired PathoGenesis Corporation on September 21, 2000 and accounted for the acquisition under the purchase method of accounting. We allocated a portion of the purchase price to purchased technologies, acquired intangible assets and goodwill. Purchased technologies represented the fair value of research and development projects, which we will develop further and support after the acquisition date. We are amortizing purchased technology on a straight-line basis over 15 years. Acquired intangible assets included the fair value of trademarks and trade names, patents and databases, which we are amortizing on a straight-line basis over 13 to 16 years. Acquired intangible assets also included the assembled workforce, which we were amortizing on a straight-line basis over 5 years. We were amortizing goodwill on a straight-line basis over 15 years. As circumstances dictate, we evaluate the useful life and value of each intangible asset, which may result in future adjustments to the amortization periods or book values.

As discussed in "New Accounting Standards" below, we implemented Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. This statement requires, among other things, that the assembled workforce be reclassified to goodwill and that goodwill (including assembled workforce) no longer be amortized, but instead be tested for impairment at least annually in accordance with this Statement. The goodwill and assembled workforce amortization expense was $14.7 million and $3.6 million in 2001 and 2000, respectively.

Restructuring and reorganization We previously recorded restructuring and reorganization charges related to (i) the integration of our worldwide vaccines operations, (ii) the closure of our Puerto Rico and

St. Louis, Missouri facilities and (iii) the ongoing restructuring of our business operations. The integration of our worldwide vaccines operations consisted of termination and other employee-related costs recognized in connection with the elimination of 28 positions in our Italian manufacturing facility, all of which had terminated as of December 31, 2000, and facility-related costs. The closure of our Puerto Rico and St. Louis facilities and the ongoing restructuring of our business operations consisted of termination and other employee-related costs recognized in connection with the elimination of 400 positions in manufacturing, research, development, sales, marketing and other administrative functions, and facility-related costs. Employee termination costs included wage continuation, advance notice pay and medical and other benefits. Facility-related costs included losses on disposal of property, plant and equipment, lease payments and other related costs.

During 1999, we decided to retain 18 of those 400 positions to support future contract manufacturing activities. Therefore, we adjusted the number of positions for elimination to 382. Again during 2000, we decided to retain 11 of those 382 positions to support future contract manufacturing activities. Therefore, we adjusted the number of positions for elimination to 371. Included in the 371 positions were 36 positions at our Amsterdam facility. We transferred these positions to a buyer in January 2000 (see "Gain (loss) on sale of asset" below) in connection with the December 1999 sale of the Amsterdam facility.

For the year ended December 31, 2001, we recorded net restructuring and reorganization charges of $0.1 million, which included a charge of $0.3 million and a charge reversal of $0.2 million. The charge of $0.3 million primarily related to revised estimates of termination and other employee-related costs in connection with the elimination of the 371 positions, of which 360 had terminated as of December 31, 2001. The

charge reversal of $0.2 million primarily related to revised estimates of facility-related costs.

For the year ended December 31, 2000, we recorded net restructuring and reorganization charge reversals of $0.4 million, which included a charge reversal of $0.6 million and a charge of $0.2 million. The charge reversal of $0.6 million primarily related to revised estimates of termination and other employee-related costs recorded in connection with the retention of 11 of the 382 positions. As described above, we adjusted the number of positions for elimination to 371, of which 356 had terminated as of December 31, 2000. The charge of $0.2 million primarily related to revised estimates of facility-related costs.

For the year ended December 31, 1999, we recorded net restructuring and reorganization charges of $0.2 million, which included a charge of $3.9 million and a charge reversal of $3.7 million. The charge of $3.9 million primarily related to termination and other employee-related costs recognized in connection with the elimination of 28 positions at our Italian manufacturing facility, of which 24 of these positions had terminated as of December 31, 1999. The charge reversal of $3.7 million related to (i) revised estimates of facility-related accruals recorded in connection with the closure of the St. Louis facility and (ii) revised estimates of termination and other employee-related costs recorded in connection with the transfer of 36 positions at our Amsterdam facility to the buyer and the retention of 18 of the 400 positions. As described above, we adjusted the number of positions for elimination to 382, of which 319 had terminated as of December 31, 1999.

We expect to substantially settle the restructuring and reorganization accruals within one to six years of accruing the related charges. We expect employee and facility-related cost savings due to these restructuring activities in cost of sales, research and development expense and selling, general and administrative expense through 2008. We believe that we have begun to achieve these cost savings.

Other operating expenses In 1999, we recognized a reduction in other operating expenses of $13.4 million resulting from a reversal in estimated tax accruals related to certain employee payments recorded in 1995. We entered into tax indemnification agreements with certain officers and accrued an amount based upon the officers' related notional excise tax obligation. As the statute of limitations expired, based upon the officers' tax return filing dates, we reversed the related excise tax accrual to the extent that claims were not made against it.

Gain (loss) on sale of assets In January 2001, we sold various assets of our San Diego facility, resulting in a net gain of $2.4 million. In February 2000, we sold substantially all assets of an Australian subsidiary, resulting in a net loss of $0.2 million. In December 1999, we sold our manufacturing facility in Amsterdam, resulting in a gain of $0.9 million.

Gain on sale of intangible assets In December 1999, we sold certain assets that we had developed or acquired in connection with the research and development of a Cytomegalovirus vaccine to Aventis Pasteur MSD and recognized a gain of $7.5 million.

Interest expense In 2001, 2000 and 1999, we recognized interest expense of $7.5 million, $12.8 million and $23.9 million, respectively. The decrease in interest expense in 2001 as compared with 2000 primarily was due to the conversions of $253.8 million of the 1.90% convertible debentures to common stock in October 2000 and $98.4 million of the 5.25% convertible debentures to common stock in May 2000, offset by interest expense recognized on the Liquid Yield Option Notes that were issued in June 2001. The decrease in interest expense in 2000 as compared with 1999 primarily was due to the convertible debenture conversions discussed previously, as well as the repayment of the note payable to Novartis AG on January 4, 2000.

Other income, net Other income, net, primarily consisted of interest income on our cash and investment balances and other non-operating gains and losses. In 2001, 2000 and 1999, we recognized interest income of $51.6 million, $84.5 million and $83.8 million, respectively. The decrease in interest income in 2001 as compared with 2000 primarily was due to lower average interest rates, partially offset by higher average cash and investment balances following the $401.8 million received upon issuance of the Liquid Yield Option Notes in June 2001. We do not expect interest income in the following periods to be commensurate with 2000 due to lower interest rates. The increase in interest income in 2000 as compared with 1999 was due to gains realized on the termination of currency swaps related to our German subsidiary and higher average interest rates.

We invest in a diversified portfolio of financial investments, including debt and equity securities. The price of these securities is subject to significant volatility. We perform periodic reviews for temporary or other-than-temporary impairment of our securities and record adjustments to the carrying values of those securities accordingly. Generally, we believe that an investment is impaired if its market value has been below its carrying value for each trading day in a six-month period, at which point we write-down the investment. In 2001, 2000 and 1999, we recognized losses attributable to the other-than-temporary impairment of certain of these debt and equity securities of $5.5 million, $5.0 million and $1.7 million, respectively. Based upon the six-month review of our equity securities through February 28, 2002, we anticipate that, for the first quarter 2002, we may recognize losses attributable to the other-than-temporary impairment of certain equity securities of $3.6 million. In 2001, 2000 and 1999, we recognized gains of $8.7 million, $3.2 million and $3.8 million, respectively, related to the sale of certain equity securities. In 2000, we recognized a net loss of $3.7 million related to the sale of certain debt securities. In addition, in 1999, we recognized an unrealized gain

of $3.4 million related to equity securities classified as trading.

On December 31, 1998, we completed the sale of our 30% interest in General Injectibles & Vaccines, Inc., a distribution business, to Henry Schein, Inc. and received payment in full of certain advances we made to General Injectibles & Vaccines. The agreement also provided for us to receive additional payments, calculated as a pre-determined percentage of Henry Schein's gross profit, through 2003. We received $2.5 million and $2.9 million in 2001 and 2000, respectively.

In January 2000, we hedged a portion of our exposure to the British pound related to Menjugate sales. We settled this hedging contract upon substantial conclusion of Menjugate sales in the United Kingdom in the second quarter 2000. This settlement resulted in a gain of approximately $5.4 million.

Income taxes The reported effective tax rate for 2001 was 31.4% of pretax income from continuing operations, which reflects the amortization of goodwill and acquired identifiable intangible assets related

to the PathoGenesis Corporation acquisition. The reported effective tax rate for 2000 was 84.4% of pretax income from continuing operations. The adjusted annual tax rate was 32.0% of pretax income from continuing operations, when taking into account (i) the write-off of purchased in-process technologies and amortization expense on goodwill and acquired identifiable intangible assets related to the PathoGenesis acquisition and (ii) $34.0 million of past royalty revenues related to the F. Hoffmann La-Roche Limited settlement. The decrease in the adjusted annual tax provision in 2001 as compared with 2000 primarily was due to increases in the amount of tax credits utilized in 2001 as compared with 2000, as well as increases in the tax benefits derived from export sales activities.

Our reported effective tax rate for 1999 was 18.0% of pretax income from continuing operations. The adjusted annual tax rate was 26.3% of pretax income from continuing operations, when adjusted for the impact of the reversal of a prior year valuation allowance, which resulted in the recognition of additional domestic deferred tax benefits of $12.9 million. The increase in the adjusted annual tax provision in 2000 as compared with 1999 primarily was due to an increase in income earned in foreign countries with marginal income tax rates higher than the marginal U.S. income tax rate, coupled with a decrease in net operating loss carryforwards available to offset such foreign income.

The effective tax rate may be affected in future periods by changes in estimates with respect to our deferred tax assets and other items affecting the overall tax rate.

Discontinued operations In a strategic effort to focus on our core businesses of biopharmaceuticals, vaccines and blood testing, we completed the sale of Chiron Diagnostics and Chiron Vision in 1998 and 1997, respectively. The "Gain (loss) on disposal of discontinued operations" consisted of the following as of December 31:

	2001	2000	1999
		(In thousands)	
Reversal of reserves for retention and severance obligations	$ 1,600	$	$
Reversal of reserves for indemnity obligations	1,500	2,190	8,305
Gain on the sale of real estate assets	1,644		1,873
Other		(708)	1,563
Income tax benefit (provision)	534	(9,070)	20,432
	$ 5,278	$ (7,588)	$ 32,173

Chiron Diagnostics Under the terms of the Bayer Corporation agreement, we were responsible for retention and severance payments to specific U.S. and international employees. Accordingly, we reserved for such retention and severance obligations. In 2001, we reversed approximately $1.6 million reserved for retention and severance obligations based upon a final reconciliation from Bayer. We recorded this amount as a component of "Gain (loss) on disposal of discontinued operations."

Chiron Vision Under the terms of the Bausch & Lomb Incorporated agreement related to the sale of Chiron Vision, we provided customary indemnities. Accordingly, we reserved for such contractual obligations to indemnify Bausch & Lomb against certain potential claims. In 2001, we reversed the remaining reserves of $1.5 million upon the sale of the remaining real estate assets, as discussed below. In 2000 and

1999, we reversed approximately $2.2 million and $8.3 million, respectively, of such reserves as such obligations had expired unused. We recorded these amounts as components of "Gain (loss) on disposal of discontinued operations."

We retained certain Chiron Vision assets, including certain Chiron Vision real estate assets with a carrying value of $25.1 million, upon the completion of the sale. In July 1999, we sold a portion of the real estate assets and recognized a net gain on the sale of these assets of $1.9 million. In April 2001, we sold the remaining real estate assets and recognized a net gain on the sale of these assets of $1.6 million. We recorded these amounts as components of "Gain (loss) on disposal of discontinued operations."

Income taxes In connection with the sale of Chiron Diagnostics and Chiron Vision, we recorded cumulative net deferred tax assets of $23.7 million and $26.5 million in 2001 and 2000, respectively, principally attributable to the timing of the deduction of certain expenses associated with these sales. We also recorded corresponding valuation allowances of $23.7 million and $26.5 million in 2001 and 2000, respectively, to offset these deferred tax assets, as we believe that it is more likely than not that the deferred tax assets to which the valuation allowance relates will not be realized. We will report the future recognition of these deferred tax assets as a component of "Gain (loss) on disposal of discontinued operations."

"Gain (loss) on disposal of discontinued operations" included an income tax benefit (provision) of $0.5 million, ($9.1) million and $20.4 million in 2001, 2000 and 1999, respectively. The tax benefit in 2001 related to the reversal of reserves and valuation allowances against deferred tax assets that were set up at the time of the sale, as discussed above. The tax provision in 2000 resulted from the 1999 estimated tax provision to tax return true-up adjustment on the Chiron Diagnostics final purchase price adjustment. The tax benefit in 1999 included the utilization of additional foreign sales corporation benefits and foreign tax credits resulting from the 1998 estimated tax provision to tax return true-up adjustments for Chiron Diagnostics and Chiron Vision.

New Accounting Standards

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (which we will refer to as "SFAS" in this section) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 supercedes SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of," in that it excludes goodwill from its impairment scope and allows for different approaches in cash flow estimation. However, SFAS 144 retains the fundamental provisions of SFAS 121 for recognition and measurement of the impairment of (a) long-lived assets to be held and used and (b) long-lived assets to be disposed of other than by sale. SFAS 144 also supercedes the business segment concept in Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," in that it permits presentation of a component of an entity, whether classified as held for sale or disposed of, as a discontinued operation. However, SFAS 144 retains the requirement of Accounting Principles Board Opinion No. 30 to report discontinued operations separately from continuing operations. We adopted the provisions of SFAS 144 effective January 1, 2002. We believe that the implementation of the impairment provisions of this standard will not have a material effect on our results of operations and financial position, since the impairment assessment under SFAS 144 is largely unchanged from SFAS 121. The provisions of this standard for assets held for sale or other disposal generally are required to be applied prospectively. Therefore, we cannot determine the potential effects that adoption of SFAS 144 as it relates to assets held for sale or other disposal will have on our financial statements.

In July 2001, the Financial Accounting Standards Board issued SFAS 141, "Business Combinations," and SFAS 142, "Goodwill and Other Intangible Assets." SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated or completed after June 30, 2001. SFAS 141 also specifies criteria that intangible assets acquired in a purchase business combination must meet to be recognized and reported apart from goodwill, noting that any purchase price allocable to an assembled workforce may not be accounted for separately. SFAS 142 requires that the assembled workforce be reclassified to goodwill and that goodwill (including assembled workforce) and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually in accordance with SFAS 142. SFAS 142 also requires that intangible assets with definite useful lives be amortized over their respective useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," which is superceded by SFAS 144 as discussed above.

We adopted the provisions of SFAS 141 immediately, and SFAS 142 effective January 1, 2002.

SFAS 141 required, upon adoption of SFAS 142, that we evaluate our existing intangible assets and goodwill that we acquired in a purchase business combination prior to June 30, 2001, and make any necessary reclassifications to conform with the new criteria in SFAS 141. As a result, we reclassified assembled workforce with a net carrying value of $7.8 million to goodwill on January 1, 2002.

Upon adoption of SFAS 142, we also began reassessing the useful lives and residual values of all intangible assets (excluding goodwill and assembled workforce) acquired in purchase business combinations, and are required to make any necessary amortization period adjustments by the end of the first quarter 2002. In addition, if an intangible asset is identified as having an indefinite useful life, we must test the intangible asset for impairment in accordance with SFAS 142 by March 31, 2002. We will measure any impairment loss as of January 1, 2002 and recognize it as the cumulative effect of a change in accounting principle in the first quarter 2002. Based upon our review to date, we do not anticipate any adjustments to amortization periods.

In connection with the transitional goodwill impairment evaluation, SFAS 142 adoption requires us to assess whether there is an indication that goodwill is impaired as of January 1, 2002. To accomplish this, we identified our reporting units as of January 1, 2002. We are in the process of determining the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of January 1, 2002. We have up to six months from January 1, 2002 to determine the fair value of each reporting unit and compare it to the reporting unit's carrying amount. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired and we must perform the second step of the transitional impairment test. In the second step, we must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of its assets (recognized and unrecognized) and liabilities in a manner similar to a purchase price allocation in accordance with SFAS 141, to its carrying amount, both of which would be measured as of January 1, 2002. This second step must be completed as soon as possible, but no later than December 31, 2002. We will recognize any transitional impairment loss as the cumulative effect of a change in accounting principle.

In addition, we must perform an impairment test at least annually. Any impairment loss from the annual test will be recognized as part of operations.

At December 31, 2001, we had unamortized goodwill (including assembled workforce) of $232.6 million. Amortization expense related to goodwill (including assembled workforce) was $17.1 million for the year ended December 31, 2001. Based upon our review to date, we do not anticipate any transitional impairment losses.

In June 2001, the Financial Accounting Standards Board issued SFAS 143, "Accounting for Asset Retirement Obligations." SFAS 143 requires liability recognition for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. We must adopt the provisions of SFAS 143 effective January 1, 2003, with earlier application encouraged. We are currently analyzing the effect, if any, the adoption of this standard will have on our financial statements.

We understand that the Financial Accounting Standards Board is considering new rules on the accounting for certain off-balance sheet lease financing. Such rules may require that, among other things, certain off-balance sheet lease financing be recorded on the balance sheet. The Financial Accounting Standards Board expects to issue the new rules in April 2002. As new information is released, we will continue to monitor the impact of these rules on our June 1996 lease agreement (see "Liquidity and Capital Resources Commitments" below).

Liquidity and Capital Resources

Our capital requirements have generally been funded from operations, cash and investments on hand, debt borrowings and issuance of common stock. Our cash and investments in marketable debt securities, which totaled $1,302.0 million at December 31, 2001, are invested in a diversified portfolio of financial instruments, including money market instruments, corporate notes and bonds, government or government agency securities and other debt securities issued by financial institutions and other issuers with strong credit ratings. By policy, the amount of credit exposure to any one institution is limited. Investments are generally not collateralized and primarily mature within three years.

Sources and Uses of Cash We had cash and cash equivalents of $320.7 million and $167.0 million at December 31, 2001 and 2000, respectively.

Operating activities In 2001, net cash provided by operating activities was $262.0 million as compared with $373.4 million in 2000. The decrease in cash provided by operating activities largely was due to (i) higher tax payments, (ii) the timing of royalty and license fee payments under the F. Hoffmann La-Roche Limited settlement agreements (see "Blood testing Royalty and license fee revenues" and "Other Royalty and license fee revenues" above) and (iii) $13.9 million of cash received upon the settlement of a cross currency interest rate swap in 2000. We made $134.8 million ($49.6 million domestic and $85.2 million foreign) in tax payments in 2001 as compared with $9.9 million in 2000. Domestic tax payments in 2001 included approximately $39.8 million related to the filing of our fiscal year 2000 tax return in September 2001. Foreign tax

payments in 2001 primarily related to tax payments made by our Italian subsidiary. Our Italian subsidiary posted profits in both 2000 and 2001, and is taxed at a substantially higher tax rate than our domestic and other foreign subsidiaries. As a result, our Italian subsidiary made significant tax payments in 2001. The decrease in cash provided by operating activities was offset partially by a $45.3 million license fee payment received from Bayer Corporation in June 2001, as discussed in "Blood testing Royalty and license fee revenues" above.

Unutilized net operating loss carryforwards and federal business credits attributed to the acquisition of PathoGenesis Corporation amounted to approximately $30.4 million and $6.0 million, respectively, and are available to offset future domestic taxable income through 2007. As a result, we do not expect domestic tax payments in following years to be commensurate with those in 2000.

We anticipate that research and development expenditures in 2002 will increase due to the research and development activities related to Proleukin® for HIV, as well as advances in research and development platforms acquired from PathoGenesis in September 2000. Net cash from operating activities will fund these research and development activities.

Investing activities In 2001, net cash used in investing activities consisted of purchases of investments in marketable debt securities of $987.3 million, capital expenditures of $64.9 million, purchases of equity securities and interests in affiliated companies of $14.9 million, cash paid for acquisition costs of PathoGenesis Corporation of $9.9 million and other uses of cash of $5.5 million. Cash used in investing activities was offset by proceeds from the sale and maturity of investments in marketable debt securities of $681.6 million, proceeds from the sale of assets of $8.2 million, proceeds from the sale of equity securities and interests in affiliated companies of $15.1 million and payments received on notes receivable of $6.4 million.

In February 2001, our Board of Directors approved a $235.0 million capital expansion project, which includes the construction of a parking structure and a research and development facility (including a supporting central utility facility) in Emeryville, California. Related to the parking structure, we had committed to $17.9 million in design and construction services, under which we had incurred costs of $8.4 million, as of December 31, 2001. Related to the research and development facility, we are evaluating various financing alternatives to fund this expansion. We expect to begin construction on the research and development facility in the second half of 2002. See also discussion under "Commitments" below.

Based on current estimates provided in the April 2001 agreement with Rhein Biotech N.V. and GreenCross Vaccine Corporation (see "Results of Operations Vaccines Research and Development" above), we committed approximately 24.4 million Euro ($21.5 million at December 31, 2001), primarily for the expansion of our Italian manufacturing facilities. These expenditures began in the fourth quarter 2001 and are expected to continue through 2008. We currently are evaluating various financing alternatives to fund this expansion.

The purchases of equity securities and interests in affiliated companies consisted of a $5.3 million capital contribution under a 2001 limited partnership agreement, a $6.6 million capital contribution under a 2000 limited partnership agreement and a $3.0 million capital contribution under a joint venture agreement. Under the 2001 limited partnership agreement, we will pay $15.0 million over ten years, of which $5.3 million was paid through December 31, 2001, for a 6.35% ownership percentage. Under the 2000 limited partnership agreement, we will pay $25.0 million over five years, of which $13.5 million was paid through December 31, 2001, for a 23.19% ownership percentage. We account for both the 2001 and 2000 limited partnership investments under the equity method of accounting. Under the joint venture agreement, we invested in a Singapore-based joint venture, S*BIO Pte Ltd, to research and develop therapeutic, diagnostic and vaccine products (see also "Results of Operations Biopharmaceuticals Collaborative agreements revenues" above). Since inception we have invested $8.0 million, which we have written off entirely due to the early stage of S*BIO's research and development activities, for a 19.9% ownership interest. We account for the investment on the cost method. Based upon the current agreement, we are not obligated to make any further investments in S*BIO.

In April 2001, we sold the remaining Chiron Vision real estate assets for $3.3 million in cash. In January 2001, we sold various assets of our San Diego facility for $4.9 million in cash.

The $6.4 million of payments received on notes receivable related to amounts collected under an April 1999 biopharmaceutical license agreement and a February 2000 agreement to sell substantially all assets of our Australian subsidiary to Mimotopes.

In 2000, net cash used in investing activities consisted of purchases of investments in marketable debt securities of $3.6 billion, cash paid to purchase PathoGenesis of $720.7 million, capital expenditures of $54.4 million and purchases of equity securities and interests in affiliated companies of $27.4 million. Cash used in investing activities was offset by proceeds from the sale and maturity of investments in marketable debt securities of $4.1 billion, proceeds from the sale of assets of $1.0 million, proceeds from the sale of equity securities and interests in affiliated companies of $5.0 million, payments received on a note receivable of $3.2 million and other sources of cash of $58.5 million. In 2000, we paid approximately $720.7 million to purchase the outstanding shares of common stock of PathoGenesis at $38.50 per share. The purchases

of equity securities and interests in affiliated companies primarily consisted of a $5.0 million capital contribution under the joint venture agreement with S*BIO (which, as discussed above, we wrote off entirely due to the early stage of S*BIO's research and development activities), a $6.9 million capital contribution under the 2000 limited partnership agreement and a $13.9 million payment to purchase common stock upon the exercise of warrants.

Financing activities In 2001, net cash provided by financing activities consisted of $401.8 million in proceeds from the issuance of the Liquid Yield Option Notes, $65.7 million in proceeds from the reissuance of treasury stock (primarily related to stock option exercises and employee stock purchases) and $8.2 million in proceeds from put options. Cash provided by financing activities was offset by $9.9 million for the payment of issuance costs on the Liquid Yield Option Notes, $201.0 million for the acquisition of treasury stock, $1.4 million for the repayment of debt and $0.6 million for the repayment of short-term borrowings.

We issued zero coupon Liquid Yield Option Notes in June 2001 for proceeds of $401.8 million. The Liquid Yield Option Notes mature on June 12, 2031. At the option of the holder, we may be required to redeem all or a portion of the Liquid Yield Option Notes on June 12, 2004 and 2006, and every five years

thereafter. In addition, upon a change in control of Chiron occurring on or before June 12, 2006, each holder may require us to purchase all or a portion of such holder's Liquid Yield Option Notes for cash at a price equal to 100% of the issue price for such Liquid Yield Option Notes plus any accrued original issue discount and contingent additional principal (and accrued original issue discount thereon) to the date of purchase.

Our Board of Directors authorized the repurchase of our common stock on the open market to offset the dilution associated with the operation of our stock option and employee stock purchase plans and the granting of share rights. In 2001, our Board of Directors approved a total 10.0 million share increase. The Board has authorized such repurchases through December 31, 2002. As of December 31, 2001, we may repurchase up to an additional 6.4 million shares of our common stock.

In January 2001, we initiated a put option program to complement our ongoing stock repurchase program. Under this program, we enter into contracts with third parties to sell put options on Chiron stock, entitling the holders to sell us a specified number of shares at a specified price on a specified date. For the year ended December 31, 2001, we collected premiums of $8.2 million and, for contracts that expired, purchased 0.4 million shares in connection with the put option program. As of December 31, 2001, we have an outstanding contract with a third party to sell put options on Chiron stock, entitling the holder to sell us 0.3 million shares. The option expires in March 2002 and has an exercise price of $45.88 per share. The contract provides that if the price of Chiron's stock is at or below $10.00 before the contract expires, the third party can exercise the option.

In 2000, net cash used in financing activities consisted of $314.4 million for the acquisition of treasury stock, $71.1 million for the repayment of debt, including the note owed to Novartis AG, and $18.9 million related to short-term borrowings. Cash used in financing activities was offset by $74.7 million in proceeds from the reissuance of treasury stock and the issuance of common stock, primarily related to stock option exercises and employee stock purchases.

On April 4, 2000, our Board of Directors authorized management to call for redemption the outstanding $100.0 million 5.25% convertible subordinated debentures. In 2000, debentures with a face value of $98.4 million were converted into 3.2 million shares of our common stock, at a conversion price of $30.83 per share. The remaining unconverted debentures were redeemed in cash.

On August 11, 2000, our Board of Directors authorized management to call for redemption the outstanding $253.9 million 1.90% convertible subordinated debentures, including $10.1 million held by Novartis. In 2000, debentures with a face value of $253.8 million were converted into 8.8 million shares of our common stock, at a conversion price of $28.91 per share. The remaining unconverted debentures were redeemed in cash.

We are currently evaluating a number of business development opportunities. To the extent that we are successful in reaching agreements with third parties, these transactions may involve selling a significant portion of our current investment portfolio.

Commitments

Our commitments as of December 31, 2001 were as follows:

	Total	Due in 2002	Due in 2003	Due in 2004	Due in 2005	Due in 2006	Due Thereafter
				(in thousands)			
Operating leases(1)	$ 165,442	$ 29,180	$ 26,191	$ 20,691	$ 17,651	$ 14,811	$ 56,918
Research and development facility(2)	172,573		172,573				
Capital Expansion Project(3)	9,529	9,529					
Technology services agreement(4)	92,768	14,936	14,416	14,328	14,072	14,063	20,953
Rhein Biotech(5)	21,526	15,526				6,000	
Purchase and capital commitments(6)	4,309	4,309					
Letter of credit(7)	4,511	4,511					
Research and development arrangements(8)	17,935	14,070	2,605	730	530		
Insurance-related items(9)	13,831	13,831					
Defined-benefit pension plan(10)	8,984		8,984				
Total	$ 511,408	$ 105,892	$ 224,769	$ 35,749	$ 32,253	$ 34,874	$ 77,871

(1)

We lease laboratory, office and manufacturing facilities, land and equipment under noncancelable operating leases, which expire through 2014. Future minimum lease payments, including those for the leaseback of office and warehouse space in the Amsterdam facility, are estimated to be approximately $165.5 million in the aggregate.

(2)

In June 1996, we entered into a seven-year agreement with a group of financial institutions (which we will refer to as the "lessors" in this section) to lease a research and development facility. Construction was completed on this facility in 1999. The total cost of the facility covered by this lease was $172.6 million. We account for this lease as an operating lease and, as a result, record neither an asset nor a liability on our balance sheet. The future minimum lease payments stated in (1) above include only our annual lease payments of $7.5 million for 2002 and $3.5 million for the first six months of 2003. Our annual lease payments represent variable-rate interest payments (indexed to the London interbank offered rate) on the $172.6 million lease financing. Since the lease payments are clearly and closely related to the host contract (the lease agreement, in this case), this lease transaction is not subject to Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." For tax purposes, the lease is considered a capital lease the annual lease payments are characterized as interest expense with the tax depreciation on the facility reducing our taxable income and, therefore, our current tax liability.

The lease provides a $146.7 million residual value guarantee from Chiron to the lessors in the event of property value declines. Based upon the current local real estate market, we believe that our research and development facility has not experienced a property value decline. However, we have no assurance that the property value will not decline between now and the termination of the lease on or before July 1, 2003. Consequently, our maximum payment obligation is $146.7 million upon termination of the lease on or before July 1, 2003.

On or before July 1, 2003, we can choose to either purchase the facility from the lessors or sell the facility to a third party. This option accelerates if we default on our lease payments.

If we purchase the facility, we must pay the lessors $172.6 million, record the facility (on our balance sheet) at its cost and depreciate it over the remaining estimated useful life of the facility. In addition, if we finance the purchase of the facility, we would incur interest expense.

If we sell the facility on the designated sale date, the sales proceeds would be distributed as follows: (1) to the lessors for their residual interest in the cost of the facility (cost of the facility less the residual value guarantee or $25.9 million); and (2) to Chiron for amounts paid under the residual value guarantee on or before July 1, 2003. If we do not sell the facility by the designated sale date, the lessors may market the facility for sale. When the lessors sell the facility, the sales proceeds first would be distributed to the lessors for marketing and operating costs, then in the order as indicated in the previous sentence. If the facility is sold for more than $172.6 million, we receive the remaining proceeds and, possibly, recognize a gain. Likewise, if the facility is sold for less than $172.6 million, we recognize a loss up to the residual value guarantee.

As of December 31, 2001, Novartis AG had guaranteed (under provisions of the Investment Agreement) payments on this lease commitment, including payment of the residual value guarantee, to a maximum of $172.6 million.

Credit rating agencies treat this operating lease as debt.

(3)

In February 2001, our Board of Directors approved a $235.0 million capital expansion project, which includes the construction of a parking structure and a research and development facility (including a supporting central utility facility) in Emeryville, California. Related to the parking structure, we had committed to $17.9 million in design and construction services, under which

we had incurred costs of $8.4 million, as of December 31, 2001. We may cancel these commitments at any time. Related to the research and development facility, we are evaluating various financing alternatives to fund this expansion. We expect to begin construction on the research and development facility in the second half of 2002.

(4)

Effective July 1, 1998, Chiron and IBM Corporation entered into a ten-year information technology services agreement under which IBM will provide us with a full range of information services. We can terminate this agreement subject to certain termination charges. If we do not terminate this agreement, payments to IBM are expected to be approximately $92.8 million. Payments to IBM are subject to adjustment depending upon the level of services and infrastructure equipment provided by IBM, as well as inflation.

(5)

Based on current estimates, our commitment related to the agreement with Rhein Biotech N.V. and GreenCross Vaccine Corporation is approximately 24.4 million Euro ($21.5 million) at December 31, 2001.

(6)

In future periods, we expect to incur substantial capital spending. At December 31, 2001, we had various outstanding firm purchase and capital project commitments totaling approximately $4.3 million.

(7)

At December 31, 2001, we had $4.5 million outstanding under a letter of credit, which is required by German law, related to ongoing legal proceedings in Germany (see Part I, Item 3. "Legal Proceedings" above).

(8)

We participate in a number of research and development arrangements with other pharmaceutical and biotechnology companies to develop and market certain technologies and products. Chiron and our collaborative partners generally contribute certain technologies and research efforts and commit, subject to certain limitations and cancellation clauses, to share costs related to certain research and development activities, including those related to clinical trials. We may also be required to make payments to certain collaborative partners upon their achievement of specified milestones. We estimate future noncancelable funding commitments under collaborative arrangements to be approximately $17.9 million in the aggregate.

(9)

We had various performance bonds and insurance-related letters of credit in the amount of $13.8 million.

(10)

We have a non-contributory retirement program covering substantially all employees of our wholly-owned German subsidiary. The benefits are based primarily on years of service and employee compensation. The program is a defined-benefit pension plan and is not externally funded. We recognized a non-current liability of $9.0 million related to this program. The actuarial valuation does not allocate the liability across future years; therefore, we have included the entire liability in 2003 for presentation purposes.

Borrowing Arrangements

Under a revolving, committed, uncollateralized credit agreement with a major financial institution, we can borrow up to $100.0 million in the U.S. This credit facility is guaranteed by Novartis AG under a November 1994 Investment Agreement, provides various interest rate options and matures in February 2003. There were no borrowings outstanding under this credit facility at December 31, 2001 and 2000. In December 1999, Chiron and Novartis amended the November 1994 Investment Agreement to reduce the maximum amount of our obligations that Novartis would guarantee from $725.0 million to $702.5 million.

We also have various credit facilities available outside the U.S. Borrowings under these facilities totaled $0.5 million and $1.2 million at December 31, 2001 and 2000, respectively. One facility is maintained for all of our European subsidiaries and allows for total borrowings of $50.0 million. There were no outstanding borrowings under this facility at December 31, 2001 and 2000. Our Italian subsidiary also has various facilities, related to its receivables, which allow for total borrowings of 10.9 million Euro ($9.6 million at December 31, 2001). There were no outstanding borrowings under this facility at December 31, 2001. At December 31, 2000, $0.1 million were outstanding under this facility. A third facility is maintained for our 51%-owned Indian subsidiary and allows for total borrowings of 200 million Indian Rupee ($4.1 million at December 31, 2001). At December 31, 2001 and 2000, $0.5 million and $1.1 million, respectively, were outstanding under this facility. Outstanding borrowings under the Indian credit facility were collateralized by machinery and equipment with a net book value of $3.6 million and trade receivables and inventory with a total net book value of $3.9 million at December 31, 2001.

Market Risk Management

Our cash flow and earnings are subject to fluctuations due to changes in foreign currency exchange rates, interest rates, the fair value of equity securities held and our stock price. We attempt to limit our exposure to some or all of these market risks through the use of various financial instruments. These activities are discussed in further detail in Item 7A. "Quantitative and Qualitative Disclosures About Market Risk."

Euro Conversion

On January 1, 1999, eleven European Union member countries established fixed conversion rates between their existing legacy currencies and one common currency, the Euro. Beginning on January 1, 2002, the legacy currencies were replaced with the Euro. We had completed system upgrades to assist in our Euro-readiness effort. The cost of the upgrades was not material to our results of operations and financial position. The Euro did not have a material effect on our product pricing and gross profit percentages.

Factors That May Affect Future Results

As a global pharmaceutical company, we are engaged in a rapidly evolving and often unpredictable business. The forward-looking statements contained in this 10-K and in other periodic reports, press releases and other statements issued by us from time to time reflect our current beliefs and expectations concerning objectives, plans, strategies, future performance and other future events. The following discussion highlights some of the factors, many of which are beyond our control, which could cause actual results to differ.

Promising Technologies Ultimately May Not Prove Successful

We focus our research and development activities on areas in which we have particular strengths and on technologies that appear promising. These technologies often are on the "cutting edge" of modern science. As a result, the outcome of any research or development program is highly uncertain. Only a very small fraction of these programs ultimately result in commercial products or even product candidates. Product candidates that initially appear promising often fail to yield successful products. In many cases, preclinical or clinical studies will show that a product candidate is not efficacious (that is, it lacks the intended therapeutic or prophylactic effect), or that it raises safety concerns or has other side effects which outweigh the intended benefit. Success in preclinical or early clinical trials (which generally focus on safety issues) may not translate into success in large-scale clinical trials (which are designed to show efficacy), often for reasons that are not fully understood. Further, success in clinical trials will likely lead to increased investment, adversely affecting short-term profitability, to bring such products to market. And even after a product is approved and launched, general usage or post-marketing studies may identify safety or other previously unknown problems with the product which may result in regulatory approvals being suspended, limited to narrow indications or revoked, or which may otherwise prevent successful commercialization.

Regulatory Approvals

We must obtain and maintain regulatory approval in order to market most of our products. Generally, these approvals are on a product-by-product and country-by-country basis. In the case of therapeutic products, a separate approval is required for each therapeutic indication. See Part I, Item 1. "Business-Government Regulation" above. Product candidates that appear promising based on early, and even large-scale, clinical trials may not receive regulatory approval. The results of clinical trials often are susceptible to varying interpretations that may delay, limit or prevent approval or result in the need for post-marketing studies.

Manufacturing

Most of our products are biologics. Manufacturing biologic products is complex. Unlike chemical pharmaceuticals, a biologic product generally cannot be sufficiently characterized (in terms of its physical and chemical properties) to rely on assaying of the finished product alone to ensure that the product will perform in the intended manner. Accordingly, it is essential to be able to both validate and control the manufacturing process, that is, to show that the process works and that the product is made strictly and consistently in compliance with that process. Slight deviations anywhere in the manufacturing process, including quality control, labeling and packaging, may result in unacceptable changes in the products that may result in lot failures or product recalls. Manufacturing processes which are used to produce the (smaller) quantities of material needed for research and development purposes may not be successfully scaled up to allow production of commercial quantities at reasonable cost or at all. All of these difficulties are compounded when dealing with novel biologic products that require novel

manufacturing processes. Accordingly, manufacturing is subject to extensive government regulation. Even minor changes in the manufacturing process require regulatory approval, which, in turn, may require further clinical studies.

Specific to our product, TOBI®, we rely on others to supply raw materials and to manufacture TOBI® according to regulatory requirements. We believe either one of our two suppliers of bulk powdered tobramycin will be able to supply sufficient quantities to meet our current needs and we have a supply agreement in place for a minimum term of 5 years with one of the suppliers. We also have an agreement in place for the formulation of TOBI® for a minimum term of 10 years. There can be no assurance that we will be able to obtain future supplies of bulk tobramycin on favorable terms, that contract manufacturers will be able to provide sufficient quantities of TOBI® or that the products supplied will meet specifications.

In addition, any prolonged interruption in our operations or in our contractors' manufacturing facilities could result in cancellations of shipments. A number of factors could cause interruptions, including equipment malfunctions or failures, damage to a facility due to natural disasters or suspension of power supplied to these facilities arising out of regional power shortages. Our difficulties or delays or those of our contractors' manufacturing of existing or new products could increase costs and cause loss of revenue or market share.

Raw Materials for Manufacturing

We use raw materials and other supplies that generally are available from multiple commercial sources. Certain manufacturing processes, however, use materials that are available from sole sources or that are in short supply or difficult for the supplier to produce and certify in accordance with our specifications. Some of our biopharmaceutical products are biologics. From time to time, concerns are raised with respect to potential contamination of biological materials that are supplied to us. These concerns can further tighten market conditions for materials that may be in short supply or available from limited sources. Moreover, regulatory approvals to market our products may be conditioned upon obtaining certain materials from specified sources. Our ability to substitute material from an alternate source may be delayed pending regulatory approval of such alternate source. Although we monitor the ability of certain suppliers to meet our needs and the market conditions for these materials, there is a risk that material shortages could impact production.

Patents Held By Third Parties May Delay or Prevent Commercialization

Third parties, including competitors, have patents and patent applications in the U.S. and other significant markets that may be useful or necessary for the manufacture, use or sale of certain products and products in development by us and our corporate partners. It is likely that third parties will obtain these patents in the future. Certain of these patents may be broad enough to prevent or delay us and our corporate partners from manufacturing or marketing products important to our current and future business. We cannot accurately predict the scope, validity and enforceability of these patents, if granted,

the extent to which we may wish or need to obtain licenses to these patents, and the cost and availability of these licenses. If we do not obtain these licenses, products may be withdrawn from the market or delays could be encountered in market introduction while an attempt is made to design around these patents. Alternatively, we could find that the development, manufacture or sale of such products is foreclosed. We could also incur substantial costs in licensing or challenging the validity and scope of these patents.

Product Acceptance

We may experience difficulties in launching new products, many of which are novel products based on technologies that are unfamiliar to the healthcare community. We have no assurance that healthcare providers and patients will accept such products. In addition, government agencies, as well as private organizations involved in healthcare, from time to time publish guidelines or recommendations to healthcare providers and patients. Such guidelines or recommendations can be very influential and may adversely affect the usage of our products directly (for example, by recommending a decreased dosage of our product in conjunction with a concomitant therapy) or indirectly (for example, by recommending a competitive product over our product).

Competition

We operate in a highly competitive environment, and the competition is expected to increase. Competitors include large pharmaceutical, chemical and blood testing companies, and biotechnology companies. Some of these competitors, particularly large pharmaceutical and blood testing companies, have greater resources than ours. Accordingly, even if we are successful in launching a product, we may find that a competitive product dominates the market for any number of reasons, including:

the possibility that the competitor may have launched its product first;

the competitor may have greater marketing capabilities; or

the competitive product may have therapeutic or other advantages.

The technologies applied by our competitors and us are rapidly evolving, and new developments frequently result in price competition and product obsolescence.

Chiron's Patents May Not Prevent Competition or Generate Revenues

We seek to obtain patents on our inventions. Without the protection of patents, competitors may be able to use our inventions to manufacture and market competing products without being required to undertake the lengthy and expensive development efforts made by us and without having to pay royalties or otherwise compensate us for the use of the invention.

We have no assurance that patents and patent applications owned or licensed to us will provide substantial protection. Important legal questions remain to be resolved as to the extent and scope of available patent protection for biotechnology products and processes in the U.S. and other important markets. We do not know how many of our pending patent applications will be granted, or the effective coverage of those that are granted. In the U.S. and other important markets, the issuance of a patent is neither conclusive as to its validity nor the enforceable scope of its claims. We have engaged in significant litigation to determine the scope and validity of certain of our patents and expect to continue to do so. An adverse outcome of litigation could result in the reduction or loss of royalty revenues.

Even if we are successful in obtaining and defending patents, there can be no assurance that these patents will provide substantial protection. The length of time necessary to resolve patent litigation successfully may allow infringers to gain significant market advantage. Third parties may be able to design around the patents and develop competitive products that do not use the inventions covered by our patents. Many countries, including certain countries in Europe, have compulsory licensing laws under

which a patent owner may be compelled to grant licenses to third parties (for example, the third party's product is needed to meet a threat to public health or safety in that country, or the patent owner has failed to "work" the invention in that country, or the third party has patented improvements). In addition, most countries limit the enforceability of patents against government agencies or government contractors. In these countries, the patent owner may be limited to monetary relief and may be unable to enjoin infringement, which could materially diminish the value of the patent.

Availability of Reimbursement; Government and Other Pressures on Pricing

In the U.S. and other significant markets, sales of our products may be affected by the availability of reimbursement from the government or other third parties, such as insurance companies. It is difficult to predict the reimbursement status of newly approved, novel biotechnology products, and current reimbursement policies for existing products may change. In certain foreign markets, governments have issued regulations relating to the pricing and profitability of pharmaceutical companies. There have been proposals in the U.S. (at both the federal and state level) to implement such controls. The growth of managed care in the U.S. also has placed pressure on the pricing of healthcare products. These pressures can be expected to continue.

Costs Associated with Expanding the Business

We expect to grow our business in areas in which we can be most competitive, either through in-licensing, collaborations or acquisitions of products or companies. In connection with these efforts, we may incur significant charges, costs and expenses which could impact our profitability, including impairment losses, restructuring charges, the write-off of purchased in-process technologies, transaction-related expenses, costs associated with integrating new businesses and the cost of amortizing goodwill and other intangibles. Some transactions may require the consent of our shareholders or a third party, or the approval by various regulatory authorities. We have no assurance that such in-licensing, collaborations or acquisitions will be successful.

Other New Products and Sources of Revenue

Many products in our current pipeline are in relatively early stages of research or development. Our ability to grow earnings in the near- to medium-term may depend, in part, on our ability to initiate and maintain other revenue generating relationships with third parties, such as licenses to certain of our technologies, and on our ability to identify and successfully acquire rights to later-stage products from third parties. We have no assurance that we will establish such other sources of revenue.

Interest Rate and Foreign Currency Exchange Rate Fluctuations

We have significant cash balances and investments. Our financial results, therefore, are sensitive to interest rate fluctuations. In addition, we sell products in many countries throughout the world, and our financial results could be significantly affected by fluctuations in foreign currency exchange rates or by weak economic conditions in foreign markets.

Corporate Partners

An important part of our business strategy depends upon collaborations with third parties, including research collaborations and joint efforts to develop and commercialize new products. As circumstances change, Chiron and our corporate partners may develop conflicting priorities or other conflicts of interest. We may experience significant delays and incur significant expenses in resolving these conflicts and may not be able to resolve these matters on acceptable terms. Even without conflicts of interest, we may disagree with our corporate partners as to how best to realize the value associated with a current product or a product in development. In some cases, the corporate partner may have responsibility for formulating

and implementing key strategic or operational plans. In addition, merger and acquisition activity within the pharmaceutical and biotechnology industries may affect our corporate partners, causing them to reprioritize their efforts related to the research collaborations and other joint efforts with us. Decisions by corporate partners on key clinical, regulatory, marketing (including pricing), inventory management and other issues may prevent successful commercialization of the product or otherwise impact our profitability.

Stock Price Volatility

The price of our stock, like that of other pharmaceutical companies, is subject to significant volatility. Any number of events, both internal and external to us, may affect our stock price. These include, without limitation,

- results of clinical trials conducted by us or by our competitors;
- announcements by us or our competitors regarding product development efforts, including the status of regulatory approval applications;
- the outcome of legal proceedings, including claims filed by us against third parties to enforce our patents and claims filed by third parties against us relating to patents held by the third parties;
- the launch of competing products;
- the resolution of (or failure to resolve) disputes with collaboration partners;
- corporate restructuring by us;
- licensing activities by us; and
- the acquisition or sale by us of products, products in development or businesses.

In connection with our research and development collaborations, from time to time we may invest in equity securities of our corporate partners. The price of these securities also is subject to significant volatility and may be affected by, among other things, the types of events that affect our stock. Changes in the market price of these securities may impact our profitability.

Income Taxes

We are taxable principally in the U.S., Germany, Italy, The Netherlands and the United Kingdom. All of these jurisdictions have in the past and may in the future make changes to their corporate tax rates and other tax laws, which could increase our future tax provision. We have negotiated a number of rulings regarding income and other taxes that are subject to periodic review and renewal. If such rulings are not renewed or are substantially modified, income taxes payable in particular jurisdictions could increase. While we believe that all material tax liabilities are reflected properly in our balance sheet, we are presently under audit in several jurisdictions, and we have no assurance that we will prevail in all cases in the event the taxing authorities disagree with our interpretations of the tax law. In addition, we have assumed liabilities for all income taxes incurred prior to the sales of our former subsidiaries, Chiron Vision (subject to certain limitations) and Chiron Diagnostics. Future levels of research and development spending, capital investment and export sales will impact our entitlement to related tax credits and benefits which have the effect of lowering our effective tax rate.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk A significant portion of our operations consists of manufacturing and sales activities in western European countries. As a result, our financial results may be affected by changes in the foreign currency exchange rates of those countries. Our primary exposure to foreign exchange rates is associated with the value of the Euro. An increase in the value of the U.S. Dollar vis-à-vis the Euro will result in a lower value of our non-U.S. Dollar based revenues. To manage foreign currency exchange risks, we enter into forward foreign currency contracts and purchase foreign currency option contracts. We do not use any of these derivative instruments for trading or speculative purposes. The total notional principal amount of these derivative financial instruments at December 31, 2001 and 2000 was $94.8 million and $48.8 million, respectively.

We use forward foreign currency contracts to hedge the gains and losses generated by the remeasurement of certain assets and liabilities denominated in nonfunctional currencies. Typically, these contracts have maturities of three months or less. At December 31, 2001, these exposures amounted to $75.1 million and were partially offset by forward foreign currency contracts with a notional principal amount of $61.3 million (fair value of $58.7 million). The notional principal amount of the forward foreign currency contracts was $48.8 million (fair value of $49.2 million) at December 31, 2000. Based on exposures at December 31, 2001, a 10% adverse movement against our portfolio of transaction exposures and hedge contracts would result in a loss of approximately $1.3 million. A 10% movement in the value of the dollar versus our portfolio of transaction exposures has not occurred in the last 12 quarters. Foreign currency transaction gains from continuing operations, including the impact of hedging, were $1.9 million and $5.5 million in 2001 and 2000, respectively, but were not significant in 1999. In 2000, we hedged a portion of our exposure to the British pound related to Menjugate sales. We settled this forward foreign currency contract upon substantial conclusion of Menjugate sales in the United Kingdom in the second quarter 2000. The settlement resulted in a gain of approximately $5.4 million, which we recorded in "Other income, net" in the Consolidated Statements of Operations.

We may selectively hedge anticipated currency exposures by purchasing foreign currency option contracts. Our primary anticipated exposures are related to foreign revenues received from selling products in western European countries. To limit hedging costs, we generally purchase out-of-the-money foreign currency option contracts. At December 31, 2001, exposures associated with certain Euro-denominated revenues amounted to $41.8 million and were partially offset by foreign currency option contracts with a notional principal amount of $33.5 million (fair value of $0.8 million). Based on exposures at December 31, 2001, a 10% adverse movement against our portfolio of anticipated transaction exposures and hedge contracts would result in a loss of approximately $2.8 million. A 10% movement in the value of the dollar versus our portfolio of anticipated transaction exposures has not occurred in the last 12 quarters. We had no foreign currency option contracts outstanding at December 31, 2000.

Interest Rate Risk We have exposure to changes in interest rates in both our investment portfolio and certain floating rate liabilities and lease commitments with interest rates tied to the London interbank offered rate. We maintain investment portfolio holdings of various issuers, types and maturities. Changes in interest rates do not affect interest expense incurred on our Liquid Yield Option Notes because the Liquid Yield Option Notes bear interest at fixed rates.

Our investment portfolio amounted to approximately $1,302.0 million at December 31, 2001. As of that date, we also had $172.6 million of floating rate obligations tied to the London interbank offered rate. We have a "natural hedge" against this exposure as a result of our portfolio holdings in floating rate fixed income securities tied to the London interbank offered rate. The analysis below focuses on the impact of changes

in interest rates to us and is based on a net portfolio balance of $1,129.4 million.

The analysis assumes an immediate parallel increase or decrease in interest rates of 150-basis points and examines the impact to us over the next twelve months. An immediate increase in interest rates of 150-basis points results in higher interest income over the 12-month period, partially offset by an

immediate decline in the market value of securities held. The net impact of this scenario is an estimated increase in reported income of $12.3 million over the 12-month period. Similarly, a 150-basis point decrease results in a decrease in reported income of $12.3 million. The impact on reported earnings would be greater given that unrealized changes in the value of the portfolio are reported in comprehensive income. We currently do not hedge these exposures.

A 150-basis point movement in the Federal Funds rate has occurred in 3 of the last 10 years, a 100-basis point movement has occurred in 5 of the last 10 years, and a 50-basis point movement has occurred in 7 of the last 10 years.

Equity Securities Risk We have exposure to equity price risk because of our investments in equity securities. Typically, we obtain these securities through our collaboration agreements with other pharmaceutical and biotechnology partners. We classify a majority of these securities as available-for-sale and, consequently, record them on the balance sheet at fair value with unrealized gains or losses reported as a component of comprehensive income or loss. We periodically review the carrying values of these securities. We recognize other-than-temporary losses against earnings in the same period the loss was deemed to have occurred. Changes in share prices affect the value of our equity portfolio. To reduce this risk, we hedged a portion of our exposure through forward sales contracts. The forward sales contracts substantially offset the long position and, in effect, neutralize the impact of market valuation shifts on the hedged securities. The notional principal amount of our forward sales contracts at December 31, 2001 was $85.8 million (fair value of $93.9 million). The notional principal amount of our forward sales contracts at December 31, 2000 was $36.2 million (fair value of $31.5 million). In the future, we may use additional hedging strategies in order to mitigate the potential adverse impact from changes in the market value of stock prices. We have no assurance that other-than-temporary losses will not have a material adverse impact on our future results of operations. We recorded charges of $1.1 million and $1.7 million in 2001 and 1999, to write down certain available-for-sale equity securities for which we deemed the decline in fair value to be other-than-temporary. We recorded no charges in 2000. At December 31, 2001, if the market price of our equity investments, including warrants and preferred stock, decreased by 10%, the market value of the equity portfolio would decrease by $3.4 million.

Counterparty Risk We manage the risk of counterparty default on our debt securities and derivative financial instruments through the use of credit standards, counterparty diversification and monitoring of counterparty financial condition. We execute debt securities and derivative financial instruments with financial institutions and other issuers with strong credit ratings, which minimizes risk of loss due to nonpayment or deterioration in credit rating. In 2001, we recorded a charge of $1.5 million to write-down debt securities with a face value of $5.0 million due to the decline in the credit rating of the issuer. On March 1, 2002, the issuer paid us principal plus interest. We have not experienced any other losses due to counterparty default.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

We incorporate the information required for this item by reference to the financial statements listed in Item 14(a) of Part IV of this 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

KPMG LLP served as our independent auditors. On December 6, 2001, we determined that KPMG LLP's appointment as independent auditors would cease following the completion of the audit of our financial statements for the fiscal year ended December 31, 2001. We engaged Ernst & Young LLP to serve as independent auditors effective for the fiscal year commencing January 1, 2002. Our audit committee approved the decision to change auditors.

In connection with the audits of the two fiscal years ended December 31, 2001 and the subsequent interim period through March 5, 2002, there were no disagreements with KPMG LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements (if not resolved to KPMG LLP's satisfaction) would have caused KPMG LLP to refer to such matters

in their reports.

The audit reports of KPMG LLP on our consolidated financial statements and consolidated financial statement schedule as of and for the fiscal years ended December 31, 2001 and 2000 did not contain any adverse opinion or disclaimer of opinion, nor were those opinions qualified or modified as to uncertainty, audit scope or accounting principles. A letter from KPMG LLP is attached as Exhibit 16.

During our two most recent fiscal years ended December 31, 2001 and the subsequent interim period through March 5, 2002, we did not consult with Ernst & Young LLP regarding any of the matters or events set forth in Item 304 (a) (2) (i) and (ii) of Regulation S-K, except as follows:

We engaged Ernst & Young LLP in July 2001 to assist us in the identification of the accounting, tax and economic impacts of a proposed leasing transaction, and to provide overall transaction coordination services. KPMG LLP also was consulted on application of accounting principles regarding this proposed leasing transaction.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

We incorporate the information required for this item by reference to our definitive Proxy Statement for our 2002 Annual Meeting. We will file our Proxy Statement with the Securities and Exchange Commission within 120 days of December 31, 2001. For information on directors, see the sections entitled "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Proxy Statement. For information on our executive officers, refer to the section entitled "Executive Officers of the Registrant" which appears at the end of Part I of this 10-K.

ITEM 11. EXECUTIVE COMPENSATION

We incorporate the information required for this item by reference to our Proxy Statement. See the section entitled "Compensation of Directors and Executive Officers" in the Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

We incorporate the information required for this item by reference to our Proxy Statement. See the sections entitled "Certain Beneficial Owners" and "Security Ownership of Directors and Executive Officers" in the Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

We incorporate the information required for this item by reference to our Proxy Statement. See the section entitled "Certain Relationships and Related Transactions" in the Proxy Statement.

Except for the information incorporated by the references in Items 10, 11, 12 and 13 of this 10-K, our definitive Proxy Statement is not deemed filed as part of this 10-K.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) 1. Index to Consolidated Financial Statements

2. Index to Financial Statement Schedules

We omitted all other schedules because those schedules are not applicable, not required or because the required information is included in the consolidated financial statements or accompanying notes.

(b)

Reports on Form 8-K

On December 13, 2001, we filed a Current Report on Form 8-K, reporting under Item 4 the change in our independent auditors. On December 6, 2001, we determined that KPMG LLP's appointment as independent auditors would cease following the completion of the audit of our financial statements for the fiscal year ended December 31, 2001. We engaged Ernst &Young LLP to serve as independent auditors effective for the fiscal year commencing January 1, 2002.

On January 10, 2002, we filed a Current Report on Form 8-K, reporting under Item 5 that on January 7, 2002, we announced the execution of an Agreement and Plan of Merger dated January 6, 2002, among Chiron, Matrix Pharmaceutical, Inc., a Delaware corporation, and Manon Acquisition Corp., a Delaware corporation and a wholly-owned subsidiary of Chiron. Pursuant to the Agreement, we agreed, subject to customary conditions, to make a tender offer to purchase any or all of the outstanding shares of common stock (par value $0.01 per share) of Matrix Pharmaceutical at a purchase price of $2.21 per share in cash. The Agreement further provides for the tender offer to be followed by a subsequent merger of Manon Acquisition Corp. with and into Matrix Pharmaceutical, after which Matrix Pharmaceutical will be a wholly-owned subsidiary of Chiron.

(c)

Exhibits

Exhibit Number	Exhibit
3.01	Restated Certificate of Incorporation of Chiron, as filed with the Office of the Secretary of State of Delaware on August 17, 1987, incorporated by reference to Exhibit 3.01 of Chiron's report on Form 10-K for fiscal year 1996.
3.02	Certificate of Amendment of Restated Certificate of Incorporation of Chiron, as filed with the Office of the Secretary of State of Delaware on December 12, 1991, incorporated by reference to Exhibit 3.02 of Chiron's report on Form 10-K for fiscal year 1996.
3.03	Certificate of Amendment of Restated Certificate of Incorporation of Chiron, as filed with the Office of the Secretary of State

Exhibit Number	Exhibit
	of Delaware on May 22, 1996, incorporated by reference to Exhibit 3.04 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
3.04	Bylaws of Chiron, as amended and restated, incorporated by reference to Exhibit 3.04 to Chiron's report on Form 10-K for fiscal year 2000.
4.01	Indenture between Chiron and State Street Bank and Trust Company, dated as of June 12, 2001, incorporated by reference to Exhibit 4.01 of Chiron's report on Form 10-Q for the period ended June 30, 2001.
4.02	Registration Rights Agreement between Chiron and Merrill Lynch & Co., Inc., and Merrill Lynch, Pierce, Fenner & Smith, Incorporated, incorporated by reference to Exhibit 4.02 of Chiron's report on Form 10-Q for the period ended June 30, 2001.
4.03	Form of Liquid Yield Option Note due 2031 (Zero Coupon Senior) (included as exhibits A-1 and A-2 to the Indenture filed as Exhibit 4.01 to Chiron's report on Form 10-Q for the period ended June 30, 2001), incorporated by reference to Exhibit 4.03 of Chiron's report on Form 10-Q for the period ended June 30, 2001.
4.04	Reserved
10.001	Purchase Agreement between BNP Leasing Corporation and Chiron, dated June 28, 1996, incorporated by reference to Exhibit 10.90 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
10.002	Lease Agreement between BNP Leasing Corporation and Chiron, dated June 28, 1996, incorporated by reference to Exhibit 10.91 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
10.003	Ground Lease between BNP Leasing Corporation and Chiron, dated June 28, 1996, incorporated by reference to Exhibit 10.92 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
10.004	through 10.099 Reserved
10.101	Revolving Credit Agreement, dated as of February 27, 1998, between Chiron and Bank of America National Trust and Savings Association, incorporated by reference to Exhibit 10.101 of Chiron's report on Form 10-K for fiscal year 1997.
10.102	Reserved
10.103	Reserved

10.104	Stock Purchase and Warrant Agreement dated May 9, 1989, between Cetus Corporation and Hoffmann-La Roche Inc. (initially filed as Exhibit 10.36 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.104 of Chiron's report on Form 10-Q for the period ended June 30, 1999.
10.105	Letter Agreement, dated as of December 12, 1991, relating to Stock Purchase and Warrant Agreement between Chiron and Hoffmann-La Roche Inc., incorporated by reference to Exhibit 10.51 of Chiron's report on Form 10-K for fiscal year 1996.
10.106	through 10.199 Reserved
10.201	Agreement between Chiron and Ortho Diagnostic Systems, Inc., a New Jersey corporation, dated August 17, 1989, and Amendment to Collaboration Agreement between Ortho Diagnostic Systems, Inc. and Chiron, dated December 22, 1989 (with certain confidential information deleted) (initially filed as Exhibit 10.29 to Chiron's report on Form 10-K for fiscal year 1989, and refiled as Exhibit 10.14 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.201 of Chiron's report on Form 10-Q for the period ended March 31, 1999.
10.202	License and Supply Agreement between Ortho Diagnostic Systems, Inc., a New Jersey corporation, Chiron and Abbott Laboratories, an Illinois corporation, dated August 17, 1989 (with certain confidential information deleted) (initially filed as Exhibit 10.31 to Chiron's report on Form 10-K for fiscal year 1989, and refiled as Exhibit 10.15 of Chiron's report on

Form 10-Q for the quarter ended June 30, 1994), incorporated by reference to Exhibit 10.202 of Chiron's report on Form 10-Q for the period ended March 31, 1999.

10.203 Regulatory Filing, Development and Supply Agreement between Chiron, Cetus Oncology Corporation, a wholly-owned subsidiary of Chiron, and Schering AG, a German company, dated as of May 10, 1993 (initially filed as Exhibit 10.50 to Chiron's report on Form 10-Q for period ended September 30, 1993), incorporated by reference to Exhibit 10.203 of Chiron's report on Form 10-K for fiscal year 1998. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential portions of material have been omitted and filed separately with the Securities and Exchange Commission.")

10.204 Letter Agreement dated December 30, 1993 by and between Chiron and Schering AG, a German company (initially filed as Exhibit 10.51 to Chiron's report on Form 10-K for fiscal year 1993), incorporated by reference to Exhibit 10.204 of Chiron's report on Form 10-K for fiscal year 1998. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential portions of material have been omitted and filed separately with the Securities and Exchange Commission.")

10.205 Amendment Agreement (HDS Fees and Deeply Discounted Vials) dated as of September 23, 1997 between Chiron and Schering Aktiengesellschaft, incorporated by reference to Exhibit 10.205 of Chiron's report on Form 10-K for fiscal year 1997. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.206 Agreement between Chiron and Cephalon, Inc. dated as of January 7, 1994, and Letter Agreements between Chiron and Cephalon dated January 13, 1995 and May 23, 1995 (initially filed as Exhibit 10.85 to Chiron's report on Form 10-K for fiscal year 1995), incorporated by reference to Exhibit 10.206 of Chiron's report on Form 10-Q for period ended March 31, 1999. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.207 Letter Agreement dated as of December 4, 1997, between Chiron and Ortho Pharmaceutical Corporation and Ortho Biotech, Inc., incorporated by reference to Exhibit 10.207 of Chiron's report on Form 10-K for fiscal year 1997. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.208 Contract Manufacturing Agreement dated as of March 17, 2000, between Chiron S.p.A. and SynCo Bio Partners B.V., incorporated by reference to Exhibit 10.208 of Chiron's report on Form 10-Q for the period ended June 30, 2000.

10.209 Second Amendment Agreement dated as of June 15, 2001, between Chiron and Schering Aktiengesellschaft, incorporated by reference to Exhibit 10.209 of Chiron's report on Form 10-Q for the period ended June 30, 2001. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.210 Contract Manufacturing Agreement dated as of July 26, 2001, between Chiron S.p.A. and SynCo Bio Partners B.V., incorporated by reference to Exhibit 10.210 of Chiron's report on Form 10-Q for the period ended September 30, 2001. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.211 Through 10.299 Reserved

10.301 Settlement Agreement on Purified IL-2, made as of April 14, 1995, by and between Cetus Oncology Corporation, dba Chiron Therapeutics, a Delaware corporation, and Takeda Chemical Industries, Ltd., a Japanese corporation, incorporated by reference to Exhibit 10.74 of Chiron's report on Form 10-Q for the period ended July 2, 1995. (We have omitted certain

information from the Agreement pursuant to our request for confidential treatment under Rule 24b-2.)

10.302 Agreement, effective as of December 21, 1988, by and between Hoffmann- La Roche Inc., a New Jersey corporation, and Cetus Corporation, incorporated by reference to Exhibit 10.70 of Chiron's report on Form 10-Q for the period ended April 2, 1995. (We have omitted certain information from the Agreement pursuant to our request for confidential treatment under Rule 24b-2.)

10.303 Agreement, effective as of December 21, 1988, by and among F. Hoffmann- La Roche Ltd., a Swiss corporation, Cetus Corporation, and EuroCetus International, B.V., a Netherlands Antilles corporation, incorporated by reference to Exhibit 10.71 of Chiron's report on Form 10-Q for the period ended April 2, 1995. (We have omitted certain information from the Agreement pursuant to our request for confidential treatment under Rule 24b-2.)

10.304 License Agreement made and entered into December 1, 1987, by and between Sloan Kettering Institute for Cancer Research, a not-for-profit New York corporation, and Cetus Corporation, incorporated by reference to Exhibit 10.75 of Chiron's report on Form 10-Q for the period ended July 2, 1995. (We have omitted certain information from the Agreement pursuant to our request for confidential treatment under Rule 24b-2.)

10.305 Cross-License Agreement dated as of November 30, 1998, between Chiron and Chiron Diagnostics Corporation, incorporated by reference to Exhibit 10.311 of Chiron's current report on Form 8-K dated November 30, 1998. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.306 HCV Probe License and Option Agreement dated September 26, 1999, between Abbott Laboratories, an Illinois corporation, and Chiron, incorporated by reference to Exhibit 10.306 of Chiron's report on Form 10-Q for the period ended September 30, 1999. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.307 HCV Probe License Agreement dated October 10, 2000, between Chiron, F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc., incorporated by reference to Exhibit 10.307 of Chiron's report on Form 10-Q for the period ended September 30, 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.308 HIV Probe License Agreement dated October 10, 2000, between Chiron, F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc., incorporated by reference to Exhibit 10.308 of Chiron's report on Form 10-Q for the period ended September 30, 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.309 Blood Screening HCV/HIV Probe License Agreement dated October 10, 2000, between Chiron, F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc., incorporated by reference to Exhibit 10.309 of Chiron's report on Form 10-Q for the period ended September 30, 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.310 License Agreement dated January 1, 1994, between Children's Hospital and Medical Center and PathoGenesis Corporation, initially filed as Exhibit 10.13 to PathoGenesis Corporation's Registration Statement on Form S-1 Registration No. 33-97070. (PathoGenesis Corporation omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to a request by PathoGenesis Corporation for confidential treatment under Rule 24b-2. Brackets denote such omissions.)

10.311 Agreement with Gen-Probe Incorporated dated June 11, 1998, incorporated by reference to Exhibit 10.311 of Chiron's Form 10-K for fiscal year 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.") (We have omitted certain information from the Agreement relating to rights and obligations assigned by Chiron to unrelated third party subsequent to the execution of Agreement. We have identified the omitted information by the following statement: "Provision Assigned.")

10.312 Addendum to Agreement with Gen-Probe Incorporated dated June 11, 1998, incorporated by reference to Exhibit 10.312 of Chiron's Form 10-K for fiscal year 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.") (We have omitted certain information from the Agreement relating to rights and obligations assigned by Chiron to unrelated third party subsequent to the execution of Agreement. We have identified the omitted information by the following statement: "Provision Assigned.")

10.313 Amendment to Agreement with Gen-Probe Incorporated dated December 7, 1999, incorporated by reference to Exhibit 10.313 of Chiron's Form 10-K for fiscal year 2000. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.") (We have omitted certain information from the Agreement relating to rights and obligations assigned by Chiron to unrelated third party subsequent to the execution of Agreement. We have identified the omitted information by the following statement: "Provision Assigned.")

10.314 Amendment No. 2 to Agreement with Gen-Probe Incorporated dated February 1, 2000. (We have omitted certain information from the Agreement relating to rights and obligations assigned by Chiron to unrelated third party subsequent to the execution of Agreement. We have identified the omitted information by the following statement: "Provision Assigned.")

10.315 Blood Screening HCV Probe License Agreement dated effective as of January 1, 2001, between Chiron, F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc., incorporated by reference to Exhibit 10.315 of Chiron's report on Form 10-Q for the period ended June 30, 2001. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.316 Blood Screening HIV Probe License Agreement dated effective as of January 1, 2001, between Chiron, F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc., incorporated by reference to Exhibit 10.315 of Chiron's report on Form 10-Q for the period ended June 30, 2001. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.317 Through 10.399 Reserved

10.401 Stock Purchase Agreement, dated as of October 21, 1997, between Bausch & Lomb Incorporated and Chiron, incorporated by reference to Exhibit 99.1 of Chiron's current report on Form 8-K dated January 12, 1998.

10.402 Stock Purchase Agreement, dated as of September 17, 1998, among Bayer Corporation, Chiron and Chiron Diagnostics Corporation, and Exhibits thereto, incorporated by reference to Exhibit 10.402 of Chiron's report on Form 10-Q for the period ended September 27, 1998. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.403 Asset Transfer Agreement dated November 30, 1998, among Chiron, Chiron Diagnostics Corporation and Bayer Corporation, incorporated by reference to Exhibit 10.403 of Chiron's current report on Form 8-K dated November 30, 1998.

10.404 Agreement and Plan of Merger, dated as of January 6, 2002, among Chiron, Manon Acquisition Corp. and Matrix Pharmaceutical, Inc., incorporated by reference to Exhibit (d)(1) of Chiron's Schedule TO-T No. 00542277, filed with the

Securities and Exchange Commission on January 14, 2002.

10.405 Through 10.499 Reserved

10.501 Chiron 1991 Stock Option Plan, as amended and restated, incorporated by reference to Exhibit 10.501 of Chiron's report on Form 10-Q for the period ended March 31, 2001.*

10.502 Form of Stock Option Agreement, and Addendum to Stock Option Agreement (Executives), Chiron 1991 Stock Option Plan, as amended.*

10.503 Form of Stock Option Agreement, Chiron 1991 Stock Option Plan, as amended, for Non-Employee Directors of Chiron, incorporated by reference to Exhibit 10.511 of Chiron's report on Form 10-Q for the period ended September 27, 1998.*

10.504 Form of Automatic Share Right Agreement for Executive Officers, Chiron 1991 Stock Option Plan, as amended.*

10.505 Forms of Option Agreements, Cetus Corporation Amended and Restated Common Stock Option Plan, incorporated by reference to Exhibit 10.27 of Chiron's report on Form 10-Q for the period ended March 30, 1997.*

10.506 Forms of Supplemental Letter concerning the assumption of Cetus Corporation options by Chiron, incorporated by reference to Exhibit 10.27 of Chiron's report on Form 10-K for fiscal year 1996.*

10.507 Form of Option Agreement (with Purchase Agreements attached thereto) between Cetus Corporation and each former limited partner of Cetus Healthcare Limited Partnership, a California limited partnership (initially filed as Exhibit 10.31 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.507 of Chiron's report on Form 10-Q for the period ended June 30, 1999.*

10.508 Form of Option Agreement (with forms of Purchase Agreements attached thereto), dated December 30, 1986, between Cetus Corporation and each former limited partner of Cetus Healthcare Limited Partnership II, a California limited partnership (initially filed as Exhibit 10.32 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.508 of Chiron's report on Form 10-Q for the period ended June 30, 1999.*

10.509 Description of Chiron Corporation's 2001 Executive Officers Variable Compensation Program.*

10.510 Form of Performance Unit Agreement, Chiron 1991 Stock Option Plan, as amended, incorporated by reference to Exhibit 10.94 of Chiron's report on Form 10-K for fiscal year 1996.*

10.511 Audit Committee Charter, incorporated by reference to Exhibit 10.511 of Chiron's report on Form 10-Q for the period ended June 30, 2000.

10.512 Change-in-Control Severance Plan, incorporated by reference to Exhibit 10.512 to Chiron's report on Form 10-Q for the period ended March 31, 2001.*

10.513 Form of Performance Stock Option Agreement for Executive Officers, Chiron 1991 Stock Option Plan, as amended.*

10.514 Form of Amendment Letter to Share Rights Letter Agreement for Executive Officers, Chiron 1991 Stock Option Plan, as amended.*

10.515 Form of Amendment Letter to Stock Option Agreement (Special Executive Form) for Executive Officers, Chiron 1991 Stock Option Plan, as amended.*

10.516 Through 10.599 Reserved.

10.601 Indemnification Agreement between Chiron and Dr. William J. Rutter, dated as of February 12, 1987 (which form of agreement is used for each member of Chiron's Board of Directors) (initially filed as Exhibit 10.21 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.601 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.602 Supplemental Benefits Agreement, dated July 21, 1989, between Chiron and Dr. William J. Rutter (initially filed as Exhibit 10.27 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.602 of Chiron's report on Form 10-Q for the period ended June 30, 1999.*

10.603 Letter Agreement dated September 26, 1990 between Chiron and William G. Green (initially filed as Exhibit 10.41 of Chiron's report on Form 10-K for fiscal year 1992), incorporated by reference to Exhibit 10.603 of Chiron's report on Form 10-K for fiscal year 1998.*

10.604 Letter Agreements dated September 11, 1992, July 15, 1994 and September 14, 1994 between Chiron and Lewis T. Williams (initially filed as Exhibit 10.54 of Chiron's report on Form 10-Q for the period ended September 30, 1994), incorporated by reference to Exhibit 10.604 of Chiron's report on Form 10-Q for the period ended June 30, 1999.*

10.605 Letter Agreement dated January 27, 1998, between Chiron and Lewis T. Williams, incorporated by reference to Exhibit 10.605 of Chiron's report on Form 10-K for fiscal year 1997.*

10.606 Letter Agreement dated December 18, 2001, between Chiron and Lewis T. Williams.*

10.607 Through 10.610 Reserved

10.611 Letter Agreement dated March 18, 1998 between Chiron and Séan P. Lance, incorporated by reference to Exhibit 10.611 of Chiron's report on Form 10-K for fiscal year 1997.*

10.612 Amended and Restated Promissory Note dated as of August 7, 1998, executed by Séan P. Lance for the benefit of Chiron, incorporated by reference to Exhibit 10.612 of Chiron's report on Form 10-K for fiscal year 1998.*

10.613 Letter Agreement dated March 19, 1998 between Chiron and James R. Sulat, incorporated by reference to Exhibit 10.612 of Chiron's report on Form 10-K for fiscal year 1997.*

10.614 Letter Agreement dated February 20, 2001 between Chiron and Lewis T. Williams, incorporated by reference to Exhibit 10.614 of Chiron's report on Form 10-K for fiscal year 2000.*

10.615 Consulting Agreement dated February 25, 2000, between Chiron and Dr. Edward E. Penhoet, incorporated by reference to Exhibit 10.615 of Chiron's report on Form 10-K for fiscal year 1999.*

10.616 Consulting Agreement dated February 25, 2000, between Chiron and Dr. William J. Rutter, incorporated by reference to Exhibit 10.616 of Chiron's report on Form 10-K for fiscal year 1999.*

10.617 Letter Agreement dated May 28, 1999 between Chiron and Peder K. Jensen, as supplemented by Promissory Notes dated as of September 21, 1999, executed by Peder K. Jensen and Isabel J. Jensen, for the benefit of Chiron, incorporated by reference to Exhibit 10.617 of Chiron's report on Form 10-Q for the period ended June 30, 2000.*

10.618 Amendment dated February 14, 2001 to Consulting Agreement dated February 25, 2000, between Chiron and Dr. William J. Rutter, incorporated by reference to Exhibit 10.618 of Chiron's report on Form 10-K for fiscal year 2000.*

10.619 Amendment dated March 1, 2002 to Consulting Agreement dated February 25, 2000, between Chiron and Dr. William J. Rutter.*

10.620 Through 10.699 Reserved

10.701 Investment Agreement dated as of November 20, 1994 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.54 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.701 of Chiron's report on Form 10-Q for the period ended June

30, 1999.

10.702 Governance Agreement dated as of November 20, 1994 among Ciba-Geigy Limited, Ciba-Geigy Corporation and Chiron Corporation (initially filed as Exhibit 10.55 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.702 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.703 Subscription Agreement dated as of November 20, 1994 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.56 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.703 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.704 Cooperation and Collaboration Agreement dated as of November 20, 1994, between Ciba-Geigy Limited and Chiron Corporation (initially filed as Exhibit 10.57 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.704 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.705 Registration Rights Agreement dated as of November 20, 1994 between Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.58 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.705 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.706 Market Price Option Agreement dated as of November 20, 1994 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.59 of Chiron's current report on Form 8-K dated November 20, 1994), incorporated by reference to Exhibit 10.706 of Chiron's report on Form 10-Q for the period ended June 30, 1999.

10.707 Amendment dated as of January 3, 1995 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.60 of Chiron's current report on Form 8-K dated January 4, 1995), incorporated by reference to Exhibit 10.707 of Chiron's report on Form 10-Q for the period ended September 30, 1999.

10.708 Supplemental Agreement dated as of January 3, 1995 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.61 of Chiron's current report on Form 8-K dated January 4, 1995), incorporated by reference to Exhibit 10.708 of Chiron's report on Form 10-Q for the period ended September 30, 1999.

10.709 Amendment with Respect to Employee Stock Option Arrangements dated as of January 3, 1995 among Ciba-Geigy Limited, Ciba-Geigy Corporation, Ciba Biotech Partnership, Inc. and Chiron Corporation (initially filed as Exhibit 10.62 of Chiron's current report on Form 8-K dated January 4, 1995), incorporated by reference to Exhibit 10.709 of Chiron's report on Form 10-Q for the period ended September 30, 1999.*

10.710 Agreement, dated November 27, 1996, between Ciba-Geigy Limited and Chiron, incorporated by reference to Exhibit 10.92 of Chiron's current report on Form 8-K filed with the Commission on December 17, 1996.

10.711 Amendment dated March 26, 1997 to Agreement dated November 27, 1996, between Novartis Pharma AG and Chiron, incorporated by reference to Exhibit 10.44 of Chiron's report on Form 10-Q for the period ended March 30, 1997.

10.712 Letter Agreement dated December 19, 1997, between Novartis Pharma AG and Chiron, incorporated by reference to Exhibit 10.712 of Chiron's report on Form 10-K for fiscal year 1997.

10.713 Letter Agreement dated December 24, 1997, between Novartis Corporation and Chiron, incorporated by reference to Exhibit 10.713 of Chiron's report on Form 10-K for fiscal year 1997. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.714 Letter Agreement, dated May 6, 1996, as to consent to assignment of contracts to Novartis Limited, among the Registrant, Ciba-Geigy Limited, Ciba-Geigy Corporation and Ciba Biotech Partnership, Inc., incorporated by reference to Exhibit 10.43 of Chiron's report on Form 10-K for fiscal year 1996.

10.715	Letter Agreement, dated December 19, 1996, regarding compensation paid by Chiron for director services performed by employees of Ciba-Geigy Limited, incorporated by reference to Exhibit 10.44 of Chiron's report on Form 10-K for fiscal year 1996.*
10.716	Letter Agreement dated September 30, 1999, between Novartis Corporation and Chiron, incorporated by reference to Exhibit 10.716 of Chiron's report on Form 10-Q for the period ended September 30, 1999. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")
10.717	Chiron Funding L.L.C. Limited Liability Company Agreement, entered into and effective as of December 28, 1995, among Chiron, Chiron Biocine Company and Biocine S.p.A. and Ciba-Geigy Corporation, incorporated by reference to Exhibit 10.80 of Chiron's report on Form 10-K for fiscal year 1995. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")
10.718	Agreement between Ciba-Geigy Limited and Chiron made November 15, 1995, incorporated by reference to Exhibit 10.81 of Chiron's report on Form 10-K for fiscal year 1995. (We have omitted certain information from the Agreement and filed it separately with the Securities and Exchange Commission pursuant to our request for confidential treatment under Rule 24b-2. We have identified the omitted confidential information by the following statement: "Confidential Treatment Requested.")

10.719	Reimbursement Agreement dated as of March 24, 1995, between Ciba-Geigy Limited, a Swiss corporation, and Chiron, incorporated by reference to Exhibit 10.76 of Chiron's report on Form 10-Q for the period ended July 2, 1995.
10.720	Reimbursement Agreement, dated as of June 28, 1996, between Ciba-Geigy Limited, a Swiss corporation, and Chiron, incorporated by reference to Exhibit 10.94 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
10.721	Reimbursement Agreement, dated as of July 12, 1996, between Ciba-Geigy Limited, a Swiss corporation, and Chiron, incorporated by reference to Exhibit 10.93 of Chiron's report on Form 10-Q for the period ended June 30, 1996.
10.722	Letter Agreement dated December 31, 1999 between Novartis Corporation and Chiron, incorporated by reference to Exhibit 10.44 of Chiron's report on Form 10-K for fiscal year 1999.*
10.723	Letter Agreement dated December 7, 2000, between Novartis Corporation and Chiron, incorporated by reference to Exhibit 10.723 of Chiron's report on Form 10-K for fiscal year 2000.
10.724	Through 10.799 Reserved
10.801	Through 10.899 Reserved
16	Letter of KPMG LLP to the Registrant regarding change in certifying accountant dated March 5, 2002.
21	List of Chiron's Subsidiaries.
23.1	Consent of KPMG LLP, Independent Auditors.
24	Power of Attorney. We incorporate the Power of Attorney on pages 73 and 74 by reference.

* Management contract, compensatory plan or arrangement.

SIGNATURES

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

CHIRON CORPORATION

Date: March 5, 2002 By: /s/ SÉAN P. LANCE

Séan P. Lance
Chief Executive Officer and
President; Chairman of the Board

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS:

That the undersigned officers and directors of Chiron Corporation, a Delaware corporation, do hereby constitute and appoint Seán P. Lance and James R. Sulat, and each of them, the lawful attorney and agent or attorneys and agents, with full power and authority to do any and all acts and things and to execute any and all instruments which said attorneys and agents, and any one of them, determine may be necessary or advisable or required to enable said corporation to comply with the Securities Exchange Act of 1934, as amended, and any rules or regulations or requirements of the Securities and Exchange Commission in connection with this Form 10-K Report. Without limiting the generality of the foregoing power and authority, the powers granted include the power and authority to sign the names of the undersigned officers and directors in the capacities indicated below to this Form 10-K report or amendments or supplements thereto, and each of the undersigned hereby ratifies and confirms all that said attorneys and agents or either of them, shall do or cause to be done by virtue hereof. This Power of Attorney may be signed in several counterparts.

IN WITNESS WHEREOF, each of the undersigned has executed this Power of Attorney as of the date indicated opposite his name.

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

Signature	Title	Date
/s/ SÉAN P. LANCE Séan P. Lance	Chief Executive Officer and President; Chairman of the Board; Director (Principal Executive Officer)	March 5, 2002
/s/ JAMES R. SULAT James R. Sulat	Vice President; Chief Financial Officer (Principal Financial Officer)	March 5, 2002
/s/ DAVID V. SMITH David V. Smith	Vice President, Finance and Principal Accounting Officer	March 5, 2002
/s/ WILLIAM J. RUTTER, PH.D. William J. Rutter, Ph.D.	Director	March 5, 2002

/s/ RAYMUND BREU, PH.D. Raymund Breu, Ph.D.	Director	March 5, 2002

/s/ VAUGHN D. BRYSON	Director	March 5, 2002
Vaughn D. Bryson		
/s/ LEWIS W. COLEMAN	Director	March 5, 2002
Lewis W. Coleman		
/s/ PIERRE E. DOUAZE	Director	March 5, 2002
Pierre E. Douaze		
/s/ PAUL L. HERRLING, PH.D.	Director	March 5, 2002
Paul L. Herrling, Ph.D.		
/s/ EDWARD E. PENHOET, PH.D.	Director	March 5, 2002
Edward E. Penhoet, Ph.D.		
/s/ JACK W. SCHULER	Director	March 5, 2002
Jack W. Schuler		
/s/ PIETER J. STRIJKERT, PH.D.	Director	March 5, 2002
Pieter J. Strijkert, Ph.D.		

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Stockholders
Chiron Corporation:

We have audited the accompanying consolidated balance sheets of Chiron Corporation and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2001. In connection with our audits of the consolidated financial statements, we also have audited the consolidated financial statement schedule as listed in the accompanying index. These consolidated financial statements and consolidated financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Chiron Corporation and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

San Francisco, California
January 28, 2002

CHIRON CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

ASSETS

	December 31,	
	2001	**2000**
Current assets:		
Cash and cash equivalents	$ 320,673	$ 166,990
Short-term investments in marketable debt securities	456,506	534,621
Total cash and short-term investments	777,179	701,611
Accounts receivable, net of allowances of $18,772 in 2001 and $14,576 in 2000:		
Unrelated parties	224,248	213,816
Related parties	981	5,130
	225,229	218,946
Current portion of notes receivable	5,103	6,179
Inventories	111,357	108,713
Current net deferred income tax asset	33,717	35,980
Derivative financial instruments	756	
Other current assets:		
Unrelated parties	35,064	30,462
Related parties	285	667
	35,349	31,129
Total current assets	1,188,690	1,102,558
Noncurrent investments in marketable debt securities	524,858	149,925
Property, plant, equipment and leasehold improvements, at cost:		
Land and buildings	144,789	138,981
Laboratory, production and office equipment	361,423	345,495
Leasehold improvements	89,392	87,899
Construction-in-progress	26,341	24,926
	621,945	597,301
Less accumulated depreciation and amortization	(308,557)	(284,098)
Property, plant, equipment and leasehold improvements, net	313,388	313,203
Purchased technologies, net of accumulated amortization of $51,887 in 2001 and $29,941 in 2000	279,298	302,134
Goodwill, net of accumulated amortization of $27,373 in 2001 and $3,515 in 2000	224,742	240,647
	155,086	163,759

	December 31,	
Other intangible assets, net of accumulated amortization of $81,554 in 2001 and $69,519 in 2000		
Investments in equity securities and affiliated companies	146,984	155,794
Noncurrent notes receivable	9,706	12,999
Other noncurrent assets:		
Unrelated parties	28,799	15,273
Related parties	1,901	1,784
	30,700	17,057
	$ 2,873,452	$ 2,458,076

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

LIABILITIES AND STOCKHOLDERS' EQUITY

	December 31,	
	2001	**2000**
Current liabilities:		
Accounts payable:		
Unrelated parties	$ 56,772	$ 45,693
Related parties	1	7
	56,773	45,700
Accrued compensation and related expenses	47,020	44,972
Derivative financial instruments	2,861	
Short-term borrowings	526	1,171
Current portion of long-term debt		1,212
Current portion of unearned revenue	28,871	50,588
Income taxes payable	83,099	146,585
Other current liabilities:		
Unrelated parties	111,753	122,305
Related parties	13	846
	111,766	123,151
Total current liabilities	330,916	413,379
Long-term debt	408,917	3,039
Noncurrent derivative financial instruments	7,646	
Noncurrent net deferred income tax liability	58,944	74,921
Noncurrent unearned revenue	74,371	42,154
Other noncurrent liabilities	42,652	40,476
Minority interest	3,894	3,025
Total liabilities	927,340	576,994

	December 31,	
Commitments and contingencies (Note 12)		
Put options	13,764	
Stockholders' equity:		
Preferred stock, $0.01 par value; 5,000,000 shares authorized; none outstanding		
Common stock, $0.01 par value; 499,500,000 shares authorized; 191,682,000 outstanding in 2001 and 2000	1,917	1,917
Restricted common stock, $0.01 par value; 500,000 shares authorized; none outstanding		
Additional paid-in capital	2,441,281	2,418,032
Deferred stock compensation	(17,506)	(22,986)
Accumulated deficit	(360,997)	(438,967)
Accumulated other comprehensive income (loss)	(21,286)	17,497
Treasury stock, at cost (2,341,000 shares in 2001 and 2,183,000 shares in 2000)	(111,061)	(94,411)
Total stockholders' equity	1,932,348	1,881,082
	$ 2,873,452	$ 2,458,076

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended December 31,		
	2001	**2000**	**1999**
Revenues:			
Product sales, net:			
Unrelated parties	$ 769,520	$ 626,689	$ 419,750
Related parties	2,366	744	1,927
	771,886	627,433	421,677
Equity in earnings of unconsolidated joint businesses	84,528	84,248	79,320
Collaborative agreement revenues:			
Unrelated parties	14,099	13,135	15,769
Related parties	31,216	19,017	60,417
	45,315	32,152	76,186
Royalty and license fee revenues	198,236	190,469	142,915
Other revenues	40,702	37,817	42,548
Total revenues	1,140,667	972,119	762,646

	Year Ended December 31,		
Operating expenses:			
Cost of sales:			
Unrelated parties	276,291	220,382	183,662
Related parties	1,284	680	752
	277,575	221,062	184,414
Research and development:			
Unrelated parties	344,415	298,414	303,399
Related parties		425	
	344,415	298,839	303,399
Selling, general and administrative:			
Unrelated parties	251,795	219,336	180,937
Related parties	822	403	
	252,617	219,739	180,937
Write-off of purchased in-process technologies		171,600	
Amortization expense	46,752	17,651	9,585
Restructuring and reorganization charges (charge reversals) (Note 6)	64	(447)	197
Other operating expenses	19,133	14,458	1,797
Total operating expenses	940,556	942,902	680,329
Income from operations	200,111	29,217	82,317

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS (Continued)
(In thousands, except per share data)

	Year Ended December 31,		
	2001	**2000**	**1999**
Income from operations	$ 200,111	$ 29,217	$ 82,317
Gain (loss) on sale of assets	2,426	(224)	872
Gain on sale of intangible assets			7,490
Interest expense:			
Unrelated parties	(7,507)	(12,739)	(20,201)
Related parties		(48)	(3,691)
	(7,507)	(12,787)	(23,892)
Other income, net:			
Unrelated parties	59,599	87,297	89,857
Related parties	1,315	787	

	Year Ended December 31,		
	60,914	88,084	89,857
Minority interest	(1,194)	(809)	
Income from continuing operations before income taxes	254,750	103,481	156,644
Provision for income taxes	79,992	87,379	28,240
Income from continuing operations	174,758	16,102	128,404
Gain (loss) on disposal of discontinued operations (Note 4)	5,278	(7,588)	32,173
Net income	$ 180,036	$ 8,514	$ 160,577
Basic earnings per share (Note 2):			
Income from continuing operations	$ 0.92	$ 0.09	$ 0.71
Net income	$ 0.95	$ 0.05	$ 0.89
Diluted earnings per share (Note 2):			
Income from continuing operations	$ 0.90	$ 0.08	$ 0.69
Net income	$ 0.92	$ 0.04	$ 0.86

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Year Ended December 31,		
	2001	**2000**	**1999**
Net income	$ 180,036	$ 8,514	$ 160,577
Other comprehensive income (loss):			
Change in foreign currency translation adjustment during the period, net of tax benefit of $5,510 and $1,715 in 2001 and 2000, respectively	(23,425)	(23,219)	(28,779)
Unrealized gains (losses) from investments:			
Net unrealized holding gains (losses) arising during the period, net of tax benefit (provision) of $7,045, $(31,849) and $(11,517) in 2001, 2000 and 1999, respectively	(9,861)	49,815	18,790
Reclassification adjustment for net gains included in net income, net of tax provision of $3,239, $594 and $62 in 2001, 2000 and 1999, respectively	(5,236)	(928)	(102)
Net unrealized gains (losses) from investments	(15,097)	48,887	18,688

	Year Ended December 31,		
Minimum pension liability adjustment, net of tax benefit (provision) of $(73), $7 and $55 in 2001, 2000 and 1999, respectively	(261)	(67)	(274)
Other comprehensive income (loss)	(38,783)	25,601	(10,365)
Comprehensive income	$ 141,253	$ 34,115	$ 150,212

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands)

	Common Stock		Additional Paid-in Capital	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Shares	Amount					Shares	Amount	
Balances at December 31, 1998	179,925	$ 1,799	$ 1,993,916	$ (9,403)	$ (437,873)	$ 2,261		$	$ 1,550,700
Repurchase of treasury stock							(4,838)	(150,425)	(150,425)
Exercise of stock options	1,742	18	28,975		(38,868)		3,419	98,575	88,700
Tax benefits from employee stock plans			42,803						42,803
Employee stock purchase plan	196	2	3,498		(1,640)		189	5,136	6,996
Deferred stock compensation			6,695	(6,695)					
Amortization of deferred stock compensation				1,990					1,990
Foreign currency translation adjustment						(28,779)			(28,779)
Net unrealized gain from investments						18,688			18,688
Minimum pension liability adjustment						(274)			(274)
Elimination of one-month lag in reporting of Chiron S.p.A					(5,233)				(5,233)
Net income					160,577				160,577
Balances at December 31, 1999	181,863	$ 1,819	$ 2,075,887	$ (14,108)	$ (323,037)	$ (8,104)	(1,230)	$ (46,714)	$ 1,685,743
Repurchase of treasury stock							(7,297)	(314,428)	(314,428)
Exercise of stock options	155	2	2,994		(88,598)		3,722	152,139	66,537
Tax benefits from employee stock plans			37,865						37,865
Employee stock purchase plan	49		1,903		(4,640)		266	10,880	8,143

	Common Stock					Accumulated Other Comprehensive Income (Loss)	Treasury Stock		
Conversion of PathoGenesis Corporation stock options			3,371						3,371
Conversion of convertible debentures	9,615	96	281,288		(31,206		2,356	103,712	353,890
Deferred stock compensation			14,724	(14,724)					
Amortization of deferred stock compensation				5,846	)				5,846
Foreign currency translation adjustment						(23,219)			(23,219)
Net unrealized gain from investments						48,887			48,887
Minimum pension liability adjustment						(67)			(67)
Net income					8,514				8,514
Balances at December 31, 2000	191,682	$ 1,917	$ 2,418,032	$ (22,986)	$ (438,967)	$ 17,497	(2,183)	$ (94,411)	$ 1,881,082

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (Continued)
(In thousands)

	Common Stock		Additional Paid-in Capital	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Treasury Stock		Total
	Shares	Amount					Shares	Amount	
Balances at December 31, 2000	191,682	$ 1,917	$ 2,418,032	$ (22,986)	$ (438,967)	$ 17,497	(2,183)	$ (94,411)	$ 1,881,082
Repurchase of treasury stock							(3,627)	(171,864)	(171,864)
Exercise of stock options			(583)		(81,344)		3,193	143,547	61,620
Exercise of stock warrant					(18,513)		419	18,513	
Exercise of put options			(1,548)				(400)	(18,586)	(20,134)
Premiums from put options			9,320						9,320
Temporary equity related to put options			(13,764)						(13,764)
Tax benefits from employee stock plans			25,893						25,893
Employee stock purchase plan					(2,209)		257	11,740	9,531
Deferred stock compensation			3,931	(3,931)					
Amortization of deferred stock compensation				9,411					9,411
Foreign currency translation adjustment						(23,425)			(23,425)
Net unrealized loss from investments						(15,097)			(15,097)
						(261)			(261)

	Common Stock					Accumulated Other Comprehensive Income (Loss)	Treasury Stock		
Minimum pension liability adjustment									
Net income					180,036				180,036
Balances at December 31, 2001	191,682	$ 1,917	$ 2,441,281	$ (17,506)	$ (360,997)	$ (21,286)	(2,341)	$ (111,061)	$ 1,932,348

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended December 31,		
	2001	**2000**	**1999**
Cash flows from operating activities:			
Net income	$ 180,036	$ 8,514	$ 160,577
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	115,046	81,426	68,895
Amortization of marketable debt securities	8,606	885	5,564
Amortization of deferred stock compensation	9,411	5,846	1,990
Write-off of purchased in-process technologies		171,600	
(Gain) loss on sale of assets	(2,426)	224	(872)
Gain on sale of intangible assets			(7,490)
(Gain) loss on disposal of discontinued operations	(5,278)	7,588	(32,173)
Net (gain) loss on sale of marketable debt securities	(836)	3,720	
Net gain on sale of equity securities	(8,706)	(3,181)	(3,783)
Gain on sale of interests in affiliated companies	(2,500)	(2,927)	
Unrealized gain on trading securities			(3,352)
Write-off of property, plant, equipment and leasehold improvements		12,801	767
Other than temporary loss on investments	5,543	5,000	1,716
Equity in loss of equity method investments	1,269		
Minority interest	1,194	809	
Changes in reserves	37,736	20,399	17,056
Changes in estimated liabilities			(2,911)
Deferred income taxes	(13,714)	(26,502)	(5,864)
Other, net	(6,472)	4,152	2,385
Changes, excluding effect of acquisitions and dispositions, to:			
Accounts receivable	(32,852)	(75,790)	(15,797)
Inventories	(13,065)	(12,017)	(37,357)
Other current assets	(6,614)	(8,162)	(327)
Derivative financial instruments	(3,936)		
Other noncurrent assets	(15,799)		
Accounts payable and accrued expenses	(21,073)	123,760	(69,115)
Current portion of unearned revenue	(14,863)	14,856	(18,142)
Other current liabilities	33,135	14,008	(38,233)

	Year Ended December 31,		
Other noncurrent liabilities	18,152	24,330	(2,649)
Proceeds from sale of equity securities		2,108	
Net cash provided by operating activities	261,994	373,447	20,885
Cash flows from investing activities:			
Purchases of investments in marketable debt securities	(987,291)	(3,571,355)	(1,155,363)
Proceeds from sale and maturity of investments in marketable debt securities	681,601	4,065,467	1,047,429
Payments on notes receivable	6,400	3,233	
Capital expenditures	(64,878)	(54,353)	(64,594)
Proceeds from sales of assets	8,217	1,000	21,751
Purchases of equity securities and interests in affiliated companies	(14,897)	(27,411)	
Proceeds from sale of equity securities and interests in affiliated companies	15,071	5,035	3,783
Cash paid to purchase businesses, net of cash acquired	(9,854)	(720,667)	
Proceeds from disposal of discontinued operations			46,912
Increase (decrease) in other assets	(5,463)	58,475	(16,745)
Net cash used in investing activities	(371,094)	(240,576)	(116,827)
Cash flows from financing activities:			
Net repayment of short-term borrowings	(619)	(18,927)	(15,332)
Repayment of debt and capital leases	(1,350)	(71,078)	(2,443)
Proceeds from issuance of Liquid Yield Option Notes	401,829		
Payment of issuance costs on Liquid Yield Option Notes	(9,929)		
Proceeds from issuance of debt			6,936
Payments to acquire treasury stock	(201,046)	(314,428)	(140,819)
Proceeds from reissuance of treasury stock	65,727	74,680	63,130
Proceeds from issuance of common stock		7	35,020
Proceeds from put options	8,171		
Net cash provided by (used in) financing activities	262,783	(329,746)	(53,508)
Net increase (decrease) in cash and cash equivalents	153,683	(196,875)	(149,450)
Cash and cash equivalents at beginning of the year	166,990	363,865	513,315
Cash and cash equivalents at end of the year	$ 320,673	$ 166,990	$ 363,865

The accompanying Notes to Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001

Note 1 The Company and Summary of Significant Accounting Policies

The Company and Basis of Presentation

Chiron Corporation is a global pharmaceutical company that develops, manufactures and markets therapeutic products for the prevention and treatment of infectious disease utilizing innovations in biology and chemistry. Chiron participates in three global healthcare markets: (i) biopharmaceuticals, with an emphasis on the treatment of cancer and infectious disease; (ii) adult and pediatric vaccines; and (iii) blood testing. Chiron is applying a broad and integrated scientific approach to the development of innovative products for preventing and treating cancer and infectious disease. This approach is supported by research strengths in therapeutic proteins, small molecules and vaccines.

On December 29, 1997, Chiron completed the sale of its ophthalmics business, Chiron Vision, to Bausch & Lomb Incorporated, and on November 30, 1998, Chiron completed the sale of its *in vitro* diagnostics business, Chiron Diagnostics, to Bayer Corporation. As a result of these transactions, Chiron's Consolidated Statements of Operations reflect the reversal of retention and severance obligations, the expiration of certain contractual obligations and the final sale of the remaining real estate assets in the gain (loss) on discontinued operations (see Note 4).

Prior to fiscal year 1999, the results of Chiron S.p.A., Chiron's Italian subsidiary, were reported on a one-month lag. In the first quarter of 1999, the results of Chiron S.p.A. were brought current. As a result, during fiscal year 1999, Chiron recorded a loss of $5.2 million for the month of December 1998 as a component of "Accumulated deficit" in the Consolidated Balance Sheets.

On September 21, 2000, Chiron acquired PathoGenesis Corporation. Chiron included PathoGenesis' operating results, including the seven business days from September 21 to 30, 2000, in its consolidated operating results beginning on October 1, 2000. PathoGenesis' operating results for the seven business days in September 2000 were not significant to Chiron's consolidated operating results (see Note 5).

Principles of Consolidation

The consolidated financial statements include the accounts of Chiron and its majority-owned subsidiaries. For consolidated majority-owned subsidiaries in which Chiron owns less than 100%, Chiron records minority interest in the consolidated financial statements to account for the ownership interest of the minority owner. Investments in joint ventures, limited partnerships and interests in which Chiron has an equity interest of 50% or less are accounted for using either the equity or cost method. All significant intercompany accounts and transactions have been eliminated in consolidation.

Chiron's most significant consolidated majority-owned subsidiaries and respective ownership percentages are as follows:

Name	Percentage Ownership
PathoGenesis Corporation	100%
31 Corsa Verwaltungsgesellschaft mbH	100%
Chiron Behring GmbH & Co.	100%
Chiron S.p.A.	100%
Chiron B.V.	100%
Chiron Iberia SL	100%
Chiron U.K. Ltd	100%
Chiron GmbH	100%
Chiron France S.a.r.l.	100%
Chiron Italia S.r.l.	100%
Chiron Blood Testing S.a.r.l.	100%
Chiron Behring Vaccines Private Limited	51%

In 2001, Chiron became a limited partner of Forward Venture IV, L.P. Chiron will pay $15.0 million over ten years, of which $5.3 million was paid through December 31, 2001, for a 6.35% ownership percentage. In 2000, Chiron became a limited partner of Burrill Biotechnology Capital Fund, L.P. Chiron will pay $25.0 million over five years, of which $13.5 million was paid through December 31, 2001, for a 23.19% ownership percentage. Chiron accounts for both investments under the equity method of accounting pursuant to Emerging Issues Task Force Topic No. D-46 "Accounting for Limited Partnership Investments."

In 2000, Chiron began consolidating, and recording minority interest related to, its 51% owned joint venture, Chiron Behring Vaccines Limited.

Use of Estimates and Reclassifications

The preparation of financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, management evaluates its estimates, including those related to investments; inventories; derivatives; intangible assets; product discounts, rebates and returns; bad debts; collaborative, royalty and license arrangements; restructuring; pension and other post-retirement benefits; income taxes; and litigation and other contingencies. Chiron bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

Chiron, prior to filing its financial statements on Form 10-K, publicly releases an unaudited condensed balance sheet and statement of operations. Between the date of Chiron's earnings release and the filing of Form 10-K, reclassifications may be required. These reclassifications, when made, have no effect on income from continuing operations, net income or earnings per share.

Certain previously reported amounts have been reclassified to conform with the current period presentation.

Related to the acquisition of PathoGenesis Corporation on September 21, 2000, Chiron allocated the purchase price based on the estimated fair values of the assets acquired and liabilities assumed. Throughout 2001, Chiron recorded purchase price adjustments resulting from (i) a final reconciliation of PathoGenesis registered shares of common stock, (ii) the true-up of severance, employee relocation, leasing and legal costs to amounts actually paid and (iii) the related deferred tax effects, the total of which resulted in a $3.8 million increase to the purchase price and a $2.2 million increase to goodwill. For each of the quarters and for the year ended December 31, 2001, this adjustment had no material impact on amortization expense or earnings per share.

Cash Equivalents, Investments in Marketable Debt Securities and Investments in Equity Securities

All highly liquid investments with a maturity of three months or less from the date of purchase are considered to be cash equivalents. Cash equivalents and short-term investments in marketable debt securities consist principally of money market instruments, including corporate notes and bonds, commercial paper and government agency securities. Noncurrent investments in marketable debt securities consist principally of corporate notes and bonds and government agency securities. The cost of securities sold is based on the specific identification method for debt securities and on the average cost method for equity securities.

In accordance with Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," Chiron has classified its investments in certain debt and equity securities as available-for-sale. Chiron has in the past, and may in the future, classify certain equity securities as trading. Available-for-sale securities are recorded at fair value based upon year-end quoted market prices. Unrealized gains and losses, deemed as temporary in nature, are reported as a separate component of comprehensive income or loss. Trading securities, if any, are recorded at fair value based upon year-end quoted market prices. Unrealized gains and losses on trading securities are included in results of operations.

Chiron periodically reviews its debt and equity securities by comparing the market value to the carrying value of the security. Impairment, if any, is based on the excess of the carrying value over the market value. If impairment is considered other-than-temporary, the security's cost is written down to market value through earnings. Generally Chiron believes that an investment is impaired if its market value has been below its carrying value for each trading day in a six-month period.

Inventories

Inventories are stated at the lower of cost or market using the moving weighted-average cost method. Inventories consisted of the following at December 31:

	2001	2000
	(In thousands)	
Finished goods	$ 26,683	$ 25,590
Work-in-process	60,512	57,754
Raw materials	24,162	25,369
	$ 111,357	$ 108,713

Derivative Financial Instruments

Effective January 1, 2001, Chiron implemented Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by Statement of Financial Accounting Standards No. 138, which establishes accounting and reporting standards for derivatives and hedging activities. All derivatives must be recorded on the balance sheet at fair value. Changes in the fair value of derivatives are accounted for depending upon the exposure being hedged and whether the derivatives qualify and are designated for hedge accounting. The effect of the adoption did not have a material impact on Chiron's results of operations or consolidated financial position in 2001.

Chiron uses various derivatives, such as foreign currency option contracts and forward foreign currency contracts, to reduce foreign exchange risks. Chiron also uses forward sales contracts to reduce equity securities ris