

Letter to Stockholders

February 28, 1997

Dear Stockholder,

1996 marked Genentech's 20th anniversary. When Herb Boyer and Bob Swanson founded Genentech, they began more than a company. They formed a philosophy and a culture that has proven productive and, even as it has matured, has guided its employees to continued success—to the benefit of many, many people. Even as the individual employees may change, key employee attributes, first brought to the company by its founders, remain the same: they're bright, they're driven from within, and they pursue a higher ideal. Over the years, Genentech has developed a reputation as a casual company and a fun—

but intense—place to work. This atmosphere helped drive our successes in 1996, laying the foundation for continued growth as we approach a new century.



Arthur D. Levinson, Ph.D.
President and Chief Executive Officer

In 1996 we received three regulatory clearances for new indications for our key marketed products, including a breakthrough indication for Activase for the treatment of acute ischemic stroke. The electronic regulatory submission for this indication is featured on the cover of this report. At the same time our two leading products, Activase and growth hormone, faced significant but anticipated market challenges. As described in the section beginning on page 9, we intend to maintain and ultimately hope to grow our markets. To do so, we are continuing our leadership efforts in education and post-marketing clinical research in partnership with the practicing medical community; we continue to defend our strong patent positions; we are focusing our efforts with managed care providers; and we are developing improved versions of our current products in the clinic.

These efforts support our first key strategy for growth: to maximize sales of marketed products. The three other key strategies for our growth are: to accelerate and expand product development; to increase the pace of forming strategic alliances; and to improve financial returns.

Our product development efforts in 1996 and early 1997 have been well rewarded, so that we now have five potential new products or indications in late-stage clinical development, with three additional new products or indications about to enter Phase III trials. Besides the three regulatory clearances for new indications, we filed a regulatory submission for marketing approval for another new indication for growth hormone—growth hormone inadequacy in adults. And our partner IDEC Pharmaceuticals filed a regulatory

submission for marketing clearance for a potential new treatment for non-Hodgkin's B-cell lymphoma. The Phase III trials for this C2B8 antibody, which IDEC completed in 1996, showed a 50 percent response rate in evaluable patients, with minimal toxicity—which is very promising for the very sick patient population studied. It is especially so when you consider that it lacks the considerable side effects of traditional chemotherapy (a benefit, also, of our anti-HER2 antibody for breast cancer, which is in Phase III clinical trials). We completed Phase II trials of nerve growth factor in patients with diabetic peripheral neuropathy, with good results, so that we are now preparing for pivotal Phase III trials. And we are poised to begin Phase III trials of an oral IIb/IIIa antagonist in acute coronary syndrome. We also moved four new products into clinical development.

In line with our third strategy, we formed important new strategic alliances in 1996 and early 1997, and made substantial progress on earlier alliances. Most significantly, our relationship with our majority stockholder Roche has moved in several positive directions. First, through an earlier collaborative agreement, Roche began Phase I clinical trials of our anti-CD18 antibody for the treatment of hemorrhagic shock.

Second, Roche exercised its options (per our 1995 arrangement with Roche) to develop three pipeline products outside the United States: the C2B8 antibody, insulin-like growth factor-I, and nerve growth factor. This provided important contract revenue to Genentech and serves as tangible validation for the medical potential of these products on a global scale.

Third, Roche agreed to have us promote its Roferon-A in the United States for its approved oncology indications. I am excited about this arrangement for two reasons: it provides us with an initial product for our growing oncology franchise; and it allows Genentech to promote yet another product that resulted from Genentech science, as we licensed patents and know-how for this product to Roche in 1980.

To name just two alliances Genentech has formed with other companies: we agreed with XOMA Corporation for XOMA to develop Genentech's anti-CD11a antibody, called hu1124, for the treatment of psoriasis and organ transplant rejection (XOMA has begun Phase I clinical trials in the former indication and filed an investigational new drug application (IND) in the latter); and we agreed with CytoTherapeutics, Inc. to work to develop treatments for Huntington's disease, Parkinson's disease and amyotrophic lateral sclerosis (ALS) using CytoTherapeutic's encapsulated cell technology to deliver several of Genentech's proprietary growth factors.

“A PROMISE TO
REMAIN TRUE TO OUR
ENTREPRENEURIAL
SPIRIT”

As expected, our fourth strategy for growth, improve financial returns, had the least visible results in 1996. Our earnings declined to \$118.3 million from \$146.4 million in 1995 as a result of strong investment to pursue the promise of our development pipeline. However, this strategy follows from the success of the first three, and should move into place over the longer term. Over the short term, earnings are restrained as we invest aggressively in R&D, which—at \$471.1 million—was at a level of almost 50 percent of revenues in 1996, compared to—at \$363.0 million—40 percent of revenues in 1995. As late-stage products progress through the pipeline, our goal is for R&D expenses to decline in absolute terms. As new products reach the market, revenues should increase. With the combination of these two factors, as we approach the turn of the century, our goal is for R&D expenditures to level off at approximately 25 to 30 percent of revenues. And I anticipate we will realize our fourth strategy. I hope you agree it will have been worth our aggressive investment in R&D today. Certainly the patients who stand to benefit from our new medicines would believe so.

As Genentech reached its 20th year, one of our cofounders stepped down to pursue new interests. Bob Swanson's retirement as chairman and from the board serves to remind us how much he has contributed to Genentech, to the biotechnology industry that his and Herb Boyer's vision began, and to the many patients who have benefited from our medicines.

Though he has large shoes to fill, eight-year board veteran Dick Munro, our new chairman, will, I know, do the job admirably. He brings a tremendous wealth of experience as both a former chief executive officer of Time Warner, Inc. and as a member of the board of several of America's premier companies.

I know our success will continue, because the original philosophy for what Genentech should be continues today. This report is dedicated to those hard-working, jeans-clad employees who emphasize that philosophy, including those first two, Herb and Bob. It is also dedicated to all Genentech stockholders. To you we make a promise to remain true to our entrepreneurial spirit, as we strive to bring both important new medicines to patients and an attractive return to our investors.

Sincerely,

/s/ Arthur D. Levinson

Arthur D. Levinson, Ph.D.

President and Chief Executive Officer

This letter contains several forward-looking statements relating to future R&D expenses and revenues. The Company's actual results may differ materially. For a discussion of the risk factors which may affect future R&D expenditures, please see page 47, "R&D Expenses," and for a discussion of the risk factors which may affect future revenues, please see page 46, "Total Product Sales" and "Activase Sales," page 47, "Growth Hormone Sales," "Pulmozyme Sales," and "Royalty and Contract Revenues," and page 48, "Successful Development of Products," "Uncertainties Surrounding Proprietary Rights," and "Market Potential/Risk."