

APPLERA CORP
Form 10-Q
February 13, 2004

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

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2003

OR

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

Commission file number: **1-4389**

APPLERA CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

06-1534213

(I.R.S. Employer
Identification No.)

301 Merritt 7, Norwalk, Connecticut

(Address of Principal Executive Offices)

06851-1070

(Zip Code)

(203) 840-2000

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

As of the close of business on February 9, 2004, there were 206,341,966 shares of Applera Corporation-Applied Biosystems Group Common Stock and 72,771,789 shares of Applera Corporation-Celera Genomics Group Common Stock outstanding.

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[Back to Index](#)**PART I** □ **FINANCIAL INFORMATION****Item 1. Financial Statements.**

APPLERA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

(Dollar amounts in thousands except per share amounts)

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|--|------------------------------------|--------------------|----------------------------------|--------------------|
| | 2002 | 2003 | 2002 | 2003 |
| Net Revenues | \$ 473,017 | \$ 485,335 | \$ 890,350 | \$ 890,372 |
| Cost of sales | 230,326 | 230,678 | 425,220 | 421,156 |
| Gross Margin | 242,691 | 254,657 | 465,130 | 469,216 |
| Selling, general and administrative | 111,426 | 123,266 | 219,527 | 230,623 |
| Research, development and engineering | 103,285 | 94,947 | 206,576 | 187,359 |
| Amortization of intangible assets | 1,723 | 725 | 4,423 | 1,450 |
| Other special charges | 24,313 | (615) | 24,313 | (615) |
| Operating Income | 1,944 | 36,334 | 10,291 | 50,399 |
| Gain (loss) on investments, net | (273) | 6,486 | (273) | 7,031 |
| Interest expense | (193) | (166) | (403) | (302) |
| Interest income | 7,875 | 6,016 | 16,464 | 12,222 |
| Other income (expense), net | 3,050 | 1,942 | 935 | 956 |
| Income before Income Taxes | 12,403 | 50,612 | 27,014 | 70,306 |
| Provision (benefit) for income taxes | (1,021) | 8,041 | 1,525 | 11,723 |
| Income from Continuing Operations | 13,424 | 42,571 | 25,489 | 58,583 |
| Loss from discontinued operations, net of income taxes | | | (16,400) | |
| Net Income | \$ 13,424 | \$ 42,571 | \$ 9,089 | \$ 58,583 |
| Applied Biosystems Group (see Note 2) | | | | |
| Income from Continuing Operations | \$ 29,187 | \$ 52,417 | \$ 63,409 | \$ 85,795 |
| Basic and diluted per share | \$ 0.14 | \$ 0.25 | \$ 0.30 | \$ 0.41 |
| Loss from Discontinued Operations | \$ □ | \$ □ | \$ (16,400) | \$ □ |
| Basic and diluted per share | \$ □ | \$ □ | \$ (0.08) | \$ □ |
| Net Income | \$ 29,187 | \$ 52,417 | \$ 47,009 | \$ 85,795 |
| Basic and diluted per share | \$ 0.14 | \$ 0.25 | \$ 0.22 | \$ 0.41 |
| Dividends per share | \$ 0.0425 | \$ 0.0425 | \$ 0.0850 | \$ 0.0850 |
| Celera Genomics Group (see Note 2) | | | | |
| Net Loss | \$ (16,124) | \$ (13,556) | \$ (35,773) | \$ (29,842) |
| Basic and diluted per share | \$ (0.23) | \$ (0.19) | \$ (0.50) | \$ (0.41) |

See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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APPLERA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Dollar amounts in thousands)

| | At June 30, 2003 | At December 31, 2003 |
|---|---------------------|----------------------------|
| | | (Unaudited) |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 654,283 | \$ 719,565 |
| Short-term investments | 749,785 | 689,967 |
| Accounts receivable, net | 423,549 | 372,133 |
| Inventories, net | 152,060 | 164,493 |
| Prepaid expenses and other current assets | 93,706 | 104,265 |
| | <hr/> | <hr/> |
| Total current assets | 2,073,383 | 2,050,423 |
| Property, plant and equipment, net | 526,591 | 518,295 |
| Other long-term assets | 657,518 | 619,511 |
| | <hr/> | <hr/> |
| Total Assets | \$ 3,257,492 | \$ 3,188,229 |
| | <hr/> | <hr/> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Current portion of long-term debt | \$ | \$ 16,660 |
| Accounts payable | 166,319 | 130,673 |
| Accrued salaries and wages | 79,623 | 66,312 |
| Accrued taxes on income | 85,943 | 81,456 |
| Other accrued expenses | 281,435 | 279,655 |
| | <hr/> | <hr/> |
| Total current liabilities | 613,320 | 574,756 |
| Long-term debt | 17,101 | |
| Other long-term liabilities | 286,786 | 273,867 |
| | <hr/> | <hr/> |
| Total Liabilities | 917,207 | 848,623 |
| Stockholders' Equity | | |
| Capital stock | | |
| Applera Corporation | 2,128 | 2,130 |
| Applera Corporation | 723 | 727 |
| Capital in excess of par value | 2,102,936 | 2,104,849 |
| Retained earnings | 355,252 | 396,017 |
| Accumulated other comprehensive loss | (54,485) | (28,053) |
| Treasury stock, at cost | (66,269) | (136,064) |
| | <hr/> | <hr/> |
| Total Stockholders' Equity | 2,340,285 | 2,339,606 |
| | <hr/> | <hr/> |
| Total Liabilities and Stockholders' Equity | \$ 3,257,492 | \$ 3,188,229 |
| | <hr/> | <hr/> |

See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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APPLERA CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(Dollar amounts in thousands)

| | Six months ended December 31, | |
|--|----------------------------------|-------------------|
| | 2002 | 2003 |
| Operating Activities of Continuing Operations | | |
| Income from continuing operations | \$ 25,489 | \$ 58,583 |
| Adjustments to reconcile income from continuing operations to net cash provided by operating activities: | | |
| Depreciation and amortization | 69,879 | 65,741 |
| Asset impairments | 10,017 | (6) |
| Provisions for office closures and severance costs | 23,744 | (609) |
| Long-term compensation programs | 3,572 | 2,079 |
| (Gain) loss from investments and sale of assets, net | 273 | (6,965) |
| Deferred income taxes | (32,340) | (19,645) |
| Loss from equity method investees | 4,338 | 758 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 14,452 | 72,786 |
| Inventories | (16,837) | (14,518) |
| Prepaid expenses and other assets | (2,438) | 5,792 |
| Accounts payable and other liabilities | (28,664) | (81,697) |
| Net Cash Provided by Operating Activities of Continuing Operations | 71,485 | 82,299 |
| Investing Activities of Continuing Operations | | |
| Additions to property, plant and equipment, net | (62,584) | (32,783) |
| Proceeds from short-term investments, net | 184,246 | 74,498 |
| Purchases of long-term investments | (16,834) | |
| Acquisitions and other investments, net | | (288) |
| Proceeds from the sale of assets, net | 539 | 21,480 |
| Net Cash Provided by Investing Activities of Continuing Operations | 105,367 | 62,907 |
| Net Cash Used by Operating Activities of Discontinued Operations | (1,263) | (79) |
| Financing Activities | | |
| Net change in loans payable | (291) | |
| Dividends | (17,798) | (26,504) |
| Purchases of common stock for treasury | (6,847) | (83,962) |
| Proceeds from stock issued for stock plans | 22,384 | 13,156 |
| Net Cash Used by Financing Activities | (2,552) | (97,310) |
| Effect of Exchange Rate Changes on Cash | 9,768 | 17,465 |
| Net Change in Cash and Cash Equivalents | 182,805 | 65,282 |
| Cash and Cash Equivalents Beginning of Period | 470,218 | 654,283 |
| Cash and Cash Equivalents End of Period | \$ 653,023 | \$ 719,565 |

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See accompanying notes to the Applera Corporation unaudited condensed consolidated financial statements.

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 □ Interim Condensed Consolidated Financial Statements

We prepare our unaudited interim condensed consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America, or GAAP. In preparing these statements, we are required to use estimates and assumptions. While we believe we have considered all available information, actual results could affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We have reclassified some prior year amounts in the condensed consolidated financial statements and notes for comparative purposes. The results for the interim periods are not necessarily indicative of trends or future financial results. When used in these notes, the terms "Applera," "Company," "we," "us," or "our" mean Applera Corporation and its subsidiaries.

We consistently applied the accounting policies described in our 2003 Annual Report to Stockholders in preparing these unaudited interim financial statements. We made all adjustments that are necessary, in our opinion, for a fair statement of the results for the interim periods. These adjustments are of a normal recurring nature. We condensed or omitted from these interim financial statements several notes and other information included in our 2003 Annual Report to Stockholders. You should read these unaudited interim condensed consolidated financial statements in conjunction with our consolidated financial statements presented in our 2003 Annual Report to Stockholders.

Note 2 □ Earnings (Loss) per Share, Including Pro Forma Effects of Stock-Based Compensation

The following tables present a reconciliation of basic and diluted earnings (loss) per share and illustrate what net income and earnings per share would have been if we had applied the fair value method of accounting for employee stock plans as required by Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation."

The earnings (loss) per share and pro forma effects on results for the three months ended December 31 are presented below:

| | Applera Corporation | |
|--|---------------------|---------|
| | 2002 | 2003 |
| (Dollar amounts in millions) | | |
| Net income, as reported | \$ 13.4 | \$ 42.6 |
| Add: Stock-based employee compensation expense included in reported net income, net of tax | 0.6 | 0.6 |
| Deduct: Stock-based employee compensation expense determined under fair value based method, net of tax | 37.7 | 35.0 |
| Pro forma net income (loss) | \$ (23.7) | \$ 8.2 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

| | Applied Biosystems Group | | Celera Genomics Group | |
|--|-----------------------------|----------------|--------------------------|------------------|
| | 2002 | 2003 | 2002 | 2003 |
| (Dollar amounts in millions, except per share amounts) | | | | |
| Net income (loss), as reported | \$ 29.2 | \$ 52.4 | \$ (16.1) | \$ (13.6) |
| Add: Stock-based employee compensation expense included in reported net income (loss), net of tax | 0.4 | 0.4 | 0.2 | 0.2 |
| Deduct: Stock-based employee compensation expense determined under fair value based method, net of tax | 29.9 | 28.4 | 7.8 | 6.5 |
| Pro forma net income (loss) | \$ (0.3) | \$ 24.4 | \$ (23.7) | \$ (19.9) |
| Weighted average number of common shares | | | | |
| Basic | 209.1 | 206.9 | 71.4 | 72.4 |
| Common stock equivalents | 1.5 | 4.7 | | |
| Diluted | 210.6 | 211.6 | 71.4 | 72.4 |
| Earnings (loss) per share | | | | |
| Basic and diluted □ as reported | \$ 0.14 | \$ 0.25 | \$ (0.23) | \$ (0.19) |
| Basic and diluted □ pro forma | \$ □ | \$ 0.12 | \$ (0.33) | \$ (0.27) |

The earnings (loss) per share and pro forma effects on results for the six months ended December 31 are presented below:

| | Applera Corporation | |
|---|---------------------|------------------|
| | 2002 | 2003 |
| (Dollar amounts in millions) | | |
| Income from continuing operations, as reported | \$ 25.5 | \$ 58.6 |
| Add: Stock-based employee compensation expense included in reported income from continuing operations, net of tax | 2.0 | 1.2 |
| Deduct: Stock-based employee compensation expense determined under fair value based method, net of tax | 75.7 | 71.0 |
| Pro forma loss from continuing operations | \$ (48.2) | \$ (11.2) |

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

| | Applied Biosystems Group | | Celera Genomics Group | |
|--|-----------------------------|----------------|--------------------------|------------------|
| | 2002 | 2003 | 2002 | 2003 |
| (Dollar amounts in millions, except per share amounts) | | | | |
| Income (loss) from continuing operations, as reported | \$ 63.4 | \$ 85.8 | \$ (35.8) | \$ (29.8) |
| Add: Stock-based employee compensation expense included in reported income (loss) from continuing operations, net of tax | 1.5 | 0.8 | 0.5 | 0.4 |
| Deduct: Stock-based employee compensation expense determined under fair value based method, net of tax | 59.5 | 57.8 | 16.2 | 13.2 |
| Pro forma income (loss) from continuing operations | \$ 5.4 | \$ 28.8 | \$ (51.5) | \$ (42.6) |
| Weighted average number of common shares | | | | |
| Basic | 208.9 | 207.6 | 71.3 | 72.3 |
| Common stock equivalents | 1.4 | 4.0 | | |
| Diluted | 210.3 | 211.6 | 71.3 | 72.3 |
| Earnings (loss) per share from continuing operations | | | | |
| Basic and diluted □ as reported | \$ 0.30 | \$ 0.41 | \$ (0.50) | \$ (0.41) |
| Basic and diluted □ pro forma | \$ 0.03 | \$ 0.14 | \$ (0.72) | \$ (0.59) |

Options to purchase stock at exercise prices greater than the average market prices of our common stocks were excluded from the computation of diluted earnings per share because the effect would have been antidilutive. Additionally, options and warrants to purchase shares of Applera Corporation-Celera Genomics Group Common Stock (□Applera-Celera stock□) were excluded from the computation of diluted loss per share because the effect was antidilutive. The following table presents the number of shares excluded from the diluted earnings and loss per share computations for the three and six month periods ended December 31:

| (Shares in millions) | 2002 | 2003 |
|---|------|-------------|
| Applera Corporation-Applied Biosystems Group Common Stock | 26.4 | 17.3 |
| Applera-Celera stock | 11.7 | 12.0 |

In determining the pro forma impact for employee stock plans under SFAS 123, we estimated the fair value of the options at the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions for the three and six month periods ended December 31:

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

| | Three months ended December 31, | | Six months ended December 31, | |
|---------------------------------|------------------------------------|---------------|----------------------------------|---------------|
| | 2002 | 2003 | 2002 | 2003 |
| Applied Biosystems Group | | | | |
| Dividend yield | 0.97% | 0.82% | 0.96% | 0.82% |
| Volatility | 71.98% | 71.08% | 71.56% | 71.25% |
| Risk-free interest rate | 3.19% | 3.32% | 3.24% | 3.23% |
| Expected option life in years | 5 | 5 | 5 | 5 |
| Celera Genomics Group | | | | |
| Volatility | 97.28% | 85.79% | 97.65% | 89.98% |
| Risk-free interest rate | 3.21% | 3.32% | 3.27% | 3.25% |
| Expected option life in years | 4 | 4 | 4 | 4 |

Note 3 □ Special Charges

During the second quarter of fiscal 2003, the Applied Biosystems group recorded pre-tax charges totaling \$33.8 million associated with the termination of approximately 400 employees, mainly in the U.S. and Europe, impairment of assets, and office closures. The \$33.8 million charge consisted of \$24.3 million recorded in other special charges and \$9.5 million for the impairment of assets recorded in cost of sales. Positions eliminated were primarily within the areas of research, manufacturing, sales, marketing and administration. The Applied Biosystems group recorded pre-tax benefits of \$4.3 million in the fourth quarter of fiscal 2003 and \$0.6 million in the second quarter of fiscal 2004 for reductions in anticipated employee-related costs associated with this program. The following table details the major components of the special charges:

| (Dollar amounts in millions) | Employee-Related Charges | | Asset Impairment | | Office Closures | | Total |
|-------------------------------------|-----------------------------|------------|---------------------|----------|--------------------|------------|---------------|
| Total charges | \$ | 22.9 | \$ | 9.5 | \$ | 1.4 | \$ 33.8 |
| Cash payments | | 16.4 | | | | 0.5 | 16.9 |
| Non-cash charges | | | | 9.5 | | 0.5 | 10.0 |
| Reduction of expected costs | | 4.9 | | | | | 4.9 |
| Balance at December 31, 2003 | \$ | 1.6 | \$ | □ | \$ | 0.4 | \$ 2.0 |

The termination of the employees and the cash payments relating to the workforce reductions and office closures were substantially completed by December 31, 2003. These payments were funded primarily by cash provided by operating activities.

Note 4 □ Comprehensive Gain

The components of comprehensive gain (loss) are reflected net of tax, except for foreign currency translation adjustments, which are generally not adjusted for income taxes as they relate to indefinite

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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investments in non-U.S. subsidiaries. Comprehensive gain (loss) for the three and six month periods ended December 31 were as follows:

| (Dollar amounts in millions) | Three months ended December 31, | | Six months ended December 31, | |
|---|------------------------------------|----------------|----------------------------------|----------------|
| | 2002 | 2003 | 2002 | 2003 |
| Net income | \$ 13.4 | \$ 42.6 | \$ 9.1 | \$ 58.6 |
| Other comprehensive gain (loss): | | | | |
| Net unrealized gains (losses) on investments | (0.4) | 2.3 | (6.1) | 3.4 |
| Net unrealized gains on investments reclassified into earnings | (0.1) | (4.2) | (0.1) | (5.7) |
| Net unrealized gains (losses) on hedge contracts | (8.5) | (15.0) | 0.8 | (24.3) |
| Net unrealized losses on hedge contracts reclassified into earnings | 6.4 | 9.6 | 8.2 | 12.3 |
| Foreign currency translation adjustments | 19.1 | 35.7 | 13.7 | 40.7 |
| Total other comprehensive gain | 16.5 | 28.4 | 16.5 | 26.4 |
| Total comprehensive gain | \$ 29.9 | \$ 71.0 | \$ 25.6 | \$ 85.0 |

Note 5 □ Inventories

Inventories included the following components:

| (Dollar amounts in millions) | June 30, 2003 | December 31, 2003 |
|------------------------------|------------------|------------------------------|
| Raw materials and supplies | \$ 58.7 | \$ 54.2 |
| Work-in-process | 5.5 | 10.4 |
| Finished products | 87.9 | 99.9 |
| Total inventories | \$ 152.1 | \$ 164.5 |

Note 6 □ Goodwill and Intangible Assets

The following table presents our intangible assets subject to amortization:

| (Dollar amounts in millions) | Weighted Average Life | June 30, 2003 | | December 31, 2003 | |
|------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| | | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Patents | 7.5 | \$ 44.7 | \$ 21.2 | \$ 44.7 | \$ 23.7 |
| Acquired technology | 5.9 | 60.0 | 30.0 | 60.0 | 33.6 |
| Favorable operating leases | 4.0 | 11.6 | 4.7 | 11.6 | 6.2 |

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| | | | | | | | | |
|-------|----|-------|----|------|----|--------------|----|-------------|
| Total | \$ | 116.3 | \$ | 55.9 | \$ | 116.3 | \$ | 63.5 |
|-------|----|-------|----|------|----|--------------|----|-------------|

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Aggregate amortization expense was as follows:

| (Dollar amounts in millions) | Three months ended December 31, | | Six months ended December 31, | |
|------------------------------|------------------------------------|---------------|----------------------------------|---------------|
| | 2002 | 2003 | 2002 | 2003 |
| Applied Biosystems group | \$ 2.4 | \$ 2.5 | \$ 4.8 | \$ 5.1 |
| Celera Genomics group | 1.7 | 0.7 | 4.4 | 1.5 |
| Celera Diagnostics | 0.5 | 0.5 | 1.0 | 1.0 |
| Consolidated | \$ 4.6 | \$ 3.7 | \$ 10.2 | \$ 7.6 |

The Applied Biosystems group records a substantial portion of amortization expense in cost of sales. The Celera Genomics group records amortization expense in amortization of intangible assets, and Celera Diagnostics records amortization expense in cost of sales. Amortization expense for the Celera Genomics group in fiscal 2003 included the amortization of some intangible assets acquired as part of the acquisition of Axys Pharmaceuticals, Inc. in fiscal 2002.

At December 31, 2003, we estimated annual amortization expense of our intangible assets for each of the next five fiscal years to be as shown in the following table. Future acquisitions or impairment events could cause these amounts to change.

| (Dollar amounts in millions) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Consolidated |
|------------------------------|--------------------------------|-----------------------------|-----------------------|----------------|
| 2004 | \$ 9.9 | \$ 2.9 | \$ 2.1 | \$ 14.9 |
| 2005 | 9.3 | 2.9 | 2.1 | 14.3 |
| 2006 | 9.2 | 1.1 | 2.1 | 12.4 |
| 2007 | 8.2 | | 2.0 | 10.2 |
| 2008 | 5.4 | | 0.4 | 5.8 |

The carrying amount of goodwill at June 30, 2003, and December 31, 2003, was \$39.4 million, of which \$36.7 million was allocated to the Applied Biosystems group and \$2.7 million was allocated to the Celera Genomics group.

Note 7 □ Supplemental Cash Flow Information

Significant non-cash financing activities were as follows:

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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| | Six months ended December 31, | |
|---------------------------------|----------------------------------|--------|
| (Dollar amounts in millions) | 2002 | 2003 |
| Dividends declared but not paid | \$ 8.9 | \$ 0 |
| Issuances of restricted stock | \$ 0.2 | \$ 6.6 |

Note 8 ☐ Guarantees**Leases**

We provide lease-financing options to our customers through third party financing companies. For some leases, the financing companies have recourse to us for any unpaid principal balance upon default by the customer. The leases typically have terms of three years and are secured by the underlying instrument. In the event of default by a customer, we would repossess the underlying instrument. We record revenues from these transactions upon the shipment of products and maintain a reserve for estimated losses on all lease transactions with recourse provisions based on historical default rates and current economic conditions. At December 31, 2003, the financing companies' outstanding balance of lease receivables with recourse to us was \$9.3 million. We believe that we could recover the entire balance from the resale of the underlying instruments in the event of default by all customers.

Guarantee of pension benefits for divested business

As part of the divestiture of our Analytical Instruments business in fiscal 1999, the purchaser of the Analytical Instruments business is paying for the pension benefits for employees of a former German subsidiary. However, we guaranteed payment of these pension benefits should the purchaser fail to do so, as these benefits were not transferable to the buyer under German law. The guaranteed payment obligation, which approximated \$53 million at December 31, 2003, is not expected to have a material adverse effect on our consolidated financial position.

Indemnifications

In the normal course of business, we enter into some contracts under which we indemnify third parties for intellectual property infringement claims or claims arising from breaches of representations or warranties. In addition, from time to time, we provide indemnity protection to third parties for claims arising from undisclosed liabilities, product liability, environmental obligations, representations and warranties, and other claims relating to past performance. In these agreements, the scope and amount of remedy, or the period in which claims can be made, may be limited. It is not possible to determine the maximum potential amount of future payments, if any, due under these indemnities due to the conditional nature of the obligations and the unique facts and circumstances involved in each agreement. Historically, payments made related to these indemnifications have not been material to our consolidated financial position.

Product warranties

We accrue warranty costs for product sales at the time of shipment based on historical experience as well as anticipated product performance. Our product warranties extend over a specified period of

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time ranging up to two years from the date of sale depending on the product subject to warranty. We periodically review the adequacy of our warranty reserve, and adjust, if necessary, the warranty percentage and accrual based on actual experience and estimated costs to be incurred.

The following table provides an analysis of the warranty reserve:

(Dollar amounts in millions)

| | |
|------------------------------|---------|
| Balance at June 30, 2003 | \$ 15.1 |
| Accruals for warranties | 14.2 |
| Usage of reserve | (13.8) |
| Balance at December 31, 2003 | \$ 15.5 |

Note 9 ☐ Contingencies
Litigation

We are involved in various legal proceedings from time to time, including actions with respect to commercial, intellectual property, antitrust, environmental, securities, and employment matters. We believe that we have meritorious defenses against the claims currently asserted against us and intend to defend them vigorously. The following is a description of some claims we are currently defending.

Applera and some of its officers are defendants in a lawsuit purportedly brought on behalf of purchasers of Applera-Celera stock in our follow-on public offering of Applera-Celera stock completed on March 6, 2000. In the offering, we sold an aggregate of approximately 4.4 million shares of Applera-Celera stock at a public offering price of \$225 per share. The lawsuit, which was commenced with the filing of several complaints in April and May 2000, is pending in the U.S. District Court for the District of Connecticut, and an amended consolidated complaint was filed on August 21, 2001. The consolidated complaint generally alleges that the prospectus used in connection with the offering was inaccurate or misleading because it failed to adequately disclose the alleged opposition of the Human Genome Project and two of its supporters, the governments of the U.S. and the U.K., to providing patent protection to our genomic-based products. Although the Celera Genomics group has never sought, or intended to seek, a patent on the basic human genome sequence data, the complaint also alleges that we did not adequately disclose the risk that the Celera Genomics group would not be able to patent this data. The consolidated complaint seeks monetary damages, rescission, costs and expenses, and other relief as the court deems proper.

We are involved in several litigation matters with MJ Research, Inc., which commenced with our filing claims against MJ Research based on its alleged infringement of some polymerase chain reaction, or PCR, patents. In response to our claims, MJ Research filed counterclaims including, among others, allegations that we have licensed and enforced these patents through anticompetitive conduct in violation of federal and state antitrust laws, and MJ Research is seeking injunctive relief, monetary damages, costs and expenses, and other relief. A trial on these matters is expected to commence in March 2004. Subsequently, on September 21, 2000, MJ Research filed an action against us in the U.S. District Court for the District of Columbia. This complaint is based on the allegation that the patents underlying our DNA sequencing instruments

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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were improperly obtained because one of the alleged inventors, whose work was funded in part by the U.S. government, was knowingly omitted from the patent applications. Our patents at issue are U.S. Patent Nos. 5,171,534, entitled "Automated DNA Sequencing Technique," 5,821,058, entitled "Automated DNA Sequencing Technique," 6,200,748, entitled "Tagged Extendable Primers and Extension Products," and 4,811,218, entitled "Real Time Scanning Electrophoresis Apparatus for DNA Sequencing." The complaint asserts violations of the federal False Claims Act and the federal Bayh Dole Act, invalidity and unenforceability of the patents at issue, patent infringement, and various other civil claims against us. MJ Research is seeking monetary damages, costs and expenses, injunctive relief, transfer of ownership of the patents in dispute, and other relief as the court deems proper. MJ Research claims to be suing in the name of the U.S. government although the government has to date declined to participate in the suit. On October 9, 2003, the case against us was dismissed but MJ Research has filed a notice of appeal.

Promega Corporation filed a patent infringement action against Lifecodes Corporation, Cellmark Diagnostics, Genomics International Corporation, and us in the U.S. District Court for the Western District of Wisconsin on April 24, 2001. The complaint alleges that the defendants are infringing Promega's U.S. Patent Nos. 6,221,598 and 5,843,660, both entitled "Multiplex Amplification of Short Tandem Repeat Loci," due to the defendants' sale of forensic identification and paternity testing kits. Promega is seeking monetary damages, costs and expenses, injunctive relief, and other relief as the court deems proper. The defendants answered the complaint on July 9, 2001, and we asserted counterclaims alleging that Promega is infringing our U.S. Patent No. 6,200,748, entitled "Tagged Extendable Primers and Extension Products," due to Promega's sale of forensic identification and paternity testing kits. As a result of settlement negotiations, the case was dismissed without prejudice on October 29, 2002, but could be re-filed against us if settlement negotiations are not successful.

Beckman Coulter, Inc. filed a patent infringement action against us in the U.S. District Court for the Central District of California on July 3, 2002. The complaint alleges that we are infringing Beckman Coulter's U.S. Patent Nos. RE 37,606 and 5,421,980, both entitled "Capillary Electrophoresis Using Replaceable Gels," and U.S. Patent No. 5,552,580, entitled "Heated Cover Device," although it does not identify the specific facts on which this allegation is based. Since Beckman Coulter filed this claim, U.S. Patent No. 5,421,980 has been reissued as U.S. Patent No. RE 37,941, entitled "Capillary Electrophoresis Using Replaceable Gels." On January 13, 2003, the court permitted Beckman Coulter to make a corresponding amendment to its complaint. Beckman Coulter is seeking monetary damages, costs and expenses, injunctive relief, and other relief as the court deems proper. On February 10, 2003, we filed our answer to Beckman Coulter's allegations, and counterclaimed for declaratory relief that the Beckman Coulter patents underlying Beckman Coulter's claim are invalid, unenforceable, and not infringed. We are seeking dismissal of Beckman Coulter's complaint, costs and expenses, declaratory and injunctive relief, and other relief as the court deems proper.

Henry Huang (an individual) filed an action against us and the Applied Biosystems group and the other parties described below in the U.S. District Court for the Central District of California on February 19, 2003. Mr. Huang's complaint seeks to change inventorship of the patents described below, and claims breach of contract, fraud, conversion, and unjust enrichment. The complaint

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relates to U.S. Patent Nos. 5,171,534, entitled "Automated DNA Sequencing Technique," 5,821,058, entitled "Automated DNA Sequencing Technique," 6,200,748, entitled "Tagged Extendable Primers and Extension Products," and 4,811,218, entitled "Real Time Scanning Electrophoresis Apparatus for DNA Sequencing." U.S. Patent Nos. 5,171,534, 5,821,058, and 6,200,748 are assigned to the California Institute of Technology and licensed by the Applied Biosystems group. U.S. Patent No. 4,811,218 is assigned to the Applied Biosystems group. Also named in the complaint are the California Institute of Technology, Lloyd Smith, Leroy Hood, Michael Hunkapiller, Timothy Hunkapiller, Charles Connell, John Lytle, William Mordan, and John Bridgham. Lloyd Smith, Leroy Hood, Michael Hunkapiller, Timothy Hunkapiller, and Charles Connell are the inventors named on U.S. Patent Nos. 5,171,534, 5,821,058, and 6,200,748. Michael Hunkapiller, Charles Connell, John Lytle, William Mordan, and John Bridgham are the inventors named on U.S. Patent No. 4,811,218. The issues involved in this litigation are related to the issues in the MJ Research, Inc. litigation that was filed September 21, 2000, which is described above. Mr. Huang is alleging that he is the sole inventor on U.S. Patent Nos. 5,171,534, 5,821,058, 6,200,748, and 4,811,218. He is seeking to substitute himself for the named inventors on the relevant patents, and to have himself named as the sole assignee of the patents, and is also seeking monetary damages, costs, expenses, and other relief as the court deems proper. A trial was completed on December 22, 2003, and a decision from the judge is pending.

Genetic Technologies Limited filed a patent infringement action against us in the U.S. District Court for the Northern District of California on March 26, 2003. They filed an amended complaint against us on August 12, 2003. The amended complaint alleges that we are infringing U.S. Patent No. 5,612,179, entitled "Intron Sequence Analysis Method for Detection of Adjacent and Remote Locus Alleles as Haplotypes," and U.S. Patent No. 5,851,762, entitled "Genomic Mapping Method by Direct Haplotyping Using Intron Sequence Analysis." The allegedly infringing products are cystic fibrosis reagent kits, Assays-on-Demand products for non-coding regions, Assays-by-DesignSM services for non-coding regions, and the Celera Discovery System ("CDS"). The complaint also alleges that haplotyping analysis performed by our businesses infringes the patents identified above. Genetic Technologies Limited is seeking monetary damages, costs, expenses, injunctive relief, and other relief as the court deems proper.

On-Line Technologies, Inc. (since acquired by MKS Instruments, Inc.) filed claims for patent infringement, trade secret misappropriation, fraud, breach of contract and unfair trade practices against PerkinElmer, Inc., Sick UPA, GmbH, and us in the U.S. District Court for the District of Connecticut on or about November 3, 1999. The complaint alleged that products called the Spectrum One and the MCS100E manufactured by former divisions of the Applied Biosystems group, which divisions were sold to the co-defendants in this case, were based on allegedly proprietary information belonging to On-Line Technologies and that the MCS100E infringed U.S. Patent No. 5,440,143. On-Line Technologies sought monetary damages, costs, expenses, injunctive relief, and other relief. On April 2, 2003, the U.S. District Court for the District of Connecticut granted our summary judgment motion and dismissed all claims brought by On-Line Technologies, Inc., though On-Line Technologies has filed an appeal with the U.S. Court of Appeals for the Federal Circuit seeking reinstatement of its claims.

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We filed claims against Roche Molecular Systems, Inc., Hoffmann-La Roche, Inc., Roche Probe, Inc., F. Hoffmann-La Roche Ltd., and other potential defendants affiliated with the named defendants (the "Roche") in California Superior Court on October 9, 2003. Our complaint asserts, among other things, breach of contract and other contract claims against the defendants arising from agreements relating to polymerase chain reaction, or PCR, technology rights entered into between us and the defendants. Our complaint also asserts various tort claims against the defendants, including breach of trust, breach of fiduciary duty, and unfair competition, relating to our PCR rights. The defendants' acts and omissions that form the basis of the complaint include, among other things, the: (i) defendants' failure to abide by contractual provisions intended to allow us to effectively compete with the defendants with respect to (a) sales of diagnostic PCR products and (b) conveyance of diagnostic PCR rights to third parties; (ii) defendants' failure to pay us requisite royalties for sales by them of thermal cyclers and other products; (iii) defendants' failure to negotiate in good faith new agreements directed at modifying the relationship between the parties in accordance with principles set forth in an existing letter agreement that states the intended framework for the negotiations (the "LOA"); (iv) defendants' failure to provide us with diagnostic PCR rights on a nondiscriminatory basis as required by a European Union commission decree; (v) defendants' failure to comply with their agreement to assign ownership to us of some PCR instrument patents and patent applications, and (vi) defendants' mishandling of the prosecution of patent applications that the defendants were obligated to assign to us, in a manner that damaged us and precluded us from obtaining the full potential scope of patent protection for our instrument rights. Contemporaneously with our filing of this complaint, we also commenced arbitration proceedings with the American Arbitration Association against the defendants asserting, among other things, patent infringement claims (both direct infringement, contributory infringement and infringement by inducing third parties to infringe), breach of contract and other contract claims, and tort claims such as breach of fiduciary duty, breach of trust, and unfair competition. The arbitration is based on our allegation that the defendants (i) have infringed our exclusive rights to PCR patents in fields exclusively licensed to us pursuant to agreements with the defendants; and (ii) by their acts and omissions, have undermined the value of our exclusive PCR rights. In both the legal complaint and the arbitration, we are seeking monetary damages, costs, expenses, injunctive relief, and other relief as the court or arbitrator deems proper. On December 15, 2003, Roche filed a motion in California Superior Court to compel arbitration of our state court complaint and to stay the litigation. Concurrently with the motion to compel arbitration, Roche also filed with the American Arbitration Association its response to our notice of arbitration in which Roche denied all of our claims against it. Roche's response included counterclaims asserting, among other things, that our exclusive patent rights under some PCR patents licensed from Roche under an existing distribution agreement were converted into nonexclusive rights by the LOA, which was entered into subsequent to the distribution agreement. Roche also alleges that (i) we breached our contractual obligation under the LOA, including our obligation to source certain enzymes exclusively from Roche; and (ii) we failed to pay Roche the full royalties required pursuant to the distribution agreement. In its counterclaim, Roche is seeking a request for declaratory judgment confirming its assertions, interest, costs, and other relief as the arbitrator deems proper. The claims and counterclaims described in this paragraph involve PCR rights used by the Applied Biosystems group and also rights that the Applied Biosystems group has contributed to Celera Diagnostics.

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Promega Corporation filed an action against us and some of our affiliates and Roche Molecular Systems, Inc. and Hoffmann-La Roche, Inc. in the U.S. District Court for the Eastern District of Virginia on April 10, 2000. The complaint asserts violations of the federal False Claims Act. On November 12, 2003, the court issued an order to have the complaint, which had previously been sealed, served on us and the other defendants. On February 9, 2004, we waived service of the complaint, which initiated our direct involvement in the case. The complaint alleges that we and Hoffmann-La Roche overcharged the U.S. government for thermal cyclers and PCR reagents. The overcharges are alleged to be the result of a licensing program based in part on U.S. Patent No. 4,889,818. Promega is asserting that U.S. Patent No. 4,889,818 was obtained fraudulently and that the licensing program run by us and Hoffmann-La Roche is the cause of the alleged overcharging. Promega is seeking monetary damages. Promega claims to be suing in the name of the U.S. government although the government has to date declined to participate in the suit.

We have not accrued for any potential losses in the cases described above because we believe that an adverse determination is not probable, and potential losses cannot be reasonably estimated, in any of these cases. However, the outcome of litigation is inherently uncertain, and we cannot be sure that we will prevail in any of the cases described above or in our other current litigation. An adverse determination in some of our current litigation, particularly the cases described above, could have a material adverse effect on our consolidated financial statements.

Discontinued Operations

In October 2002, we received an adverse jury verdict in connection with a patent lawsuit between TA Instruments, Inc., a subsidiary of Waters Corporation, and The Perkin-Elmer Corporation relating to thermal analysis products. The Applied Biosystems group is involved as the successor to The Perkin-Elmer Corporation, having sold the thermal instruments product line as part of the sale of its Analytical Instruments business to EG&G, Inc. (now named PerkinElmer, Inc.) in 1999. In fiscal 2003, the jury awarded TA instruments \$13.3 million based on lost sales, price erosion, and reasonable royalties. This award is subject to entry of a final order by the court, where additional interest and costs may be added. We recorded a charge of \$16.4 million, net of income taxes, as part of discontinued operations in the first quarter of fiscal 2003. In June 2003, we appealed the judgment to the U.S. Court of Appeals for the Federal Circuit.

Note 10 □ Segment and Consolidating Information

Presented below is our segment and consolidating financial information, including the allocation of expenses between the segments in accordance with our allocation policies, as well as other related party transactions, such as sales of products between segments. Our board of directors approves the method of allocating earnings to each class of common stock for purposes of calculating earnings per share. This determination is generally based on net income or loss amounts of the corresponding group calculated in accordance with GAAP, consistently applied.

During fiscal 2002, the Applied Biosystems group formed the Knowledge Business to develop and market products and services designed to meet the needs of life science researchers in performing specific biological analysis applications. The Knowledge Business was focused on generating value to life science customers through products and services with high information content that support

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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improved experimental work-flows. Concurrently with the Applied Biosystems group's formation of the Knowledge Business, in April 2002, the Celera Genomics group and the Applied Biosystems group entered into a ten-year marketing and distribution agreement pursuant to which the Applied Biosystems group became the exclusive marketer of the Celera Genomics group's CDS and related human genetic and other biological and medical information. As a result of this arrangement, the Applied Biosystems group has integrated CDS and other genomic and biological information into its product offerings. During the second quarter of fiscal 2004, the Applied Biosystems group reorganized its internal operations and, among other things, integrated the operations of the former Knowledge Business into other business units of the Applied Biosystems group. However, the Applied Biosystems group and the Celera Genomics group continue to operate under the marketing and distribution agreement on the same terms and conditions as in effect prior to the reorganization.

See Note 15 to our consolidated financial statements included in our 2003 Annual Report to Stockholders for a detailed description of the segments and the management and allocation policies applicable to the attribution of assets, liabilities, revenues and expenses to the segments (which information is incorporated herein by reference).

| (Dollar amounts in millions) | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|------------------------------------|---------------|----------------------------------|---------------|
| | 2002 | 2003 | 2002 | 2003 |
| Applied Biosystems Group | | | | |
| Sales to the Celera Genomics group (1) | \$ 0.7 | \$ 0.6 | \$ 1.6 | \$ 0.9 |
| Sales to Celera Diagnostics (1) | 1.1 | 2.1 | 2.0 | 4.7 |
| Nonreimbursable utilization of tax benefits (2) | 6.5 | 5.4 | 16.3 | 11.5 |
| Payments for reimbursable utilization of tax benefits (3) | 3.7 | 4.1 | 9.8 | 9.4 |
| Funding of Celera Diagnostics (4) | 1.3 | 3.3 | 3.1 | 5.5 |
| Celera Genomics Group | | | | |
| Sales to the Applied Biosystems group (5) | \$ 0.4 | \$ 0.6 | \$ 0.8 | \$ 1.2 |
| Funding of Celera Diagnostics (6) | 10.2 | 10.8 | 24.4 | 23.2 |
| Celera Diagnostics | | | | |
| Sales to the Applied Biosystems group (7) | \$ 0.1 | \$ □ | \$ 3.1 | \$ □ |

- (1) The Applied Biosystems group recorded net revenues from leased instruments, consumables, and project materials to the Celera Genomics group and Celera Diagnostics.
- (2) The Applied Biosystems group used, without reimbursement, some of the tax benefits generated by the Celera Genomics group in accordance with our tax allocation policy.
- (3) The Applied Biosystems group paid the Celera Genomics group for the use of existing tax benefits acquired by the Celera Genomics group in business combinations and other tax benefits, including those associated with Celera Diagnostics in accordance with our tax allocation policy.

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- (4) The Applied Biosystems group recorded its share of capital expenditures and working capital funding for Celera Diagnostics.
- (5) The Celera Genomics group recorded net revenues primarily for royalties generated from sales by the Applied Biosystems group of products integrating CDS and some other genomic and biological information under a marketing and distribution agreement.
- (6) The Celera Genomics group recorded operating losses and its share of capital expenditures and working capital funding for Celera Diagnostics.
- (7) Celera Diagnostics recorded net revenues from the sale of diagnostics products to the Applied Biosystems group under a distribution agreement. On October 1, 2002, sales responsibilities for products manufactured by Celera Diagnostics were largely transferred to the diagnostic division of Abbott Laboratories, pursuant to the profit-sharing alliance announced on June 30, 2002.

For the three and six month periods ended December 31, 2002 and 2003, the Celera Genomics group recorded 100% of the losses of Celera Diagnostics in its net loss as well as the tax benefit associated with those losses. In the following tables, the "Eliminations" column represents the elimination of intersegment activity and the losses of Celera Diagnostics, which are included both in the "Celera Diagnostics" column and net within the "Celera Genomics group" column as "Loss from joint venture."

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Consolidating Statement of Operations for the Three Months Ended December 31, 2003

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|--|--------------------------------|-----------------------------|-----------------------|--------------|--------------|
| Net revenues from external customers | \$ 455,714 | \$ 18,588 | \$ 11,033 | \$ □ | \$ 485,335 |
| Intersegment revenues | 2,689 | 630 | 15 | (3,334) | |
| Net Revenues | 458,403 | 19,218 | 11,048 | (3,334) | 485,335 |
| Cost of sales | 222,388 | 3,680 | 6,328 | (1,718) | 230,678 |
| Gross Margin | 236,015 | 15,538 | 4,720 | (1,616) | 254,657 |
| Selling, general and administrative | 102,443 | 5,709 | 2,809 | 12,305 | 123,266 |
| Corporate allocated expenses | 10,164 | 1,508 | 633 | (12,305) | |
| Research, development and engineering | 60,741 | 25,229 | 10,627 | (1,650) | 94,947 |
| Amortization of intangible assets | | 725 | | | 725 |
| Other special charges | (615) | | | | (615) |
| Operating Income (Loss) | 63,282 | (17,633) | (9,349) | 34 | 36,334 |
| Gain on investments, net | 6,351 | 135 | | | 6,486 |
| Interest income, net | 3,213 | 2,637 | | | 5,850 |
| Other income (expense), net | (44) | 1,986 | | | 1,942 |
| Loss from joint venture | | (9,349) | | 9,349 | |
| Income (Loss) before Income Taxes | 72,802 | (22,224) | (9,349) | 9,383 | 50,612 |
| Provision (benefit) for income taxes | 20,385 | (8,668) | | (3,676) | 8,041 |
| Net Income (Loss) | \$ 52,417 | \$ (13,556) | \$ (9,349) | \$ 13,059 | \$ 42,571 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Condensed Consolidating Statement of Operations for the Six Months Ended December 31, 2003

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|--|--------------------------------|-----------------------------|-----------------------|------------------|------------------|
| Net revenues from external customers | \$ 835,437 | \$ 35,394 | \$ 19,541 | \$ □ | \$ 890,372 |
| Intersegment revenues | 5,637 | 1,181 | 28 | (6,846) | |
| Net Revenues | 841,074 | 36,575 | 19,569 | (6,846) | 890,372 |
| Cost of sales | 408,678 | 6,402 | 9,983 | (3,907) | 421,156 |
| Gross Margin | 432,396 | 30,173 | 9,586 | (2,939) | 469,216 |
| Selling, general and administrative | 187,716 | 12,458 | 6,653 | 23,796 | 230,623 |
| Corporate allocated expenses | 19,522 | 2,985 | 1,289 | (23,796) | |
| Research, development and engineering | 120,338 | 46,979 | 23,049 | (3,007) | 187,359 |
| Amortization of intangible assets | | 1,450 | | | 1,450 |
| Other special charges | (615) | | | | (615) |
| Operating Income (Loss) | 105,435 | (33,699) | (21,405) | 68 | 50,399 |
| Gain (loss) on investments, net | 7,539 | (508) | | | 7,031 |
| Interest income, net | 6,146 | 5,774 | | | 11,920 |
| Other income (expense), net | 40 | 916 | | | 956 |
| Loss from joint venture | | (21,405) | | 21,405 | |
| Income (Loss) before Income Taxes | 119,160 | (48,922) | (21,405) | 21,473 | 70,306 |
| Provision (benefit) for income taxes | 33,365 | (19,080) | | (2,562) | 11,723 |
| Net Income (Loss) | \$ 85,795 | \$ (29,842) | \$ (21,405) | \$ 24,035 | \$ 58,583 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Condensed Consolidating Statement of Financial Position at December 31, 2003

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|---|--------------------------------|-----------------------------|-----------------------|--------------------|---------------------|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 639,575 | \$ 79,990 | \$ | \$ | 719,565 |
| Short-term investments | | 689,967 | | | 689,967 |
| Accounts receivable, net | 356,538 | 10,079 | 7,033 | (1,517) | 372,133 |
| Inventories, net | 150,662 | 2,332 | 11,636 | (137) | 164,493 |
| Prepaid expenses and other current assets | 93,531 | 11,540 | 1,873 | (2,679) | 104,265 |
| Total current assets | 1,240,306 | 793,908 | 20,542 | (4,333) | 2,050,423 |
| Property, plant and equipment, net | 412,200 | 95,728 | 10,652 | (285) | 518,295 |
| Other long-term assets | 470,225 | 168,027 | 7,637 | (26,378) | 619,511 |
| Total Assets | \$ 2,122,731 | \$ 1,057,663 | \$ 38,831 | \$ (30,996) | \$ 3,188,229 |
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities | | | | | |
| Loans payable | \$ | \$ 16,660 | \$ | \$ | 16,660 |
| Accounts payable | 126,172 | 5,043 | 2,937 | (3,479) | 130,673 |
| Accrued salaries and wages | 53,657 | 9,429 | 3,226 | | 66,312 |
| Accrued taxes on income | 68,224 | 13,232 | | | 81,456 |
| Other accrued expenses | 242,373 | 35,281 | 2,718 | (717) | 279,655 |
| Total current liabilities | 490,426 | 79,645 | 8,881 | (4,196) | 574,756 |
| Other long-term liabilities | 258,226 | 15,007 | 634 | | 273,867 |
| Total Liabilities | 748,652 | 94,652 | 9,515 | (4,196) | 848,623 |
| Total Stockholders' Equity | 1,374,079 | 963,011 | 29,316 | (26,800) | 2,339,606 |
| Total Liabilities and Stockholders' Equity | \$ 2,122,731 | \$ 1,057,663 | \$ 38,831 | \$ (30,996) | \$ 3,188,229 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Condensed Consolidating Statement of Cash Flows for the Six Months Ended December 31, 2003

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|---|--------------------------------|-----------------------------|-----------------------|--------------|--------------|
| Operating Activities | | | | | |
| Net income (loss) | \$ 85,795 | \$ (29,842) | \$ (21,405) | \$ 24,035 | \$ 58,583 |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | | | | |
| Depreciation and amortization | 49,981 | 12,152 | 3,674 | (66) | 65,741 |
| Asset impairments | (6) | | | | (6) |
| Provisions for office closures and severance costs | (609) | | | | (609) |
| Long-term compensation programs | 1,584 | 495 | | | 2,079 |
| (Gain) loss from investments and sale of assets, net | (7,715) | 750 | | | (6,965) |
| Deferred income taxes | (17,143) | 156 | | (2,658) | (19,645) |
| Loss from joint venture and equity method investees | | 22,163 | | (21,405) | 758 |
| Nonreimbursable utilization of intergroup tax benefits | 11,467 | (11,467) | | | |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | 69,760 | 6,629 | (1,930) | (1,673) | 72,786 |
| Inventories | (11,914) | 194 | (2,796) | (2) | (14,518) |
| Prepaid expenses and other assets | 6,651 | (468) | (1,187) | 796 | 5,792 |
| Accounts payable and other liabilities | (52,466) | (25,821) | (4,383) | 973 | (81,697) |
| Net Cash Provided (Used) by Operating Activities | 135,385 | (25,059) | (28,027) | □ | 82,299 |
| Investing Activities | | | | | |
| Additions to property, plant and equipment, net | (30,001) | (2,323) | (690) | 231 | (32,783) |
| Proceeds from short-term investments, net | | 74,498 | | | 74,498 |
| Investments in joint venture and other, net | (5,781) | (23,224) | | 28,717 | (288) |
| Proceeds from the sale of assets, net | 20,916 | 795 | | (231) | 21,480 |
| Net Cash Provided (Used) by Investing Activities | (14,866) | 49,746 | (690) | 28,717 | 62,907 |
| Net Cash Used by Operating Activities | (79) | | | | (79) |

**of Discontinued
Operations****Financing Activities**

| | | | | | |
|--|----------|-------|--------|----------|----------|
| Dividends | (26,504) | | | | (26,504) |
| Net cash funding from groups | | | 28,717 | (28,717) | |
| Purchases of common stock for treasury | (83,962) | | | | (83,962) |
| Proceeds from stock issued for stock plans | 10,470 | 2,686 | | | 13,156 |

**Net Cash Provided (Used)
by Financing Activities**

| | | | | |
|----------|-------|--------|----------|----------|
| (99,996) | 2,686 | 28,717 | (28,717) | (97,310) |
|----------|-------|--------|----------|----------|

**Effect of Exchange Rate
Changes on Cash**

| | | | | |
|--------|--|--|--|--------|
| 17,465 | | | | 17,465 |
|--------|--|--|--|--------|

**Net Change in Cash and
Cash Equivalents**

| | | | | |
|--------|--------|---|---|--------|
| 37,909 | 27,373 | □ | □ | 65,282 |
|--------|--------|---|---|--------|

**Cash and Cash
Equivalents Beginning of
Period**

| | | | | |
|---------|--------|--|--|---------|
| 601,666 | 52,617 | | | 654,283 |
|---------|--------|--|--|---------|

Cash and Cash

| | | | | | |
|----------------------------------|------------|-----------|------|------|---------|
| Equivalents End of Period | \$ 639,575 | \$ 79,990 | \$ □ | \$ □ | 719,565 |
|----------------------------------|------------|-----------|------|------|---------|

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

Consolidating Statement of Operations for the Three Months Ended December 31, 2002

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|--|--------------------------------|-----------------------------|-----------------------|--------------|--------------|
| Net revenues from external customers | \$ 442,835 | \$ 22,485 | \$ 7,697 | \$ □ | \$ 473,017 |
| Intersegment revenues | 1,851 | 368 | 147 | (2,366) | |
| Net Revenues | 444,686 | 22,853 | 7,844 | (2,366) | 473,017 |
| Cost of sales | 225,738 | 3,707 | 2,169 | (1,288) | 230,326 |
| Gross Margin | 218,948 | 19,146 | 5,675 | (1,078) | 242,691 |
| Selling, general and administrative | 90,969 | 5,359 | 2,318 | 12,780 | 111,426 |
| Corporate allocated expenses | 10,575 | 1,643 | 562 | (12,780) | |
| Research, development and engineering | 59,173 | 32,901 | 12,690 | (1,479) | 103,285 |
| Amortization of intangible assets | | 1,723 | | | 1,723 |
| Other special charges | 24,313 | | | | 24,313 |
| Operating Income (Loss) | 33,918 | (22,480) | (9,895) | 401 | 1,944 |
| Loss on investments, net | | (273) | | | (273) |
| Interest income, net | 2,954 | 4,728 | | | 7,682 |
| Other income (expense), net | 2,460 | 590 | | | 3,050 |
| Loss from joint venture | | (9,895) | | 9,895 | |
| Income (Loss) before Income Taxes | 39,332 | (27,330) | (9,895) | 10,296 | 12,403 |
| Provision (benefit) for income taxes | 10,145 | (11,206) | | 40 | (1,021) |
| Net Income (Loss) | \$ 29,187 | \$ (16,124) | \$ (9,895) | \$ 10,256 | \$ 13,424 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

Condensed Consolidating Statement of Operations for the Six Months Ended December 31, 2002

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|--|--------------------------------|-----------------------------|-----------------------|------------------|-----------------|
| Net revenues from external customers | \$ 836,953 | \$ 45,671 | \$ 7,726 | \$ □ | \$ 890,350 |
| Intersegment revenues | 3,630 | 830 | 3,098 | (7,558) | |
| Net Revenues | 840,583 | 46,501 | 10,824 | (7,558) | 890,350 |
| Cost of sales | 419,036 | 7,125 | 4,586 | (5,527) | 425,220 |
| Gross Margin | 421,547 | 39,376 | 6,238 | (2,031) | 465,130 |
| Selling, general and administrative | 178,455 | 10,395 | 4,487 | 26,190 | 219,527 |
| Corporate allocated expenses | 21,365 | 3,599 | 1,226 | (26,190) | |
| Research, development and engineering | 120,205 | 65,434 | 23,753 | (2,816) | 206,576 |
| Amortization of intangible assets | | 4,423 | | | 4,423 |
| Other special charges | 24,313 | | | | 24,313 |
| Operating Income (Loss) | 77,209 | (44,475) | (23,228) | 785 | 10,291 |
| Loss on investments, net | | (273) | | | (273) |
| Interest income, net | 6,148 | 9,913 | | | 16,061 |
| Other income (expense), net | 3,505 | (2,570) | | | 935 |
| Loss from joint venture | | (23,228) | | 23,228 | |
| Income (Loss) before Income Taxes | 86,862 | (60,633) | (23,228) | 24,013 | 27,014 |
| Provision (benefit) for income taxes | 23,453 | (24,860) | | 2,932 | 1,525 |
| Income (Loss) from Continuing Operations | 63,409 | (35,773) | (23,228) | 21,081 | 25,489 |
| Loss from discontinued operations, net of income taxes | (16,400) | | | | (16,400) |
| Net Income (Loss) | \$ 47,009 | \$ (35,773) | \$ (23,228) | \$ 21,081 | \$ 9,089 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

Consolidating Statement of Financial Position at June 30, 2003

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|---|--------------------------------|-----------------------------|-----------------------|--------------------|---------------------|
| Assets | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | \$ 601,666 | \$ 52,617 | \$ □ | \$ □ | 654,283 |
| Short-term investments | | 749,785 | | | 749,785 |
| Accounts receivable, net | 404,928 | 16,708 | 5,103 | (3,190) | 423,549 |
| Inventories, net | 140,833 | 2,526 | 8,840 | (139) | 152,060 |
| Prepaid expenses and other current assets | 84,393 | 10,510 | 686 | (1,883) | 93,706 |
| Total current assets | 1,231,820 | 832,146 | 14,629 | (5,212) | 2,073,383 |
| Property, plant and equipment, net | 409,626 | 104,742 | 12,574 | (351) | 526,591 |
| Other long-term assets | 485,269 | 185,178 | 8,699 | (21,628) | 657,518 |
| Total Assets | \$ 2,126,715 | \$ 1,122,066 | \$ 35,902 | \$ (27,191) | \$ 3,257,492 |
| Liabilities and Stockholders' Equity | | | | | |
| Current liabilities | | | | | |
| Accounts payable | \$ 153,124 | \$ 10,241 | \$ 7,651 | \$ (4,697) | \$ 166,319 |
| Accrued salaries and wages | 63,859 | 11,886 | 3,878 | | 79,623 |
| Accrued taxes on income | 73,611 | 12,332 | | | 85,943 |
| Other accrued expenses | 232,674 | 46,907 | 2,230 | (376) | 281,435 |
| Total current liabilities | 523,268 | 81,366 | 13,759 | (5,073) | 613,320 |
| Long-term debt | | 17,101 | | | 17,101 |
| Other long-term liabilities | 265,274 | 21,373 | 139 | | 286,786 |
| Total Liabilities | 788,542 | 119,840 | 13,898 | (5,073) | 917,207 |
| Total Stockholders' Equity | 1,338,173 | 1,002,226 | 22,004 | (22,118) | 2,340,285 |
| Total Liabilities and Stockholders' Equity | \$ 2,126,715 | \$ 1,122,066 | \$ 35,902 | \$ (27,191) | \$ 3,257,492 |

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APPLERA CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
continued

Condensed Consolidating Statement of Cash Flows for the Six Months Ended December 31, 2002

| (Dollar amounts in thousands) | Applied Biosystems Group | Celera Genomics Group | Celera Diagnostics | Eliminations | Consolidated |
|--|--------------------------------|-----------------------------|-----------------------|--------------|--------------|
| Operating Activities of Continuing Operations | | | | | |
| Income (loss) from continuing operations | \$ 63,409 | \$ (35,773) | \$ (23,228) | \$ 21,081 | \$ 25,489 |
| Adjustments to reconcile income (loss) from continuing operations to net cash provided (used) by operating activities: | | | | | |
| Depreciation and amortization | 47,428 | 21,332 | 1,959 | (840) | 69,879 |
| Asset impairments | 10,017 | | | | 10,017 |
| Provisions for office closures and severance costs | 23,744 | | | | 23,744 |
| Long-term compensation programs | 2,698 | 874 | | | 3,572 |
| Loss on sale of assets | | 273 | | | 273 |
| Deferred income taxes | (33,611) | (1,393) | | 2,664 | (32,340) |
| Loss from joint venture and equity method investees | | 27,566 | | (23,228) | 4,338 |
| Non reimbursable utilization of intergroup tax benefits | 16,250 | (16,250) | | | |
| Changes in operating assets and liabilities: | | | | | |
| Accounts receivable | 12,046 | 6,356 | (3,541) | (409) | 14,452 |
| Inventories | (15,232) | (449) | (1,149) | (7) | (16,837) |
| Prepaid expenses and other assets | (2,288) | (142) | (48) | 40 | (2,438) |
| Accounts payable and other liabilities | (9,866) | (22,115) | 2,618 | 699 | (28,664) |
| Net Cash Provided (Used) by Operating Activities of Continuing Operations | 114,595 | (19,721) | (23,389) | □ | 71,485 |
| Investing Activities of Continuing Operations | | | | | |
| Additions to property, plant and equipment, net | (54,981) | (3,487) | (4,116) | | (62,584) |
| Proceeds from short-term investments, net | 29,646 | 154,600 | | | 184,246 |
| Purchases of long-term investments | | (16,834) | | | (16,834) |
| Investments in joint venture, net | (3,118) | (24,387) | | 27,505 | |
| Proceeds from the sale of assets, net | | 539 | | | 539 |
| Net Cash Provided (Used) by Investing Activities | (28,453) | 110,431 | (4,116) | 27,505 | 105,367 |

of Continuing Operations

| | | | | | |
|---|------------|------------|--------|----------|----------|
| Net Cash Used by Operating Activities of Discontinued Operations | (1,263) | | | | (1,263) |
| Financing Activities | | | | | |
| Net change in loans payable | (291) | | | | (291) |
| Dividends | (17,798) | | | | (17,798) |
| Net cash funding from groups | | | 27,505 | (27,505) | |
| Purchases of common stock for treasury | (6,847) | | | | (6,847) |
| Proceeds from stock issued for stock plans | 8,760 | 13,624 | | | 22,384 |
| Net Cash Provided (Used) by Financing Activities | (16,176) | 13,624 | 27,505 | (27,505) | (2,552) |
| Effect of Exchange Rate Changes on Cash | 9,768 | | | | 9,768 |
| Net Change in Cash and Cash Equivalents | 78,471 | 104,334 | □ | □ | 182,805 |
| Cash and Cash Equivalents Beginning of Period | 441,328 | 28,890 | | | 470,218 |
| Cash and Cash Equivalents End of Period | \$ 519,799 | \$ 133,224 | \$ □ | \$ □ | 653,023 |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.
APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS

The purpose of the following management's discussion and analysis is to provide an overview of the business of Applera Corporation to help facilitate an understanding of significant factors influencing our historical operating results, financial condition, and cash flows and also to convey our expectations of the potential impact of known trends, events, or uncertainties that may impact our future results. You should read this discussion in conjunction with our consolidated financial statements and related notes included in this report and in our 2003 Annual Report to Stockholders. Historical results and percentage relationships are not necessarily indicative of operating results for future periods. When used in the management discussion and analysis, the terms "Applera," "Company," "we," "us," or "our" mean Applera Corporation and its subsidiaries.

Overview

We are comprised of three business segments: the Applied Biosystems group, the Celera Genomics group, and Celera Diagnostics.

The Applied Biosystems group serves the life science industry and research community by developing and marketing instrument-based systems, consumables, software, and services. Customers use these tools to analyze nucleic acids (DNA and RNA), small molecules, and proteins to make scientific discoveries, develop new pharmaceuticals, and conduct standardized testing.

The Celera Genomics group is engaged principally in integrating advanced technologies to discover and develop new therapeutics. The Celera Genomics group intends to leverage its proteomic, bioinformatic, and genomic capabilities to identify and validate drug targets, and to discover and develop new therapeutics. Its Celera Discovery System's online platform, marketed exclusively by the Applied Biosystems group, is an integrated source of information based on the human genome and other biological and medical sources.

Celera Diagnostics, a 50/50 joint venture between the Applied Biosystems group and the Celera Genomics group, is focused on the discovery, development, and commercialization of novel diagnostic products.

In fiscal 1999, as part of a recapitalization of our Company, we created two classes of common stock referred to as "tracking" stocks. Tracking stock is a class of stock of a corporation intended to "track" or reflect the relative performance of a specific business within the corporation.

Applera Corporation-Applied Biosystems Group Common Stock ("Applera-Applied Biosystems stock") is listed on the New York Stock Exchange under the ticker symbol "ABI" and is intended to reflect the relative performance of the Applied Biosystems group. Applera Corporation-Celera Genomics Group Common Stock ("Applera-Celera stock") is listed on the New York Stock Exchange under the ticker symbol "CRA" and is intended to reflect the relative performance of the

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

Celera Genomics group. There is no single security that represents the performance of Applera Corporation as a whole, nor is there a separate security traded for Celera Diagnostics.

Holders of Applera-Applied Biosystems stock and Applera-Celera stock are stockholders of Applera. The Applied Biosystems group and the Celera Genomics group are not separate legal entities, and holders of these stocks are stockholders of a single company, Applera. As a result, holders of these stocks are subject to all of the risks associated with an investment in Applera and all of its businesses, assets, and liabilities. The Applied Biosystems group and the Celera Genomics group do not have separate boards of directors. Applera has one board of directors, which will make any decision in accordance with its good faith business judgment that the decision is in the best interests of Applera and all of its stockholders as a whole.

More information about the risks relating to our capital structure, particularly our two classes of capital stock, is contained in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Our fiscal year ends on June 30. The financial information for each segment is presented in Note 10 to our condensed consolidated financial statements, Segment and Consolidating Information. Management's discussion and analysis addresses the consolidated financial results followed by the discussions of our three segments.

The following business developments have occurred since the beginning of fiscal 2004:

Applied Biosystems Group

- In September 2003, Catherine M. Burzik joined the Applied Biosystems group as Executive Vice President, responsible for global commercial activities, and became a member of the Applera Executive Committee.
- Also in September 2003, the Applied Biosystems group announced the introduction of the 8500 Affinity Chip Analyzer, which rapidly identifies and characterizes antibody diagnostic and therapeutic candidates.
- In January 2004, the Applied Biosystems group announced the commercial availability of the SNPlex Genotyping System, a reagent and software product designed to allow researchers to conduct ultra high throughput genotyping studies for the characterization of complex diseases using the Applied Biosystems group's 3730xl and 3730 DNA Analyzers.
- In February 2004, the Applied Biosystems group announced the availability of two new real-time PCR systems for the detection and quantification of nucleic acid sequences.
- Also in February 2004, the Applied Biosystems group announced the commercial availability of the VariantSeq Resequencing System, the first complete, cost-effective solution for the discovery of DNA variants.

Celera Genomics Group

- Scientists have advanced target identification and validation programs for protein therapeutics and small molecules, and identified small molecule compounds for further preclinical evaluation.

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

Celera Diagnostics

- In September 2003, Celera Diagnostics announced the discovery of several novel genetic markers associated with an increased risk for myocardial infarction, or heart attack.
- In October 2003, Celera Diagnostics announced a research collaboration with Merck & Co. to identify and validate genetic markers useful in the development of prognostic tests and therapeutics for selected cancers.
- During the second quarter of fiscal 2004, Celera Diagnostics and its collaborators presented selected results from three genomic studies, including findings regarding risk of distant metastasis in breast cancer, interferon responsiveness in hepatitis C patients, and Alzheimer's disease.

Critical Accounting Policies

Please refer to the discussion of our critical accounting policies contained in the management's discussion and analysis section of our 2003 Annual Report to Stockholders (which discussion is incorporated herein by reference).

Events Impacting Comparability

We are providing the following information on some actions taken by us or events that occurred in the periods indicated. We describe the effect of these items on our reported earnings for the purpose of providing you with a better understanding of our on-going operations. You should consider these items when making comparisons to past performance and assessing prospects for future results.

Other Special Charges

During the second quarter of fiscal 2003, the Applied Biosystems group recorded pre-tax charges totaling \$33.8 million associated with the termination of approximately 400 employees, mainly in the U.S. and Europe, impairment of assets, and office closures. The \$33.8 million charge consisted of \$24.3 million recorded in other special charges and \$9.5 million for the impairment of assets recorded in cost of sales. Positions eliminated were primarily within the areas of research, manufacturing, sales, marketing and administration. The Applied Biosystems group recorded pre-tax benefits of \$4.3 million in the fourth quarter of fiscal 2003 and \$0.6 million in the second quarter of fiscal 2004 for reductions in anticipated employee-related costs associated with this program. The following table details the major components of the special charges:

| (Dollar amounts in millions) | Employee-Related Charges | Asset Impairment | Office Closures | Total |
|-------------------------------------|-----------------------------|---------------------|--------------------|---------------|
| Total charges | \$ 22.9 | \$ 9.5 | \$ 1.4 | \$ 33.8 |
| Cash payments | 16.4 | | 0.5 | 16.9 |
| Non-cash charges | | 9.5 | 0.5 | 10.0 |
| Reduction of expected costs | 4.9 | | | 4.9 |
| Balance at December 31, 2003 | \$ 1.6 | \$ 0.4 | \$ 0.4 | \$ 2.0 |

The termination of the employees and the cash payments relating to the workforce reductions and office closures were substantially completed by December 31, 2003. These payments were funded primarily by cash provided by operating activities.

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

Investments

The Applied Biosystems group recorded before tax gains of \$6.4 million in the second quarter of fiscal 2004 and \$7.5 million in the first six months of fiscal 2004 related primarily to the sales of minority equity investments. These investment sales resulted from management's decision to liquidate non-strategic investments.

Acquired In-Process Research and Development

During fiscal 2002, we acquired Axy's Pharmaceuticals, Inc. and recorded a charge to write off the value of acquired in-process research and development (IPR&D). During the second quarter of fiscal 2004, we continued to pursue all acquired projects that were active as of June 30, 2003, and the pre-clinical studies for these projects are expected to continue through fiscal 2004. The Celera Genomics group believes that a partnered compound could enter clinical trials during fiscal 2004. The Celera Genomics group's partners will make clinical development decisions with respect to partnered compounds. Please refer to the events impacting comparability section contained in the management's discussion and analysis and Note 2 to our consolidated financial statements in our 2003 Annual Report to Stockholders for more information on the IPR&D.

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

Discussion of Consolidated Operations

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|--------------------------------------|------------------------------------|-----------------|------------------------------|----------------------------------|-----------------|------------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| Net revenues | \$ 473.0 | \$ 485.3 | 2.6% | \$ 890.3 | \$ 890.4 | □% |
| Cost of sales | 230.3 | 230.7 | 0.2% | 425.2 | 421.2 | (0.9%) |
| Gross margin | 242.7 | 254.6 | 4.9% | 465.1 | 469.2 | 0.9% |
| SG&A expenses | 111.4 | 123.2 | 10.6% | 219.5 | 230.6 | 5.1% |
| R&D | 103.3 | 94.9 | (8.1%) | 206.6 | 187.3 | (9.3%) |
| Amortization of intangible assets | 1.7 | 0.7 | (58.8%) | 4.4 | 1.5 | (65.9%) |
| Other special charges | 24.3 | (0.6) | (102.5%) | 24.3 | (0.6) | (102.5%) |
| Operating income | 2.0 | 36.4 | | 10.3 | 50.4 | 389.3% |
| Gain (loss) on investments, net | (0.3) | 6.5 | | (0.3) | 7.0 | |
| Interest income, net | 7.7 | 5.8 | (24.7%) | 16.1 | 11.9 | (26.1%) |
| Other income (expense), net | 3.0 | 1.9 | (36.7%) | 0.9 | 1.0 | 11.1% |
| Income before income taxes | 12.4 | 50.6 | 308.1% | 27.0 | 70.3 | 160.4% |
| Provision (benefit) for income taxes | (1.0) | 8.0 | (900.0%) | 1.5 | 11.7 | 680.0% |
| Income from continuing operations | \$ 13.4 | \$ 42.6 | 217.9% | \$ 25.5 | \$ 58.6 | 129.8% |
| Percentage of net revenues: | | | | | | |
| Gross margin | 51.3% | 52.5% | | 52.2% | 52.7% | |
| SG&A expenses | 23.6% | 25.4% | | 24.7% | 25.9% | |
| R&D | 21.8% | 19.6% | | 23.2% | 21.0% | |
| Operating income | 0.4% | 7.5% | | 1.2% | 5.7% | |
| Effective income tax (benefit) rate | (8)% | 16% | | 6% | 17% | |

As previously described in events impacting comparability, fiscal 2004 and 2003 results were impacted by the following items at the Applied Biosystems group:

- \$0.6 million reduction in fiscal 2004 of severance costs previously recorded during the second quarter of fiscal 2003;
- gains relating to investments of \$6.4 million for the second quarter and \$7.5 million for the first six months of fiscal 2004; and
- \$33.8 million charge, including \$9.5 million recorded in cost of sales, for cost reductions including severance, asset impairments, and other special charges in fiscal 2003.

The total tax benefit recorded on the fiscal 2003 charges was \$10.4 million. The total tax expense recorded was \$2.5 million on the second quarter fiscal 2004 gains and \$2.9 million on the six-month fiscal 2004 gains. The net effect of foreign currency on income from continuing operations was a benefit of approximately \$2 million during the second quarter of fiscal 2004 and a benefit of approximately \$4 million during the first half of fiscal 2004. Please refer to the discussion on pages 34 to 43 of this quarterly report for further information on the financial results of our segments.

The favorable effects of foreign currency increased net revenues by approximately 2%. As a result, net revenues in the second quarter of fiscal 2004 increased only slightly after adjusting for currency compared with the prior year quarter. Revenues increased at the Applied Biosystems group, driven by strength in both the SDS and Other Applied Genomics and Mass Spectrometry product categories,

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
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partially offset by lower revenues in Other Product Lines. The increase in revenues in the SDS and Other Applied Genomics product category reflected the widening use of these products for gene expression and genotyping in both basic biological research and drug discovery and development. In Mass Spectrometry, the revenue increase was primarily driven by the strength of proteomics systems sales. Net revenues decreased at the Celera Genomics group, primarily as a result of the expiration of various Online/Information Business customer agreements.

Net revenues for the first six months of fiscal 2004 were relatively flat compared with the prior year period. The favorable effects of foreign currency increased net revenues by approximately 2%. Revenues increased slightly at the Applied Biosystems group, due primarily to strength in the SDS and Other Applied Genomics product category, partially offset by lower sequencing-related revenues caused by delays in government funding. In addition, manufacturing capabilities of the Applied Biosystems/MDS Sciex Instruments joint venture for the 4000 Q TRAP[®] LC/MS/MS System remained constrained during the second quarter of fiscal 2004, while demand for the system increased. Net revenues decreased at the Celera Genomics group, primarily as a result of the expiration of various Online/Information Business customer agreements.

The higher gross margin percentage for both the second quarter and first half of fiscal 2004 compared to fiscal 2003 was due primarily to the asset impairment charges recorded in fiscal 2003 and the favorable effects of foreign currency. This increase was partially offset by higher license revenue in fiscal 2003 at the Applied Biosystems group and lower revenues in fiscal 2004 at the Celera Genomics group. In addition, for the six-month period results, changes in product sales mix at the Applied Biosystems group also offset this increase.

SG&A expenses, as a percentage of net revenues, increased in both the second quarter and the six-month periods of fiscal 2004 primarily due to: higher legal fees, insurance and pension costs; increased spending on the development of, and enhancements to, the Applied Biosystems myScienceSM virtual research community and e-commerce website (collectively known as the Applied Biosystems Portal); and the unfavorable effects of foreign currency. In addition, the increase in the six-month period was partially offset by the reduction in personnel at the Applied Biosystems group announced in December 2002.

R&D expenses decreased for both the second quarter and six-month periods of fiscal 2004 compared to the same periods last year primarily due to the completion of the funding for the Applera Genomics Initiative, the costs of which were shared among our three businesses, cost reductions in the Online/Information Business and the elimination of non-strategic activities at the Celera Genomics group. This decrease was partially offset by support for new product introductions at the Applied Biosystems group and increased spending for discovery programs and product development at Celera Diagnostics.

Interest income, net decreased during the second quarter and first six months of fiscal 2004 compared to the prior year periods primarily due to lower average interest rates, partially offset by higher average cash and cash equivalents and short-term investments.

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

The change in the effective tax rate for both the second quarter and six-month periods of 2004 was primarily due to the previously discussed special charges recorded in fiscal 2003, as well as changes in forecasted R&D credits.

Applera Corporation
Discussion of Condensed Consolidated Financial Resources and Liquidity

We had cash and cash equivalents and short-term investments of \$1.4 billion at December 31, 2003 and June 30, 2003. We maintain a \$50 million revolving credit agreement with three banks that expires on April 20, 2005, under which there were no borrowings outstanding at December 31, 2003. Cash provided by operating activities has been our primary source of funds over the last fiscal year.

We believe that existing funds, cash generated from operations, and existing sources of debt financing are more than adequate to satisfy our normal operating cash flow needs, planned capital expenditures, dividends, and potential authorized share repurchases for the next twelve months and for the foreseeable future thereafter. However, if the Celera Genomics group is successful in its preclinical programs it may require additional funds to advance these programs through regulatory process.

| (Dollar amounts in millions) | June 30, 2003 | December 31, 2003 |
|--|------------------|----------------------|
| Cash and cash equivalents | \$ 654.3 | \$ 719.5 |
| Short-term investments | 749.8 | 690.0 |
| Total cash and cash equivalents and short-term investments | \$ 1,404.1 | \$ 1,409.5 |
| Total debt | 17.1 | 16.7 |
| Working capital | 1,460.1 | 1,475.7 |
| Debt to total capitalization | 0.7% | 0.7% |

Cash and cash equivalents increased in the first half of fiscal 2004 as cash generated from operating activities and proceeds from the sales and maturities of short-term investments, sales of assets and proceeds from stock issuances exceeded the amount expended on capital and other assets, payment of dividends, and the repurchase of Applera-Applied Biosystems stock. Our cash and cash equivalents and short-term investments increased by \$5.4 million during the first six months of fiscal 2004. Net cash flows of continuing operations for the six months ended December 31 were as follows:

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
RESULTS OF OPERATIONS continued

| (Dollar amounts in millions) | 2002 | 2003 |
|------------------------------------|---------|----------------|
| Net cash from operating activities | \$ 71.5 | \$ 82.3 |
| Net cash from investing activities | 105.4 | 62.9 |
| Net cash from financing activities | (2.6) | (97.3) |

Operating activities:

The increase in net cash from operating activities of continuing operations for the first six months of fiscal 2004 compared to the first six months of fiscal 2003 resulted primarily from a larger decrease in accounts receivable in fiscal 2004 due to improved collections and the timing of the receipt of dividends and distributions from investments in unconsolidated subsidiaries and higher tax payments in fiscal 2003, partially offset by lower income-related cash flows in fiscal 2004, the funding of our U.S. pension plan of approximately \$28 million in fiscal 2004, the timing of royalty and vendor payments, and lower cash receipts in fiscal 2004 due to the expiration of various Online/Information Business customer agreements at the Celera Genomics group.

Investing activities:

Capital expenditures, net of disposals, were \$29.8 million less than the prior fiscal year period primarily due to lower expenditures for the Applied Biosystems group's Pleasanton, California facility. During the first six months of fiscal 2004, proceeds generated from sales and maturities of short-term investments were \$109.7 million lower than in the prior year period. Proceeds from the sale of investments were \$20.9 million higher in fiscal 2004.

Financing activities:

During the first six months of fiscal 2004, we repurchased 3.9 million shares of Applera-Applied Biosystems stock for \$84.0 million. During the first six months of fiscal 2003, we repurchased 380,000 shares of Applera-Applied Biosystems stock for \$6.8 million. The second quarter of fiscal 2004 included two dividend payments on Applera-Applied Biosystems stock compared to one payment in the second quarter of fiscal 2003. Proceeds received from employee stock option exercises during the first six months of fiscal 2004 were \$9.2 million less than the prior fiscal year period.

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Discussion of Segments Operations, Financial Resources and Liquidity**Applied Biosystems Group**

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|-----------------------------------|------------------------------------|-----------------|---------------------------|----------------------------------|-----------------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| Net revenues | \$ 444.7 | \$ 458.4 | 3.1% | \$ 840.6 | \$ 841.1 | 0.1% |
| Cost of sales | 225.8 | 222.4 | (1.5%) | 419.1 | 408.7 | (2.5%) |
| Gross margin | 218.9 | 236.0 | 7.8% | 421.5 | 432.4 | 2.6% |
| SG&A expenses | 101.5 | 112.6 | 10.9% | 199.8 | 207.3 | 3.8% |
| R&D | 59.2 | 60.7 | 2.5% | 120.2 | 120.3 | 0.1% |
| Other special charges | 24.3 | (0.6) | (102.5%) | 24.3 | (0.6) | (102.5%) |
| Operating income | 33.9 | 63.3 | 86.7% | 77.2 | 105.4 | 36.5% |
| Gain on investments, net | | 6.4 | | | 7.5 | |
| Interest income, net | 3.0 | 3.2 | 6.7% | 6.2 | 6.2 | □% |
| Other income (expense), net | 2.5 | (0.1) | (104.0%) | 3.5 | 0.1 | (97.1%) |
| Income before income taxes | 39.4 | 72.8 | 84.8% | 86.9 | 119.2 | 37.2% |
| Provision for income taxes | 10.2 | 20.4 | 100.0% | 23.5 | 33.4 | 42.1% |
| Income from continuing operations | \$ 29.2 | \$ 52.4 | 79.5% | \$ 63.4 | \$ 85.8 | 35.3% |
| Percentage of net revenues: | | | | | | |
| Gross margin | 49.2% | 51.5% | | 50.1% | 51.4% | |
| SG&A expenses | 22.8% | 24.6% | | 23.8% | 24.6% | |
| R&D | 13.3% | 13.2% | | 14.3% | 14.3% | |
| Operating income | 7.6% | 13.8% | | 9.2% | 12.5% | |
| Effective income tax rate | 26% | 28% | | 27% | 28% | |

The net effects of foreign currency on income from continuing operations was a benefit of approximately \$2 million, or \$0.01 per share, during the second quarter of fiscal 2004 and a benefit of approximately \$4 million, or \$0.02 per share, during the first half of fiscal 2004.

Revenues overall summary

The following table sets forth the Applied Biosystems group's revenues by product categories for the three and six-month periods ended December 31:

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| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|---|------------------------------------|-------------------------------|---------------------------|----------------------------------|-------------------------------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| DNA sequencing products <i>% of total revenues</i> | \$ 174.8 39% | \$ 170.4 37% | (3%) | \$ 324.1 39% | \$ 295.4 35% | (9%) |
| SDS and other applied genomics products ^(b) <i>% of total revenues</i> | 85.4 19% | 104.3 23% | 22% | 168.9 20% | 198.4 24% | 17% |
| Mass Spectrometry ^(a) <i>% of total revenues</i> | 92.6 21% | 103.4 23% | 12% | 176.7 21% | 185.9 22% | 5% |
| Core DNA synthesis and PCR products <i>% of total revenues</i> | 51.9 12% | 51.3 11% | (1%) | 100.9 12% | 102.4 12% | 1% |
| Other Product Lines ^{(a) (b)} <i>% of total revenues</i> | 40.0 9% | 29.0 6% | (28%) | 70.0 8% | 59.0 7% | (16%) |
| Total | \$ 444.7 | \$ 458.4 | 3% | \$ 840.6 | \$ 841.1 | 0% |

(a) A reclassification of \$1.1 million for the quarter ended December 31, 2002, and \$1.8 million for the six months ended December 31, 2002, was made from Other Product Lines to Mass Spectrometry.

(b) A reclassification of \$0.1 million for the quarter ended December 31, 2002, and \$0.2 million for the six months ended December 31, 2002, was made from Other Product Lines to SDS and other applied genomics.

The favorable effects of foreign currency increased net revenues by approximately 3% during the second quarter of fiscal 2004. As a result, net revenues in the second quarter of fiscal 2004 increased only slightly after adjusting for currency compared with the prior year quarter. Revenue growth in the quarter was driven by strength in both the SDS and Other Applied Genomics and Mass Spectrometry product categories. Revenues in the SDS and Other Applied Genomics product category increased 22 percent, reflecting the widening use of these products for gene expression and genotyping in both basic biological research and drug discovery and development. In Mass Spectrometry, revenues increased 12 percent, driven primarily by the strength of proteomics systems sales, including sales of the QSTAR XL LC/ MS/MS System and the 4700 Proteomics Discovery System with TOF/TOF Optics. Also impacting Mass Spectrometry revenues were the manufacturing capabilities of the Applied Biosystems/MDS Sciex Instruments joint venture for the 4000 Q TRAP[®] LC/MS/MS System, which remained constrained during the second quarter of fiscal 2004, while demand for the system increased.

The favorable effects of foreign currency increased net revenues by approximately 2% during the first half of fiscal 2004. As a result, for the six-month period, net revenues were relatively flat with the prior year period. Growth in the SDS and Other Applied Genomics product category and higher service and support revenues were offset by a decline in sales of the Applied Biosystems 3730xl DNA Analyzer to large-scale genome centers and lower technology license fees. In addition, the manufacturing capabilities of the Applied Biosystems/MDS Sciex Instruments joint venture for the 4000 Q

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TRAP[®] LC/MS/MS System remained constrained during the second quarter of fiscal 2004, while demand for the system increased.

The decrease in revenues from Other Product Lines for both the second quarter and first half of fiscal 2004 resulted primarily from lower software sales and consulting revenues compared with the prior year periods.

Revenues by geographic area

The following table sets forth the Applied Biosystems group's revenues by geographic area for the second quarters and six months ended December 31:

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|------------------------------------|------------------------------------|-----------------|---------------------------|----------------------------------|-----------------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| United States | \$ 206.7 | \$ 216.0 | 4.5% | \$ 419.3 | \$ 405.7 | (3.2%) |
| Europe | 142.7 | 137.3 | (3.8%) | 239.2 | 241.5 | 1.0% |
| Asia Pacific | 84.2 | 91.8 | 9.0% | 158.4 | 169.1 | 6.8% |
| Latin America and other markets | 11.1 | 13.3 | 19.8% | 23.7 | 24.8 | 4.6% |
| Total | \$ 444.7 | \$ 458.4 | 3.1% | \$ 840.6 | \$ 841.1 | 0.1% |

The effects of foreign currency increased revenues by approximately 6% in Europe and 3% in Asia Pacific during the second quarter of fiscal 2004. Revenues in the U.S. increased during the second quarter, with the largest factor being an increase in sales of the 3730xl systems to large-scale genome centers. European revenues decreased due primarily to an order in fiscal 2003 from a large-scale genome center for a substantial number of 3730xl instrument systems, which was not repeated in fiscal 2004. Additionally, difficult economic conditions in certain European countries, most notably Germany and France, continued to negatively impact government funding for life science research. This constrained level of government funding negatively impacted our second quarter fiscal 2004 sales.

The effects of foreign currency increased revenues by approximately 6% in Europe and 2% in Asia Pacific during the first half of fiscal 2004. The decrease in sales in the U.S. for the six-month period of fiscal 2004 was primarily attributed to the delays in government funding to our large-scale genome center customers and the manufacturing constraints related to the 4000 Q TRAP[®] LC/MS/MS System discussed below.

Revenue by sources

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|------------------------------|------------------------------------|-----------------|---------------------------|----------------------------------|-----------------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| Instruments | \$ 225.9 | \$ 235.1 | 4.1% | \$ 414.9 | \$ 407.3 | (1.8%) |
| Consumables | 144.0 | 149.4 | 3.8% | 282.4 | 289.1 | 2.4% |
| Other sources | 74.8 | 73.9 | (1.2%) | 143.3 | 144.7 | 1.0% |
| Total | \$ 444.7 | \$ 458.4 | 3.1% | \$ 840.6 | \$ 841.1 | 0.1% |

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Instruments

For the second quarter of fiscal 2004, revenues from instrument sales increased primarily due to growth in each of the Applied Biosystems group's three major product categories (DNA Sequencing, SDS and Other Applied Genomics, and Mass Spectrometry), which more than offset the decrease in instrument sales primarily in the Other Product Lines product category.

For the first six months of fiscal 2004, revenues from instrument sales decreased primarily due to a decline in sales of the Applied Biosystems 3730xl DNA Analyzer, in part due to delays in government funding, which more than offset the growth in SDS and Other Applied Genomics instrument sales and Mass Spectrometry instrument sales.

Results for both the second quarter and first six months of fiscal 2004 were also impacted by the manufacturing capabilities of the Applied Biosystems/MDS Sciex Instruments joint venture for the 4000 Q TRAP[®] LC/MS/MS System, which remained constrained during the second quarter of fiscal 2004, while demand for the system increased.

Consumables

For the second quarter and first six months of fiscal 2004, consumables sales increased primarily due to growth in sales of SDS and Other Applied Genomics consumables. Also, for the second quarter of fiscal 2004, consumables sales increased due to growth in DNA sequencing consumables. These increases were offset by the declines in consumables sales in each of the other product categories. Sales growth in SDS and Other Applied Genomics consumables was due in part to the increasing adoption of the Applied Biosystems Assays-on-Demand[®] and Assays-by-DesignSM products for gene expression and genotyping experiments in both basic research and drug discovery and development.

Other sources

Revenues from other sources, which included service and support, royalties, licenses, and contract research, decreased for the second quarter primarily due to a decline in technology license fees, partially offset by an increase in service and support revenues. Revenues from other sources increased for the fiscal year to date period primarily from higher service and support revenues, partially offset by lower technology licensing fees.

Gross margin, as a percentage of net revenues, increased for both the second quarter and six-month periods over the prior year periods due primarily to the asset impairment charges recorded in fiscal 2003 and the favorable effects of foreign currency, partially offset by higher license revenue in fiscal 2003. In addition, for the six months of fiscal 2004, changes in product sales mix also offset this increase.

SG&A expenses, as a percentage of net revenues, increased over the second quarter and first six months of fiscal 2003 due primarily to: increased legal fees, insurance and pension costs; increased spending on the development of, and enhancements to the Applied Biosystems Portal; and the unfavorable effects of foreign currency. The increase in the first six months of fiscal 2004 was partially offset by the reduction in personnel announced in December 2002.

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R&D expenses for both the second quarter and six month periods of fiscal 2004 increased slightly over the prior year periods. This increase resulted primarily from support for new product introductions, partially offset by the completion of funding for the Applera Genomics Initiative and the associated reduction in personnel announced in December 2002.

Other income (expense), net decreased for both the second quarter and six month periods in comparison to the prior year periods primarily due to lower benefits associated with our foreign currency risk management program.

The increase in the effective tax rate for both the second quarter and six-month periods of fiscal 2004 was primarily due to the previously discussed special charges recorded in fiscal 2003.

Applied Biosystems Group

Discussion of Financial Resources and Liquidity

The Applied Biosystems group had cash and cash equivalents of \$639.6 million at December 31, 2003 and \$601.7 million at June 30, 2003. We maintain a \$50 million revolving credit agreement with three banks that expires on April 20, 2005, under which there were no borrowings outstanding at December 31, 2003. Cash provided by operating activities has been the Applied Biosystems group's primary source of funds.

We believe that existing funds, cash generated from operations, and existing sources of debt financing are more than adequate to satisfy the Applied Biosystems group's normal operating cash flow needs, planned capital expenditures, its share of funding of the Celera Diagnostics joint venture, dividends, and potential authorized share repurchases for the next twelve months and for the foreseeable future thereafter.

We manage the investment of surplus cash and the issuance and repayment of short-term and long-term debt for the Applied Biosystems group and the Celera Genomics group on a centralized basis and allocate activity within these balances to the group that uses or generates such resources.

| (Dollar amounts in millions) | June 30, 2003 | December 31, 2003 |
|--|------------------|------------------------------|
| Cash and cash equivalents | \$ 601.7 | \$ 639.6 |
| Short-term investments | | |
| Total cash and cash equivalents and short-term investments | \$ 601.7 | \$ 639.6 |
| Total debt | | |
| Working capital | 708.6 | 749.9 |
| Debt to total capitalization | □% | □% |

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Cash and cash equivalents for the six months ended December 31, 2003 increased as cash generated from operating activities and proceeds from stock issuances were only partially offset by expenditures for capital and other assets, the funding of the Celera Diagnostics joint venture, the payment of dividends, and the repurchase of Applera-Applied Biosystems stock. Net cash flows of continuing operations for the six months ended December 31 were as follows:

| (Dollar amounts in millions) | 2002 | 2003 |
|------------------------------------|----------|-----------------|
| Net cash from operating activities | \$ 114.6 | \$ 135.4 |
| Net cash from investing activities | (28.5) | (14.9) |
| Net cash from financing activities | (16.2) | (100.0) |

Operating activities:

Net cash from operating activities of continuing operations for the first six months of fiscal 2004 was \$20.8 million higher than the first six months of fiscal 2003. This increase resulted primarily from a larger decrease in accounts receivable in fiscal 2004 due to improved collections and the timing of the receipt of dividends and distributions from investments in unconsolidated subsidiaries and higher tax payments in fiscal 2003, partially offset by the funding of our U.S. pension plan of approximately \$28 million in fiscal 2004, and the timing of royalty and vendor payments. The Applied Biosystems group's days sales outstanding was 67 days at December 31, 2003, 75 days at June 30, 2003, and 63 days at December 31, 2002. Inventory on hand was 3.5 months at December 31, 2003 compared to 3.3 months at June 30, 2003.

Investing activities:

Capital expenditures for the first six months of fiscal 2004, net of disposals, were \$25.0 million less than the prior fiscal year period primarily due to lower expenditures for the Pleasanton, California facility. The first six months of fiscal 2004 included \$20.9 million of proceeds primarily from the sale of investments. The first six months of fiscal 2003 included \$29.6 million of proceeds from the maturity of a short-term investment.

Financing activities:

During the first six months of fiscal 2004, we repurchased 3.9 million shares of Applera-Applied Biosystems stock for \$84.0 million. During the first six months of fiscal 2003, we repurchased 380,000 shares of Applera-Applied Biosystems stock for \$6.8 million. The second quarter of fiscal 2004 included two dividend payments on Applera-Applied Biosystems stock compared to one payment in the second quarter of fiscal 2003.

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Celera Genomics Group

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|-----------------------------------|------------------------------------|-----------|---------------------------|----------------------------------|-----------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| Net revenues | \$ 22.9 | \$ 19.2 | (16.2%) | \$ 46.5 | \$ 36.6 | (21.3%) |
| Cost of sales | 3.7 | 3.7 | □% | 7.1 | 6.4 | (9.9%) |
| R&D | 32.9 | 25.2 | (23.4%) | 65.5 | 47.0 | (28.2%) |
| SG&A expenses | 7.0 | 7.2 | 2.9% | 14.0 | 15.4 | 10.0% |
| Amortization of intangible assets | 1.7 | 0.7 | (58.8%) | 4.4 | 1.5 | (65.9%) |
| Operating loss | (22.4) | (17.6) | (21.4%) | (44.5) | (33.7) | (24.3%) |
| Gain (loss) on investments, net | (0.3) | 0.1 | (133.3%) | (0.3) | (0.5) | 66.7% |
| Interest income, net | 4.7 | 2.6 | (44.7%) | 9.9 | 5.8 | (41.4%) |
| Other income (expense), net | 0.6 | 2.0 | 233.3% | (2.6) | 0.9 | (134.6%) |
| Loss from joint venture | (9.9) | (9.3) | (6.1%) | (23.2) | (21.4) | (7.8%) |
| Loss before income taxes | (27.3) | (22.2) | (18.7%) | (60.7) | (48.9) | (19.4%) |
| Benefit for income taxes | 11.2 | 8.6 | (23.2%) | 24.9 | 19.1 | (23.3%) |
| Net loss | \$ (16.1) | \$ (13.6) | (15.5%) | \$ (35.8) | \$ (29.8) | (16.8%) |
| Effective income tax benefit rate | 41% | 39% | | 41% | 39% | |
| Online/Information Business: | | | | | | |
| Revenues | \$ 20.3 | \$ 16.3 | | \$ 40.9 | \$ 31.5 | |
| Operating income | 9.3 | 8.4 | | 18.4 | 15.4 | |

The lower net loss in the second quarter and first six months of fiscal 2004 in comparison to the fiscal 2003 periods primarily resulted from lower R&D expenses and lower amortization of intangible assets, partially offset by lower revenues and net interest income. Lower Online/Information Business operating income for the both second quarter and first half of fiscal 2004 resulted from lower revenue partially offset by reduced operating expenses due to the Celera Genomics group's decision to forgo new business unrelated to drug discovery. Online/Information Business revenues decreased primarily as a result of the expiration of various customer agreements. Under the terms of the marketing and distribution agreement between the Celera Genomics group and the Applied Biosystems group, the Celera Genomics group has not sought any new customers for its Celera Discovery System and related information products and services since June 2002, and therefore its revenues from sales of these products and services have been limited. Expenses related to the Applera Genomics Initiative are not allocated to the Online/Information Business.

R&D expenses decreased in the second quarter of fiscal 2004 in comparison to the same quarter last year primarily due to the completion of the Applera Genomics Initiative, cost reductions in the Online/Information Business, and the elimination of non-strategic activities. These decreases were partially offset by higher expenses associated with preclinical development activities and the hiring of additional therapeutic personnel. R&D expenses decreased for the first six months of fiscal 2004 compared to the same period last year due primarily to

the completion of the Applera Genomics Initiative, cost reductions in the Online/Information Business, and \$2.9 million recorded in the first quarter of fiscal 2003 for asset write-downs associated with the Rockville, Maryland sequencing facility due to the group's decision not to pursue additional sequencing service business. R&D

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expenses for both the second quarter and first six months of fiscal 2004 include a \$1.8 million write-off of building improvements related to a reconfiguration of space in the Rockville, Maryland facility.

SG&A expenses increased in the first six months of fiscal 2004 compared to the prior year period primarily due to higher employee-related costs, including severance.

Amortization expense of intangible assets decreased in the second quarter and first six months of fiscal 2004 due to the completion of the amortization of some intangible assets acquired as part of the acquisition of Axys Pharmaceuticals, Inc. in fiscal 2002.

Interest income, net decreased during both the second quarter and first six months of fiscal 2004 compared to the prior year periods primarily due to lower average interest rates and, to a lesser extent, lower average cash and cash equivalents and short-term investments.

In the second quarter of fiscal 2004, other income, net increased compared to the prior year quarter due to a non-recurring receipt of \$2.0 million related to the March 2002 sale of the Celera Genomics group's animal genomics and genotyping business. For the first six months of fiscal 2004, other income (expense), net included the \$2.0 million receipt and lower losses recorded for equity method investments compared to the first six months of fiscal 2003.

The decrease in the effective income tax benefit rate for both the second quarter and six-month periods of fiscal 2004 was primarily attributable to changes in forecasted R&D credits.

Celera Genomics Group
Discussion of Financial Resources and Liquidity

The Celera Genomics group had cash and cash equivalents and short-term investments of \$770.0 million at December 31, 2003 and \$802.4 million at June 30, 2003. We maintain a \$50 million revolving credit agreement with three banks that expires on April 20, 2005, under which there were no borrowings outstanding at December 31, 2003.

We believe that existing funds and existing sources of debt financing are more than adequate to satisfy the Celera Genomics group's normal operating cash flow needs, planned capital expenditures, and its share of funding of the Celera Diagnostics joint venture for the next twelve months and for the foreseeable future thereafter. However, if the Celera Genomics group is successful in its preclinical programs it may require additional funds to advance these programs through the regulatory process.

We manage the investment of surplus cash and the issuance and repayment of short-term and long-term debt for the Celera Genomics group and the Applied Biosystems group on a centralized basis and allocate activity within these balances to the group that uses or generates such resources.

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| (Dollar amounts in millions) | June 30, 2003 | December 31, 2003 |
|--|------------------|----------------------|
| Cash and cash equivalents | \$ 52.6 | \$ 80.0 |
| Short-term investments | 749.8 | 690.0 |
| Total cash and cash equivalents and short-term investments | \$ 802.4 | \$ 770.0 |
| Total debt | 17.1 | 16.7 |
| Working capital | 750.8 | 714.3 |
| Debt to total capitalization | 1.7% | 1.7% |

Cash and cash equivalents for the first six months of fiscal 2004 increased as proceeds from the sales and maturities of short-term investments, sales of assets, and stock issuances exceeded the amount expended on operations, the funding of the Celera Diagnostics joint venture and the purchase of capital assets. As a result, the Celera Genomics group's cash and cash equivalents and short-term investments decreased by \$32.4 million during the first six months of fiscal 2004. Net cash flows for the six months ended December 31 were as follows:

| (Dollar amounts in millions) | 2002 | 2003 |
|------------------------------------|-----------|------------------|
| Net cash from operating activities | \$ (19.7) | \$ (25.1) |
| Net cash from investing activities | 110.4 | 49.7 |
| Net cash from financing activities | 13.6 | 2.7 |

Operating activities:

Net cash used by operating activities for the first six months of fiscal 2004 was \$5.4 million higher than the first six months of fiscal 2003. The higher use of cash resulted primarily from higher net cash operating losses and lower cash receipts in fiscal 2004 due to the expiration of various Online/Information Business customer agreements, partially offset by lower compensation costs due to the June 2002 restructuring of the organization.

Investing activities:

Net cash from investing activities for the first six months of fiscal 2004 decreased from the first six months of fiscal 2003 due to lower proceeds received from the sales and maturities of short-term investments, partially offset by fewer purchases of long-term investments.

Financing activities:

Net cash from financing activities for the first six months of fiscal 2004 decreased from the first six months of fiscal 2003 due to lower proceeds received from employee stock option exercises.

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Celera Diagnostics

| (Dollar amounts in millions) | Three Months Ended December 31, | | | Six Months Ended December 31, | | |
|---|------------------------------------|----------|---------------------------|----------------------------------|-----------|---------------------------|
| | 2002 | 2003 | % Increase/ (Decrease) | 2002 | 2003 | % Increase/ (Decrease) |
| Net revenues | \$ 7.8 | \$ 11.0 | 41.0% | \$ 10.8 | \$ 19.6 | 81.5% |
| Cost of sales | 2.2 | 6.3 | 186.4% | 4.6 | 10.0 | 117.4% |
| R&D | 12.6 | 10.6 | (15.9%) | 23.7 | 23.1 | (2.5%) |
| SG&A expenses | 2.9 | 3.4 | 17.2% | 5.7 | 7.9 | 38.6% |
| Operating loss | \$ (9.9) | \$ (9.3) | (6.1%) | \$ (23.2) | \$ (21.4) | (7.8%) |
| Equalization payments | \$ 5.1 | \$ 8.2 | | \$ 5.1 | \$ 14.2 | |
| End-user sales of products manufactured by Celera Diagnostics | \$ 5.0 | \$ 10.4 | | \$ 8.9 | \$ 19.5 | |

Net revenues consist primarily of equalization payments from Abbott Laboratories resulting from the profit-sharing alliance between Abbott and Celera Diagnostics and primarily accounted for the increase in net revenues. Equalization payments fluctuate from period to period due to differences in end-user sales of alliance products and operating expenses between the alliance partners. End-user sales of alliance products also increased due to continued growth in sales of cystic fibrosis analyte specific reagents (ASRs), and to a lesser extent, products for infectious disease testing.

R&D expenses decreased in both the second quarter and first six months of fiscal 2004 as a result of the completion of the Applera Genomics Initiative, partially offset by increased spending for discovery programs and product development.

SG&A expenses for the first six months of fiscal 2004 included a \$1.1 million charge related to a facility lease agreement.

Market Risks

Our foreign currency risk management strategy uses derivative instruments to hedge certain foreign currency forecasted revenues and to offset the impact of changes in foreign currency exchange rates on certain foreign currency-denominated assets and liabilities. The principal objective of this strategy is to minimize the risks and/or costs associated with our global financial and operating activities. We use foreign exchange forward, option, and range forward contracts to manage our foreign currency exposures. At December 31, 2003, we recorded in our condensed consolidated financial statements a net liability of \$27.2 million related to these currency forwards and option contracts, compared with a net liability of \$2.3 million at June 30, 2003. This increase was primarily attributed to the fluctuations in foreign currency rates. We do not use derivative financial instruments for trading or speculative purposes, nor are we a party to leveraged derivatives.

We performed a sensitivity analysis as of December 31, 2003. Assuming a hypothetical adverse change of 10% in foreign exchange rates in relation to the U.S. dollar as of December 31, 2003, we calculated a hypothetical after-tax loss of \$42.8 million, as compared to a hypothetical after-tax loss

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of \$36.8 million at June 30, 2003. Our analysis included the change in value of the derivative financial instruments, along with the impact of translation on foreign currency-denominated assets and liabilities. Our analysis excluded the impact of translation of foreign currency-denominated forecasted sales. If foreign currency exchange rates actually change in a manner similar to the assumed change in the foregoing calculation, the hypothetical loss calculated would be more than offset by the recognition of higher U.S. dollar equivalent foreign revenues. Actual gains and losses in the future could, however, differ materially from this analysis, based on changes in the timing and amount of foreign currency exchange rate movements and actual exposures and hedges.

For more information on our market risks, please refer to the market risk section of the management's discussion and analysis included on pages 34 and 35 of our 2003 Annual Report to Stockholders (which section is incorporated herein by reference).

Recently Issued Accounting Standards

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act") introduced a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans. In January 2004, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position ("FSP") No. FAS 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." This FSP permits a sponsor of a postretirement health care plan that provides a prescription drug benefit to retirees to make a one-time election to defer accounting for the effects of the Act if there is insufficient data, time or guidance available to ensure appropriate accounting. The guidance in this FSP is effective for interim or annual financial statements of fiscal years ending after December 7, 2003. We have elected to defer accounting for any effects of the Act while evaluating the Act further and pending the issuance of authoritative guidance on the accounting for the Act and its effect, if any, on our results of operations, financial position and financial statement disclosures. Therefore, the amounts included in the accompanying condensed consolidated financial statements related to our postretirement benefit plans do not reflect the effects of the Act.

In December 2003, the FASB issued a revised Statement of Financial Accounting Standards ("SFAS") No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106, and a revision of FASB Statement No. 132." SFAS No. 132 (revised 2003) requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. The interim provisions of this Statement are required for our fiscal 2004 third quarter. The remaining provisions of this Statement are effective for our fiscal 2004 fourth quarter.

Also in December 2003, the FASB issued a revised FASB Interpretation No. 46 ("FIN 46R"), "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51." The FASB published the revision to clarify and amend some of the original provisions of FIN 46, which was issued in January 2003, and to exempt certain entities from its requirements. A variable interest entity ("VIE") refers to an entity subject to consolidation according to the provisions of this Interpretation. FIN 46R applies to entities whose equity investment at risk is insufficient to

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finance that entity's activities without receiving additional subordinated financial support provided by any parties, including equity holders, or where the equity investors (if any) do not have a controlling financial interest. FIN 46R provides that if an entity is the primary beneficiary of a VIE, the assets, liabilities, and results of operations of the VIE should be consolidated in the entity's financial statements. In addition, FIN 46R requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE provide additional disclosures. The provisions of FIN 46R are effective for our fiscal 2004 third quarter. We are currently analyzing the effects of FIN 46R, but do not expect its application to have a material impact on our consolidated financial statements.

Outlook

Applied Biosystems Group

The Applied Biosystems group believes demand from commercial customers should improve during the remainder of fiscal 2004. However, the Applied Biosystems group believes a number of issues relating to government funding for life science research exist that have the potential to negatively impact fiscal 2004 second-half financial results. While the Applied Biosystems group does not expect the funding situation in Europe to change significantly in the near-term, the Applied Biosystems group is increasingly cautious about the situation in Japan. The Applied Biosystems group expects the transition of universities to Independent Administrative Agencies will lead to lower than previously expected sales in Japan during the remainder of fiscal 2004. In the U.S., Congress recently approved, and the President signed, the spending bill that included the fiscal 2004 NIH budget. However, previous experience suggests that the lag time between approval and the Applied Biosystems group's U.S. academic customers' receipt of their annual grant funds can delay customer purchases.

Despite these funding constraints, the Applied Biosystems group forecasts single digit annual revenue growth for fiscal 2004, consistent with the Applied Biosystems group's prior guidance. For the second half of fiscal 2004, the Applied Biosystems group expects revenue growth to be driven by new product sales. The Applied Biosystems group expects fiscal 2004 annual earnings per share growth at a rate equal to or slightly above annual revenue growth.

During fiscal 2004, the Applied Biosystems group expects each of the three product types — instruments, consumables, and other sources — to generate annual revenue growth. Regarding fiscal 2004 annual revenue growth for the five product categories, the Applied Biosystems group expects both the SDS and Other Applied Genomics product category and the Mass Spectrometry product category to generate annual revenue growth. The Applied Biosystems group does not expect any significant change in the absolute level of annual revenue generated by either the Core DNA Synthesis and PCR product category or the Other Product Lines category during fiscal 2004. Finally, for the DNA Sequencing product category, the Applied Biosystems group expects annual revenue to decline modestly during fiscal 2004, primarily as a result of more modest sales of the 3730xl system to large-scale genome centers and, to a lesser degree, a decline in sequencing consumables sales.

The Applied Biosystems group presently estimates that the fiscal 2004 annual gross margin will be approximately equal to that of fiscal 2003. The Applied Biosystems group expects annual SG&A expenses to increase as a percent of total revenues during fiscal 2004 due to a number of factors, including expenses associated with Applera's legal actions with F. Hoffmann-La Roche Ltd. and the expected commencement in March 2004 of a patent infringement trial involving MJ Research, Inc. Additional factors include: costs associated with the development of, and enhancements to, the new Applied Biosystems Portal; and increased insurance and pension costs. The Applied Biosystems group expects total annual R&D expenditures for fiscal 2004 to be approximately equal to those in fiscal 2003.

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The Applied Biosystems group expects the effective tax rate for fiscal 2004 to be approximately 28 percent. Future tax legislation may repeal or replace the existing U.S. export tax regime, as well as significantly change other international tax provisions of the Internal Revenue Code. Such changes may result in a change in the effective tax rate for the Applied Biosystems group.

For the fiscal third quarter, the Applied Biosystems group anticipates earnings per share will be slightly above prior year quarter results. This forecast includes the expected legal expenses related to the trial discussed above.

Capital spending in fiscal 2004 is anticipated to be within the range of \$70-80 million.

The Applied Biosystems group derives some rights to PCR technology under a series of agreements with Hoffmann-La Roche, Inc. and its affiliates which own some of the patents covering the PCR process. The group receives royalties from third-party sales of products incorporating this technology through a series of licensing programs. The first of these patents expires in 2005 in the U.S., and in 2006 in Europe and some other jurisdictions. The expiration of these patents may result in reduced royalty payments to the Applied Biosystems group. However, we expect that any reduction will be offset by royalties received from new PCR-related licensing programs. In addition, the PCR agreements are the subject of legal proceedings described in Note 9 to our condensed consolidated financial statements included in this report. The outcome of legal proceedings is inherently uncertain, and an adverse outcome in these proceedings could negatively affect the value of our PCR rights.

The Applied Biosystems group has engaged a leading strategy consulting firm to assist management in an in-depth review of the entire product portfolio. The purpose of this review is to identify opportunities for growth, increased profitability, and shareholder value creation. The Applied Biosystems group expects to complete this review in fiscal 2004. Financial statement implications, if any, as a result of this review will be addressed when appropriate.

Celera Genomics Group

Fiscal 2004 goals for the Celera Genomics group include establishing one or more strategic relationships that advance its therapeutic pipeline and/or take advantage of its combination of genomic, proteomic, and bioinformatic capabilities. The Celera Genomics group also seeks to establish a relationship to identify and develop therapeutic antibodies against therapeutic targets discovered through its proteomic programs. In the future, the Celera Genomics group may partner other therapeutic discovery programs that it elects not to pursue independently.

The Celera Genomics group plans to conduct identification of potential targets and to advance target validation within its three ongoing proteomic oncology programs in pancreatic cancer, lung cancer, and colon cancer, and to initiate a new proteomic discovery program in breast cancer. The Celera Genomics group believes that a partnered compound could enter clinical trials during fiscal 2004; however, its partners will make clinical development decisions with respect to partnered compounds.

The financial outlook for the Celera Genomics group for fiscal 2004 is as follows:

□ The Celera Genomics group's net cash use is expected to be between \$80 and \$90 million, including an anticipated \$25 to \$30 million for the Celera Genomics group's portion of the funding for the Celera Diagnostics joint venture. The impact of lower Online/Information Business revenues and operating profit should be partially offset by lower losses and cash demands related to Celera Diagnostics, and the first quarter of fiscal 2004 conversion of approximately \$16 million of long-term treasury securities to short-term investments.

□ During the first half of fiscal 2004, expenses associated with the expansion of the Celera Genomics group's development organization were lower than previously anticipated. The Celera

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Genomics group now anticipates R&D expenses in the range of \$96 to \$106 million. Actual R&D expenses will depend on the rate of progress in discovery and development programs. Pre-tax losses related to the Celera Diagnostics joint venture are expected to be in the range of \$38 to \$44 million.

□ The Celera Genomics group anticipates fiscal 2004 revenues will continue to trend downward to a range of \$55 to \$60 million. Additional Online/Information Business agreements are expected to expire through fiscal 2006. Agreements that were contributing approximately \$5 million in quarterly revenue have recently expired.

Celera Diagnostics

For fiscal 2004, end-user sales of products manufactured by Celera Diagnostics and marketed primarily through the alliance with Abbott Laboratories are expected to approximately double to a range of \$45 to \$50 million. Celera Diagnostics anticipates fiscal 2004 pre-tax losses decreasing to a range of \$38 to \$44 million, and fiscal 2004 net cash use decreasing to a range of \$46 to \$52 million, including capital spending of up to \$5 million. This outlook assumes continued demand growth for current products, such as ASRs for cystic fibrosis and products for infectious disease testing.

Forward-Looking Statements

Some statements contained in, or incorporated by reference in, this quarterly report are forward-looking. Similarly, the press releases we issue and other public statements we make from time to time may contain language that is forward-looking. These forward-looking statements may be identified by the use of forward-looking words or phrases such as "forecast," "believe," "expect," "intend," "anticipate," "should," "plan," "estimate," "potential," among others. The forward-looking statements contained in this quarterly report are based on our current expectations and those made at other times will be based on our expectations when the statements are made. We cannot guarantee that any forward-looking statements will be realized.

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. In order to comply with the terms of the safe harbor, we note that a variety of factors could cause actual results and experience to differ materially from anticipated results or other expectations expressed in forward-looking statements. We also note that achievement of anticipated results or expectations in forward-looking statements is subject to the possibility that assumptions underlying forward-looking statements will prove to be inaccurate. Investors should bear this in mind as they consider forward-looking statements. The risks and uncertainties that may affect the operations, performance, development, and results of our business include, but are not limited to, those described below under the headings "Factors Relating to the Applied Biosystems Group," "Factors Relating to the Celera Genomics Group," and "Factors Relating to Celera Diagnostics, a 50/50 Joint Venture between the Applied Biosystems Group and Celera Genomics Group."

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Factors Relating to the Applied Biosystems Group

Rapidly changing technology in life sciences could make the Applied Biosystems group's product line obsolete unless it continues to develop and manufacture new and improved products, and pursue new market opportunities. A significant portion of the net revenues for the Applied Biosystems group each year is derived from products that did not exist in the prior year. The Applied Biosystems group's products are based on complex technology which is subject to rapid change as new technologies are developed and introduced in the marketplace. The Applied Biosystems group's future success depends on its ability to continually improve its current products, develop and introduce, on a timely and cost-effective basis, new products that address the evolving needs of its customers, and pursue new market opportunities that develop as a result of technological and scientific advances in life sciences. These new market opportunities may be outside the scope of the group's proven expertise or in areas which have unproven market demand. For example, the Applied Biosystems group has committed significant resources to researching, developing, marketing, and distributing new products and services designed to integrate laboratory experimentation with relevant scientific information, and to new Internet web sites devoted to promoting the group's products and supporting customer research and development activities. These are emerging business areas for the Applied Biosystems group, and there can be no assurance that there will be market acceptance of the utility and value of these products and services. The inability to gain market acceptance of new products and services could adversely affect the group's future operating results. The group's future success also depends on its ability to manufacture these improved and new products to meet customer demand in a timely and cost-effective manner, including its ability to resolve in a timely manner manufacturing issues that may arise from time to time as the group commences production of these complex products. Unanticipated difficulties or delays in replacing existing products with new products or in manufacturing improved or new products in sufficient quantities to meet customer demand could adversely affect future demand for the group's products and its future operating results.

The Applied Biosystems group relies on third parties for the manufacture of some of its products and also for the supply of some components of the products it manufactures on its own. Although the Applied Biosystems group has contracts with most of these manufacturers and suppliers, there can be no assurance that their operations will not be disrupted. The Applied Biosystems group does not currently have alternative third party manufacturing or supply arrangements for some of the key products and key components manufactured or supplied by third parties. Although the Applied Biosystems group has its own manufacturing facilities, and believes it might be able to manufacture some of the products and components currently sourced from third parties, it also believes that it would take considerable time and resources to establish the capability to do so. Accordingly, if third party manufacturers or suppliers are unable or fail to fulfill their obligations to the Applied Biosystems group, the Applied Biosystems group might not be able to satisfy customer demand in a timely manner, and its business could be adversely affected.

A significant portion of sales depends on customers' capital spending policies that may be subject to significant and unexpected decreases. A significant portion of the Applied Biosystems group's instrument product sales are capital purchases by its customers. The Applied Biosystems group's customers include pharmaceutical, environmental, research, biotechnology, and chemical companies, and the capital spending policies of these companies can have a significant effect on the demand for the Applied Biosystems group's products. These policies are based on a wide variety of factors, including the resources available to make purchases, the spending priorities among various types of research equipment, and policies regarding capital expenditures during recessionary periods. Any

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decrease in capital spending or change in spending policies of these companies could significantly reduce the demand for the Applied Biosystems group's products.

A substantial portion of the Applied Biosystems group's sales is to customers at universities or research laboratories whose funding is dependent on both the amount and timing of funding from government sources. As a result, the timing and amount of revenues from these sources may vary significantly due to factors that can be difficult to forecast. Although research funding has increased during the past several years, grants have, in the past, been frozen for extended periods or otherwise become unavailable to various institutions, sometimes without advance notice. Budgetary pressures may result in reduced allocations to government agencies that fund research and development activities. If government funding necessary to purchase the Applied Biosystems group's products were to become unavailable to researchers for any extended period of time, or if overall research funding were to decrease, the business of the Applied Biosystems group could be adversely affected.

The Applied Biosystems group is currently and could in the future be subject to claims for infringement of patents and other intellectual property rights. The Applied Biosystems group's products are based on complex, rapidly developing technologies. These products could be developed without knowledge of previously filed patent applications that mature into patents that cover some aspect of these technologies. In addition, there are relatively few decided court cases interpreting the scope of patent claims in these technologies, and the Applied Biosystems group's belief that its products do not infringe the technology covered by valid and enforceable patents could be successfully challenged by third parties. Also, in the course of its business, the Applied Biosystems group may from time to time have access to confidential or proprietary information of third parties, and these parties could bring a claim against the Applied Biosystems group asserting that the Applied Biosystems group had misappropriated their technologies, which though not patented are protected as trade secrets, and had improperly incorporated such technologies into the Applied Biosystems group's products. The Applied Biosystems group has been made a party to litigation regarding intellectual property matters, including the litigation described in the following paragraph and elsewhere in this report, some of which, if determined adversely, could have a material adverse effect on the Applied Biosystems group. Due to the fact that the Applied Biosystems group's business depends in large part on rapidly developing and dynamic technologies, there remains a constant risk of intellectual property litigation affecting the group. The Applied Biosystems group has from time to time been notified that it may be infringing patents and other intellectual property rights of others. It may be necessary or desirable in the future to obtain licenses relating to one or more products or relating to current or future technologies, and the Applied Biosystems group cannot be assured that it will be able to obtain these licenses or other rights on commercially reasonable terms.

Several legal actions have been filed against us that could affect the intellectual property rights of the Applied Biosystems group, including the following:

- In response to claims by us against MJ Research, Inc., MJ Research filed counterclaims against us including, among others, allegations that we have licensed and enforced some polymerase chain reaction, or PCR, patents through anticompetitive conduct in violation of federal and state antitrust laws. Subsequently, MJ Research filed a lawsuit against us based

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on the allegation that four patents underlying the Applied Biosystems group's DNA sequencing instruments were invalidly obtained because an alleged inventor, whose work was funded in part by the U.S. government, was knowingly omitted from the patent applications. MJ Research claims to be suing in the name of the U.S. government although the government has to date declined to participate in the lawsuit. Henry Huang has filed a lawsuit against us alleging that he is the sole inventor of the four patents referred to above, and the issues involved in his claim are related to the issues in the MJ Research claim. Although the MJ Research case has been dismissed pending appeal, the case filed by Henry Huang is still pending.

- Promega Corporation has filed a lawsuit against us alleging that the Applied Biosystems group, along with some other named defendants, is infringing two Promega patents due to the sale of forensic identification and paternity testing kits.
- Beckman Coulter, Inc. has filed a lawsuit against us alleging that the Applied Biosystems group is infringing three Beckman Coulter patents, although it has not identified the specific facts on which the allegation is based.
- Genetic Technologies Limited has filed a lawsuit against us alleging that we are infringing two of its patents due to the sale of cystic fibrosis reagent kits, some of our Assays-on-Demand™ products and Assays-by-DesignSM services, and the Celera Discovery System. Genetic Technologies Limited has also alleged that haplotyping analysis performed by our businesses infringes these patents.
- In response to an arbitration claim filed by us against Roche Molecular Systems, Inc., Hoffmann-La Roche, Inc., Roche Probe, Inc., F. Hoffmann-La Roche Ltd., and other potential defendants affiliated with those defendants, they have asserted counterclaims against us in the arbitration that could affect our exclusive rights to some PCR patents licensed from them.

The cost of litigation and the amount of management time associated with these cases may be significant. There can be no assurance that these matters will be resolved favorably; that we will not be enjoined from selling the products in question or other products as a result; or that any monetary or other damages assessed against us will not have a material adverse effect on the financial condition of our company, the Applied Biosystems group, or the Celera Genomics group.

Since the Applied Biosystems group's business is dependent on foreign sales, fluctuating currencies will make revenues and operating results more volatile. Approximately 50% of the Applied Biosystems group's net revenues for our 2003 fiscal year were derived from sales to customers outside of the U.S. The majority of these sales were based on the relevant customer's local currency. A significant portion of the related costs for the Applied Biosystems group are based on the U.S. dollar. As a result, the Applied Biosystems group's reported and anticipated operating results and cash flows are subject to fluctuations due to material changes in foreign currency exchange rates that are beyond the Applied Biosystems group's control.

Integrating acquired technologies may be costly and may not result in technological advances. The future growth of the Applied Biosystems group depends in part on its ability to acquire complementary technologies through acquisitions and investments. The consolidation of employees, operations, and marketing and distribution methods could present significant managerial challenges.

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For example, the Applied Biosystems group may encounter operational difficulties in the integration of manufacturing or other facilities. In addition, technological advances resulting from the integration of technologies may not be achieved as successfully or rapidly as anticipated, if at all.

The Applied Biosystems group's businesses, particularly those focused on developing and marketing information-based products and services, depend on the continuous, effective, reliable, and secure operation of its computer hardware, software, and Internet applications and related tools and functions. Because the Applied Biosystems group's business requires manipulating and analyzing large amounts of data, and communicating the results of the analysis to its internal research personnel and to its customers via the Internet, the Applied Biosystems group depends on the continuous, effective, reliable, and secure operation of its computer hardware, software, networks, Internet servers, and related infrastructure. To the extent that the Applied Biosystems group's hardware or software malfunctions or access to the Applied Biosystems group's data by internal research personnel or customers through the Internet is interrupted, the Applied Biosystems group's business could suffer.

The Applied Biosystems group's computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, power loss, earthquakes, telecommunications failures, physical or software break-ins, and similar events. In addition, the Applied Biosystems group's online products and services are complex and sophisticated, and as such, could contain data, design, or software errors that could be difficult to detect and correct. Software defects could be found in current or future products. If the Applied Biosystems group fails to maintain and further develop the necessary computer capacity and data to support its computational needs and its customers' access to information-based product and service offerings, it could experience a loss of or delay in revenues or market acceptance. In addition, any sustained disruption in Internet access provided by third parties could adversely affect the Applied Biosystems group.

Earthquakes could disrupt operations in California. The headquarters and principal operations of the Applied Biosystems group are located in the San Francisco Bay area, a region near major California earthquake faults. The ultimate impact of earthquakes on the Applied Biosystems group, its significant suppliers, and the general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake.

Applera-Applied Biosystems stock price is volatile. The market price of Applera-Applied Biosystems stock has been and may continue to be volatile due to the risks and uncertainties described in this section of this report, as well as other factors that may have affected or may in the future affect the market price, such as:

- conditions and publicity regarding the genomics, biotechnology, pharmaceutical, or life sciences industries generally;
- price and volume fluctuations in the stock market at large which do not relate to the Applied Biosystems group's operating performance; and
- comments by securities analysts or government officials, including with regard to the viability or profitability of the biotechnology sector generally or with regard to intellectual property rights of life science companies, or the Applied Biosystems group's ability to meet market expectations.

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The stock market has from time to time experienced extreme price and volume fluctuations that are unrelated to the operating performance of particular companies. In the past, companies that have experienced volatility have sometimes been the subjects of securities class action litigation. If litigation was instituted on this basis, it could result in substantial costs and a diversion of management's attention and resources.

Factors Relating to the Celera Genomics Group

The Celera Genomics group has incurred net losses to date and may not achieve profitability. The Celera Genomics group has accumulated net losses of approximately \$689 million as of December 31, 2003, and expects that it will continue to incur net losses for the foreseeable future. These cumulative losses are expected to increase as the Celera Genomics group continues to make investments in new technology and product development, including its investments in the discovery and development of therapeutic products, as well as investments in diagnostics through Celera Diagnostics, its joint venture with the Applied Biosystems group. The Celera Genomics group will record all initial cash operating losses of Celera Diagnostics up to a maximum of \$300 million, after which any additional operating losses would be shared equally by the Celera Genomics group and the Applied Biosystems group. However, the Applied Biosystems group reimburses the Celera Genomics group for all tax benefits generated by Celera Diagnostics to the extent such tax benefits are used by the Applied Biosystems group, and the effect of recording Celera Diagnostics' operating losses on the Celera Genomics group's net losses will be partially offset by this reimbursement. Celera Diagnostics has accumulated cash operating losses of approximately \$109 million as of December 31, 2003. As an early stage business, the Celera Genomics group faces significant challenges in expanding its business operations into the discovery and development of therapeutic products. As a result, there is a high degree of uncertainty that the Celera Genomics group will be able to achieve profitable operations.

The marketing and distribution agreement with the Applied Biosystems group may not generate significant royalty payments. Effective April 2002, the Applied Biosystems group became the exclusive distributor of the Celera Discovery System and the Celera Genomics group's related human genomic and other biological and medical information under the terms of a ten-year marketing and distribution agreement. Under the terms of that agreement, the Applied Biosystems group is obligated to pay a royalty to the Celera Genomics group based on sales of some products sold by the Applied Biosystems group after July 1, 2002. This royalty rate and the corresponding payments to be made to the Celera Genomics group were based on the sales of these products that the groups anticipated at the time of the execution of the agreement. The Applied Biosystems group has not guaranteed any minimum royalty payments to the Celera Genomics group, and the actual amount of royalty payments to be paid to the Celera Genomics group depends on the Applied Biosystems group's ability to successfully commercialize the products subject to the royalty. The Applied Biosystems group has not proven its ability to successfully commercialize these products. The Celera Genomics group believes that in order for the Applied Biosystems group's sales of these products to

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meet original expectations, the Applied Biosystems group will have to continue devoting a significant amount of its resources to researching, developing, marketing, and distributing them. However, the Celera Genomics group has no control over the amount and timing of the Applied Biosystems group's use of its resources, including for products subject to the royalty. In addition, the market for these products is intensely competitive, and there can be no assurance that there will be market acceptance of the utility and value of these product offerings.

The Celera Genomics group has not sought any new customers for its Celera Discovery System and related information products and services since June 30, 2002, and therefore its future revenues from its sale of these products and services will be limited. Under the terms of the marketing and distribution agreement between the Celera Genomics group and the Applied Biosystems group described in the preceding paragraph, the Celera Genomics group will receive all revenues under, and be responsible for all costs and expenses associated with, the Celera Discovery System and related information contracts that were entered into on or prior to June 30, 2002. However, the Applied Biosystems group took full responsibility for marketing and contracting for the Celera Discovery System and related products and services after that date. Accordingly, the Celera Genomics group does not expect any revenues from the Celera Discovery System and related products and services other than under contracts existing on June 30, 2002, so long as they remain in effect, and from potential royalty payments from the Applied Biosystems group under the marketing and distribution agreement. The Applied Biosystems group has agreed to reimburse the Celera Genomics group for any shortfall in earnings before interest, taxes, depreciation, and amortization from these contracts below a total of \$62.5 million during the four fiscal years ending with the 2006 fiscal year, if the shortfall is due to the actions of the Applied Biosystems group including changes in marketing strategy for the Celera Discovery System. However, this commitment is also subject to the Celera Genomics group otherwise continuing to perform under these contracts and does not protect the Celera Genomics group from lost revenue due to other circumstances such as a customer bankruptcy. Although under some contracts with existing Celera Discovery System customers the Celera Genomics group is entitled to milestone payments or future royalties based on products developed by its customers, the Celera Genomics group believes these arrangements are unlikely to produce any significant revenue for the group.

Because of the close working relationship between the Celera Genomics group and the Applied Biosystems group under the marketing and distribution agreement, it may be difficult to ascertain responsibility for claims, liabilities, or other issues that may arise under Celera Discovery System contracts or the marketing and distribution agreement. Under the marketing and distribution agreement described above, the two groups have agreed to cooperation guidelines to enable the Celera Genomics group to perform its obligations under existing Celera Discovery System agreements and to facilitate the development of the Applied Biosystems group's products covered by the agreement. These guidelines provide for the application of relevant resources and expertise of the groups to the relationship, and have led to a close working relationship among personnel within the two groups. Because of this working relationship, if any customers assert any claims under Celera Discovery System

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contracts, it may be difficult to determine which group was responsible for the actions that gave rise to the claim. In addition, the Applied Biosystems group may from time to time take good faith actions in pursuit of its marketing strategy that affect Celera Discovery System contracts that were in existence on June 30, 2002. Because of the working relationship between the two groups, it may be difficult to determine whether the actions of the Applied Biosystems group are within the scope of the reimbursement obligation described above.

The Celera Genomics group's ability to develop and commercialize proprietary therapeutic products is unproven. As the Celera Genomics group expands its business operations in the area of therapeutic product discovery and development, it faces the difficulties inherent in developing and commercializing these products. It is possible that the Celera Genomics group's discovery and development efforts will not result in any commercial products. In particular, the Celera Genomics group and its collaborators are seeking to develop new therapeutic products based on information derived from the study of the genetic material of organisms, or genomics, the study of proteins, or proteomics, and the large-scale disease association studies being performed by Celera Diagnostics. These methods are unproven, as few therapeutic products based on genomic or proteomic discoveries have been developed and commercialized and, to our knowledge, no one to date has developed or commercialized any therapeutic products based on the Celera Genomics group's technologies. In addition, pursuant to its current business and scientific plan, the Celera Genomics group is seeking to capitalize on its relationship with Celera Diagnostics through the evaluation of the therapeutic relevance of targets that Celera Diagnostics may identify in its disease association studies. However, Celera Diagnostics is not obligated to continue those studies, and if Celera Diagnostics discontinues in whole or in part its disease study program, the Celera Genomics group's business and scientific plan could be adversely affected.

Therapeutic product candidates may never result in a commercialized product. All of the Celera Genomics group's therapeutic product candidates are in various stages of research and development and will require significant additional research and development efforts by the Celera Genomics group or its collaborators before they can be marketed. These efforts include extensive preclinical and clinical testing and lengthy regulatory review and clearance or approval by the FDA and comparable agencies in other countries. The Celera Genomics group's development of therapeutic products is highly uncertain and subject to a number of significant risks. To date, the Celera Genomics group has not commercialized a therapeutic product and the Celera Genomics group does not expect any of its therapeutic product candidates to be commercially available for a number of years, if ever. Therapeutic product candidates that appear to be promising at early stages of development may not be developed into commercial products, or may not be successfully marketed, for a number of reasons, including:

- the Celera Genomics group or its collaborators may not successfully complete any research and development efforts;
- the Celera Genomics group or its collaborators may not successfully build the necessary preclinical and clinical development organizations;
- any therapeutic product candidates that the Celera Genomics group or its collaborators develop may be found during preclinical testing or clinical trials to be ineffective or to cause harmful side effects;
- the Celera Genomics group or its collaborators may fail to obtain required regulatory approvals for products they develop;

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- the Celera Genomics group or its collaborators may be unable to manufacture enough of any potential products at an acceptable cost and with appropriate quality;
- the Celera Genomics group or its collaborators may fail to build necessary distribution channels;
- the Celera Genomics group's or its collaborators' products may not be competitive with other existing or future products;
- adequate reimbursement for the Celera Genomics group's or its collaborators' products may not be available to healthcare providers and patients from the government or insurance companies; and
- the Celera Genomics group or its collaborators may be unable to obtain necessary intellectual property protection, or third parties may own proprietary rights that prevent the Celera Genomics group or its collaborators from commercializing their products.

If the Celera Genomics group fails to maintain its existing collaborative relationships and enter into new collaborative relationships, or if collaborators do not perform under collaboration agreements, development of its therapeutic product candidates could be delayed. The Celera Genomics group's strategy for the discovery, development, clinical testing, manufacturing and commercialization of most of its therapeutic product candidates includes entering into collaborations with partners. Although the Celera Genomics group has expended, and continues to expend, time and money on internal research and development programs, it may be unsuccessful in creating therapeutic product candidates that would enable it to form additional collaborations and receive milestone and/or royalty payments from collaborators.

Each of the Celera Genomics group's existing collaboration agreements may be canceled under some circumstances. In addition, the amount and timing of resources to be devoted to research, development, clinical trials and commercialization activities by the Celera Genomics group's collaborators are not within the Celera Genomics group's control. The Celera Genomics group cannot ensure that its collaborators will perform their obligations as expected. If any of the Celera Genomics group's collaborators terminate their agreements or otherwise fail to conduct their collaborative activities in a timely manner, the development or commercialization of therapeutic products may be delayed or otherwise adversely affected. If in some cases the Celera Genomics group assumes responsibilities for continuing programs on its own after termination of a collaboration, the Celera Genomics group may be required to devote additional resources to product development and commercialization or the Celera Genomics group may need to cancel some development programs.

If the Celera Genomics group fails to satisfy regulatory requirements for any therapeutic product candidate, the Celera Genomics group will be unable to complete the development and commercialization of that product. The Celera Genomics group is currently developing its internal capability to move potential products through clinical testing, manufacturing and the approval processes of the FDA and comparable agencies in other countries. In the U.S., either the Celera Genomics group or its collaborators must show through pre-clinical studies and clinical trials that each of the Celera Genomics group's therapeutic product candidates is safe and effective in humans for each indication before obtaining regulatory clearance from the FDA for the commercial sale of

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that product. Outside of the U.S., the regulatory requirements vary from country to country. If the Celera Genomics group or its collaborator fails to adequately show the safety and effectiveness of a therapeutic product, regulatory clearance or approval could be delayed or denied. The results from pre-clinical studies may be different from the results that are obtained in clinical trials. The Celera Genomics group cannot be certain that it will show sufficient safety and effectiveness in its clinical trials to allow it to obtain the needed regulatory clearance or approval for any therapeutic product candidate. The regulatory review and approval process can take many years and require substantial expense and may not be successful. Many companies in the therapeutic industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after promising results in earlier studies.

Even if the Celera Genomics group obtains regulatory clearance or approval for a particular therapeutic product, it will be subject to risks and uncertainties relating to regulatory compliance, including post-approval clinical studies and inability to meet the compliance requirements of the FDA's Good Manufacturing Practices regulations. In addition, identification of some adverse side effects after a therapeutic product is on the market or the occurrence of manufacturing problems could cause subsequent suspension of product manufacture or withdrawal of approval, or could require reformulation of a therapeutic product, additional testing, or changes in labeling of the product. This could delay or prevent the Celera Genomics group from generating revenues from the sale of that therapeutic product.

For some of the Celera Genomics group's research and product development programs, particularly its proteomics efforts, the Celera Genomics group needs access to human and other tissue samples from diseased and healthy individuals, other biological materials, and related clinical and other information, which may be in limited supply. The Celera Genomics group may not be able to obtain or maintain access to these materials and information on acceptable terms, or may not be able to obtain needed consents from individuals providing tissue or other samples. In addition, government regulation in the U.S. and foreign countries could result in restricted access to, or use of, human and other tissue samples. If the Celera Genomics group loses access to sufficient numbers or sources of tissue samples or other required biological materials, or if tighter restrictions are imposed on the use of related clinical or other information or information generated from tissue samples or other biological materials, these research and development programs and the Celera Genomics group's business could be adversely affected.

The pharmaceutical industry is intensely competitive and evolving. There is intense competition among pharmaceutical and biotechnology companies attempting to discover candidates for potential new therapeutic products. These companies may:

- develop new therapeutic products in advance of the Celera Genomics group;
- develop therapeutic products which are more effective as therapeutics, or more cost-effective, than those developed by the Celera Genomics group;
- obtain regulatory approvals of their therapeutic products more rapidly than the Celera Genomics group; or

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- obtain patent protection or other intellectual property rights that would limit the Celera Genomics group's ability to develop and commercialize therapeutic products.

Introduction of new products may expose the Celera Genomics group to product liability claims. New products developed by the Celera Genomics group or its collaborators could expose the Celera Genomics group to potential product liability risks that are inherent in the testing, manufacturing, marketing and sale of human therapeutic products. Product liability claims or product recalls, regardless of the ultimate outcome, could require the Celera Genomics group to spend significant time and money in litigation and to pay significant damages. Although the Celera Genomics group expects to seek and maintain product liability insurance to cover claims relating to the testing and use of therapeutic products, there can be no assurance that such insurance will be available on commercially reasonable terms, if at all, or that the amount of coverage obtained will be adequate to cover losses from any particular claim.

Therapeutics discovery and development is a highly technical field and there is a competitive market for personnel with the expertise needed for the expansion of the Celera Genomics group's business operations within this field. The Celera Genomics group believes that in order to develop and commercialize therapeutic products, it will need to recruit and retain scientific and management personnel having specialized training or advanced degrees, or otherwise having the technical background, necessary for an understanding of therapeutic products. There is a shortage of qualified scientific and management personnel who possess this technical background. The Celera Genomics group competes for these personnel with other pharmaceutical and biotechnology companies, academic institutions and government entities. If the Celera Genomics group is unable to retain and attract qualified scientific and management personnel, the growth of the group's business operations in the area of therapeutic product discovery and development could be delayed or curtailed.

The Celera Genomics group could incur liabilities relating to hazardous materials that it uses in its research and development activities. The Celera Genomics group's research and development activities involve the controlled use of hazardous materials, chemicals and various radioactive materials. In the event of an accidental contamination or injury from these materials, the Celera Genomics group could be held liable for damages in excess of its resources.

The Celera Genomics group's business depends on the continuous, effective, reliable, and secure operation of its computer hardware, software, and Internet applications and related tools and functions. Because the Celera Genomics group's business requires manipulating and analyzing large amounts of data, and communicating the results of the analysis to its internal research personnel and to its customers via the Internet, the Celera Genomics group depends on the continuous, effective, reliable, and secure operation of its computer hardware, software, networks, Internet servers, and related infrastructure. To the extent that the Celera Genomics group's hardware or software malfunctions or access to the Celera Genomics group's data by the Celera Genomics group's internal research personnel or customers through the Internet is interrupted, the group's business could suffer.

The Celera Genomics group's computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, power loss, earthquakes,

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telecommunications failures, physical or software break-ins, and similar events. In addition, the Celera Genomics group's online products are complex and sophisticated, and as such, could contain data, design, or software errors that could be difficult to detect and correct. Software defects could be found in current or future products. If the Celera Genomics group fails to maintain and further develop the necessary computer capacity and data to support its computational needs and its customers' therapeutic products discovery and research efforts, it could experience a loss of or delay in revenues. In addition, any sustained disruption in Internet access provided by third parties could adversely affect the Celera Genomics group's business.

The Celera Genomics group's competitive position depends on maintaining its intellectual property protection and obtaining licenses to intellectual property it may need from others. The Celera Genomics group's ability to compete and to achieve and maintain profitability depends on its ability to protect its proprietary discoveries and technologies, in large part, through obtaining and enforcing patent rights, obtaining copyright protection, maintaining its trade secrets, and operating without infringing the intellectual property rights of others. The Celera Genomics group's ability to obtain patent protection for the inventions it makes is uncertain. The patentability of biotechnology and pharmaceutical inventions involves complex factual and legal questions. As a result, it is difficult to predict whether patents will issue or the breadth of claims that will be allowed in biotechnology and pharmaceutical patents. This may be particularly true with regard to the patenting of gene sequences, gene functions, and genetic variations. In this regard, the U.S. Patent and Trademark Office has adopted guidelines for use in the review of the utility of inventions, particularly biotechnology inventions. These guidelines increased the amount of evidence required to demonstrate utility in order to obtain a patent in the biotechnology field, making patent protection more difficult to obtain. Although others have been successful in obtaining patents to biotechnology inventions, since the adoption of these guidelines, these patents have been issued with increasingly less frequency. As a result, patents may not issue from patent applications that the Celera Genomics group may own or license if the applicant is unable to satisfy the new guidelines.

The U.S. Patent and Trademark Office has issued several patents to third parties covering inventions involving single nucleotide polymorphisms or "SNPs," naturally occurring genetic variations that scientists believe can be correlated with susceptibility to disease, disease prognosis, therapeutic efficiency, and therapeutic toxicity. These inventions are subject to the same new guidelines as other biotechnology inventions. In addition, the Celera Genomics group may need to obtain rights to patented SNPs in order to develop, use and sell analyses of the overall human genome or particular full-length genes. These licenses may not be available to the Celera Genomics group on commercially acceptable terms, or at all.

In some instances, patent applications in the U.S. are maintained in secrecy until a patent issues. In most instances, the content of U.S. and international patent applications is made available to the public approximately 18 months after the initial filing from which priority is claimed. As a result, the Celera Genomics group cannot be certain that others have not filed patent applications for inventions covered by the Celera Genomics group's patent applications or that the Celera Genomics group inventors were the first to make the invention. Accordingly, the Celera Genomics group's patent applications may be preempted or the Celera Genomics group may have to participate in interference

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proceedings before the U.S. Patent and Trademark Office. These proceedings determine the priority of invention and the right to a patent for the claimed invention in the U.S.

Furthermore, lawsuits may be necessary to enforce any patents issued to the Celera Genomics group or to determine the scope and validity of the rights of third parties. Lawsuits and interference proceedings, even if they are successful, are expensive to pursue, and the Celera Genomics group could use a substantial amount of its financial resources in either case. An adverse outcome could subject the Celera Genomics group to significant liabilities to third parties and require the Celera Genomics group to license disputed rights from third parties or to cease using the technology.

The Celera Genomics group may be dependent on protecting its proprietary databases through copyright law to prevent other organizations from taking information from those databases and copying and reselling it. Copyright law currently provides uncertain protection regarding the copying and resale of factual data. Changes in copyright law could either expand or reduce the extent to which the Celera Genomics group and its customers are able to protect their intellectual property. Accordingly, the Celera Genomics group is uncertain as to whether it can prevent such copying or resale through copyright law.

The Celera Genomics group also relies on trade secret protection for its confidential and proprietary information and procedures, including procedures related to sequencing genes and to searching and identifying important regions of genetic information. The Celera Genomics group protects its trade secrets through recognized practices, including access control, confidentiality and nonuse agreements with employees, consultants, collaborators and customers, and other security measures. These confidentiality and nonuse agreements may be breached, however, and the Celera Genomics group may not have adequate remedies for a breach. In addition, the Celera Genomics group's trade secrets may otherwise become known or be independently developed by competitors. Accordingly, it is uncertain whether the Celera Genomics group's reliance on trade secret protection will be adequate to safeguard its confidential and proprietary information and procedures.

Disputes may arise in the future with regard to the ownership of rights to any invention developed with collaborators. These and other possible disagreements with collaborators could lead to delays in the achievement of milestones or receipt of royalty payments or in research, development and commercialization of the Celera Genomics group's products. In addition, these disputes could require or result in lawsuits or arbitration. Lawsuits and arbitration are time-consuming and expensive. Even if the Celera Genomics group wins, the cost of these proceedings could adversely affect its business, financial condition and operating results.

The Celera Genomics group may infringe the intellectual property rights of third parties and may become involved in expensive intellectual property litigation. The intellectual property rights of biotechnology companies, including the Celera Genomics group, are generally uncertain and involve complex legal, scientific and factual questions. The Celera Genomics group's success in therapeutic product discovery and development may depend, in part, on its ability to operate without infringing the intellectual property rights of others and to prevent others from infringing its intellectual property rights.

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There has been substantial litigation regarding patents and other intellectual property rights in the biotechnology and pharmaceutical industries. The Celera Genomics group may become a party to patent litigation or proceedings at the U.S. Patent and Trademark Office to determine its patent rights with respect to third parties. Interference proceedings may be necessary to establish which party was the first to make the invention sought to be patented. The Celera Genomics group may become involved in patent litigation against third parties to enforce its patent rights, to invalidate patents held by the third parties, or to defend against these claims. The cost to the Celera Genomics group of any patent litigation or similar proceeding could be substantial, and it may absorb significant management time. If infringement litigation against the Celera Genomics group is resolved unfavorably to the Celera Genomics group, the Celera Genomics group may be enjoined from manufacturing or selling its products or services without a license from a third party. The Celera Genomics group may not be able to obtain a license on commercially acceptable terms, or at all.

Ethical, legal, and social issues related to the use of genetic information and genetic testing may cause less demand for the Celera Genomics group's products. Genetic testing has raised issues regarding confidentiality and the appropriate uses of the resulting information. For example, concerns have been expressed regarding the use of genetic test results by insurance carriers or employers to discriminate on the basis of this information, resulting in barriers to the acceptance of genetic tests by consumers. This could lead to governmental authorities calling for limits on or regulation of the use of genetic testing or prohibiting testing for genetic predisposition to some diseases, particularly those that have no known cure. Any of these scenarios could reduce the potential markets for products of the Celera Genomics group.

Future acquisitions and other transactions may absorb significant resources, may be unsuccessful and could dilute the holders of Applera-Celera stock. The Celera Genomics group expects to pursue acquisitions, investments and other strategic relationships and alliances. Acquisitions, investments and other strategic relationships and alliances may involve significant cash expenditures, debt incurrence, additional operating losses, and expenses that could have a material effect on the Celera Genomics group's financial condition and operating results. Acquisitions involve numerous other risks, including:

- difficulties integrating acquired technologies and personnel into the business of the Celera Genomics group;
- diversion of management from daily operations;
- inability to obtain required financing on favorable terms;
- entry into new markets in which the Celera Genomics group has little previous experience;
- potential loss of key employees, key contractual relationships, or key customers of acquired companies or of the Celera Genomics group; and
- assumption of the liabilities and exposure to unforeseen liabilities of acquired companies.

It may be difficult for the Celera Genomics group to complete these transactions quickly and to integrate these acquired operations efficiently into its current business operations. Any acquisitions, investments or other strategic relationships and alliances by the Celera Genomics group may

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ultimately have a negative impact on its business and financial condition. For example, future acquisitions may not be as successful as originally anticipated and may result in special charges. We have incurred special charges in recent years as a result of acquisitions. As a result of the Celera Genomics group's acquisition of Paracel, Inc., we incurred charges for impairment of goodwill, intangibles and other assets and other charges in the amounts of \$69.1 million during our 2001 fiscal year and \$25.9 million during our 2002 fiscal year. Similarly, as a result of the Applied Biosystems group's acquisition of Molecular Informatics, Inc., we incurred charges related to the impairment of assets in the amount of \$14.5 million during our 1999 fiscal year.

In addition, acquisitions and other transactions may involve the issuance of a substantial amount of Applera-Celera stock without the approval of the holders of Applera-Celera stock. Any issuances of this nature will be dilutive to holders of Applera-Celera stock.

Earthquakes could disrupt operations in California. The Celera Genomics group has research and development facilities in South San Francisco, California. South San Francisco is located near major California earthquake faults. The ultimate impact of earthquakes on the Celera Genomics group, its significant suppliers, and the general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake.

Applera-Celera stock price is volatile. The market price of Applera-Celera stock has been and may continue to be volatile due to the risks and uncertainties described in this section of this report, as well as other factors that may have affected or may in the future affect the market price, such as:

- conditions and publicity regarding the genomics, biotechnology, pharmaceutical, or life sciences industries generally;
- price and volume fluctuations in the stock market at large which do not relate to the Celera Genomics group's operating performance; and
- comments by securities analysts or government officials, including with regard to the viability or profitability of the biotechnology sector generally or with regard to intellectual property rights of life science companies, or the Celera Genomics group's ability to meet market expectations.

The stock market has from time to time experienced extreme price and volume fluctuations that are unrelated to the operating performance of particular companies. In the past, companies that have experienced volatility have sometimes been the subjects of securities class action litigation. If litigation was instituted on this basis, it could result in substantial costs and a diversion of management's attention and resources.

Our company is subject to a purported class action lawsuit relating to its 2000 offering of shares of Applera-Celera stock that may be expensive and time consuming. Our company and some of our officers are defendants in a lawsuit purportedly brought on behalf of purchasers of Applera-Celera stock in our follow-on public offering of Applera-Celera stock completed on March 6, 2000. In the offering, we sold an aggregate of approximately 4.4 million shares of Applera-Celera stock at a public offering price of \$225 per share. The lawsuit was commenced with the filing of several

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complaints in 2000, which have been consolidated into a single case. The consolidated complaint generally alleges that the prospectus used in connection with the offering was inaccurate or misleading because it failed to adequately disclose the alleged opposition of the Human Genome Project and two of its supporters, the governments of the U.S. and the U.K., to providing patent protection to our genomic-based products. Although the Celera Genomics group has never sought, or intended to seek, a patent on the basic human genome sequence data, the complaint also alleges that we did not adequately disclose the risk that the Celera Genomics group would not be able to patent this data. The consolidated complaint seeks unspecified monetary damages, rescission, costs and expenses, and other relief as the court deems proper. Although we believe the asserted claims are without merit and intend to defend the case vigorously, the outcome of this or any other litigation is inherently uncertain. The defense of this case will require management attention and resources.

Factors Relating to Celera Diagnostics, a 50/50 Joint Venture between the Applied Biosystems Group and the Celera Genomics Group

Celera Diagnostics' ability to develop and commercialize proprietary diagnostic products is unproven. Celera Diagnostics faces the difficulties inherent in developing and commercializing diagnostic products. It is possible that Celera Diagnostics' discovery and development efforts will not result in any new commercial products or services. In particular, Celera Diagnostics and its collaborators are seeking to develop new diagnostic products based on information derived from the study of the genetic material of organisms, or genomics. This method carries inherent risks, as only a limited number of diagnostic products based on genomic discoveries have been developed and commercialized to date.

Diagnostic product candidates may never result in a commercialized product. Most of Celera Diagnostics' potential diagnostic products are in various stages of research and development and will require significant additional research and development efforts by Celera Diagnostics or its collaborators before they can be marketed. These efforts include extensive clinical testing and may require lengthy regulatory review and clearance or approval by the FDA and comparable agencies in other countries. Celera Diagnostics' development of new diagnostic products is highly uncertain and subject to a number of significant risks. Diagnostic product candidates that appear to be promising at early stages of development may not be developed into commercial products, or may not be successfully marketed, for a number of reasons, including:

- Celera Diagnostics or its collaborators may not successfully complete any research and development efforts;
- any diagnostic products that Celera Diagnostics or its collaborators develop may be found during clinical trials to have limited medical value;
- Celera Diagnostics or its collaborators may fail to obtain required regulatory clearances or approvals for products they develop;
- Celera Diagnostics or its collaborators may be unable to manufacture enough of any potential products at an acceptable cost and with appropriate quality;
- any diagnostic products Celera Diagnostics or its collaborators develop may not be competitive with other existing or future products;

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- adequate reimbursement for Celera Diagnostics and its collaborators' products may not be available to physicians or patients from the government or insurance companies; and
- Celera Diagnostics may be unable to obtain necessary intellectual property protection, or third parties may own proprietary rights that prevent Celera Diagnostics or its collaborators from commercializing their products.

If Celera Diagnostics fails to satisfy regulatory requirements for any diagnostic product candidate, it may be unable to complete the development and commercialization of that product. Celera Diagnostics is currently developing its capability to move potential products through clinical testing, manufacturing, and the approval processes of the FDA and comparable agencies in other countries. In the U.S., either Celera Diagnostics or its collaborators must show through pre-clinical studies and clinical trials that each of Celera Diagnostics' diagnostic product candidates is safe and effective for each indication before obtaining regulatory clearance or approval from the FDA for the commercial sale of that product as an in-vitro diagnostic product with clinical claims. Outside of the U.S., the regulatory requirements vary from country to country. If Celera Diagnostics or its collaborator fails to adequately show the safety and effectiveness of a diagnostic product, regulatory clearance or approval could be delayed or denied. The results from pre-clinical studies may be different from the results that are obtained in clinical trials. Celera Diagnostics cannot be certain that it will show sufficient safety and effectiveness in its clinical trials to allow it to obtain the needed regulatory clearance or approval. The regulatory review and approval process can take many years and require substantial expense and may not be successful. A number of companies in the diagnostics industry, including biotechnology companies, have suffered significant setbacks in advanced clinical trials, even after promising results in earlier studies.

Even if Celera Diagnostics obtains regulatory clearance or approval, it will be subject to risks and uncertainties relating to regulatory compliance, including post-clearance or approval clinical studies and inability to meet the compliance requirements of the FDA's Quality System Regulations. In addition, the occurrence of manufacturing problems could cause subsequent suspension of product manufacture or withdrawal of clearance or approval, or could require reformulation of a diagnostic product, additional testing, or changes in labeling of the product. This could delay or prevent Celera Diagnostics from generating revenues from the sale of that diagnostic product.

Celera Diagnostics' products may not be fully accepted by physicians and laboratories. Celera Diagnostics' growth and success will depend on market acceptance by physicians and laboratories of its products as clinically useful and cost-effective. Celera Diagnostics expects that most of its products will use genotyping and gene expression information to predict predisposition to diseases, disease progression or severity, or responsiveness to treatment. Market acceptance will depend on the widespread acceptance and use by doctors and clinicians of genetic testing for these purposes. The use of genotyping and gene expression information by doctors and clinicians for these purposes is relatively new. Celera Diagnostics cannot be certain that doctors and clinicians will want to use its products designed for these purposes.

Even if genetic testing is accepted as a method to manage health care, Celera Diagnostics cannot be certain that its products will be accepted in the clinical diagnostic market. If genetic testing becomes

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widely accepted in the clinical diagnostic market, Celera Diagnostics cannot predict the extent to which doctors and clinicians may be willing to utilize Celera Diagnostics' products in providing patient care. Doctors and clinicians may prefer competing technologies and products that can be used for the same purposes as Celera Diagnostics' products.

Ethical, legal, and social issues related to the use of genetic information and genetic testing may cause less demand for Celera Diagnostics' products. Genetic testing has raised issues regarding confidentiality and the appropriate uses of the resulting information. For example, concerns have been expressed regarding the use of genetic test results by insurance carriers or employers to discriminate on the basis of this information, resulting in barriers to the acceptance of genetic tests by consumers. This could lead to governmental authorities calling for limits on or regulation of the use of genetic testing or prohibiting testing for genetic predisposition to some diseases, particularly those that have no known cure. Any of these scenarios could reduce the potential markets for products of Celera Diagnostics.

If insurance companies and other third-party payors do not reimburse doctors and patients for Celera Diagnostics' tests, its ability to sell its products to the clinical diagnostics market will be impaired. Sales of Celera Diagnostics' products will depend, in large part, on the availability of adequate reimbursement to users of those products from government insurance plans, including Medicare and Medicaid in the U.S., managed care organizations, and private insurance plans. Physicians' recommendations to use diagnostic tests, as well as decisions by patients to pursue those tests, are likely to be influenced by the availability of reimbursement by insurance companies and other third party payors. Third-party payors are increasingly attempting to contain health care costs by limiting both the extent of coverage and the reimbursement rate for testing and treatment products and services. In particular, products and services that are determined to be investigational in nature or that are not considered "reasonably necessary" for diagnosis or treatment may be denied reimbursement coverage. In addition, third-party payors are increasingly limiting reimbursement coverage for medical diagnostic products and, in many instances, are exerting pressure on medical suppliers to reduce their prices. Thus, third-party reimbursement may not be consistently available or financially adequate to cover the cost of Celera Diagnostics' products. This could limit the ability of Celera Diagnostics to sell its products, cause Celera Diagnostics to reduce the prices of its products, or otherwise adversely affect Celera Diagnostics' operating results.

Because each third-party payor individually approves reimbursement, obtaining these approvals is a time-consuming and costly process that requires Celera Diagnostics to provide scientific and clinical support for the use of each of its products to each payor separately with no assurance that such approval will be obtained. This process can delay the broad market introduction of new products and could have a negative effect on Celera Diagnostics' revenues and operating results.

If Celera Diagnostics fails to maintain its existing collaborative relationships and enter into new collaborative relationships, or if collaborators do not perform under collaboration agreements, development of its diagnostic products could be delayed. Celera Diagnostics' strategy for the discovery, development, clinical testing, manufacturing and commercialization of most of its diagnostic product candidates includes entering into collaborations with partners. Although Celera

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Diagnostics has expended, and continues to expend, time and money on internal research and development programs, it may be unsuccessful in creating diagnostic product candidates that would enable it to form additional collaborations.

Celera Diagnostics has entered into a strategic alliance agreement with Abbott Laboratories for the joint discovery, development, manufacturing, and commercialization of nucleic acid-based diagnostic products. The Abbott Laboratories agreement may be terminated by the non-breaching party in the event of a material breach and, under some circumstances, by either party in the event of a change in control of the other party. In addition, the amount and timing of resources to be devoted to research, development, eventual clinical trials and commercialization activities by Abbott are not within Celera Diagnostics' control. Future collaborations with other third parties are likely to be subject to similar terms and conditions. Celera Diagnostics cannot ensure that its collaborators will perform their obligations as expected. If any of Celera Diagnostics' collaborators terminate or elect to cancel their agreements or otherwise fail to conduct their collaborative activities in a timely manner, the development or commercialization of diagnostics products may be delayed or otherwise adversely affected. If in some cases Celera Diagnostics assumes responsibilities for continuing programs on its own after termination of a collaboration, Celera Diagnostics may be required to devote additional resources to product development and commercialization or Celera Diagnostics may need to cancel some development programs.

Celera Diagnostics does not have a sales and service capability in the clinical diagnostic market. Celera Diagnostics currently does not have a sales and service organization. Accordingly, its ability to successfully sell its products will depend on its ability to either develop a sales and service organization or work with Abbott Laboratories under their current agreement, or a combination of both. In jurisdictions where Celera Diagnostics uses third party distributors, its success will depend to a great extent on the efforts of the distributors.

Celera Diagnostics has limited manufacturing capability and may encounter difficulties expanding Celera Diagnostics' operations. Celera Diagnostics has limited commercial manufacturing experience and capabilities. If product sales increase, Celera Diagnostics will have to increase the capacity of its manufacturing processes and facilities or rely on its collaborators, if any. Celera Diagnostics may encounter difficulties in scaling-up manufacturing processes and may be unsuccessful in overcoming such difficulties. In such circumstances, Celera Diagnostics' ability to meet product demand may be impaired or delayed.

Celera Diagnostics' facilities are subject, on an ongoing basis, to the FDA's Quality System Regulations, international quality standards and other regulatory requirements, including requirements for good manufacturing practices and the State of California Department of Health Services Food and Drug Branch requirements. Celera Diagnostics may encounter difficulties expanding Celera Diagnostics' manufacturing operations in accordance with these regulations and standards, which could result in a delay or termination of manufacturing or an inability to meet product demand.

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Celera Diagnostics has relocated most of its manufacturing operations to a new facility in Alameda, California, though it has maintained a limited but key component of its manufacturing operations at an Applied Biosystems group facility. Celera Diagnostics expects to operate its manufacturing out of these facilities for the foreseeable future, and it does not have alternative production plans in place or alternative facilities available should its existing manufacturing facilities cease to function. Accordingly, Celera Diagnostics' business could be adversely affected by unexpected interruptions in manufacturing caused by events such as labor problems, equipment failures, or other factors, and the resulting inability to meet customer orders on a timely basis.

Celera Diagnostics' research and product development depends on access to tissue and blood samples from diseased and healthy individuals, other biological materials, and related clinical and other information, which may be in limited supply. Celera Diagnostics may not be able to obtain or maintain access to these materials and information on acceptable terms, or may not be able to obtain needed consents from individuals providing tissue or blood samples. In addition, government regulation in the U.S. and foreign countries could result in restricted access to, or use of, human tissue or blood samples. If Celera Diagnostics loses access to sufficient numbers or sources of tissue or blood samples, or if tighter restrictions are imposed on its use of the information generated from tissue or blood samples, its business may be harmed.

Single suppliers or a limited number of suppliers provide key components of Celera Diagnostics' products. If these suppliers fail to supply these components, Celera Diagnostics may be unable to satisfy product demand. Several key components of Celera Diagnostics' products come from, or are manufactured for Celera Diagnostics by, a single supplier or a limited number of suppliers. This applies in particular to components such as enzymes and oligonucleotides. Celera Diagnostics acquires some of these and other key components on a purchase-order basis, meaning that the supplier is not required to supply Celera Diagnostics with specified quantities over longer periods of time or set-aside part of its inventory for Celera Diagnostics' forecasted requirements. Celera Diagnostics has not arranged for alternative supply sources for some of these components and it may be difficult to find alternative suppliers, especially to replace enzymes and oligonucleotides. Furthermore, in order to maintain compliance with Quality System regulations, Celera Diagnostics must verify that its suppliers of key components are in compliance with all applicable FDA regulations. Celera Diagnostics believes that compliance with these regulatory requirements would increase the difficulty in arranging for needed alternative supply sources, particularly for components that are from "single source" suppliers, which means that they are currently the only supplier of custom-ordered components. If Celera Diagnostics' product sales increase beyond the forecast levels, or if its suppliers are unable or unwilling to supply it on commercially acceptable terms or comply with regulations applicable to manufacturing of Celera Diagnostics' products, it may not have access to sufficient quantities of key components on a timely basis and may be unable to satisfy product demand.

In addition, if any of the components of Celera Diagnostics' products are no longer available in the marketplace, it may be forced to further develop its products or technology to incorporate alternate components. The incorporation of new components into its products may require Celera Diagnostics

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to seek clearances or approvals from the FDA or foreign regulatory agencies prior to commercialization.

Celera Diagnostics' competitive position depends on maintaining its intellectual property protection and obtaining licenses to intellectual property it may need from others. Celera Diagnostics' ability to compete and to achieve and maintain profitability depends on its ability to protect its proprietary discoveries and technologies, in large part, through obtaining and enforcing patent rights, maintaining its trade secrets, and operating without infringing the intellectual property rights of others. Celera Diagnostics' ability to obtain patent protection for the inventions it makes is uncertain. The patentability of biotechnology inventions involves complex factual and legal questions. As a result, it is difficult to predict whether patents will issue or the breadth of claims that will be allowed in biotechnology and pharmaceutical patents. This may be particularly true with regard to the patenting of gene sequences, gene functions, and genetic variations. In this regard, the U.S. Patent and Trademark Office has adopted guidelines for use in the review of the utility of inventions, particularly biotechnology inventions. These guidelines increased the amount of evidence required to demonstrate utility in order to obtain a patent in the biotechnology field, making patent protection more difficult to obtain. Although others have been successful in obtaining patents to biotechnology inventions, since the adoption of these guidelines, these patents have been issued with increasingly less frequency. As a result, patents may not issue from patent applications that Celera Diagnostics may own or license if the applicant is unable to satisfy the new guidelines.

In some instances, patent applications in the U.S. are maintained in secrecy until a patent issues. In most instances, the content of U.S. and international patent applications is made available to the public approximately 18 months after the initial filing from which priority is claimed. As a result, Celera Diagnostics cannot be certain that others have not filed patent applications for inventions covered by Celera Diagnostics' patent applications or that Celera Diagnostics inventors were the first to make the invention. Accordingly, Celera Diagnostics' patent applications may be preempted or Celera Diagnostics may have to participate in interference proceedings before the U.S. Patent and Trademark Office. These proceedings determine the priority of invention and the right to a patent for the claimed invention in the U.S.

Furthermore, lawsuits may be necessary to enforce any patents issued to Celera Diagnostics or to determine the scope and validity of the patent rights of third parties. Lawsuits and interference proceedings, even if they are successful, are expensive to pursue, and Celera Diagnostics could use a substantial amount of its financial resources in either case. An adverse outcome could subject Celera Diagnostics to significant liabilities to third parties and require Celera Diagnostics to license disputed rights from third parties or to cease development or sales of a product.

Celera Diagnostics also relies on trade secret protection for its confidential and proprietary information and procedures. Celera Diagnostics protects its trade secrets through recognized practices, including access control, confidentiality and nonuse agreements with employees, consultants, collaborators and customers, and other security measures. These confidentiality and nonuse agreements may be breached, however, and Celera Diagnostics may not have adequate remedies for a breach. In addition, Celera Diagnostics' trade secrets may otherwise become known or

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APPLERA CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND
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be independently developed by competitors. Accordingly, it is uncertain whether Celera Diagnostics' reliance on trade secret protection will be adequate to safeguard its confidential and proprietary information and procedures.

Disputes may arise in the future with regard to the ownership of rights to any invention developed with collaborators. These and other possible disagreements with collaborators could lead to delays in the achievement of milestones or receipt of royalty payments or in research, development, and commercialization of Celera Diagnostics' products. In addition, these disputes could require or result in lawsuits or arbitration. Lawsuits and arbitration are time-consuming and expensive. Even if Celera Diagnostics wins, the cost of these proceedings could adversely affect its business, financial condition and operating results.

Celera Diagnostics may infringe the intellectual property rights of third parties and may become involved in expensive intellectual property litigation. The intellectual property rights of biotechnology companies, including Celera Diagnostics, are generally uncertain and involve complex legal, scientific and factual questions. Celera Diagnostics' success in diagnostic discovery and development may depend, in part, on its ability to operate without infringing the intellectual property rights of others and to prevent others from infringing its intellectual property rights.

There has been substantial litigation regarding patents and other intellectual property rights in the biotechnology and pharmaceutical industries. Celera Diagnostics may become a party to patent litigation or proceedings at the U.S. Patent and Trademark Office to determine its patent rights with respect to third parties. For example, Genetic Technologies Limited has filed a lawsuit against us alleging that we are infringing two of its patents due to the sale of cystic fibrosis reagent kits. In addition, interference proceedings may be necessary to establish which party was the first to make the invention sought to be patented. Also, Celera Diagnostics may become involved in patent litigation against third parties to enforce its patent rights, to invalidate patents held by the third parties, or to defend against these claims. The cost to Celera Diagnostics of any patent litigation or similar proceeding could be substantial, and it may absorb significant management time. If infringement litigation against Celera Diagnostics is resolved unfavorably to Celera Diagnostics, Celera Diagnostics may be enjoined from manufacturing or selling its products or services without a license from a third party. Celera Diagnostics may not be able to obtain a license on commercially acceptable terms, or at all. Similarly, contractual disputes related to existing license rights under third party patents may affect Celera Diagnostics' ability to develop, manufacture, and sell its products. For example, existing legal proceedings between Applera Corporation and Roche Molecular Systems, Inc., Hoffmann-La Roche, Inc., Roche Probe, Inc., and F. Hoffmann-La Roche, Ltd. may adversely affect the PCR patent rights that the Applied Biosystems group has contributed to Celera Diagnostics.

Introduction of new products may expose Celera Diagnostics to product liability claims. New products developed by Celera Diagnostics or its collaborators could expose Celera Diagnostics to potential product liability risks that are inherent in the testing, manufacturing, marketing, and sale of human diagnostic products. In addition, clinicians, patients, third-party payors, and others may at times seek damages based on testing or analysis errors based on a technician's misreading of results,

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mishandling of the patient samples, or similar claims. Product liability claims or product recalls, regardless of the ultimate outcome, could require Celera Diagnostics to spend significant time and money in litigation and to pay significant damages. Although Celera Diagnostics expects to seek and maintain product liability insurance to cover claims relating to the testing and use of diagnostic products, there can be no assurance that such insurance will be available on commercially reasonable terms, if at all, or that the amount of coverage obtained will be adequate to cover losses from any particular claim.

The diagnostics industry is intensely competitive and evolving. There is intense competition among health care, biotechnology, and diagnostic companies attempting to discover candidates for potential new diagnostic products. These companies may:

- develop new diagnostic products in advance of Celera Diagnostics;
- develop diagnostic products which are more effective or more cost-effective than those developed by Celera Diagnostics;
- obtain regulatory clearances or approvals of their diagnostic products more rapidly than Celera Diagnostics; or
- obtain patent protection or other intellectual property rights that would limit Celera Diagnostics' ability to develop and commercialize, or its customers' ability to use, Celera Diagnostics' diagnostic products.

Celera Diagnostics competes with companies in the U.S. and abroad that are engaged in the development and commercialization of products and services that provide genetic information. These companies may develop products that are competitive with the products offered by Celera Diagnostics, such as analyte specific reagents or diagnostic test kits that perform the same or similar purposes as Celera Diagnostics' products. Also, clinical laboratories may offer testing services that are competitive with the products sold by Celera Diagnostics. For example, a clinical laboratory can use either reagents purchased from manufacturers other than Celera Diagnostics, or use their own internally developed reagents, to make diagnostic tests. If clinical laboratories make tests in this manner for a particular disease, they could offer testing services for that disease as an alternative to products sold by Celera Diagnostics used to test for the same disease. The testing services offered by clinical laboratories may be easier to develop and market than test kits developed by Celera Diagnostics because the testing services are not subject to the same clinical validation requirements that are applicable to FDA-cleared or approved diagnostic test kits. The genetic testing services market is dominated by a small number of large clinical testing laboratories, including Laboratory Corporation of America Holdings, Quest Diagnostics Inc., and Specialty Laboratories, Inc.

Also, a substantial portion of all sales of diagnostic products are made to a small number of clinical reference laboratories, including those identified above, and therefore Celera Diagnostics expects to rely on these laboratories for a substantial portion of its sales. Celera Diagnostics' inability to establish or maintain one or more of these laboratories as a customer could adversely affect its business, financial condition, and operating results.

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Earthquakes could disrupt operations in California. The headquarters and principal operations of Celera Diagnostics are located in Alameda, California, and Celera Diagnostics has manufacturing facilities in Foster City, California. Alameda and Foster City are located near major California earthquake faults. The ultimate impact of earthquakes on Celera Diagnostics, its significant suppliers, and the general infrastructure is unknown, but operating results could be materially affected in the event of a major earthquake.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to potential loss from exposure to market risks represented principally by changes in foreign exchange rates, interest rates, and equity prices. Please refer to the market risk section of the management's discussion and analysis included on pages 43 and 44 of this report. Additional information can also be found in the market risk section of the management's discussion and analysis included on pages 34 and 35 of our 2003 Annual Report to Stockholders (which section is incorporated herein by reference).

Item 4. Controls and Procedures.

We maintain disclosure controls and procedures designed to ensure that the information required to be disclosed in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of these disclosure controls and procedures as of the end of the second quarter of our 2004 fiscal year, the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to achieve their stated purpose. However, there is no assurance that our disclosure controls and procedures will operate effectively under all circumstances. No changes were made to our internal control over financial reporting during the second quarter of our 2004 fiscal year that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II □ OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved in various legal proceedings from time to time, including actions with respect to commercial, intellectual property, antitrust, environmental, securities, and employment matters. The following paragraphs contain a description of some of the legal proceedings that we are currently a party to. We are describing these proceedings either because they were recently initiated or because there have been recent developments.

We believe that we have meritorious defenses against the claims currently asserted against us, including the claims described below, and we intend to defend them vigorously. However, the outcome of litigation is inherently uncertain, and we cannot be sure that we will prevail in the cases described below or in our other current litigation. An adverse determination in the cases we are currently defending, particularly the claims against us described below and the other claims we are defending that are described elsewhere in this report, could have a material adverse effect on us, the Applied Biosystems group, or the Celera Genomics group.

We are involved in several litigation matters with MJ Research, Inc., which commenced with our filing claims against MJ Research based on its alleged infringement of some polymerase chain reaction, or PCR, patents. In response to our claims, MJ Research filed counterclaims including, among others, allegations that we have licensed and enforced these patents through anticompetitive conduct in violation of federal and state antitrust laws, and MJ Research is seeking injunctive relief, monetary damages, costs and expenses, and other relief. A trial on these matters is expected to commence in March 2004. Subsequently, on September 21, 2000, MJ Research filed an action against us in the U.S. District Court for the District of Columbia. This complaint is based on the allegation that the patents underlying our DNA sequencing instruments were improperly obtained because one of the alleged inventors, whose work was funded in part by the U.S. government, was knowingly omitted from the patent applications. Our patents at issue are U.S. Patent Nos. 5,171,534, entitled □Automated DNA Sequencing Technique,□ 5,821,058, entitled □Automated DNA Sequencing Technique,□ 6,200,748, entitled □Tagged Extendable Primers and Extension Products,□ and 4,811,218, entitled □Real Time Scanning Electrophoresis Apparatus for DNA Sequencing.□ The complaint asserts violations of the federal False Claims Act and the federal Bayh Dole Act, invalidity and unenforceability of the patents at issue, patent infringement, and various other civil claims against us. MJ Research is seeking monetary damages, costs and expenses, injunctive relief, transfer of ownership of the patents in dispute, and other relief as the court deems proper. MJ Research claims to be suing in the name of the U.S. government although the government has to date declined to participate in the suit. On October 9, 2003, the case against us was dismissed but MJ Research has filed a notice of appeal.

Henry Huang (an individual) filed an action against us and the Applied Biosystems group and the other parties described below in the U.S. District Court for the Central District of California on February 19, 2003. Mr. Huang's complaint seeks to change inventorship of the patents described below, and claims breach of contract, fraud, conversion, and unjust enrichment. The complaint relates to U.S. Patent Nos. 5,171,534, entitled □Automated DNA Sequencing Technique,□ 5,821,058, entitled □Automated DNA Sequencing Technique,□ 6,200,748, entitled □Tagged Extendable Primers and Extension Products,□ and 4,811,218, entitled □Real Time Scanning Electrophoresis Apparatus for DNA Sequencing.□ U.S. Patent Nos. 5,171,534, 5,821,058, and 6,200,748 are assigned to the California Institute of Technology and licensed by the Applied Biosystems group. U.S. Patent No. 4,811,218 is assigned to the Applied Biosystems group. Also named in the complaint are the California Institute of Technology, Lloyd Smith,

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Leroy Hood, Michael Hunkapiller, Timothy Hunkapiller, Charles Connell, John Lytle, William Mordan, and John Bridgham. Lloyd Smith, Leroy Hood, Michael Hunkapiller, Timothy Hunkapiller, and Charles Connell are the inventors named on U.S. Patent Nos. 5,171,534, 5,821,058, and 6,200,748. Michael Hunkapiller, Charles Connell, John Lytle, William Mordan, and John Bridgham are the inventors named on U.S. Patent No. 4,811,218. The issues involved in this litigation are related to the issues in the MJ Research, Inc. litigation that was filed September 21, 2000, which is described above. Mr. Huang is alleging that he is the sole inventor on U.S. Patent Nos. 5,171,534, 5,821,058, 6,200,748, and 4,811,218. He is seeking to substitute himself for the named inventors on the relevant patents, and to have himself named as the sole assignee of the patents, and is also seeking monetary damages, costs, expenses, and other relief as the court deems proper. A trial was completed on December 22, 2003, and a decision from the judge is pending.

We filed claims against Roche Molecular Systems, Inc., Hoffmann-La Roche, Inc., Roche Probe, Inc., F. Hoffmann-La Roche Ltd., and other potential defendants affiliated with the named defendants (["Roche"]) in California Superior Court on October 9, 2003. Our complaint asserts, among other things, breach of contract and other contract claims against the defendants arising from agreements relating to polymerase chain reaction, or PCR, technology rights entered into between us and the defendants. Our complaint also asserts various tort claims against the defendants, including breach of trust, breach of fiduciary duty, and unfair competition, relating to our PCR rights. The defendants' acts and omissions that form the basis of the complaint include, among other things, the: (i) defendants' failure to abide by contractual provisions intended to allow us to effectively compete with the defendants with respect to (a) sales of diagnostic PCR products and (b) conveyance of diagnostic PCR rights to third parties; (ii) defendants' failure to pay us requisite royalties for sales by them of thermal cyclers and other products; (iii) defendants' failure to negotiate in good faith new agreements directed at modifying the relationship between the parties in accordance with principles set forth in an existing letter agreement that states the intended framework for the negotiations (the ["LOA"]); (iv) defendants' failure to provide us with diagnostic PCR rights on a nondiscriminatory basis as required by a European Union commission decree; (v) defendants' failure to comply with their agreement to assign ownership to us of some PCR instrument patents and patent applications, and (vi) defendants' mishandling of the prosecution of patent applications that the defendants were obligated to assign to us, in a manner that damaged us and precluded us from obtaining the full potential scope of patent protection for our instrument rights. Contemporaneously with our filing of this complaint, we also commenced arbitration proceedings with the American Arbitration Association against the defendants asserting, among other things, patent infringement claims (both direct infringement, contributory infringement and infringement by inducing third parties to infringe), breach of contract and other contract claims, and tort claims such as breach of fiduciary duty, breach of trust, and unfair competition. The arbitration is based on our allegation that the defendants (i) have infringed our exclusive rights to PCR patents in fields exclusively licensed to us pursuant to agreements with the defendants; and (ii) by their acts and omissions, have undermined the value of our exclusive PCR rights. In both the legal complaint and the arbitration, we are seeking monetary damages, costs, expenses, injunctive relief, and other relief as the court or arbitrator deems proper. On December 15, 2003, Roche filed a motion in California Superior Court to compel arbitration of our state court complaint and to stay the litigation. Concurrently with the motion to compel arbitration, Roche also filed with the American Arbitration Association its response to our notice of arbitration in which Roche denied all of our claims against it. Roche's response included counterclaims asserting, among other things, that our exclusive patent rights under some PCR patents licensed from Roche under an existing distribution agreement were converted into nonexclusive rights by the LOA, which was entered into subsequent to the distribution agreement. Roche also alleges that

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(i) we breached our contractual obligation under the LOA, including our obligation to source certain enzymes exclusively from Roche; and (ii) we failed to pay Roche the full royalties required pursuant to the distribution agreement. In its counterclaim, Roche is seeking a request for declaratory judgment confirming its assertions, interest, costs, and other relief as the arbitrator deems proper. The claims and counterclaims described in this paragraph involve PCR rights used by the Applied Biosystems group and also rights that the Applied Biosystems group has contributed to Celera Diagnostics.

Promega Corporation filed an action against us and some of our affiliates and Roche Molecular Systems, Inc. and Hoffmann-La Roche, Inc. in the U.S. District Court for the Eastern District of Virginia on April 10, 2000. The complaint asserts violations of the federal False Claims Act. On November 12, 2003, the court issued an order to have the complaint, which had previously been sealed, served on us and the other defendants. On February 9, 2004, we waived service of the complaint, which initiated our direct involvement in the case. The complaint alleges that we and Hoffmann-La Roche overcharged the U.S. government for thermal cyclers and PCR reagents. The overcharges are alleged to be the result of a licensing program based in part on U.S. Patent No. 4,889,818. Promega is asserting that U.S. Patent No. 4,889,818 was obtained fraudulently and that the licensing program run by us and Hoffmann-La Roche is the cause of the alleged overcharging. Promega is seeking monetary damages. Promega claims to be suing in the name of the U.S. government although the government has to date declined to participate in the suit.

Item 4. Submission of Matters to a Vote of Security Holders.

We held our Annual Meeting of Stockholders on October 16, 2003. At that meeting, our stockholders elected all of the nominees for director and ratified the selection of our independent accountants, each as described in the Notice of Annual Meeting and Proxy Statement dated September 5, 2003. The results of the voting of the stockholders with respect to these matters is set forth below.

I. Election of Directors.

| | Total Vote For Each Director | Total Vote Withheld From Each Director |
|----------------------|------------------------------------|--|
| Richard H. Ayers | 207,367,644 | 7,487,482 |
| Jean-Luc Bélingard | 186,827,069 | 28,028,057 |
| Robert H. Hayes | 207,373,085 | 7,482,041 |
| Arnold J. Levine | 153,272,506 | 61,582,620 |
| William H. Longfield | 208,339,688 | 6,515,438 |
| Theodore E. Martin | 207,393,330 | 7,461,796 |
| Carolyn W. Slayman | 186,827,974 | 28,027,152 |
| Orin R. Smith | 186,766,304 | 28,088,822 |
| James R. Tobin | 207,411,552 | 7,443,574 |
| Tony L. White | 207,237,941 | 7,617,185 |

II. Ratification of the selection of PricewaterhouseCoopers LLP as our independent accountants for the fiscal year ending June 30, 2004.

| <u>FOR</u> | <u>AGAINST</u> | <u>ABSTAIN</u> |
|-------------|----------------|----------------|
| 209,274,758 | 4,604,606 | 975,762 |
| | | 74 |

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Item 5. Other Information.

During our 2002 fiscal year, the Applied Biosystems group formed the Knowledge Business to develop and market products and services designed to meet the needs of life science researchers in performing specific biological analysis applications. The Knowledge Business was focused on generating value to life science customers through products and services with high information content that support improved experimental work-flows. Concurrently with the Applied Biosystems group's formation of the Knowledge Business, in April 2002, the Celera Genomics group and the Applied Biosystems group entered into a ten-year marketing and distribution agreement pursuant to which the Applied Biosystems group became the exclusive marketer of the Celera Genomics group's Celera Discovery System[®] (CDS) and related human genetic and other biological and medical information. As a result of this arrangement, the Applied Biosystems group has integrated CDS and other genomic and biological information into its product offerings. During the second quarter of our 2004 fiscal year, the Applied Biosystems group reorganized its internal operations and, among other things, integrated the operations of the former Knowledge Business into other business units of the Applied Biosystems group. However, the Applied Biosystems group and the Celera Genomics group continue to operate under the marketing and distribution agreement on the same terms and conditions as in effect prior to the reorganization.

The Celera Genomics group is no longer using the delta technology, which was used to develop the compounds that it reacquired from Bayer, in its tryptase program. However, the group is continuing to pursue its tryptase program and its efforts have been shifted to new proprietary compounds.

Item 6. Exhibits and Reports on Form 8-K.

(a) *Exhibits.*

- 13 Annual Report to Stockholders for the fiscal year ended June 30, 2003, to the extent incorporated herein by reference (incorporated by reference to Exhibit 13 to Annual Report on Form 10-K of the Company for the fiscal year ended June 30, 2003 (Commission file number 1-4389)).
- 31.1 Certification of Principal Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) *Reports on Form 8-K.*

During the quarter ended December 31, 2003, we filed a Current Report on Form 8-K dated October 22, 2003, to disclose under Items 9 and 12 thereof our October 22, 2003, press releases setting forth the financial results of Applera and the Applied Biosystems group and the Celera Genomics group for the first quarter of our 2004 fiscal year.

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SIGNATURES

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

APPLERA CORPORATION

By: /s/ Dennis L. Winger
Dennis L. Winger
Senior Vice President and
Chief Financial Officer

By: /s/ Ugo D. DeBlasi
Ugo DeBlasi
Vice President and
Controller
(Chief Accounting Officer)

Dated: February 13, 2004

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EXHIBIT INDEX

Exhibit Number

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-