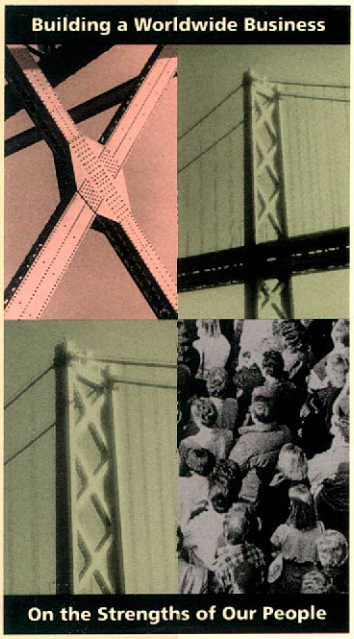
1991 Chiron Annual Report



We have built a strong organization that spans three continents and draws upon advanced biological research.

Hormone and Antibody Research Focus

- IGF
- PDGF
- EGF
- FGF
- NGF
- Insulin
- Factor VIII
- SOD
- T-88 antibody
- TNF antibody
- TNF convertase inhibitor
- Bone growth proteins
- Soluble receptors
- Serpentine receptors
- Peptide synthesis

Chiron IntraOptics

- Merger of Chiron Ophthalmics with IntraOptics creates new business, Chiron IntraOptics.
- IntraOptics merger follows entry into the European market through the purchase of Adatomed GmbH of Germany.
- Approval of two new foldable IOLs gives Chiron IntraOptics a comprehensive line of lenses and equipment for small-incision surgeries.
- Acquisition of Magnum Diamond makes Chiron IntraOptics the largest domestic supplier of surgical knives for refractive surgery.

Chiron Technologies

- TNF antibody and T-88 antibody begin large-scale Phase 3 trials in U.S. and Europe to study potential efficacy in treating septic shock.
- IGF begins Phase 2 trials to study potential efficacy in treating type II diabetes.
- Chiron's production technology for recombinant human insulin delivers royalties from world's largest insulin provider, Novo Nordisk.
- Hepatitis B vaccine recommended for all children by Centers for Disease Control.
- Acquisition of Coselco Mimotopes, an Australian company specializing in innovative peptide research, gives Chiron new capabilities in drug and vaccine development.

Infectious Disease and Cancer Research Focus

- Hepatitis C virus
- Hepatitis B virus
- HIV (AIDS)
- Herpes virus
- Cytomegalovirus
- Interleukin-2
- PEG Interleukin-2
- M-CSF
- Ras oncogenes
- Gene therapy
- Bi-specific antibodies
- erbB2 antibody

Chiron Diagnostics

- The joint Chiron-Ortho diagnostics business is the world's largest supplier of microplate blood screening tests.
- Chiron-Ortho receives FDA approval for improved second-generation hepatitis C screening test on March 13, 1992.
- Testing of plasma doubles the U.S. market potential for HCV screening tests.
- First patent covering hepatitis C invention issues in the United Kingdom.
- RIBA™ HCV tests are being used in research and to provide additional information about positive screening test samples.
- DNA probe tests for detecting HBV and HCV viruses and monitoring the course of treatment are entering clinical evaluations.

Cetus Oncology/EuroCetus

- Cetus Oncology and EuroCetus combined are a significant cancer therapeutics business on a worldwide scale.
- FDA Advisory Committee recommends licensing Proleukin®IL-2 as treatment for metastatic kidney cancer.
- Proleukin now being marketed in ten European countries.
- OncoScint™cancer imaging test approved and launched in early 1992 in six European countries.
- Cardioxane™receives first worldwide approvals in Italy and Denmark in early 1992.
- Macrolin® M-CSF begins Phase 2 clinical trials to study its potential efficacy in treating fungal diseases in transplant and cancer patients.

The Biocine Company

- Chiron and CIBA-GEIGY purchase Sclavo vaccine business to begin commercial vaccine activities on a worldwide basis and prepare for launch of new vaccines.
- Biocine Sclavo prepares to launch recombinant pertussis vaccine in Italy and to begin clinical trials in the U.S.
- Two candidate AIDS vaccines begin U.S. clinical trials.
- Phase 2 trials to study potential efficacy of candidate vaccine to treat genital herpes near completion.
- Candidate genital herpes vaccine including an advanced adjuvant begins Phase 1 trials.
- Preclinical studies to select hepatitis C vaccine antigens provide promising results.

Success in healthcare springs from the creative efforts of dedicated, energetic and entrepreneurial people. On December 12, 1991, the people of Chiron and Cetus joined together to form a new organization that combines strengths of both companies. The talented people of this new Chiron share a common passion: to make a difference in world healthcare by developing and introducing new products that will diagnose, treat and eradicate major diseases. Throughout this report, woven into an update on the 1991 progress of Chiron's businesses, you will hear the voices of Chiron people expressing their desire to make a contribution.

Chiron

Chiron Diagnostics

Chiron/Ortho Diagnostics

Cetus Oncology

EuroCetus

The Biocine Company

Biocine Sclavo

Chiron IntraOptics

Adatomed GmbH

Chiron Technologies

Chiron Mimotopes

Chiron/CIBA-GEIGY

Chiron/Ethicon

Chiron/Bayer

Financial Highlights

(in thousands except per share data)	Year ending December 31, 1991	1990	1989	1988	1987
Consolidated Statement of Operations Data:					
Total revenues	$ 118,459	$ 78,512	$ 35,474	$ 32,814	$ 16,989
Other income, net	14,156	6,655	5,179	2,449	2,019
Income/(loss) before extraordinary item	(425,231)	4,024	(21,629)	(14,405)	(9,909)
Net income/(loss)	(425,131)	6,829	(21,629)	(14,405)	(9,909)
Income/(loss) per share before extraordinary item	(22.12)	.24	(1.51)	(1.23)	(.86)
Income/(loss) per share	(22.11)	.40	(1.51)	(1.23)	(.86)
Weighted average shares outstanding	19,226	17,177	14,339	11,742	11,570

	December 31, 1991	1990	1989	1988	1987
Consolidated Balance Sheet Data:					
Working capital	$ 492,432	$153,097	$ 88,804	$ 51,975	$ 47,393
Total assets	895,272	265,374	124,410	84,847	71,499
Long-term obligations	238,639	121,500	—	79	285
Accumulated deficit	(481,064)	(55,933)	(62,762)	(41,133)	(26,728)
Stockholders' equity	524,366	120,257	109,330	76,080	65,742
Number of employees	1,510	611	491	443	368

The Chiron Name

According to Homer's Iliad, Chiron was the wise and beneficent centaur who tended the wounds of many heroes and taught the healing arts to Asclepius, the first physician, and thus was the mythical creative source of medical knowledge. Chiron Corporation chose its name to reflect its mission: to apply creative strategies to develop novel products for human healthcare. Half-man and half-horse, the centaur also is a recombinant organism that symbolizes Chiron's genetic engineering foundation technology.

To Our Stockholders

Since its founding in May 1981, Chiron has pursued a strategy to evolve from a research organization into a fully integrated, worldwide healthcare company. Today, Chiron has significant positions in four markets: diagnostics, oncology, vaccines, and ophthalmics. Three recent business combinations have deepened Chiron's reservoir of technical skills, expanded manufacturing capacity, added geographic reach and new products in these key markets and provided experienced management talent to the organization. As a result, we believe that the Chiron organization is strategically well-placed to capitalize on the new products that will reach market from its research programs and clinical studies over the next several years.

Joint Diagnostic Business Expands. Chiron's joint diagnostic business with Ortho Diagnostic Systems, a Johnson & Johnson company, is the world's largest seller of AIDS and hepatitis blood screening tests in the microplate format. Chiron's 50 percent share of pre-tax profit from this business increased to $49.8 million in 1991.

DNA Probe Tests Move Closer to Market. In 1992, Chiron will initiate clinical evaluations of its DNA probe tests and upon completion will seek marketing approval in the United States and Europe. Chiron's diagnostic business is headed by William G. Gerber, M.D., formerly head of Cetus' PCR business.

Merger of Chiron and Cetus Creates Powerful Healthcare Company. On December 12, 1991, Chiron combined with Cetus, a pioneering biotechnology company founded in 1971. The new organization has a presence in both the domestic and European oncology markets.

Office of the Chairman

Hollings C. Renton, president and chief operating officer; William J. Rutter, Ph.D., chairman; and Edward E. Penhoet, Ph.D., chief executive officer

Cancer is a substantial health problem where innovative companies can play an important role because the knowledge base and therapies for treating cancer are expanding through new technologies. Chiron is at the forefront of both new products and new knowledge.

On January 17, the Biological Response Modifiers Advisory Committee of the Food and Drug Administration voted to recommend Cetus' Proleukin (interleukin-2) as a treatment for metastatic renal cell carcinoma, a disease for which the prognosis is grim, and for which there is no approved treatment. When approved, Proleukin will be the first drug that focuses the power of the patient's own immune system directly on cancer cells.

EuroCetus now sells Proleukin in ten countries in the European market. In January 1992, EuroCetus began selling OncoScint CR103, a diagnostic imaging agent for use in staging colorectal cancer, in six countries and in early 1992 received in Italy and Denmark the first worldwide approvals to sell Cardioxane, a cardiac protector against side effects in chemotherapy.

Cetus Oncology is headed by James E. Rurka, and EuroCetus is headed by Filippo La Monica, Ph.D., both of whom joined Cetus from large pharmaceutical companies. They report to Hollings C. Renton, who became president and chief operating officer of Chiron following the merger.

Cetus has been a leader in identifying and describing the biological mechanisms for cancer. The combination of this technology with Chiron's technology in vaccines may help develop new approaches to controlling both infectious diseases and cancers by enhancing the body's own immune response.

In addition, the new organization, including Chiron Mimotopes, has an advanced program in the creation of peptides and peptide analogs as drug candidates and in the synthesis and utilization of receptors as targets for drug development, which has significant potential in developing new anti-cancer compounds.

Business Unit Management

Chiron Diagnostics: *Mickey Urdea, Ph.D., division vice president, DNA probes research; Alan J. Polito, Ph.D., division vice president, immunodiagnostic development; William G. Gerber, M.D., president; and Michael Richey, division vice president, DNA probes marketing and sales*

Cetus Oncology: *Edward F. Kenney, division vice president, marketing and sales; and James E. Rurka, president*

Sclavo Acquisition Paves Way for Launch of New Vaccines. Chiron and its vaccine joint venture partner, CIBA-GEIGY Limited, are acquiring the vaccine business of Sclavo SpA of Italy, now renamed Biocine Sclavo. Biocine Sclavo is a key element in building a fully integrated worldwide vaccine business by the mid-1990s, one that we expect will be fully competitive with current major vaccine companies.

Separately, CIBA-GEIGY has agreed to invest up to $45 million in excess of its 50 percent obligation to fund activities of The Biocine Company over the next four years. In return, it will acquire a preferred interest in the earnings of The Biocine Company, which Chiron has an option to repurchase for CIBA-GEIGY's preferred investment plus interest.

Biocine Sclavo has a significant presence in the European pediatric vaccine market, operates state-of-the-art manufacturing facilities and is researching new technologies for bacterial and pediatric vaccines. These capabilities complement The Biocine Company's recombinant vaccine technology and advanced adjuvants for immune stimulation, and its focus on new adult vaccines for infectious diseases.

Chiron's worldwide vaccine business will be headed by Jacques-Francois Martin, formerly chief executive officer of Institut Merieux, who has 25 years of international healthcare and vaccine industry experience. Biocine Sclavo will be managed by Mario Lorenzoni, formerly with CIBA-GEIGY Italy. Research and development activities of The Biocine Company will continue to be directed by Dino Dina, M.D.

Chiron IntraOptics Joins Ranks of Worldwide Ophthalmic Players. Also in January 1992, Chiron Ophthalmics combined with IntraOptics, Inc., to form Chiron IntraOptics. Chiron IntraOptics markets a line of new foldable intraocular lenses (IOLs), a complete line of narrow-profile IOLs, and phacoemulsification equipment, which are specialized instruments used to break up and remove cataracts through a small surgical incision. These products give Chiron IntraOptics a comprehensive line of lenses and equipment for small-incision surgeries.

EuroCetus: *Filippo LaMonica, Ph.D., president*

The Biocine Company/Biocine Sclavo: *Jacques-Francois Martin, chief executive officer, The Biocine Company; Mario Lorenzoni, president, Biocine Sclavo; and Dino Dina, M.D., vice president, vaccines research*

Chiron's ophthalmic business is directed by William J. Link, Ph.D., chairman and chief executive officer, and James R. Cook, M.D., president and chief operating officer. Bill and Jim have played major roles in the growth of the ophthalmic surgery segment as founders of several successful businesses.

Maximizing Return on Technology Investment. To focus on commercial opportunities from Chiron's research programs, we have created a fifth business unit, Chiron Technologies, headed by Michael Ostrach, formerly head of corporate development and general counsel at Cetus. This group will market to other companies Chiron technologies that are not central to our four other businesses, and will acquire new products and technologies to help build these businesses.

Positioned for Success. Success in the healthcare industry requires productive science and effective products. Chiron has been a leader in both areas. Total end-user sales of biotechnology products from Chiron and Cetus technology, including hepatitis C tests, interleukin-2, hepatitis B vaccine and recombinant human insulin, exceeded $600 million in 1991. Chiron enters 1992 with the capabilities required for sustained commercial success in place, including a broad and promising pipeline of products, an organization structured to move these products to market rapidly, modern manufacturing capacity for each of its product areas, direct sales presences in its key markets, and a deep, experienced management team.

William J. Rutter, Ph.D.
Chairman

Edward E. Penhoet, Ph.D.
Vice Chairman and Chief Executive Officer

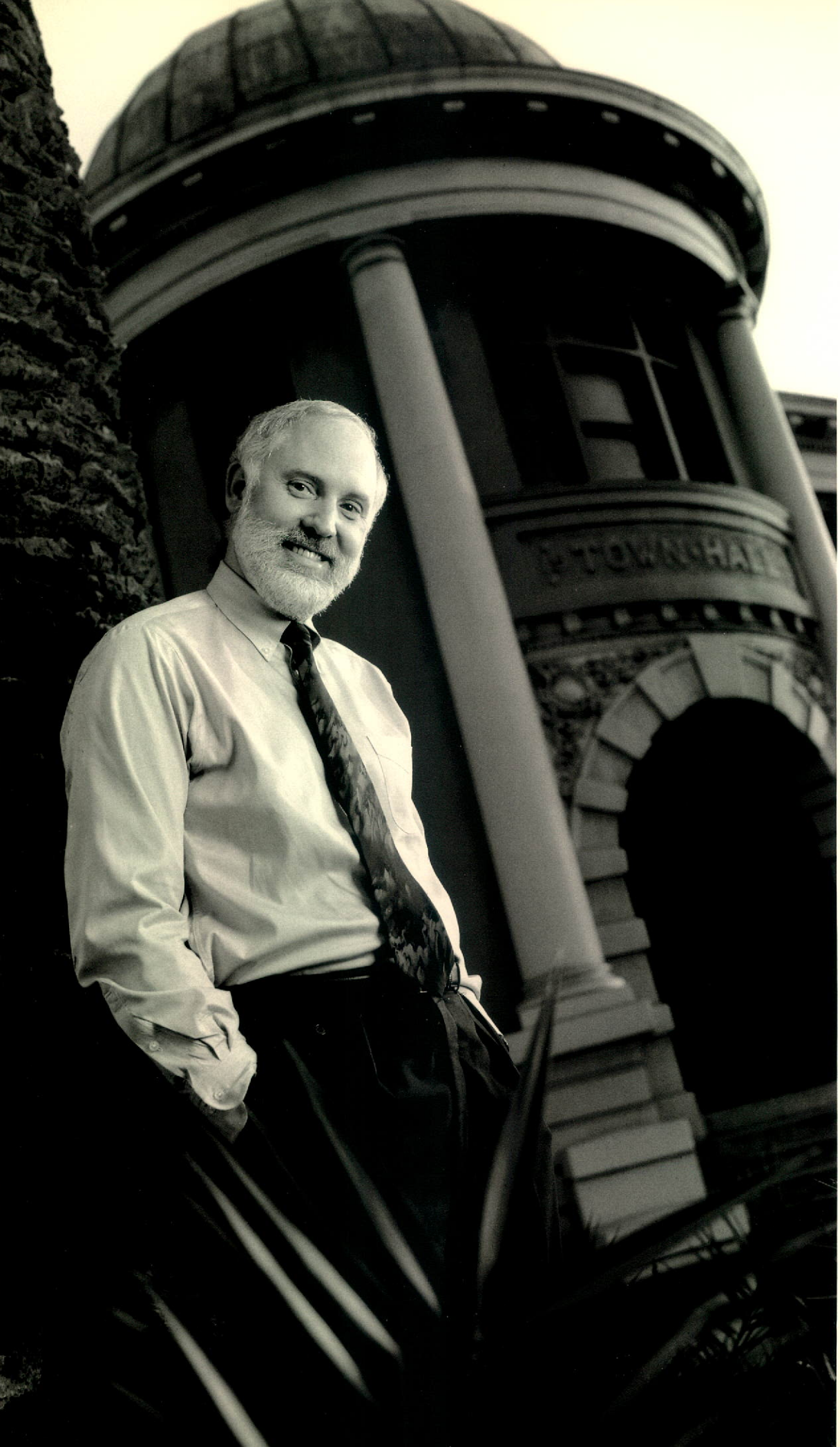
Hollings C. Renton
President and Chief Operating Officer

March 16, 1992

Chiron IntraOptics: *James R. Cook, M.D., president and chief operating officer; and William J. Link, Ph.D., chairman and chief executive officer*

Chiron Technologies: *Niek J. Roosdorp, Ph.D., division vice president; and Michael S. Ostrach, president*

Achieving sustainable success in the healthcare field requires both a productive research program that spawns valuable technology, and a business structure that maximizes the technology's value. Chiron has a highly regarded research group that has produced valuable technology such as the discovery of the hepatitis C virus; the first treatment for metastatic kidney cancer, Proleukin interleukin-2; recombinant hepatitis B vaccine; recombinant human insulin; and fundamental understanding of the mechanisms of cancer. In 1991, Chiron expanded its international market positions by combining with other fully integrated organizations in its areas of business focus. The following sections provide updates for the activities and programs in Chiron's five businesses. In part, the stories will be told in the words of the Chiron people featured.



"The entrepreneurial environment at Chiron encourages us to develop leading-edge science into practical products for the fast-paced and exciting diagnostics field."

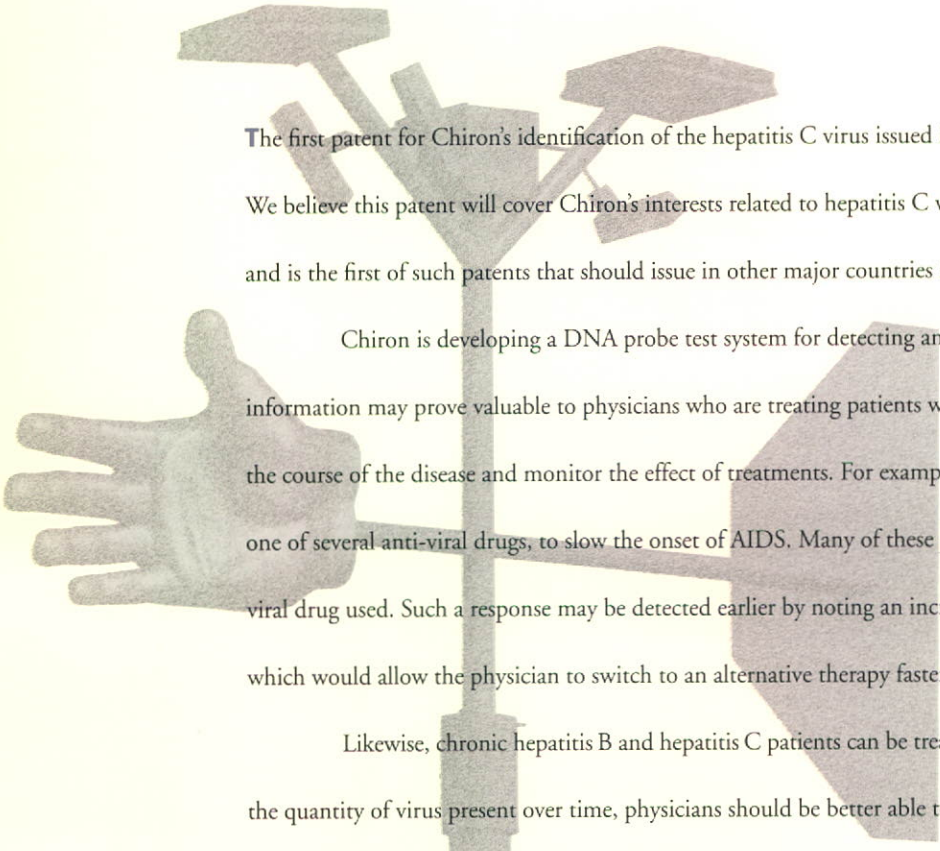
Paul Neuwald
Manager of Assay Development, DNA Probes
Research and Development
Chiron Diagnostics
Emeryville, California

Since the introduction of hepatitis C virus (HCV) tests in late 1989, more than 100 million units of whole blood and plasma have been screened. By eliminating potentially infective units, possibly 500,000 people who otherwise would have been exposed to HCV infection through transfusion have not contracted this disease. While all routes of HCV transmission are not yet fully understood, it is now generally believed that hepatitis C virus is the world's leading cause of serious liver disease, including cirrhosis and liver cancer. Chiron and Ortho Diagnostic Systems are developing additional HCV immunoassay tests that may prove useful in studying the prevalence of HCV infection and modes of transmitting the virus.

Chiron and Ortho introduced a second-generation HCV screening test in Europe in March 1991, and on March 13, 1992, received FDA approval and began shipping tests to blood centers across the United States. This test identifies additional cases of HCV-infected blood while reducing the number of safe blood units discarded.

Chiron's RIBA HCV test identifies the presence of specific virus antibodies in samples that have tested positive on HCV screening tests. This information may allow blood centers to counsel donors whose blood donations have been rejected as a result of a positive test result. On March 12, 1992, an FDA Advisory Committee recommended RIBA HCV for use as a supplemental test. During the FDA's review process, a laboratory at Chiron has been testing samples sent from blood centers around the country for research purposes. RIBA HCV tests are being used extensively in Europe, and by research collaborators in their studies to learn more about the nature, transmission and consequences of hepatitis C infection.

The University of California, Berkeley Campanile is visible throughout the Bay Area. Chiron's Emeryville location is central to local universities.



The first patent for Chiron's identification of the hepatitis C virus issued in the United Kingdom in January 1992. We believe this patent will cover Chiron's interests related to hepatitis C virus testing, treatment and prevention, and is the first of such patents that should issue in other major countries in the next year.

Chiron is developing a DNA probe test system for detecting and quantitating the presence of virus. This information may prove valuable to physicians who are treating patients with viral infections, to help them stage the course of the disease and monitor the effect of treatments. For example, HIV-positive patients are treated with one of several anti-viral drugs, to slow the onset of AIDS. Many of these patients develop resistance to the anti-viral drug used. Such a response may be detected earlier by noting an increase in the amount of virus present, which would allow the physician to switch to an alternative therapy faster.

Likewise, chronic hepatitis B and hepatitis C patients can be treated with alpha interferon. By monitoring the quantity of virus present over time, physicians should be better able to make decisions about dosage and duration of treatment. Patients who successfully complete a course of treatment can be monitored to detect a return of infection and allow earlier re-treatment. DNA probe tests also may prove useful to drug developers, who can monitor the effect of new drugs on patients in clinical trials. Chiron is beginning clinical evaluations of DNA probe tests for hepatitis B virus and hepatitis C virus, with a test for HIV in development. We expect to submit applications to market these tests to the FDA following the completion of evaluations.

According to the U.S. census, Emeryville ranks first in artists per capita. Their studios are converted warehouses and their creative sculptures dot the cityscape.

"It's been rewarding to work for five years developing RIBA tests and see these products accepted as the standard for supplemental testing for HCV and AIDS in blood samples. I'm proud to be a part of a business unit where we achieve our goals through dedicated teamwork and commitment."

Frances Lee

Manager,

RIBA Strip Manufacturing

Chiron Diagnostics

Emeryville, California

"I consider a project team concept representing the coordinated efforts of more than a hundred people from many different departments over several years to be critical to accelerating drug development. This approach helped Cetus bring a new therapy, Proleukin, to a previously untreatable population of patients."

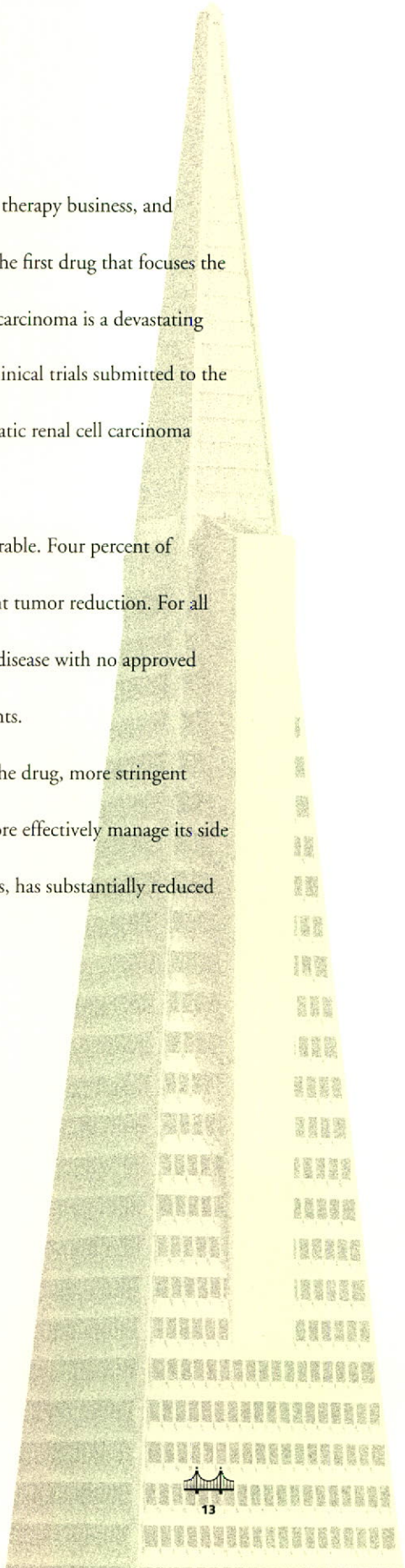
Sandra Patterson
Director,
Biological Therapeutics
Regulatory Affairs
Emeryville, California

Proleukin is the flagship product for both Cetus Oncology, Chiron's domestic cancer therapy business, and EuroCetus, Chiron's fully integrated European cancer therapy business. Proleukin is the first drug that focuses the power of the body's own immune system directly on cancer cells. Metastatic renal cell carcinoma is a devastating disease. The median survival time for a patient is less than 12 months. In data from clinical trials submitted to the FDA, Proleukin treatment reduced the size of tumors in 15 percent of the 255 metastatic renal cell carcinoma patients studied.

Most important, the reduction of these tumors was both significant and durable. Four percent of patients had their tumors totally disappear and six percent had more than a 90 percent tumor reduction. For all responding patients, the median duration of tumor response was 23.2 months. For a disease with no approved treatment and a grim prognosis for survival, Proleukin offers new hope to these patients.

The side effects of Proleukin treatment are severe. Increased knowledge of the drug, more stringent patient selection and alternative forms of administration may enable physicians to more effectively manage its side effects. In Europe, subcutaneous administration, some by patients in their own homes, has substantially reduced side effects.

Once known as a financial center, the San Francisco Bay Area has become the nation's biotechnology capital. Its nine counties are home to more than 300 bioscience companies.



EuroCetus uses a 46-person field sales force to sell Proleukin. In the United States, where we hope to receive approval to market Proleukin this year, the sales force, which currently sells a broad line of generic chemotherapy drugs, will be expanded to 46 people prior to Proleukin's launch. Clinical trials studying the potential use of Proleukin as a treatment for melanoma, colorectal cancer, ovarian cancer, bladder cancer, lymphomas and in AIDS patients and for viral infections, are now underway. Proleukin also is being studied in combination with other drugs such as alpha interferon and other traditional chemical therapeutics.

Proleukin is the first of a series of anti-cancer products in development at Cetus Oncology. Macrolin, macrophage-colony stimulating factor, is a natural protein that also plays a role in the body's immune response. Phase 2 trials are underway studying Macrolin as a treatment for fungal diseases in transplant and cancer patients.

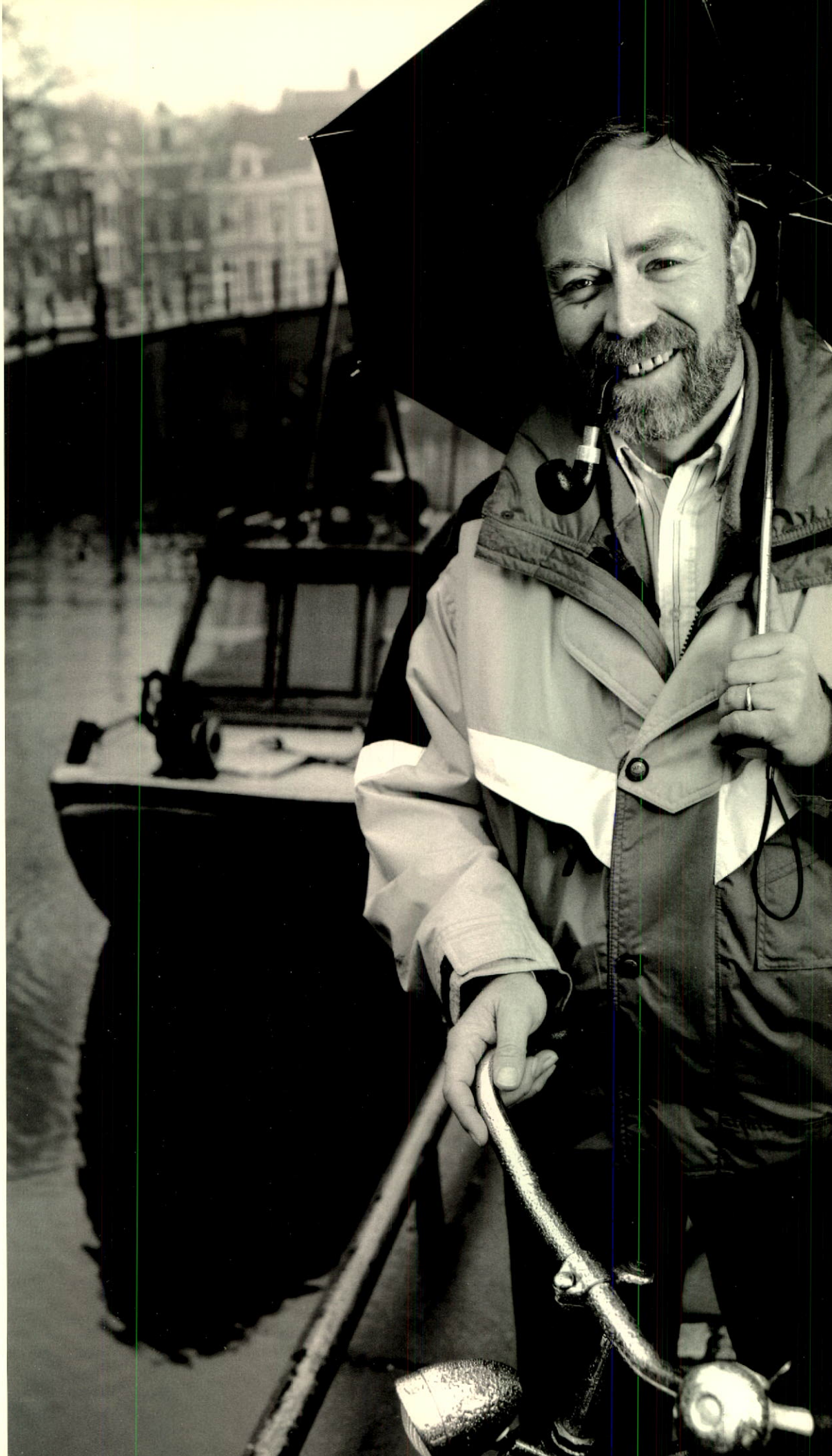
The National Cancer Institute is studying the application of a form of gene therapy using blood cells transformed by genes produced by Cetus Oncology as a new approach for treating cancer. Clinical trials also are planned to study a bi-specific antibody, which with one site identifies tumor cells for destruction and with the other site attracts the body's natural destroying agent.

In March 1992, Chiron and a group of venture investors formed Onyx Pharmaceuticals, an independent company that will research and develop novel cancer therapeutics using technology licensed from Chiron. Onyx will focus on the genes and proteins which regulate the growth of cancer cells, while Chiron continues its research into the potential use of antibodies, receptors, gene therapy and vaccines to prevent and treat cancer.

Amsterdam's Rijksmuseum houses the national art collection of the Netherlands, including 5,000 paintings in 250 rooms. Its clock tower guides visitors to its doors.

"As part of a highly skilled, multidisciplinary team at EuroCetus, it's a thrill to meet the challenge of moving a novel therapeutic such as Proleukin to market in the shortest possible time."

Mic N. Hammers, Ph.D.
Director of Manufacturing
and Process Development
EuroCetus
Amsterdam, Netherlands



"Based on my 16 years of enthusiastic and exciting work in the vaccine field, I firmly believe that biotechnology is a superior tool to obtain a new generation of molecules that can be used to develop safer vaccines."

Luciano Nencioni, Ph.D.
Head of Vaccine
Development, Biocine
Sclavo Research Center
Siena, Italy

Eradicating infectious disease through the use of vaccines has been a goal of medicine since the first vaccine for smallpox in the 18th century. The Biocine Company has a broad research program that is developing a series of vaccines for adult infectious diseases, while Biocine Sclavo is focusing on improved and safer vaccines for children.

Genetically engineered vaccines use molecular replicas or mimics of the actual viruses to stimulate the body's natural immune system into a response without the likelihood of side effects that are present in traditional vaccines. Biocine vaccines further enhance the immune response by combining the viral mimics with adjuvants.

Human clinical trials are now underway studying two candidate AIDS vaccines, two candidate herpes vaccines, recombinant pertussis vaccine, a haemophilus influenza (Hib) vaccine and a meningococcus A+C (meningitis) vaccine. Phase 1 trials of Biocine's first AIDS vaccine began in January 1991 under the sponsorship of the AIDS Vaccine Evaluation Group (AVEG) of the National Institutes for Allergies and Infectious Diseases. To date, 68 volunteers have received this vaccine. The immune responses of the volunteers are being studied, and if encouraging, Phase 2 trials studying the vaccine's efficacy in treating HIV-positive individuals will begin later this year.

Phase 1 trials of a second AIDS vaccine using a protein, gp120, that mimics the surface of HIV, began in 1991 in San Francisco and with AVEG. Preclinical trial results showed that this protein elicited an immune response not only against the HIV strain upon which it is based, but also against other strains found across the world, including distantly related strains from Africa. To date, 75 volunteers have received this vaccine.

The Palio is an ancient bareback horse race that takes its name from the Siena town square. This detail of a masterpiece by Simone Martini pays tribute to the tradition.

Because the AIDS virus mutates, an effective preventive vaccine must protect against many strains. We are encouraged that Biocine's candidate gp120 vaccine may do so, and are planning expanded treatment and prevention trials in 1992.

Phase 2 clinical trials of a Biocine vaccine to treat genital herpes infection began early in 1991. A second version of this vaccine, using two herpes virus protein mimics and Biocine's advanced adjuvant, began Phase 1 trials in mid-1991. Expanded Phase 2 and 3 studies of these vaccines are planned for 1992.

Biocine Sclavo, with facilities in Siena and Rosia, Italy, near Florence, is the largest pediatric vaccine company in Italy. Its market position and modern manufacturing plant provide a springboard for the expected launch of Biocine vaccines in Europe later in the decade.

Biocine Sclavo has been a leader in developing new versions of pediatric vaccines that use genetically engineered components to improve safety and efficacy. Pertussis (whooping cough) vaccine, which is a component of the diphtheria/pertussis/tetanus combination childhood vaccine, historically has caused side effects in a small number of children. Biocine Sclavo has developed a pertussis vaccine that uses a genetically engineered inactive form of the toxin responsible for the side effects, without reducing the effectiveness of the vaccine. This vaccine is expected to be approved for use in Italy this year. Clinical trials will begin in the United States in 1992.

Victorian row houses add to the charm of San Francisco's hilly geography. Ornate, stately and colorful, they are described affectionately as "painted ladies."

"Ten years of experience in treating AIDS patients has reinforced my conviction that cutting-edge research will yield a solution to this terrible epidemic. Chiron has the brainpower and resources to provide answers."

David N. Chernoff, M.D.
Associate Director,
Medical Affairs,
The Biocine Company
Emeryville, California;
Attending Physician,
UCSF Medical Center
San Francisco, California

"The experience and values of Chiron IntraOptics' leadership fosters a supportive working climate for sales people. Biotech healthcare has the potential for bringing dramatic treatments to ophthalmic surgeons."

Peggy K. Keating
Territory Manager,
Chiron IntraOptics
Phoenix, Arizona

With pro-forma combined 1991 product sales of $40 million, a full line of ophthalmic surgical products, 60 sales representatives in the United States and another 25 in foreign markets, and modern manufacturing facilities in the United States, Europe and Australia, Chiron IntraOptics has a growing presence in the surgical segment of the eye care market. The mission of Chiron IntraOptics is to meet the needs of ophthalmic surgeons for new products and technologies that correct vision.

Chiron IntraOptics is a leader in small-incision cataract surgery products, and in radial keratotomy surgical products and education. For the longer term, the company is developing new wound-healing pharmaceuticals for the eye, and a lens to be surgically fixed on the eye to correct vision in place of spectacles or contact lenses.

When replacing cataracts with implantable intraocular lenses (IOLs), smaller incisions can enable faster healing and vision recovery. Chiron IntraOptics manufactures and markets IOLs that are specifically designed to reduce the size of incision required for insertion into the eye. These IOLs include new foldable Chiroflex™ lenses and narrow-profile traditional lenses. The company also sells a line of phacoemulsification equipment, which uses ultrasound energy to break up the cataract and remove it through a small incision.

The Chiron IntraOptics product line allows ophthalmic surgeons to progress from larger incisions to smaller incisions as their surgical technique becomes more advanced. The product line provides the skilled surgeon with maximum flexibility to tailor the choice of lens to a patient's individual need.

Historical missions, many of which still function as churches 200 years later, represent the Spanish heritage of today's Southwest United States.

Chiron IntraOptics also manufactures and markets diamond surgical knives for corneal refractive surgery, which reshapes the eye to improve unaided vision and often eliminates the need for spectacles or contact lenses. In addition to supplying surgical instruments, Chiron IntraOptics has helped train hundreds of ophthalmologists to perform this delicate, highly successful surgery by sponsoring seminars given by expert ophthalmic refractive surgeons skilled in achieving optimum results.

Chiron IntraOptics also sells corneal shields to protect the surface of the eye following surgical procedures or abrasions, and corneal storage media to store donor corneas awaiting transplant. Chiron IntraOptics has completed clinical trials to study epidermal growth factor (EGF) in corneal storage media to preserve endothelial cell conditions. On June 14, 1991, an FDA advisory panel recommended approval of this product. When licensed, this product will be the first approved use of a genetically engineered growth factor in any indication.

Clinical trials to study the potential efficacy of EGF in healing corneal wounds are underway. Clinical trials to study the potential efficacy of EGF as a component of viscoelastics used in intraocular surgeries also have begun. A viscoelastic is in the final stages of preclinical development. Chiron IntraOptics is developing synthetic corneal lenses to correct vision in place of spectacles or contact lenses. These lenses are designed to be surgically placed on or in the cornea to correct refractive vision errors. Preclinical studies are underway, with human clinical trials planned for 1993.

Orange County got its name from the groves of oranges on its many farms. In Irvine, orange groves have given way to palm-lined industrial developments.

"Making foldable silicone lenses to be placed in the eyes of cataract patients requires a high level of care and quality that we all take pride in and dedicate ourselves to. It's fun to work with friendly people in a growing company."

Jenny Ratnaransy
Senior Molder,
Silicone Lens Manufacturing
Chiron IntraOptics
Irvine, California

"Since childhood, my heroes have been people like Koch and Pasteur. For me, the opportunity to work directly on frontier technologies developing new therapies for serious illnesses is a dream come true."

Abla A. Creasey, Ph.D.
Senior Scientist, Director of Cell Biology Molecular Oncology Research
Emeryville, California

Chiron Technologies focuses on strategies for capturing maximum value while generating revenue and development support for new product candidates and technology that is not central to our four other businesses. The group also will develop strategies for Chiron's entry into new therapeutic markets and will assist existing businesses in acquiring products to expand their market positions.

Among the most promising products in the Chiron pipeline are an antibody to tumor necrosis factor for septic shock (anti-TNF), an antibody to bacterial components involved in septic shock (T-88), insulin-like growth factor (IGF) and platelet-derived growth factor (PDGF). Anti-TNF is being manufactured and developed by the Cutter Laboratories division of Bayer/Miles. Cutter is conducting Phase 3 trials studying the potential efficacy of anti-TNF in treating septic shock. These trials, which will enroll about 1,000 patients in both North America and Europe, are expected to be completed during 1992.

T-88 antibody is in Phase 3 trials studying its potential efficacy in treating Gram-negative sepsis. These trials, which will enroll about 600 patients in the United States, also are expected to be completed in 1992.

Insulin-like growth factor is being studied for treating type 2 diabetes, kidney failure and wasting associated with severe trauma. CIBA-GEIGY is conducting Phase 2 clinical trials for type 2 diabetes with IGF manufactured by Chiron.

Coit Tower, in the shape of a nozzle, is a monument to San Francisco firefighters. Atop Telegraph Hill, it dominates the city's Embarcadero waterfront skyline.

Platelet-derived growth factor is one of a series of growth factors produced by Chiron being developed by Ethicon, a Johnson & Johnson company, for treating topical wounds. Phase 2 trials studying PDGF in treating skin ulcers should be completed in 1992.

Chiron has an advanced program in drug design and development. Discovery and development of new drugs are greatly assisted by the ability to identify and produce the biological targets that influence cell activity, such as receptors, as well as the ability to produce in large numbers potential compounds that may interact with these targets. Together, Chiron and Cetus have produced numerous targets that may influence cellular activity. These targets are being screened to identify potential lead compounds that may be further developed as novel drugs.

Chiron and Cetus scientists, coupled with the capabilities of Chiron Mimotopes, have developed technology for the synthesis of large numbers of individual peptides and diverse peptide mixtures. These peptides are being screened against targets such as receptors, using high-throughput robotic techniques, to select those that demonstrate activity. Chiron also is using advanced computer technology to study three-dimensional structures of key receptors and enzymes, to design and synthesize unique compounds as drug candidates.

Formerly industrial Emeryville is undergoing a transformation into a bustling community of art galleries, restaurants, entertainment clubs and shopping areas.

"The speed and flexibility of our interdisciplinary drug discovery team enables us to quickly evaluate new ideas and identify exciting leads. Working in a small, integrated group challenges me to expand my knowledge beyond chemistry into peptide chemistry, biochemistry, biology, molecular biology and robotic synthetic techniques."

David Spellmeyer, Ph.D.
Principal Scientist,
Chiron Drug Design
Emeryville, California

EXECUTIVE OFFICERS

William J. Rutter, Ph.D.
Chairman

Edward E. Penhoet, Ph.D.
Chief Executive Officer

Hollings C. Renton
President and Chief Operating Officer

William G. Green, Esq.
Senior Vice President, Secretary and General Counsel

Pablo D.T. Valenzuela, Ph.D.
Senior Vice President, Biological Research and Development

Dennis L. Winger
Senior Vice President, Finance and Administration, Chief Financial Officer

Rajen K. Dalal
Vice President, Corporate Planning

Dino Dina, M.D.
Vice President, Vaccines Research

William G. Gerber, M.D.
Vice President, President, Chiron Diagnostics

Filippo La Monica, Ph.D.
Vice President, President, EuroCetus

William J. Link, Ph.D.
Vice President, Chairman and Chief Executive Officer, Chiron IntraOptics

Walter H. Moos, Ph.D.
Vice President, Chemical Therapeutics Research and Development

Michael S. Ostrach, Esq.
Vice President, President, Chiron Technologies

James E. Rurka
Vice President, President, Cetus Oncology

DIRECTORS

William J. Rutter, Ph.D.
Chairman

Edward E. Penhoet, Ph.D.
Vice Chairman and Chief Executive Officer

Hollings C. Renton
President and Chief Operating Officer

Gilbert F. Amelio
President and Chief Executive Officer, National Semiconductor Corporation

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Vice Chairman, Bank of America

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Professor of Physics, Molecular Biology and Neurobiology, University of California, Berkeley

Henri Schramek, Ph.D.
Retired Vice Chairman, CIBA-GEIGY Limited

Jack W. Schuler
Chairman, Stericycle, Inc.

Pieter J. Strijkert, Ph.D.
Member, Board of Management Gist-brocades NV

John H. Williford
Chairman, Advanced Polymer Systems

CORPORATE INFORMATION

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Telephone: (415) 954-9512

Corporate Counsel
Brobeck, Phleger & Harrison
San Francisco, California

Certified Public Accountants
Ernst & Young
San Francisco, California

Number of Holders of Common Stock
As of December 31, 1991, there were approximately 2,104 stockholders of record of Chiron common stock. As of December 31, 1991, there were approximately 11,736 stockholders of record of Cetus common stock, whose holdings had not converted into Chiron common stock.

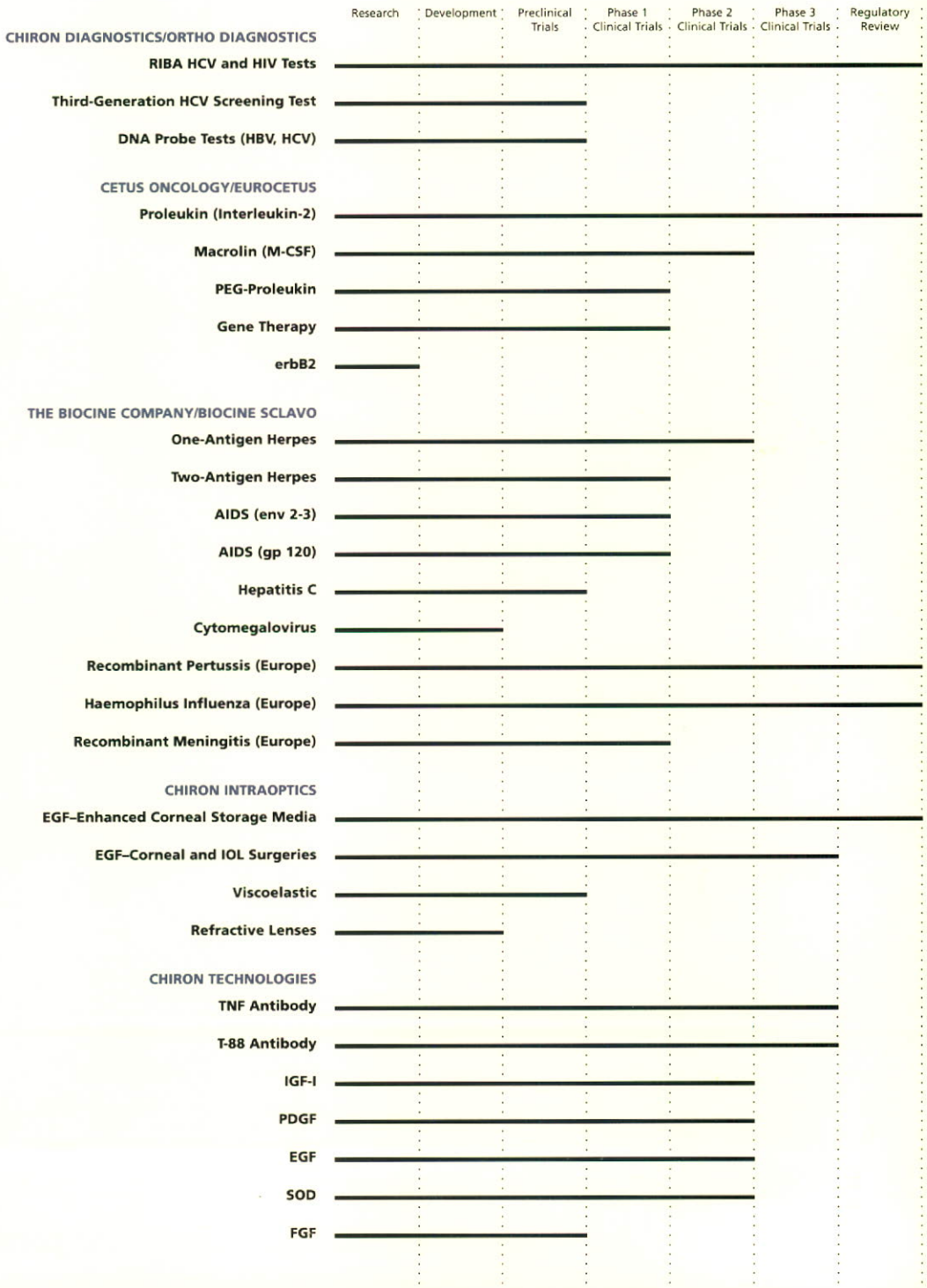
SEC Form 10-K
A copy of the Company's annual report to the Securities and Exchange Commission on Form 10-K exclusive of exhibits is available without charge upon written request to:

Larry Kurtz
Vice President, Corporate Communications
Chiron Corporation
4560 Horton Street
Emeryville, California 94608-2916

Annual Meeting
The Annual Meeting of Stockholders will be held at 10:00 am, Thursday, May 7, 1992, at the Chiron Auditorium, 1450 53rd Street, Emeryville, California.

Design: Russell, Howry & Associates, San Francisco Photography: David Powers, San Francisco Printing: Lithographix, Los Angeles

Chiron Products in Development



MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Chiron applies genetic engineering and other tools of biotechnology to develop products that diagnose, prevent and treat human disease. On December 12, 1991, Chiron acquired Cetus Corporation, a biotechnology company located in adjacent facilities in Emeryville, which has been renamed Cetus Oncology Corporation ("Cetus"). The combined company is building a healthcare business to address needs in four markets: diagnostics, including immunodiagnostics and new quantitative diagnostics based on nucleic acid probe technology; vaccines, emphasizing adult and pediatric infectious diseases; therapeutics, with an emphasis on cancer therapeutics; and ophthalmics, including innovative devices and novel wound-healing products for the eye. Chiron is researching additional therapeutic products, including a new generation of pharmaceuticals developed through advanced techniques of drug discovery and design. The acquisition of Cetus has been accounted for as a purchase and the financial statements reflect the inclusion of Cetus from December 12, 1991 forward.

During 1990, Chiron began earning revenues from its joint diagnostic business with Ortho Diagnostic Systems, Inc. ("Ortho"). This business was founded to develop and commercialize certain immunodiagnostic products. Chiron's 50 percent share of the pre-tax operating earnings generated by this business are included in "Equity in unconsolidated joint businesses" within the Revenues section of the Consolidated Statement of Operations. During 1990, Chiron achieved profitability for the first time, primarily as a result of this joint diagnostic business. Although the Chiron-Ortho joint business remains highly profitable, Chiron is not profitable for 1991. The Cetus merger resulted in the allocation of a substantial portion of the purchase price to in-process technology which was expensed at the time of the merger and totaled $426,043,000.

Early in 1992, Chiron and CIBA-GEIGY Limited ("CIBA-GEIGY") are expected to complete their joint purchase of the vaccine business of Sclavo SpA of Italy. In addition, Chiron merged with IntraOptics, Inc. ("IntraOptics") in a transaction which will be accounted for as a pooling-of-interests.

Results of Operations

Revenues

Revenues from the joint business with Ortho are expected to continue to be the largest single source of Chiron's revenues in the near term. In 1991, Chiron's 50 percent share of the profits were $49,803,000 compared with $26,105,000 for 1990. The 1990 revenues consisted of $32,105,000 representing Chiron's 50 percent share of profits before a $6,000,000 charge relating to the acquisition of in-process technology described below. These revenues are recorded by Chiron on a one-month lag based on estimates supplied by Ortho and are subject to a final accounting during the first quarter of the subsequent year. While Chiron and Ortho believe that these estimates reasonably portray the results of the joint business, there can be no assurance that subsequent adjustment will not be required. Chiron management believes that any subsequent adjustment will not have a material adverse effect on the amounts previously recorded. Included in the 1991 revenues is approximately $3,000,000 as a result of the final 1990 accounting. During the first quarter of 1990, Chiron and Ortho jointly purchased the microplate blood-screening business of E.I. du Pont de Nemours & Company, Inc. Chiron's portion of the purchase price was $9,000,000 and was allocated to various intangible assets and to in-process technology based upon their estimated values. As a result, "Equity in unconsolidated joint businesses" includes a charge of $6,000,000 expensing the acquired in-process technology. Revenues for 1991 also include $17,258,000 as reimbursements for research, development and manufacturing expenses under Chiron's agreements with Ortho, $12,529,000 in 1990.

Over 80 percent of the sales and an even higher percentage of the profits of the Chiron-Ortho joint business are attributable to the sales of tests for the hepatitis C virus. The market for hepatitis C tests is rapidly evolving. From November 1989 to July 1990, Chiron-Ortho was the sole, worldwide supplier

of the blood-screening test for the hepatitis C virus. Chiron-Ortho licensed Abbott Laboratories ("Abbott"), the largest seller of blood screening tests in the world, to market its own hepatitis C diagnostic tests using Chiron-Ortho technology. Abbott introduced its blood screening test for hepatitis C in July 1990 and has since acquired a substantial portion of the worldwide market. The Chiron-Ortho business receives a royalty from the sales of hepatitis C tests sold by Abbott; however, the revenue contribution per test from the Abbott royalties differs from (and at current price levels is less than) that of direct sales of the test by the Chiron-Ortho joint business. Abbott royalties are received and reported one calendar quarter after actual Abbott sales. The Red Cross, the largest customer in the United States for blood-screening products, began a new three-year contract, effective May 1, 1991, to purchase from Abbott approximately 90 percent of its blood screening tests, including tests for hepatitis C. These tests had previously been supplied to the Red Cross by Chiron-Ortho at a rate in excess of 6 million tests per year. In 1991, the effect to the joint business of reduced product sales to the Red Cross was offset in part by increased Abbott royalties. On March 13, 1992, Chiron-Ortho received FDA approval for its second-generation hepatitis C screening tests, and because the Abbott version of this test was not yet approved, the Red Cross began purchasing all of its hepatitis C screening tests from Chiron-Ortho, and is expected to continue to purchase a majority of its tests from the Chiron-Ortho joint business until this new contract expires on December 31, 1993. In Japan, Abbott received approval for its second-generation hepatitis C screening test while Chiron-Ortho is awaiting approval. As a result, Abbott is now supplying 100 percent of the hepatitis C blood screening tests to the Japanese Red Cross. Chiron-Ortho anticipates approval of its second generation test in mid 1992 and hopes to regain some portion of the Japanese Red Cross business at that time. The market for hepatitis C tests is expected to grow as new segments, including possible sales to plasma processing centers, and new diagnostic products are developed beyond the existing blood-screening segment. Future hepatitis C revenues for the joint business will be affected by the overall demand for current and new tests, the market share of the joint business, the mix of Abbott royalties versus direct sales revenues and attempted patent infringements.

An important primary source of Chiron's revenues continues to be collaborative research agreements. Collaborative research agreement revenues consist of fees received for research services as they are performed, fees received for completed research or technology, fees received upon attainment of benchmarks specified in the related research agreements, and proceeds of sales of biological materials to research partners for clinical and preclinical testing. Revenues earned under collaborative research agreements increased slightly in 1990. This was primarily due to four collaborative agreements: revenue earned under the research and development cost reimbursement portion of the agreement with Ortho increased substantially; revenue earned under an agreement with Daiichi Pure Chemicals Co., Ltd. ("Daiichi"), to develop and commercialize DNA probe technology; receipt of a $2,400,000 initial payment from Takeda Chemical Industries, Ltd. ("Takeda") upon the signing of an agreement providing Takeda with certain rights to commercialize human superoxide dismutase in certain Asian countries; receipt of a $1,500,000 payment from Bayer AG for the achievement of a clinical milestone in the development of anti-tumor necrosis factor. In 1991 collaborative revenues were flat when compared with 1990. Decreasing revenues from Daiichi and Warner Lambert were offset by revenues earned under a new agreement for the development of bone morphogenetic protein and increased revenues from the joint business with Ortho.

Product sales have shown substantial increases in all years presented. In 1990 and 1991, the increase was due to increased shipments of antigens and AIDS diagnostic kits to Ortho and increased sales of ophthalmic products. In 1991, sales by Adatomed GmbH, Chiron's German ophthalmic subsidiary, also contributed to the increase. As a result of Chiron's merger with IntraOptics, product sales should continue to increase in 1992.

Other revenues, which consist principally of product royalties and government grants, increased in both 1990 and 1991. In 1990, the increase was due to a new license agreement for insulin with

Novo Nordisk A/S which was partially offset by a reduction in grant revenue due to the expiration of a grant from the State of California for AIDS vaccine research and a decline in royalties received from Merck & Co., Inc., in connection with its marketing of Chiron's recombinant hepatitis B vaccine. In 1991, the State of California AIDS grant was renewed, resulting in an increase in grant revenue. Additional revenues were also earned under the agreement with Novo Nordisk A/S.

Cost and Expenses

Research and development expenses increased during each of the three years as Chiron pursued the activities necessary to move products closer to commercialization. The Company continued its investment in its core development areas such as vaccines through The Biocine Company, immunodiagnostics with Ortho, and increasingly important areas such as DNA probe research and novel drug design. During the second quarter of 1990, Chiron began supplying 50 percent of the cash requirements of The Biocine Company and recording its 50 percent share of the expenses of the joint business. In 1990, other principal reasons for the increase included an accrual of payments to the Centers for Disease Control of the U.S. Department of Health and Human Services in consideration of contributions to the identification of the hepatitis C virus and payments to STAAR Surgical Company by Chiron Ophthalmics for the purchase of certain in-process technology. The increase in research and development expense in 1991 resulted from the buy out of the royalty interest in Chiron's ophthalmic limited partnership; the acquisition of the minority interest in Chiron's Protos subsidiary; expansion of the DNA probe program and Cetus' research expenses since the merger date. Product development and related expenses are anticipated to increase as Chiron implements the steps necessary to augment its manufacturing and marketing of products. These factors could result in increased research and development expenses in future periods.

The increase in cost of sales was consistent with the increase in product sales. Under its joint business agreement with Ortho, Chiron sells diagnostic antigens and kits to Ortho at cost. As a result, Chiron's cost of sales relative to product sales remains high. Profits are recognized by Chiron through its share of the profits of the joint business.

Selling, general and administrative expenses continue to increase. A significant portion of this increase was due to the growth of Chiron Ophthalmics' operations, particularly costs associated with sales and marketing activities and, in 1990 and 1991, a portion of the cost of implementing the Stock Exchange Rights Plan described below. In the second quarter of 1991, Chiron began consolidating the results of a German ophthalmic subsidiary acquired in March 1991, resulting in a $2,070,000 increase in selling, general and administrative expense. Selling, general and administrative expenses from Cetus subsequent to the merger totaled $3,545,000. Accrued employee related expenses accounted for most of the remaining increase.

In 1990, Chiron incurred additional compensation expense associated with implementation of its 1988 Stock Exchange Rights Plan (the "Stock Exchange Rights Plan"). The Stock Exchange Rights Plan was adopted by Chiron to allow employees and consultants of participating subsidiaries to exchange vested options under these subsidiary stock option plans for cash or shares of Chiron common stock. The Board of Directors approved participation in the Stock Exchange Rights Plan for Chiron Ophthalmics employees and consultants. As a result, $2,772,000 was recorded in 1990 as compensation expense representing the difference between the option exercise price and current per share valuation of Chiron Ophthalmics (based upon an independent valuation). Subsequently in 1991, Chiron acquired the remaining minority interest in Chiron Ophthalmics and converted all outstanding options in Chiron Ophthalmics to Chiron options. Chiron will adjust its liability as future vesting occurs. As a result, in 1991, an additional $1,542,000 was recorded, primarily as selling, general and administrative expense.

For financial reporting purposes, the merger with Cetus has been recorded using the purchase method of accounting. The purchase price (consisting of the fair value of shares of Chiron common

stock and options issued, transaction expenses and liabilities assumed by Chiron) was allocated to the assets acquired based on estimated fair values at the time of the merger. As required under generally accepted accounting principles, Chiron expensed amounts allocable to in-process technology acquired from Cetus. This resulted in a one-time, non-cash charge to income of $426 million.

Chiron entered into three real estate partnerships in 1987 to allow Chiron to expand its manufacturing capability on a site convenient to its main operating facilities. Construction was postponed and as a result, in the first quarter of 1990, Chiron accrued certain costs totaling $1,033,000 through the anticipated time of resolution. These costs have been presented as other operating expenses. Chiron obtained the option to buy out the partnership interests held by a real estate development company in the remaining two partnerships. Since March 1991, Chiron has paid the interest and other costs of carrying these properties and in July 1991, repaid the outstanding indebtedness secured by the properties of approximately $6,400,000. The California Department of Transportation has advised Chiron that it intends to condemn a portion of the property for use in a highway project. As a result, in 1991 the Company decided not to construct a plant on this property and has written off certain plant development costs totaling $1,488,000. These costs are included in other operating expenses. Currently, Chiron is considering various alternatives for the use or disposition of the remaining portion of these properties.

Other Items

Other income consists of investment income on the Company's cash reserves, offset in 1990 and 1991 by accrued interest payable on the convertible debt. The substantial increase in 1991 is due to larger cash balances available for investment following an offering of common stock in March 1991, partially offset by lower interest rates. In 1990, interest income increased due to interest earned on the proceeds of an offering of convertible debentures in June 1990, but this increase was largely offset by interest expense associated with the convertible debentures.

Chiron has reported a loss in the year ended December 31, 1991 resulting from the expensing of in-process technology as a result of the merger with Cetus Corporation. Because the merger was structured as a tax-free reorganization, substantially all of the loss will not be deductible for income tax purposes and would therefore not increase the Company's existing net operating loss carryforward. In addition, certain limitations apply to the use of loss carryforwards to offset taxable income for alternative minimum tax purposes. The provision for income taxes is presented in the statement of operations as a charge in lieu of income taxes of $786,000 in 1991 ($3,030,000 in 1990), based on the combined federal, state and foreign tax that Chiron would have paid had its net operating loss carryforward not been available to offset pre-tax income for the period. The provision is partially offset by an extraordinary item of $100,000 ($2,805,000 in 1990), representing the amount by which Chiron's net operating loss carryforward resulted in a reduction of taxes otherwise payable. The difference of $686,000 ($225,000 in 1990) includes a provision for alternative minimum tax to the extent the loss carryforward is not available to fully offset pre-tax income, as well as state and foreign taxes at estimated effective rates. Legislation enacted in California in 1991 precludes the use of net operating loss carryforwards to reduce state income taxes in 1991 and 1992.

Chiron has not adopted Financial Accounting Standards Board Statement No. 109 regarding accounting for income taxes, and management does not believe that the adoption would have a material effect on its financial statements.

Outlook

Cetus reported losses for its fiscal year ended June 30, 1991 of $75 million, on total revenues of $52 million, including product-related revenues of $35 million. Chiron expects that the combined Company will incur a loss in 1992. The ability of the Company to achieve profitability thereafter depends upon a number of factors including realization of economies through substantial reductions in staffing levels, the elimination or reduction of programs and elimination of redundancies and inefficiencies, reductions in other operating costs, the development of new sources of collaborative revenues to

support continuing research and development programs, the achievement of substantially increased contribution to profit from increased product sales in all categories including sales by EuroCetus, United States sales of generic cancer therapeutics by Cetus, FDA approval and market acceptance of Proleukin in the United States, and increased sales of ophthalmics products by Chiron Ophthalmics. There can be no assurance when or whether any combination of these factors can be achieved that will result in profitable operations by the Company, and Chiron does not presently expect to be able to bring the Company to profitability on a full year consolidated basis prior to 1993.

On January 23, 1992, CIBA-GEIGY completed its acquisition of the vaccine business of Sclavo SpA of Siena, Italy, for the Swiss franc equivalent of approximately 150 billion lira. This investment will be held by a Netherlands company, of which Chiron has agreed to purchase 50 percent. The business has been renamed Biocine Sclavo.

On January 8, 1992, the Company acquired IntraOptics Inc. of Boca Raton, Florida ("IntraOptics"), a privately held manufacturer and marketer of intraocular lenses and instruments for cataract surgeries, in exchange for 578,000 newly issued shares of Chiron common stock. The business combination will be accounted for by the pooling-of-interests method. IntraOptics will be combined with Chiron's wholly owned subsidiary, Chiron Ophthalmics. For its year ended December 31, 1991, IntraOptics reported a net loss of $1,837,000 on revenues of $23,040,000.

On March 16, 1992, Chiron and a group of venture investors formed an independent company, Onyx Pharmaceuticals ("Onyx"), to focus on the discovery and development of cancer therapeutics through research into molecular oncology mechanisms using technology licensed from Chiron. Chiron will contribute $4 million in services, equipment, facilities use and cash, and a technology license, and will own 42.8 percent of Onyx's initial capital stock. Approximately 20 Chiron employees are expected to become employees of Onyx. Chiron will record its 42.8 percent share of Onyx's losses as research and development expense.

Independent of the Cetus, Sclavo and IntraOptics transactions, Chiron's operating results are difficult to predict. The market for immunodiagnostic screening tests is evolving rapidly since the introduction of hepatitis C tests by Chiron-Ortho and by Abbott. Existing competitors in the market are beginning to introduce hepatitis C products and may continue to do so unless and until Chiron establishes a significant patent position. Other of Chiron's programs will require substantial additional investment, including the cost of clinical trials and the completion of commercial scale manufacturing facilities and the marketing and sales expenses associated with product introductions and start-up costs associated with Chiron Ophthalmics. The research, development and market introduction of new products will require the application of considerable technical and financial resources by Chiron, while revenues that are generated from such products, assuming they are successfully developed, may not be realized for several years. Other material and unpredictable factors which could affect operating results include the uncertainty of the timing of product approvals and introductions and of sales growth, the issuance, use or possible claim of infringement of patents and proprietary technology by Chiron or its competitors, the effect of possible technology and/or other business acquisitions or transfers, and actions by collaborators, customers and competitors. In addition, a substantial portion of Chiron's revenues will continue to be derived from collaborative research agreements and, to a lesser extent, from the sale of biological materials for research and clinical testing. Chiron's collaborative research agreements generally can be terminated by the sponsor upon notice not exceeding six months or if Chiron fails to perform. Future collaborative research revenues will depend in part upon achievement of development objectives under the operative research agreements. The achievement of these objectives and the time it may take to achieve them cannot be predicted accurately. Chiron's other licenses and agreements to manufacture and supply bulk materials are also subject to termination by the licensee or contract sponsor in the event of breach by Chiron and in certain other events. Chiron may experience losses if research contracts are not renewed or replaced. Furthermore, Chiron's operating results over the near term will be adversely affected as a result of funding its share of expenses in

certain of its joint venture collaborations. Accordingly, Chiron's operating results are expected to fluctuate from period to period. Chiron does not believe that inflation has a significant effect upon its business.

Liquidity and Capital Resources

Chiron's balance sheet at December 31, 1991 reflects the inclusion of Cetus' assets and liabilities, adjusted to fair value at the merger date. The increase in cash and investments is due to $134,000,000 from Chiron's 1991 offering of common stock in addition to $326,000,000 from Cetus.

Since its inception, Chiron has financed product development, operations and capital expenditures primarily from public and private sales of equity and convertible debt and collaborative research revenues. Chiron's cash and working capital will be used to fund future operations, including possible operating deficits, capital investments and acquisitions.

Until required for operations, Chiron's policy is to keep its cash and investments in bank deposits, United States government instruments, certificates of deposit, commercial paper, corporate notes and other readily marketable debt instruments. Chiron's investment criteria include instruments with maturities of up to two years. Investments with maturities in excess of one year are presented on the balance sheet as noncurrent investments.

In March 1991, Chiron Ophthalmics purchased for approximately $9,000,000 a majority interest, with an option to acquire the remaining minority interest, in Adatomed, a leading Munich-based supplier of ophthalmic surgical products to the German market. The operating results of Adatomed are recorded by Chiron on a one month lag; this reporting lag does not have a material impact on Chiron's financial statements.

Chiron and CIBA-GEIGY have agreed, subject to budget reviews and approvals, to each fund 50 percent of the capital requirements of The Biocine Company through 1992. Chiron's annual share of these requirements was approximately $10,000,000 in 1991 (compared to approximately $6,742,000 invested in 1990) and is expected to be $16,800,000 in 1992. However, as a result of an agreement reached early in 1992, CIBA-GEIGY will fund, through 1996, their 50 percent share of expenses as well as Chiron's share up to $45 million. In exchange, CIBA-GEIGY will have a preferred interest in future profits and cash flow from The Biocine Company. Chiron will have an option through 1996 of reestablishing its 50 percent position by paying an amount equal to one-half of the incremental funding provided by CIBA-GEIGY, plus interest.

Substantial capital investments will be required during the next few years as Chiron's vaccine and therapeutic products approach commercialization. These include investment in additional plant and facilities to support expanded manufacturing and product development activities. Chiron expects to continue to finance its capital requirements through a combination of collaborative agreements, off-balance sheet financing (such as research and development limited partnerships), working capital, finance lease agreements and possible sales of equity or debt securities.

Outlook

Payment of the Sclavo purchase price, taxes on the PCR sale, repayment of subsidiaries' debt and other general corporate uses will likely reduce cash balances by $120-$140 million during the first quarter of 1992. In addition, the portion of the Sclavo purchase price representing in-process technology will be expensed in the first quarter of 1992.

Chiron expects its participation with CIBA-GEIGY in the acquisition of the vaccine business of Sclavo will require up to $75 million in acquisition costs and capital contributions to fund near term requirements for working capital and to fund operating losses expected by Biocine Sclavo.

Cetus' business and Sclavo's vaccine business each are also likely to require additional investment over the next few years to further the development, manufacture and market introduction of their respective products.

CHIRON CORPORATION

CONSOLIDATED BALANCE SHEET

ASSETS

	December 31, 1991	December 31, 1990
Current assets:		
Cash and cash equivalents	$ 313,209,000	$ 46,163,000
Short-term cash investments	245,112,000	107,989,000
Total cash and short-term cash investments	558,321,000	154,152,000
Accounts receivable (Notes 3 and 4)		
Related parties	22,488,000	10,279,000
Unrelated parties	12,886,000	4,292,000
Other current assets	23,299,000	5,409,000
Total current assets	616,994,000	174,132,000
Noncurrent cash investments	113,668,000	56,124,000
Property, equipment and leasehold improvements, at cost:		
Land and buildings	26,201,000	1,940,000
Laboratory, production and office equipment	48,097,000	21,619,000
Leasehold improvements	22,757,000	17,478,000
Construction in progress	3,853,000	3,192,000
	100,908,000	44,229,000
Less accumulated depreciation and amortization	22,916,000	19,750,000
Net property, equipment and leasehold improvements	77,992,000	24,479,000
Purchased technologies	49,541,000	2,700,000
Other assets	37,077,000	7,939,000
	$ 895,272,000	$ 265,374,000

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:		
Accounts payable	$ 10,699,000	$ 3,449,000
Accrued bond interest (Note 6)	7,029,000	4,404,000
Accrued compensation and related expenses (Note 5)	20,218,000	4,700,000
Unearned revenue under collaborative research agreements	6,111,000	2,258,000
Current portion of long-term debt	7,095,000	—
Taxes payable, principally related to PCR sale (Note 9)	20,638,000	—
Cetus acquisition purchase contingencies (Note 2)	16,890,000	—
Other current liabilities (Note 6)	35,882,000	6,224,000
Total current liabilities	124,562,000	21,035,000
Long-term debt (Note 6)	238,639,000	121,500,000
Other noncurrent liabilities (Note 7)	7,705,000	2,582,000
Commitments and contingencies (Notes 7 and 12)		
Stockholders' equity (Note 8):		
Preferred stock, $.01 par value; 5,000,000 shares authorized; none outstanding	—	—
Common stock, $.01 par value; 99,500,000 shares authorized; 29,340,996 outstanding (16,281,532 outstanding at December 31, 1990)	293,000	163,000
Restricted common stock, $.01 par value; 500,000 shares authorized; none outstanding	—	—
Additional paid-in capital	1,005,137,000	176,027,000
Accumulated deficit	(481,064,000)	(55,933,000)
Total stockholders' equity	524,366,000	120,257,000
	$ 895,272,000	$ 265,374,000

See accompanying notes.

CHIRON CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

	Year Ended December 31,		
	1991	1990	1989
Revenues:			
Collaborative research agreement revenues (Note 3)			
Related parties	$ 18,331,000	$16,276,000	$ 11,620,000
Unrelated parties	12,144,000	14,625,000	13,954,000
Equity in unconsolidated joint businesses (Note 4)	49,845,000	26,105,000	—
Product sales			
Related parties	10,576,000	8,029,000	667,000
Unrelated parties	17,657,000	6,715,000	4,267,000
Other revenues	9,906,000	6,762,000	4,966,000
Total revenues	118,459,000	78,512,000	35,474,000
Expenses:			
Research and development (Note 5)	79,397,000	50,203,000	46,100,000
Cost of sales	21,303,000	12,031,000	4,028,000
Selling, general and administrative	28,030,000	14,846,000	12,154,000
Write-off of in-process technologies (Note 2)	426,043,000	—	—
Other operating expenses (Note 7)	2,287,000	1,033,000	—
Total expenses	557,060,000	78,113,000	62,282,000
Income/(loss) from operations	(438,601,000)	399,000	(26,808,000)
Other income, net (Note 10)	14,156,000	6,655,000	5,179,000
Income/(loss) before income taxes and extraordinary item	(424,445,000)	7,054,000	(21,629,000)
Provision for income taxes (Note 9)	786,000	3,030,000	—
Income/(loss) before extraordinary item	(425,231,000)	4,024,000	(21,629,000)
Extraordinary item — utilization of operating loss carryforward	100,000	2,805,000	—
Net income/(loss)	$(425,131,000)	$ 6,829,000	$(21,629,000)
Net income/(loss) per share:			
Before extraordinary item	$ (22.12)	$ 0.24	$ (1.51)
Extraordinary item	0.01	0.16	—
Net income/(loss) per share	$ (22.11)	$ 0.40	$ (1.51)
Weighted average number of shares used in computing per share amounts	19,225,884	17,176,836	14,339,152

See accompanying notes.

CHIRON CORPORATION

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount			
Balances at December 31, 1988	12,983,955	$130,000	$ 117,083,000	$ (41,133,000)	$ 76,080,000
Issuance of shares of common stock in a public offering less costs of issuance of $2,917,000	2,721,000	27,000	51,476,000	—	51,503,000
Exercise of stock options	288,458	3,000	2,889,000	—	2,892,000
Employee stock purchase plan	34,468	—	484,000	—	484,000
Net loss	—	—	—	(21,629,000)	(21,629,000)
Balances at December 31, 1989	16,027,881	160,000	171,932,000	(62,762,000)	109,330,000
Exercise of stock options	182,858	2,000	2,599,000	—	2,601,000
Employee stock purchase plan	70,793	1,000	1,496,000	—	1,497,000
Net income	—	—	—	6,829,000	6,829,000
Balances at December 31, 1990	16,281,532	163,000	176,027,000	(55,933,000)	120,257,000
Issuance of shares of common stock in a public offering less costs of issuance of $5,916,000	2,440,300	24,000	134,377,000	—	134,401,000
Exercise of stock options, net of tax effect	415,892	4,000	8,400,000	—	8,404,000
Employee stock purchase plan	106,458	1,000	2,586,000	—	2,587,000
Common stock, stock options and warrants related to Cetus acquisition	10,086,828	101,000	683,426,000	—	683,527,000
Other	9,986	—	321,000	—	321,000
Net loss	—	—	—	(425,131,000)	(425,131,000)
Balances at December 31, 1991	29,340,996	$293,000	$1,005,137,000	$(481,064,000)	$ 524,366,000

See accompanying notes.

CHIRON CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

	Year Ended December 31,		
	1991	1990	1989
Cash flows from operating activities:			
Net income (loss)	$(425,131,000)	$ 6,829,000	$(21,629,000)
Adjustments to reconcile net income/(loss) to net cash used in operating activities:			
Depreciation and amortization	8,337,000	5,130,000	4,805,000
Net realized and unrealized gains	—	—	(183,000)
Write-off of purchased technology	426,043,000	7,506,000	—
Write-down of property and equipment	4,028,000	—	3,613,000
Changes in, net of the Cetus acquisition:			
Accounts receivable	(15,501,000)	(5,492,000)	2,842,000
Inventories	(3,602,000)	(2,032,000)	142,000
Prepaid expenses and other current assets	(200,000)	(17,000)	(480,000)
Accounts payable	3,221,000	904,000	1,518,000
Bond interest payable	—	4,404,000	—
Accrued compensation and related expenses	6,220,000	3,274,000	663,000
Unearned revenue under collaborative research agreements	1,387,000	(3,119,000)	4,727,000
Increase in joint venture liability	1,910,000	816,000	—
Other liabilities	11,123,000	1,216,000	1,357,000
Other noncurrent liabilities	46,000	(400,000)	—
Net cash provided by (used in) operating activities	17,881,000	19,019,000	(2,625,000)
Cash flows from investing activities:			
Purchase of investments	(531,018,000)	(288,443,000)	(98,937,000)
Sale of investments	336,351,000	203,254,000	20,013,000
Cash from the Cetus acquisition	326,495,000	—	—
Capital expenditures	(14,329,000)	(8,799,000)	(5,255,000)
Purchase of DuPont intangibles	—	(9,000,000)	—
Advances to real estate partnership	(6,356,000)	—	—
Changes in:			
Other assets	(5,574,000)	(1,557,000)	121,000
Cash paid for acquisition of assets acquired	(2,417,000)	—	—
Purchase of marketable securities	—	—	(6,277,000)
Sale of marketable securities	—	—	14,465,000
Net cash provided by (used in) investing activities	103,152,000	(104,545,000)	(75,870,000)
Cash flows from financing activities:			
Repayments of obligations under capital leases	—	(64,000)	(236,000)
Proceeds from sale of common stock	146,013,000	4,098,000	54,879,000
Proceeds from issuance of subordinated debt	—	117,916,000	—
Increase (decrease) in notes payable	—	—	(1,716,000)
Net cash provided by financing activities	146,013,000	121,950,000	52,927,000
Net increase (decrease) in cash and cash equivalents	267,046,000	36,424,000	(25,568,000)
Cash and cash equivalents at beginning of year	46,163,000	9,739,000	35,307,000
Cash and cash equivalents at end of year	$ 313,209,000	$ 46,163,000	$ 9,739,000

See accompanying notes.

CHIRON CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1991

Note 1 — The Company and Summary of Significant Accounting Policies

The Company

Chiron Corporation (the "Company" or "Chiron") applies genetic engineering and other tools of biotechnology to develop products that diagnose, prevent and treat human disease.

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated. Investments in joint ventures and partnerships in which Chiron has an equity interest of 50 percent or less are accounted for by the equity method.

Cash Equivalents and Investments

Cash equivalents, short-term and noncurrent cash investments consist principally of deposits with major banks, Eurodollar time deposits and certificates of deposit, and money market securities of the United States government and companies with strong credit ratings from a variety of industries. Classification of the investments is dependent upon maturity at the date acquired with cash equivalents having a maturity of less than three months, short-term investments having a maturity between three months and one year and long-term investments having maturities greater than one year. All investments are stated at cost, which approximates market value.

Inventories

Inventories (included in other current assets) are stated at the lower of cost or market using the average cost method. A Chiron subsidiary maintains an inventory of ophthalmic products valued at cost (first-in, first-out basis) which is less than market value. Inventories consist primarily of finished goods and work-in-process with small inventories of raw materials.

Property, Equipment and Leasehold Improvements

Property, equipment and leasehold improvements are stated at cost. Depreciation on property and equipment is computed by the straight-line method over the estimated useful lives of the assets (three to ten years for equipment and 15 to 40 years for buildings). Leasehold improvements are amortized on a straight-line basis over the remaining fixed lease term or asset life, whichever is shorter.

Purchased Technologies

Purchased technologies are amortized on a straight-line basis, principally over 15 years. Accumulated amortization at December 31, 1991 and 1990 was immaterial and has been included in other operating expenses.

Revenues

The Company has entered into collaborative research agreements that provide for the partial or complete funding of specified projects in exchange for licenses to produce and sell the resulting products. In certain of these agreements, the Company retains the right to manufacture and supply the active ingredient in bulk form. Collaborative research agreement revenue is earned and recognized based upon work performed, upon the sale of product rights, upon shipment of product for use in preclinical and clinical testing or upon the attainment of benchmarks specified in the related agreements. Equity in unconsolidated joint businesses primarily represents the Company's share of the pretax operating earnings generated by the Chiron-Ortho joint business. Earnings are recognized by Chiron as reported by its joint business partner, as discussed in Note 4. Product sales consist of

Note 1 — The Company and Summary of Significant Accounting Policies (Continued)

shipments of diagnostic kits, commercial antigens, therapeutics and ophthalmic products sold to healthcare providers in North America and Europe. Other revenues consist primarily of royalty payments under license agreements and grants from federal or state governments that partially fund research activities. Other revenues are recognized when earned.

Research and Development Expenses

All costs of research and development are expensed in the period incurred.

Income Taxes

The provision for income taxes includes federal, state and foreign taxes currently payable and deferred income taxes arising from differences in reporting results of operations for financial statement and income tax purposes. Investment credits and research and development tax credits are accounted for using the flow-through method.

In February 1992, the Financial Accounting Standards Board issued Statement No. 109, "Accounting for Income Taxes," which establishes a new method of accounting for income taxes. The Company is required to adopt the provisions of the Statement in its fiscal year ending December 31, 1993. The effect of the adoption of this Statement would be to eliminate the presentation of the extraordinary item from the utilization of operating loss carryforwards in 1990. In addition, the Company would be required to reclassify the tax effects of differences between the estimated fair values and the tax bases of certain Cetus assets and liabilities from the assigned value of the asset to a deferred tax asset, the realization of all or part of which would be subject to management's expectations regarding future taxable income.

Statement of Cash Flows

Supplemental disclosure to the Statement of Cash Flows for the year ended December 31, 1991 is as follows:

	1991
Cetus acquisition (Note 2):	
Fair value of assets acquired	$ 887,829,000
Common stock issued, 10,086,828 shares	(644,296,000)
Acquisition costs	(19,015,000)
Value of converted stock options and warrants	(39,231,000)
Liabilities assumed	$ 185,287,000
Other non-cash financing activities:	
Bonds converted into common stock	$ 2,000
Cash paid for interest	$ 8,916,000
Cash paid for income taxes	$ 241,000

Per Share Data

Per share information is based on the weighted average number of common shares outstanding. Shares issuable upon the exercise of stock options are not included in the 1991 and 1989 calculations

Note 1 — The Company and Summary of Significant Accounting Policies (Continued)

since their inclusion would be anti-dilutive; however, they are included as appropriate in the calculation for 1990. Shares assumed to be issued upon conversion of the Company's convertible debentures and exercise of warrants are not included since their inclusion would be anti-dilutive. Fully diluted per share data has not been presented as the amounts would not differ from primary per share data.

Translation of Foreign Currencies

Adjustments resulting from the translation of the financial statements of the Company's foreign subsidiaries are excluded from the Statement of Operations and are accumulated as a component of stockholders' equity. At December 31, 1991 the accumulated translation adjustment was not material; there were no foreign operations at December 31, 1990. Foreign currency transaction gains and losses are included in income and were immaterial for the year ended December 31, 1991. Local currencies are considered to be the functional currency.

Concentration of Credit and Market Risk

The Company invests cash which is not required for immediate operating needs principally in a diversified portfolio of financial instruments of institutions with strong credit ratings and the United States government. By policy, the amount of credit exposure to any one institution is limited. These investments are generally not collateralized and primarily mature within two years. The Company has not experienced any significant losses on these investments.

The Company has not experienced any credit losses from its collaborative research or joint business partners and none are currently expected. Trade receivables also arise from sales to customers of ophthalmic and therapeutic products. The Company performs ongoing credit evaluations of these customers and generally does not require collateral. Reserves are maintained for potential trade receivable credit losses and such losses have been within management's expectations.

Note 2 — Acquisition of Cetus Corporation

On December 12, 1991, the Company acquired Cetus, a publicly held biotechnology company engaged primarily in developing therapeutic drugs, through an exchange of 10,087,000 shares of Chiron common stock for 33,623,000 shares of Cetus common stock, based on an exchange ratio of 1 to 0.3. The acquisition included the conversion of all outstanding Cetus stock options and warrants into stock options and warrants to purchase 2,379,000 shares of Chiron common stock, based on the same ratio.

The purchase price of $887,829,000, including acquisition costs and liabilities assumed, has been allocated to the acquired assets based on their estimated fair value on the acquisition date, based upon an independent appraisal. The excess acquisition cost over the fair value of the identifiable tangible and intangible assets was allocated to in-process technology, valued at $426,043,000, and base technology, an intangible asset, valued at $44,847,000. The in-process technology was expensed on the acquisition date; the base technology is being amortized using the straight-line method over a 15 year life.

The business combination has been accounted for by the purchase method; therefore, the results of the operations of Cetus are included in the accompanying consolidated financial statements from December 12, 1991.

Note 2 — Acquisition of Cetus Corporation (Continued)

The following unaudited pro forma financial information assumes the acquisition occurred on January 1, 1990.

	1991	1990
Revenues	$146,532,000	$107,299,000
Loss from operations	$ 95,221,000	$ 73,284,000
Loss from continuing operations before extraordinary item	$ 86,310,000	$ 71,170,000
Loss per share before extraordinary item	$2.88	$2.80

The pro forma financial information does not purport to be indicative of the operating results which would have been achieved had the combination occurred on January 1, 1990 and should not be construed as representative of the future operating results.

Prior to the acquisition, Cetus sold substantially all its GeneAmp polymerase chain reaction ("PCR") technology business to Hoffmann-LaRoche Inc. and F. Hoffmann-LaRoche Ltd. for $300 million in cash plus possible royalties on certain future sales of PCR products and services. Financial activity related to the PCR business is not included in the above unaudited, pro forma financial information.

Note 3 — Collaborative Research Agreements

Biocine Joint Venture

Chiron and an affiliate of CIBA-GEIGY Ltd. of Basel, Switzerland ("CIBA-GEIGY") each own a 50 percent equity interest in The Biocine Company, a joint venture partnership formed for vaccine research. The joint venture agreement provides that Chiron will contribute to the joint venture exclusive licenses to certain technology and that CIBA-GEIGY will contribute cash (to prescribed limits) to fund the joint venture's operations. In the second quarter of 1990, CIBA-GEIGY'S initial funding reached the amount at which Chiron became obligated to share 50 percent of the capital funding requirements and loss allocation. Revenues included in the Statement of Operations represent amounts earned from The Biocine Company, less Chiron's share of the Biocine loss in 1991 and 1990. At December 31, 1991, accounts receivable due from The Biocine Company totaled $9,949,000, $5,223,000 at December 31, 1990. Chiron and CIBA-GEIGY have agreed to contribute $16,800,000 each to the joint venture through 1992. In an agreement reached early in 1992, CIBA-GEIGY will fund, through 1996, its 50 percent share of expenses as well as Chiron's share up to $45 million. In exchange, CIBA-GEIGY will have a preferred interest in future profits and cash flow from The Biocine Company. Chiron will have an option through 1996 of reestablishing its position by paying to CIBA-GEIGY an amount equal to one-half of the incremental funding, plus interest.

Other Collaborative Arrangements

The Company has entered into other collaborative research agreements which provide for the partial or complete funding of specified projects in exchange for licenses to produce and sell the resulting products. In certain of these agreements, the Company retains the right to manufacture and supply the active ingredient in bulk form.

Note 3 — Collaborative Research Agreements (Continued)

The following table summarizes collaborative research revenues for the years ended December 31, 1991, 1990 and 1989:

	1991	1990	1989
The Biocine Company	$10,256,000	$ 9,624,000	$10,309,000
Ortho Joint Business	6,682,000	4,500,000	550,000
Chiron Ophthalmic Research Partners	—	—	1,321,000
Shipment for clinical testing	2,931,000	1,387,000	4,316,000
Other collaborative arrangements	10,606,000	15,390,000	9,078,000
	$30,475,000	$30,901,000	$25,574,000

Note 4 — Joint Business Arrangements

Diagnostic Joint Business

In 1989, Chiron entered into agreements with Ortho Diagnostic Systems, Inc. ("Ortho"), a Johnson & Johnson company, to jointly develop certain immunoassay diagnostic products. Under the terms of the agreement, Chiron receives 50 percent of the pre-tax operating profits generated by the joint business and is reimbursed for its continuing research, development and manufacturing costs. Ortho and Chiron also licensed Abbott to sell its own immunoassay diagnostic tests for hepatitis C using certain technology from the joint business. In February 1990, Chiron and Ortho purchased the microplate blood-screening business of E.I. du Pont de Nemours & Company ("DuPont"). Ortho purchased all tangible assets of the business and the intangible assets were acquired jointly by Chiron and Ortho. Chiron's portion of the intangible assets purchased was $9,000,000, of which $6,000,000 was expensed as relating to in-process technology.

Chiron records its share of profits of the Chiron-Ortho diagnostic business with a one month lag using estimates provided by Ortho. These estimates are subject to a final adjustment 90 days after the end of each calendar year and profit sharing distributions are payable to Chiron within 90 days after the end of each quarter. At December 31, 1991, $12,539,000 was due from Ortho, $5,055,000 at December 31, 1990. From December 1990 through November 1991, revenues of the Chiron-Ortho diagnostic business were approximately $200,000,000 ($178,000,000 from inception through November 1990). Chiron's 50 percent share of the profits from the joint business were $49,803,000 in 1991 and include approximately $3,000,000 as a result of the final 1990 accounting. In 1990 the profits of $32,105,000 have been reduced by a $6,000,000 write-off resulting from the purchase of in-process technology described above. Revenues recognized under the cost reimbursement portion of the agreement with Ortho were $6,682,000 for collaborative research and $10,576,000 for product sales in 1991. These revenues totaled $12,529,000 in 1990 and $1,217,000 in 1989.

Generic Chemotherapeutics Joint Venture

Chiron's recently acquired subsidiary, Cetus, is a partner in a joint venture with Ben Venue Laboratories, Inc. for the manufacture, commercialization and marketing of generic chemotherapeutic cancer products. Cetus' 50 percent share of the joint venture profits are included in the 1991 financial statements for the period subsequent to the acquisition and amounted to $42,000.

Note 5 — Limited Partnerships

Chiron Ophthalmics

The Company's ophthalmic subsidiary, Chiron Ophthalmics, Inc. ("Chiron Ophthalmics") entered into a cost-reimbursement research agreement with Chiron Ophthalmic Research Partners ("CORP") in 1986. In January 1991, Chiron Ophthalmics purchased the assets and liabilities of CORP for a cash payment of $801,000 and an ongoing royalty on products currently sold or in development up to a maximum of $6,483,000. The cash payment was charged to research and development expense in the 1990 financial statements. Royalty expense was not significant. In January 1992, Chiron purchased the royalty interest of CORP and the partnership was liquidated. The amount paid for the royalty interest and related expenses of $5,174,000 was charged to research and development expense in the 1991 financial statements.

Cetus Healthcare Limited Partnerships

Pursuant to certain agreements between the Company and the former partners of Cetus Healthcare Limited Partnership ("CHLP"), the Company is obligated to fund development of certain CHLP products through regulatory approval if, based on the Company's assessment, the products are believed to be technically feasible and commercially viable. Because of the inherent uncertainties both as to the likelihood of any particular product continuing to be viewed as technically feasible and commercially viable and as to the cost of developing any particular product through regulatory approval, the Company is unable to estimate future costs of developing the products subject to this obligation. Installment payments based on sales of CHLP products are being paid to the limited partners and expensed as incurred.

In December 1990, Cetus exercised its purchase options to acquire all the limited partners' interest in Cetus Healthcare Limited Partnership II ("CHLP II"). The former partners are entitled to receive a fixed percentage of the net sales of certain products in Europe (through December 31, 2005) and the United States (until certain aggregate returns are realized).

Note 6 — Debt Obligations and Capital Leases

At December 31, 1991 and 1990, long-term debt and capital leases consist of the following:

	1991	1990
Chiron 7¼% convertible subordinated debentures	$121,498,000	$121,500,000
Cetus 5¼% convertible subordinated debentures . .	88,200,000	—
Notes payable	19,186,000	—
Capital lease obligations	16,850,000	—
	245,734,000	121,500,000
Less current portion	7,095,000	—
	$238,639,000	$121,500,000

In July 1990, the Company issued $121,500,000 of 7¼ percent subordinated debentures which are convertible, at any time, into Chiron common stock at $47 per share. At the option of the Company, the debentures may be redeemed at any time after July 1, 1992, at an initial redemption premium of 105.8 percent of the principal amount and declining annually thereafter to 100 percent of the principal in 2000. Interest is due semi-annually and, from July 1, 2001 through July 1, 2014, the Company is

Note 6 — Debt Obligations and Capital Leases (Continued)

required to make sinking fund payments in each year sufficient to retire 5 percent of the aggregate principal amount of the debentures issued. Financing costs of $3,700,000 are being amortized over the term of the debentures.

Cetus' 5¼ percent convertible subordinated debentures are due in 2002, have a face value of $100,000,000 and are convertible at the holders' option at any time into common stock of Chiron at $123.33 per share. Interest is due annually. At the option of the Company, the debentures may be redeemed at any time at a current redemption premium of 102 percent of the principal amount and declining annually thereafter to 100 percent of the principal in May 1993. These debentures were recorded at $88,200,000 at the date Chiron acquired Cetus based upon an independent opinion as to a current interest rate for these obligations. The difference between the face value of the debentures and their present value will be accreted over the remaining term of the debentures using the interest method.

The Company has various secured notes payable with interest rates ranging from 6 percent to 12 percent. Maturities range from 1992 through 2008. Capital leases with interest rates between 8 percent and 11 percent mature at various dates through 2019.

Maturities of long-term debt in 1992 and in the four subsequent years are $7,095,000, $2,336,000, $2,423,000, $1,064,000 and $602,000, respectively and $232,214,000 thereafter.

Note 7 — Commitments and Contingencies

Leases

Chiron leases laboratory, office and manufacturing facilities and equipment under non-cancelable operating leases which expire at varying times through 2000. Land and equipment are leased under non-cancelable capital leases with a net book value of $25,668,000 at December 31, 1991. Future minimum payments under these leases are as follows:

	Capital Leases	Operating Leases
1992	$ 2,917,000	$ 8,525,000
1993	2,780,000	6,575,000
1994	3,110,000	4,998,000
1995	2,695,000	3,639,000
1996	2,672,000	1,738,000
Thereafter	48,257,000	8,574,000
Total minimum lease payments	62,431,000	$34,049,000
Less amount representing interest	45,581,000	
Present value of minimum lease payments	$16,850,000	

Rent expense was $5,589,000 in 1991 ($4,575,000 in 1990 and $4,373,000 in 1989). Deferred rent expense of $1,222,000 ($1,604,000 in 1990), representing proration of minimum rental payments equally over the fixed term of the leases, is included in other current and noncurrent liabilities.

Note 7 — Commitments and Contingencies (Continued)

Real Estate Partnerships

Chiron entered into three real estate partnerships in 1987 to allow Chiron to expand its manufacturing capability on a site convenient to its main operating facilities. Construction was postponed and as a result, in the first quarter of 1990, Chiron accrued certain costs totaling $1,033,000 through the anticipated time of resolution. These costs have been presented as other operating expenses. Chiron obtained the option to buy out the partnership interests held by a real estate development company in the remaining two partnerships. Since March 1991, Chiron has paid the interest and other costs of carrying these properties and in July 1991, repaid the outstanding indebtedness secured by the properties of approximately $6,400,000. The California Department of Transportation has advised Chiron that it intends to condemn a portion of the property for use in a highway project. As a result, in 1991 the Company decided not to construct a plant on this property and has written off certain plant development costs totaling $1,488,000. These costs are included in other operating expenses. Currently, Chiron is considering various alternatives for the use or disposition of the remaining portion of these properties.

Note 8 — Stockholders' Equity

Stock Option Plans

In December 1991, Chiron adopted a new stock option plan ("1991 Plan") to replace and supersede the six separate plans maintained by Chiron, Cetus and certain Chiron subsidiaries. The 1991 Plan provides for the grant to key employees and directors of either nonqualified or incentive options and the grant to consultants and contractors of nonqualified options. Incentive options are to be granted at not less than the fair market value of common stock at the date of grant and nonqualified options at not less than 85 percent of fair market value. Options are exercisable as determined by the Board of Directors.

Initially the 1991 Plan will have reserved, and available for issuance, options to 4,500,000 shares of Chiron common stock plus any remaining options available under the prior Chiron plans. This amount will be adjusted annually by a number of shares equal to 1.5 percent of common stock outstanding plus shares issuable upon conversion or exercise of outstanding warrants, options and convertible securities. At December 31, 1991, 4,968,152 shares were available for grant.

A summary of stock option activity follows:

	Incentive Stock Options	Nonqualified Stock Options
Outstanding options at December 31, 1990	1,392,043	695,212
Granted	664,207	311,506
Conversion of options	72,385	1,034,556
Forfeited	(49,235)	(26,778)
Exercised	(325,386)	(110,320)
Outstanding options at December 31, 1991	1,754,014	1,904,176
At December 31, 1991:		
Average price of outstanding options	$33.70	$29.91
Exercisable options	532,609	1,388,841

Note 8 — Stockholders' Equity (Continued)

Limited stock appreciation rights ("LSARs") have been granted in tandem with outstanding options to certain key Cetus employees. Converted options and the associated LSARs were assumed by Chiron; the LSARs are exercisable for a period up to 110 days after the December 12, 1991 merger.

Employee Stock Purchase Plan

Chiron has a stock purchase plan in which eligible employees may participate through payroll deductions. A total of 750,000 shares have been reserved for issuance under the plan of which 538,281 shares were available for purchase at December 31, 1991. At the end of each quarter, funds deducted from participating employees' salaries are used to purchase common stock at 85 percent of the lower of market value at the purchase date or the beginning date of the purchase period. During 1991, purchases of 106,458 shares were made under the plan (70,793 in 1990).

Cetus also has a stock purchase plan for eligible employees which was in place at the time of the acquisition. This plan will remain in effect through June 30, 1992 at which time participants will become eligible for the Chiron Stock Purchase Plan. Under the Cetus plan, Chiron stock will be purchased at June 30, 1992 at 85 percent of the fair market value at that date or the employee's enrollment date, whichever is less.

Common Stock Warrants

As a result of the acquisition of Cetus, the following warrants to purchase Chiron common stock are outstanding at December 31, 1991:

Number of Shares	Exercise Price	Expiration Date
409,920	$100.00	June 30, 1993
292,815	$ 95.33	December 15, 1996
49,740	$100.52	March 31, 1992
150,000	$ 52.50	December 31, 1998
150,000	$ 52.50	August 10, 1999

Note 9 — Income Taxes

The provision for income taxes (before extraordinary item) is summarized as follows:

	1991	1990
Federal	$117,000	$2,308,000
State	375,000	722,000
Foreign	294,000	—
	$786,000	$3,030,000

No provision for income taxes was made in 1989 due to net operating losses incurred for both financial reporting and income tax purposes. Cash paid for income taxes was $241,000 in 1991 ($150,000 in 1990; none in 1989). Taxes payable by Cetus as a result of the PCR sale (Note 2), were approximately $44 million, of which approximately $23 million was paid prior to the merger and the balance of which was assumed as a liability as of the date of the merger.

Note 9 — Income Taxes (Continued)

A reconciliation of the provision for income taxes for 1991 and 1990, computed at the statutory United States income tax rate, to the reported provision amounts is as follows:

	1991	1990
Tax provision at statutory rates	$(144,311,000)	$2,400,000
Tax effect of charge-off of in-process technology	141,978,000	—
State taxes, net of federal tax benefit	375,000	476,000
Losses of foreign subsidiaries not providing benefit in current year	1,585,000	—
Research and development expense reduction	71,000	154,000
Effect of net operating loss carried forward	997,000	—
Other	91,000	—
Provision for income taxes (before extraordinary item)	$ 786,000	$3,030,000

As of December 31, 1991, the Company had net operating loss carryforwards available for financial statement and for federal income tax purposes of approximately $57,000,000 and $24,000,000, respectively, expiring principally from 2002 to 2004. Net operating loss carryforwards are different for financial statement and federal income tax purposes due principally to different methods of revenue recognition used for tax purposes and financial reporting purposes, the timing of expenses related to the acquisition of technology and product rights and the timing of certain compensation expenses and certain reserves.

Included in determining the net operating loss carryforward for federal income tax purposes is approximately $23,000,000 related to tax deductions for the Company's stock option plans. The tax benefit of such deductions is recorded as an increase to paid-in capital when realized. In 1991, a tax benefit of approximately $1,200,000 was recorded as an increase to paid-in capital.

The Company has a net operating loss carryforward of approximately $2,500,000 available for state tax purposes, expiring in 2003 and 2004. In addition, the Company has available a net operating loss carryforward for state tax purposes of approximately $80,000,000 as a result of the merger with Cetus Corporation (Note 2), the benefit of which will be accounted for as a reduction of the purchase price of the Cetus assets when realized. Due to certain changes in California tax law effective in 1991, such net operating loss carryforwards will not be available to reduce state taxable income in 1991 or 1992. The Company has foreign net operating loss carryforwards of approximately $600,000 which expire in 1996.

The Company has research and development tax credit and investment tax credit carryforwards of approximately $2,100,000 to offset future income taxes; such credit carryforwards expire principally from 1995 through 2007.

Due to certain provisions regarding changes in ownership for tax purposes, utilization of the net operating loss carryforwards to offset future tax liabilities may be subject to an annual limitation in future periods based upon certain events including changes in ownership of the Company's stock. However, management does not believe that any limitation on use of the Company's net operating loss and credit carryforwards has resulted from certain changes in ownership through December 31, 1991, including the issuance of convertible subordinated debentures (Note 6) and the issuance of stock in connection with the merger with Cetus Corporation (Note 2).

Note 10 — Other Income

Other income consists of the following:

	1991	1990	1989
Interest income	$22,223,000	$11,248,000	$5,614,000
Dividend income	321,000	—	109,000
Unrealized gain on marketable securities	—	—	513,000
Loss on real estate investments	—	(102,000)	(731,000)
Net realized gain/(loss) on sale of marketable securities	1,083,000	—	(330,000)
Interest expense and related costs on convertible debentures	(8,937,000)	(4,491,000)	—
Interest expense	(474,000)	—	(77,000)
Other	(60,000)	—	81,000
	$14,156,000	$ 6,655,000	$5,179,000

Note 11 — Major Customers and Revenues by Geographic Area

There was one major customer in 1991 (Johnson & Johnson) accounting for 58 percent of the Company's total revenues. This customer is a related party (Note 4). In 1990, two customers contributed 52 percent (Johnson & Johnson) and 12 percent (The Biocine Company) of total revenues; both were related parties (Notes 3 and 4). During 1989, two customers contributed 29 percent and 26 percent of total revenues; one of these was a related party.

The Company had no foreign operations until 1991; revenues, operating results and identifiable assets of the foreign operations are not material. Revenues were derived from customers based in the following geographic areas:

	1991	1990	1989
North America	$ 95,334,000	$ 63,620,000	$ 31,965,000
Europe	13,368,000	6,643,000	2,946,000
Asia and Pacific Basin	9,757,000	8,249,000	563,000
	$118,459,000	$ 78,512,000	$ 35,474,000

Note 12 — Legal Proceedings

The Company is involved in litigation in the ordinary course of its business. While the outcome of litigation cannot be accurately predicted, based upon information presently known to management, the Company does not believe that the ultimate resolution of any such litigation matter, including the matters described below, should have a material adverse effect upon its financial statements as presented herein.

Scripps Clinic and Research Foundation

Chiron is defending a lawsuit filed in 1983, by the Scripps Clinic and Research Foundation and Revlon, Inc. The plaintiffs allege that Chiron's research program to synthesize a protein associated with human blood clotting, Factor VIII:C, through genetic engineering techniques infringes plaintiffs' rights under a patent for purified Factor VIII:C. The suit seeks an injunction against further infringement, an

Note 12 — Legal Proceedings (Continued)

accounting, compensatory damages of at least $10 million and punitive damages in the same amount. The case is awaiting the setting of a trial date. Chiron recently received a patent for the recombinant expression of Factor VIII:C.

Merger Related Litigation

Following announcement in July 1991 of the merger agreement among Chiron, Cetus and Chiron Acquisition Subsidiary, Inc. (the "Merger Agreement"), eight related class action lawsuits were filed in Delaware on behalf of the stockholders of Cetus Corporation against Cetus, members of the Cetus Board of Directors, Chiron and, in the case of several of the actions, certain of Chiron's directors and officers. The complaints generally allege, among other things, that the acts of Cetus and its directors in approving and entering into the Merger Agreement constituted breaches of fiduciary duties owing to Cetus stockholders. The lawsuits sought to enjoin the consummation of the Merger, unspecified damages, and other injunctive and equitable relief. The Merger was consummated on December 12, 1991. The parties agreed to consolidate the eight actions and further agreed to an indefinite extension of the time to answer or otherwise respond to the complaints.

Kodak Arbitration and Litigation

In 1991, Eastman Kodak Company ("Kodak") filed a demand for arbitration against Cetus arising from an agreement covering a research and development program between Kodak and Cetus in effect during the period February 1986 to February 1989. Kodak is seeking a determination that it has the rights to the polymerase chain reaction ("PCR") technology developed by Cetus for a broad range of *in vitro* human diagnostic products, unspecified monetary damages, and nullification of the transfer of PCR assets to Hoffmann-LaRoche.

Kodak also filed a suit against Cetus requesting a preliminary injunction against the transfer of PCR technology to Roche and against the disclosure of certain information relating to PCR. Kodak's motion for an injunction was denied, and the sale of the PCR business to Roche was consummated on December 11, 1991.

In connection with the sale of the PCR business, Cetus and Roche have made arrangements to cooperate in the defense of litigation (including the arbitration and lawsuit described above) with Kodak relating to PCR technology and to share in the defense costs. If Cetus and Roche are not able to agree on any issue relating to such defense, Roche will have the final right to decide that issue. However, Cetus and Roche have agreed not to settle any such litigation without the other's consent, which each has agreed not to withhold unreasonably.

Doxorubicin

In 1991, Alco Chemicals, Ltd. and Sicor SpA ("Sicor"), Cetus Ben Venue Therapeutics' ("CBVT") former supplier of bulk doxorubicin, filed suit against Cetus, Ben Venue, CBVT and Erbamont, Inc. and its affiliates. Sicor had been prevented from manufacturing product for CBVT since September 1990, when Sicor's facilities in Italy were ordered closed by the government in connection with trade secret litigation in Italy. In March, 1991, CBVT entered into an agreement with Erbamont which provided for, among other things, the settlement of several legal proceedings then pending relating to Erbamont's alleged doxorubicin proprietary rights, and the exclusive supply of doxorubicin to CBVT by Erbamont. The Sicor complaint alleges breach of the CBVT contract to purchase bulk doxorubicin from Sicor, as well as antitrust violations and interference with contractual relations, and seeks

Note 12 — Legal Proceedings (Continued)

unspecified damages. Cetus has denied any entitlement to recovery in this lawsuit and has filed a counterclaim against the plaintiffs for fraud and breach of contract based on Sicor's failure to deliver the bulk product.

Note 13 — Subsequent Events

Acquisition of IntraOptics, Inc.

On January 8, 1992, the Company acquired IntraOptics Inc. ("IntraOptics"), a privately held manufacturer and marketer of intraocular lenses and instruments for cataract surgeries, in exchange for 578,000 newly issued shares of Chiron common stock. The business combination will be accounted for as a pooling-of-interests. IntraOptics will be combined with Chiron's wholly owned subsidiary, Chiron Ophthalmics. For the year ended December 31, 1991, IntraOptics reported a net loss of $1,837,000 on revenues of $23,040,000.

Investment in Sclavo SpA

On January 23, 1992, CIBA-GEIGY completed its acquisition of the vaccine business of Sclavo SpA of Siena, Italy, for the Swiss franc equivalent of approximately 150 billion lira. This investment is being held by a Netherlands company, of which Chiron will purchase 50 percent early in 1992. The business, which has been renamed Biocine Sclavo, will not be combined with The Biocine Company at this time. Strategic activities are being determined jointly by the two partners. The Company anticipates that acquisition costs and capital contributions to fund near term working capital requirements will be up to $75 million.

Investment in Onyx Pharmaceuticals

On March 16, 1992, Chiron and a group of venture investors formed an independent company, Onyx Pharmaceuticals ("Onyx"), to focus on the discovery and development of cancer therapeutics through research into molecular oncology mechanisms using technology licensed from Chiron. Chiron will contribute $4 million in services, equipment, facilities use and cash, and a technology license and will own 42.8 percent of Onyx's initial capital stock. Chiron has agreed to support up to $350,000 of additional services, provided such services do not require Chiron to incur additional expense or cash disbursements. Approximately 20 Chiron employees are expected to become employees of Onyx. Chiron will record its 42.8 percent share of Onyx's losses as research and development expense.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Chiron Corporation

We have audited the consolidated balance sheet of Chiron Corporation as of December 31, 1991 and 1990 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1991. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Chiron Corporation at December 31, 1991 and 1990, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1991, in conformity with generally accepted accounting principles.

ERNST & YOUNG

San Francisco, California
February 14, 1992

CHIRON CORPORATION
MARKET PRICE OF COMMON STOCK

The common stock of Chiron Corporation is traded in the NASDAQ National Market System under the symbol CHIR. As of December 31, 1991, there were 2,104 holders of record of Chiron common stock and 11,736 holders of record of Cetus common stock. The Company has declared no dividends since its inception and does not expect to pay any dividends in the foreseeable future. The quarterly high and low closing sales price of Chiron common stock for 1991 and 1990 are shown below.

	1991		1990	
	High	Low	High	Low
First Quarter	67¼	37¼	30⅜	23½
Second Quarter	68¾	47¼	39¾	26¼
Third Quarter	75	48	42¼	30
Fourth Quarter	77½	60¾	44¾	31¼

CHIRON CORPORATION

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