UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 000-30111

LEXICON GENETICS INCORPORATED
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	76-0474169
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

8800 TECHNOLOGY FOREST PLACE
THE WOODLANDS, TEXAS 77381
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES AND ZIP CODE)

(281) 863-3000
(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	X	No

As of November 4, 2002, 52,353,180 shares of the registrant's common stock, par value $0.001 per share, were outstanding.

LEXICON GENETICS INCORPORATED

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FACTORS AFFECTING FORWARD LOOKING STATEMENTS

This quarterly report on Form 10-Q contains forward-looking statements. These statements relate to future events or our future financial performance. We have attempted to identify forward-looking statements by terminology including "anticipate," "believe," "can," "continue," "could," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "should" or "will" or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks outlined under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - Risk Factors," that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels or activity, performance or achievements expressed or implied by these forward-looking statements.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We are not under any duty to update any of the forward-looking statements after the date of this quarterly report on Form 10-Q to conform these statements to actual results, unless required by law.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LEXICON GENETICS INCORPORATED

CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PAR VALUE)

	AS OF SEPTEMBER 30, 2002	AS OF DECEMBER 31, 2001
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents, including restricted cash of $44,751 and $6,693, respectively	$ 79,724	$ 23,048
Short-term investments, including restricted investments of $12,410 and $36,645, respectively	34,158	133,394
Accounts receivable, net of allowance for doubtful accounts of $109 and $211, respectively	4,993	4,544
Prepaid expenses and other current assets	5,645	5,456
Total current assets	124,520	166,442
Property and equipment, net of accumulated depreciation of $17,238 and $10,747, respectively	35,990	26,707
Long-term investments	5,738	10,398
Goodwill	25,798	25,798
Intangible assets, net of amortization of $1,460 and $560, respectively	4,540	5,440
Other assets	2,303	5,205
Total assets	$ 198,889	$ 239,990
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,270	$ 3,168
Accrued liabilities	4,782	5,016
Current portion of deferred revenue	8,294	10,595
Total current liabilities	17,346	18,779
Deferred revenue, net of current portion	--	2,500
Other long-term liabilities	540	339
Total liabilities	17,886	21,618
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value; 5,000 shares authorized; no shares issued and outstanding	--	--
Common stock, $.001 par value; 120,000 shares authorized; 52,327 and 52,022 shares issued and outstanding	52	52
Additional paid-in capital	330,645	331,092
Deferred stock compensation	(13,714)	(22,260)
Accumulated deficit	(135,883)	(90,075)
Accumulated other comprehensive loss	(97)	(437)
Total stockholders' equity	181,003	218,372
Total liabilities and stockholders' equity	$ 198,889	$ 239,990

The accompanying notes are an integral part of these consolidated financial statements.

LEXICON GENETICS INCORPORATED

CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001	2002	2001
Revenues:				
Subscription and license fees	$ 3,319	$ 8,638	$ 11,689	$ 11,668
Collaborative research	4,632	3,685	13,155	7,408
Compound libraries and other	62	1,170	236	1,230
Total revenues	8,013	13,493	25,080	20,306
Operating expenses:				
Research and development, including stock-based compensation of $1,288, $1,338, $3,862 and $4,148, respectively	19,753	15,009	55,649	35,564
General and administrative, including stock-based compensation of $1,278, $1,309, $3,836 and $3,961, respectively	5,751	6,439	17,739	15,756
Total operating expenses	25,504	21,448	73,388	51,320
Loss from operations	(17,491)	(7,955)	(48,308)	(31,014)
Interest and other income	683	1,820	2,505	7,142
Interest expense	(1)	(85)	(5)	(295)
Net loss	$ (16,809)	$ (6,220)	$ (45,808)	$ (24,167)
Net loss per common share, basic and diluted	$ (0.32)	$ (0.12)	$ (0.88)	$ (0.49)
Shares used in computing net loss per common share, basic and diluted	52,314	51,500	52,230	49,626

The accompanying notes are an integral part of these consolidated financial statements.

LEXICON GENETICS INCORPORATED

CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	NINE MONTHS ENDED SEPTEMBER 30,	
	2002	2001
Cash flows from operating activities:		
Net loss	$ (45,808)	$ (24,167)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	6,561	3,409
Amortization of intangible assets, other than goodwill	900	260
Amortization of deferred stock compensation	7,698	8,108
Loss on sale of long-term investments	197	-
Changes in operating assets and liabilities:		
Increase in accounts receivable	(449)	(4,861)
Increase in prepaid expenses and other current assets	(267)	(2,937)
(Increase) decrease in other assets	2,902	(4,861)
Increase in accounts payable and other liabilities	1,070	463
Increase (decrease) in deferred revenue	(4,802)	9,771
Net cash used in operating activities	(31,998)	(14,815)
Cash flows from investing activities:		
Purchases of property and equipment	(15,844)	(7,679)
Purchases of short-term investments	(55,586)	(141,024)
Maturities of short-term investments	154,822	152,533
Sale of long-term investments	4,803	-
Payment of transaction costs, net of cash acquired of $423	-	(735)
Net cash provided by investing activities	88,195	3,095
Cash flows from financing activities:		
Proceeds from issuance of common stock	479	520
Repayment of debt borrowings	-	(3,544)
Net cash provided by (used in) financing activities	479	(3,024)
Net increase in cash and cash equivalents	56,676	(14,744)
Cash and cash equivalents at beginning of period	23,048	37,811
Cash and cash equivalents at end of period	$ 79,724	$ 23,067
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 5	$ 291
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized gain on long-term investments	$ 340	$ -
Cancellation of equity securities issued in connection with acquisition	$ (79)	$ -
Reversal of deferred stock compensation in connection with stock options	$ 947	$ 942
Deferred stock compensation in connection with issuance of restricted stock	$ (99)	$ -
Issuance of equity securities in connection with acquisition	$ -	$ 34,865
Retirement of property and equipment	$ 70	$ -

The accompanying notes are an integral part of these consolidated financial statements.

LEXICON GENETICS INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Lexicon Genetics Incorporated (Lexicon or the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the nine-month period ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002.

The accompanying consolidated financial statements include the accounts of Lexicon and its subsidiary. Intercompany transactions and balances are eliminated in consolidation.

For further information, refer to the financial statements and footnotes thereto included in Lexicon's annual report on Form 10-K for the year ended December 31, 2001, as filed with the SEC.

In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." These statements, which Lexicon fully adopted on January 1, 2002, generally require that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. Additionally, any resulting goodwill will not be amortized, but rather will be subject to at least an annual impairment test. Acquired intangible assets will be separately recognized and amortized over their useful lives.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This new standard on asset impairment, which Lexicon adopted effective January 1, 2002, supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The adoption of this standard had no impact on the Company.

2. RESTRICTED CASH AND INVESTMENTS

Lexicon is required to maintain restricted cash, cash equivalents or investments to collateralize borrowings made under the synthetic lease agreement under which it leases its office and laboratory facilities in The Woodlands, Texas (see Note 7). As of September 30, 2002 and December 31, 2001, the Company maintained restricted cash and investments of $57.2 million and $43.3 million, respectively, to collateralize borrowings of $55.0 million and $41.7 million.

3. COMPREHENSIVE LOSS

Comprehensive loss is comprised of net loss and unrealized gains and losses on long-term investments, which are considered available-for-sale securities. Comprehensive loss for the three-month

and nine-month periods ended September 30, 2002 was $16.8 million and $45.5 million, respectively, reflecting a $45,000 and $0.3 million unrealized gain on long-term investments, respectively. Net loss for the three-month and nine-month periods ended September 30, 2002 included a $0.2 million realized loss on the sale of long-term investments. There was no difference between net loss and comprehensive loss in the comparable prior year periods.

4. NET LOSS PER SHARE

Net loss per share is computed using the weighted average number of shares of common stock outstanding during the applicable period. Shares associated with stock options and warrants are not included because they are antidilutive. There are no differences between basic and diluted net loss per share for all periods presented.

5. DEFERRED STOCK COMPENSATION

Deferred stock compensation represents the difference between the exercise price of stock options and the fair value of Lexicon's common stock at the date of grant. Deferred stock compensation is amortized over the vesting periods of the individual stock options for which it was recorded, generally four years. For the nine months ended September 30, 2002 and 2001, Lexicon amortized $7.7 million and $8.1 million, respectively, of deferred stock compensation. If vesting continues in accordance with the outstanding individual stock options, Lexicon expects to record amortization expense for deferred stock compensation as follows: $2.6 million during the last three months of 2002, $10.2 million during 2003 and $0.9 million during 2004. The amount of stock based compensation expense to be recorded in future periods may decrease if unvested options for which deferred stock compensation expense has been recorded are subsequently canceled or forfeited or may increase if additional options are granted to individuals other than employees or directors.

6. COELACANTH ACQUISITION

On July 12, 2001, Lexicon completed the acquisition of Coelacanth Corporation (Coelacanth) in a merger, under an Agreement and Plan of Merger entered into on June 13, 2001. Coelacanth, now Lexicon Pharmaceuticals (New Jersey), Inc., forms the core of Lexicon Pharmaceuticals, the division of the Company responsible for small molecule compound discovery. The results of Lexicon Pharmaceuticals (New Jersey), Inc. are included in the Company's results of operations subsequent to the acquisition.

7. COMMITMENTS AND CONTINGENCIES

In October 2000, Lexicon entered into a synthetic lease agreement under which the lessor purchased the Company's existing laboratory and office buildings and animal facility in The Woodlands, Texas and agreed to fund the construction of an additional laboratory and office building and a second animal facility. The synthetic lease agreement was subsequently expanded to include funding for the construction of a central plant facility. Including the purchase price for the Company's existing facilities, the synthetic lease, as amended, provided for funding of up to $55.0 million in property and improvements. The term of the agreement is six years, which includes the construction period and a lease period. Lease payments for the new facilities began upon completion of construction, which occurred at the end of the first quarter of 2002. Lease payments are subject to fluctuation based on LIBOR rates. Based on a LIBOR rate of 1.81% at September 30, 2002 the Company's total lease payments would be approximately $1.1 million per year. At the end of the lease term, the lease may be extended for one-year terms, up to seven additional terms, or the Company may purchase the properties for a price including the outstanding lease balance. If the

Company elects not to renew the lease or purchase the properties, it may arrange for the sale of the properties to a third party or surrender the properties to the lessor. If the Company elects to arrange for the sale of the properties or surrender the properties to the lessor, it has guaranteed approximately 86% of the total original cost as the residual fair value of the properties. The Company is required to maintain restricted cash or investments to collateralize borrowings made under the synthetic lease agreement. In addition, Lexicon has agreed to maintain cash and investments of at least $30.0 million in excess of the Company's restricted cash and investments. If the Company's cash and investments fall below that level, the Company may be required to seek a waiver of that agreement or to purchase the properties or arrange for their sale to a third party. Because the Company's cost to purchase the properties would not materially exceed the amount of restricted cash and investments it is required to maintain under the synthetic lease, the Company believes that any requirement that it do so would not have a material adverse effect on its financial condition.

On February 13, 2002, the FASB announced that it intended to propose for adoption before the end of 2002 that companies be required to consolidate special purpose entities, such as the lessor under Lexicon's synthetic lease, on their balance sheets under certain circumstances. In a proposed interpretation dated June 28, 2002, the FASB outlined new rules that would require such consolidation by a lessee that provides a residual value guarantee or similar arrangement to the lessor/special purpose entity. While the lessor under the Company's synthetic lease qualifies for off-balance sheet treatment under current rules, the Company will be required to consolidate the lessor on the Company's balance sheet if the FASB's proposed interpretation as currently drafted is adopted. If such consolidation is required, the Company's balance sheet will reflect as assets additional property and equipment approximating the $55.0 million funded under the synthetic lease for property and improvements and the same amount as a liability. In addition, the Company will be required to depreciate such property and improvements over their useful lives. The proposed guidance would require companies with calendar-fiscal years that have existing special purpose entities, such as Lexicon, to apply the new standards on April 1, 2003. Lexicon believes that the consolidation of the lessor, if required, will not have a material adverse effect on its financial condition or results of operations.

On May 23, 2002, Lexicon Pharmaceuticals (New Jersey), Inc. signed a ten-year lease for a 76,000 square-foot facility in Princeton, New Jersey. The lease provides for an escalating yearly rent payment of $1.3 million in the first year, $1.7 million in years two and three, $1.8 million in years four to six, $2.0 million in years seven to nine and $2.1 million in year ten. The lease also provides Lexicon Pharmaceuticals with the option in the second year of the lease to borrow $2.0 million in tenant improvement funds from the landlord, at which time rental payments due under the lease will increase as the tenant improvement allowance is amortized over a ten-year period. Lexicon is the guarantor of the obligations of Lexicon Pharmaceuticals (New Jersey), Inc. under the lease.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We are a biopharmaceutical company focused on the discovery of breakthrough treatments for human disease. We are using gene knockout technology to systematically discover the physiological functions of genes in living mammals, or in vivo. We generate our gene function discoveries using knockout mice - mice whose DNA has been altered to disrupt, or "knock out," the function of the altered gene. Our patented gene trapping and gene targeting technologies enable us to rapidly generate these knockout mice by altering the DNA of genes in a special variety of mouse cells, called embryonic stem (ES) cells, which can be cloned and used to generate mice with the altered gene. We employ an integrated platform of advanced medical technologies to systematically discover and validate which genes, when knocked out, result in a favorable medical profile with pharmaceutical utility. We then pursue those genes and the proteins they encode as potential targets for therapeutic intervention in our drug discovery programs.

We employ internal resources and drug discovery alliances to discover potential small molecule drugs, therapeutic antibodies and therapeutic proteins for in vivo-validated drug targets that we consider to have high pharmaceutical value. We use our own sophisticated libraries of drug-like chemical compounds and an industrialized medicinal chemistry platform to identify small molecule drug candidates for our in vivo-validated drug targets. We have established alliances with Abgenix, Inc. for the discovery and development of therapeutic antibodies based on our drug target discoveries and with Incyte Genomics, Inc. for the discovery and development of therapeutic proteins. In addition, we have established collaborations and license agreements with many other leading pharmaceutical and biotechnology companies under which we receive fees and, in many cases, are eligible to receive milestone and royalty payments, for access to some of our technologies and discoveries for use in their own drug discovery efforts.

We derive substantially all of our revenues from subscriptions to our databases, drug discovery alliances, functional genomics collaborations for the development and, in some cases, analysis of the physiological effects of genes altered in knockout mice, technology licenses and compound library sales. To date, we have generated a substantial portion of our revenues from a limited number of sources.

Our operating results and, in particular, our ability to generate additional revenues are dependent on many factors, including our success in establishing research collaborations and technology licenses, new database subscriptions, expirations of our research collaborations and database subscriptions, the success rate of our discovery efforts leading to opportunities for new research collaborations and licenses, as well as milestone payments and royalties, the timing and willingness of collaborators to commercialize products which may result in royalties, and general and industry-specific economic conditions which may affect research and development expenditures. Our future revenues from database subscriptions, collaborations and alliances are uncertain because our existing agreements have fixed terms or relate to specific projects of limited duration. Our future revenues from technology licenses are uncertain because they depend, in large part, on securing new agreements. Subject to limited exceptions, we do not intend to continue to make our compound libraries available for purchase in the future. Our ability to secure future revenue-generating agreements will depend upon our ability to address the needs of our potential future subscribers, collaborators and licensees, and to negotiate agreements that we believe are in our long-term best interests. We may determine that our interests are better served by retaining rights to our discoveries and advancing our therapeutic programs to a later stage, which could limit our near-term revenues. Because of these and other factors, our quarterly operating results have fluctuated in the past

and are likely to do so in the future, and we do not believe that quarter-to-quarter comparisons of our operating results are a good indication of our future performance.

Since our inception, we have incurred significant losses and, as of September 30, 2002, we had an accumulated deficit of $135.9 million. Our losses have resulted principally from costs incurred in research and development, general and administrative costs associated with our operations, and non-cash stock-based compensation expenses associated with stock options granted to employees and consultants prior to our April 2000 initial public offering. Research and development expenses consist primarily of salaries and related personnel costs, material costs, legal expenses resulting from intellectual property prosecution and other expenses related to our drug discovery and LexVision programs, the development and analysis of knockout mice and our other functional genomics research efforts, and the development of compound libraries. General and administrative expenses consist primarily of salaries and related expenses for executive, finance and other administrative personnel, professional fees and other corporate expenses including business development and general legal activities, as well as expenses related to our patent infringement litigation against Deltagen, Inc., which was settled in September 2001. In connection with the expansion of our drug discovery programs and our functional genomics research efforts, we expect to incur increasing research and development and general and administrative costs. As a result, we will need to generate significantly higher revenues to achieve profitability.

CRITICAL ACCOUNTING POLICIES

Revenue Recognition

Fees for access to our databases and other functional genomics resources are recognized ratably over the subscription or access period. Payments received in advance under these arrangements are recorded as deferred revenue until earned. Collaborative research payments are generally non-refundable, regardless of the success of the research effort, and are recognized as revenue as we perform our obligations related to such research. Milestone-based fees are recognized upon completion of specified milestones according to contract terms. Non-refundable technology license fees are recognized as revenue upon the grant of the license to third parties, when performance is complete and there is no continuing involvement. A change in our revenue recognition policy or changes in the terms of contracts under which we recognize revenues could have an impact on the amount and timing of our recognition of revenues.

Research and Development Expenses

Research and development expenses consist of costs incurred for company-sponsored as well as collaborative research and development activities. These costs include direct and research-related overhead expenses and are expensed as incurred. Patent costs and technology license fees for technologies that are utilized in research and development and have no alternative future use are expensed when incurred.

Stock-Based Compensation

Deferred stock-based compensation and related amortization represents the difference between the exercise price of stock options granted and the fair value of our common stock at the applicable date of grant. Stock-based compensation is amortized as research and development expense or general and administrative expense, as appropriate, over the vesting period of the individual stock options for which it was recorded, generally four years. If employees and consultants continue to vest in accordance with their individual stock options, we expect to record amortization expense for deferred stock-based compensation as follows: $2.6 million during the last three months of 2002, $10.2 million during 2003

and $0.9 million during 2004. The amount of stock-based compensation expense to be recorded in future periods may decrease if unvested stock options for which deferred stock-based compensation has been recorded are subsequently canceled or forfeited or may increase if additional stock options are granted to individuals other than employees or directors.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 141, "Business Combinations," and No. 142, "Goodwill and Other Intangible Assets." These statements, which we fully adopted on January 1, 2002, generally require that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. Additionally, any resulting goodwill will not be amortized, but rather will be subject to at least an annual impairment test. Acquired intangible assets will be separately recognized and amortized over their useful lives.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This new standard on asset impairment, which we adopted effective January 1, 2002, supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." The adoption of this standard had no impact on the Company.

RESULTS OF OPERATIONS

Three Months Ended September 30, 2002 and 2001

Revenues. Total revenues decreased 41% to $8.0 million in the three months ended September 30, 2002 from $13.5 million in the corresponding period in 2001. The decrease was primarily the result of our recognition of revenues in the third quarter of 2001 for technology license fees under sublicense agreements completed in that period with GlaxoSmithKline plc and Merck & Co., Inc., and to a lesser extent, our recognition of revenues under agreements with pharmaceutical and biotechnology companies for access to chemical libraries and optimization services, as a result of our acquisition of Coelacanth in July 2001. These decreases were offset in part by a $0.9 million increase in revenues derived from functional genomics collaborations for the development and analysis of knockout mice.

Research and Development Expenses. Research and development expenses, including stock-based compensation expense, increased 32% to $19.8 million in the three months ended September 30, 2002 from $15.0 million in the corresponding period in 2001. The increase of $4.8 million was primarily attributable to increased personnel costs to support the expansion of our drug discovery programs, the development and analysis of knockout mice and our other functional genomics research efforts. Research and development expenses for both three-month periods included $1.3 million of stock-based compensation primarily relating to option grants made prior to our April 2000 initial public offering.

General and Administrative Expenses. General and administrative expenses, including stock-based compensation expense, decreased 11% to $5.8 million in the three months ended September 30, 2002 from $6.4 million in the corresponding period in 2001. The decrease of $0.6 million was due primarily to a reduction in legal costs as a result of the September 2001 settlement of our patent infringement litigation against Deltagen, Inc., offset by additional personnel costs. General and administrative expenses for both three-month periods included $1.3 million of stock-based compensation primarily relating to option grants made prior to our April 2000 initial public offering.

Interest and Other Income, Net. Interest and other income, net decreased to $0.7 million in the three months ended September 30, 2002 from $1.7 million in the corresponding period in 2001. The decrease resulted from lower average cash and investment balances and lower average interest rates during the 2002 period.

Net Loss and Net Loss Per Common Share. Net loss increased to $16.8 million in the three months ended September 30, 2002 from $6.2 million in the corresponding period in 2001. Net loss per common share increased to $0.32 in the three months ended September 30, 2002 from $0.12 in the corresponding period of 2001. A portion of the net loss for the three months ended September 30, 2002 and 2001 was attributable to stock-based compensation expense. Excluding stock-based compensation expense, we would have had a net loss of $14.2 million and net loss per common share of $0.27 in the three months ended September 30, 2002, as compared to a net loss of $3.6 million and net loss per common share of $0.07 in the corresponding period in 2001.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future, and we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance.

Nine Months Ended September 30, 2002 and 2001

Revenues. Total revenues increased 24% to $25.1 million in the nine months ended September 30, 2002 from $20.3 million in the corresponding period in 2001. Of the $4.8 million increase, $5.7 million was derived from increased revenues from functional genomics collaborations for the development and analysis of knockout mice and from our drug discovery alliance with Incyte Genomics, Inc., offset by a decrease of $1.0 million in revenues for access to our chemical libraries and optimization services as a result of our decision to use our compound libraries principally in our own drug discovery efforts and not, subject to limited exceptions, to make them available for purchase.

Research and Development Expenses. Research and development expenses, including stock-based compensation expense, increased 56% to $55.6 million in the nine months ended September 30, 2002 from $35.6 million in the corresponding period in 2001. The increase of $20.0 million was primarily attributable to increased personnel costs to support the expansion of our drug discovery programs, the development and analysis of knockout mice and our other functional genomics research efforts. Research and development expenses for the nine months ended September 30, 2002 and 2001 included $3.9 million and $4.1 million, respectively, of stock-based compensation primarily relating to option grants made prior to our April 2000 initial public offering.

General and Administrative Expenses. General and administrative expenses, including stock-based compensation expense, increased 13% to $17.7 million in the nine months ended September 30, 2002 from $15.8 million in the corresponding period in 2001. The increase of $1.9 million was due primarily to additional personnel costs, offset by a reduction in legal costs as a result of the September 2001 settlement of our patent infringement litigation against Deltagen, Inc. General and administrative expenses for the nine months ended September 30, 2002 and 2001 included $3.8 million and $4.0 million, respectively, of stock-based compensation primarily relating to option grants made prior to our April 2000 initial public offering.

Interest and Other Income, Net. Interest and other income, net decreased to $2.5 million in the nine months ended September 30, 2002 from $6.8 million in the corresponding period in 2001. The decrease resulted from lower average cash and investment balances, lower average interest rates and a loss of $197,000 realized on the sale of long-term investments during the 2002 period.

Net Loss and Net Loss Per Common Share. Net loss increased to $45.8 million in the nine months ended September 30, 2002 from $24.2 million in the corresponding period in 2001. Net loss per common share increased to $0.88 in the nine months ended September 30, 2002 from $0.49 in the corresponding period of 2001. A portion of the net loss for the nine months ended September 30, 2002 and 2001 was attributable to stock-based compensation expense. Excluding stock-based compensation expense, we would have had a net loss of $38.1 million and net loss per common share of $0.73 in the nine months ended September 30, 2002, as compared to a net loss of $16.1 million and net loss per common share of $0.32 in the corresponding period in 2001.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations from inception primarily through sales of common and preferred stock, contract and milestone payments to us under our database subscription, collaboration and license agreements, equipment financing arrangements and leasing arrangements. From our inception through September 30, 2002, we had received net proceeds of $242.6 million from issuances of common and preferred stock, including $203.2 million of net proceeds from the initial public offering of our common stock in April 2000. In addition, from our inception through September 30, 2002, we received $81.7 million in cash payments from database subscription and technology license fees, drug discovery alliances, functional genomics collaborations, sales of compound libraries and reagents, and government grants, of which $78.4 million had been recognized as revenues through September 30, 2002.

As of September 30, 2002, we had $119.6 million in cash, cash equivalents, short-term and long-term investments (including restricted cash and investments), as compared to $166.8 million as of December 31, 2001. We used cash of $32.0 million in operations in the nine months ended September 30, 2002. This consisted primarily of the net loss for the period of $45.8 million offset by non-cash charges of $7.7 million related to stock-based compensation expense, $6.6 million related to depreciation expense and $0.9 million related to amortization of intangible assets other than goodwill. Investing activities provided cash of $88.2 million in the nine months ended September 30, 2002, principally as a result of net maturities of short-term investments and the sale of long-term investments, offset in part by purchases of property and equipment. We received cash of $0.5 million in financing activities in the nine months ended September 30, 2002, principally as a result of stock option exercises.

In October 2000, we entered into a synthetic lease agreement under which the lessor purchased our existing laboratory and office buildings and animal facility in The Woodlands, Texas and agreed to fund the construction of an additional laboratory and office building and a second animal facility. The synthetic lease agreement was subsequently expanded to include funding for the construction of a central plant facility for the distribution of utilities and related services among our facilities. Including the purchase price for our existing facilities, the synthetic lease, as amended, provided for funding of up to $55.0 million in property and improvements. The term of the agreement is six years, which includes the construction period and a lease period. Lease payments for the new facilities began upon completion of construction, which occurred at the end of the first quarter of 2002. Lease payments are subject to fluctuation based on LIBOR rates. Based on a LIBOR rate of 1.81% at September 30, 2002, our total lease payments would be approximately $1.1 million per year. At the end of the lease term, the lease may be extended for one-year terms, up to seven additional terms, or we may purchase the properties for a price including the outstanding lease balance. If we elect not to renew the lease or purchase the properties, we may arrange for the sale of the properties to a third party or surrender the properties to the lessor. If we elect to arrange for the sale of the properties or surrender the properties to the lessor, we have guaranteed approximately 86% of the total original cost as the residual fair value of the properties. We are required to maintain restricted cash or investments to collateralize borrowings made under the synthetic lease agreement. In addition, we have agreed to maintain cash and investments of at least $30.0 million in excess of our restricted cash and investments. If our cash and investments fall below that level, we may

be required to seek a waiver of that agreement or to purchase the properties or arrange for their sale to a third party. Because our cost to purchase the properties would not materially exceed the amount of restricted cash and investments we are required to maintain under the synthetic lease, we believe that any requirement that we do so would not have a material adverse effect on our financial condition. As of September 30, 2002 and December 31, 2001, we maintained restricted cash and investments of $57.2 million and $43.3 million, respectively, to collateralize borrowings of $55.0 million and $41.7 million.

On February 13, 2002, the FASB announced that it intended to propose for adoption before the end of 2002 that companies be required to consolidate special purpose entities, such as the lessor under our synthetic lease, on their balance sheets under certain circumstances. In a proposed interpretation dated June 28, 2002, the FASB outlined new rules that would require such consolidation by a lessee that provides a residual value guarantee or similar arrangement to the lessor/special purpose entity. While the lessor under our synthetic lease qualifies for off-balance sheet treatment under current rules, we will be required to consolidate the lessor on our balance sheet if the FASB's proposed interpretation as currently drafted is adopted. If such consolidation is required, our balance sheet will reflect as assets additional property and equipment approximating the $55.0 million funded under the synthetic lease for property and improvements and the same amount as a liability. In addition, we will be required to depreciate such property and improvements over their useful lives. The proposed guidance would require companies with calendar-fiscal years that have existing special purpose entities, such as ours, to apply the new standards on April 1, 2003. We believe that the consolidation of the lessor, if required, will not have a material adverse effect on our financial condition or results of operations. We will continue to monitor the FASB's proposals and evaluate their impact on our synthetic lease.

On May 23, 2002, Lexicon Pharmaceuticals (New Jersey), Inc. signed a ten-year lease for a 76,000 square-foot facility in Princeton, New Jersey. The lease provides for an escalating yearly rent payment of $1.3 million in the first year, $1.7 million in years two and three, $1.8 million in years four to six, $2.0 million in years seven to nine and $2.1 million in year ten. The lease also provides Lexicon Pharmaceuticals with the option in the second year of the lease to borrow $2.0 million in tenant improvement funds from the landlord, at which time rental payments due under the lease will increase as the tenant improvement allowance is amortized over a ten-year period. Lexicon is the guarantor of the obligations of Lexicon Pharmaceuticals (New Jersey), Inc. under the lease.

Our future capital requirements will be substantial and will depend on many factors, including our ability to obtain database subscription, alliance, collaboration and technology license agreements, the amount and timing of payments under such agreements, the level and timing of our research and development expenditures, market acceptance of our products, the resources we devote to developing and supporting our products and other factors. Our capital requirements will also be affected by any expenditures we make in connection with license agreements and acquisitions of and investments in complementary technologies and businesses. We expect to devote substantial capital resources to continue our research and development efforts, to expand our support and product development activities, and for other general corporate activities. We believe that our current unrestricted cash and investment balances and revenues we expect to derive from subscriptions to our databases, functional genomics collaborations, technology licenses and drug discovery alliances will be sufficient to fund our operations at least through the end of 2003. During or after this period, if cash generated by operations is insufficient to satisfy our liquidity requirements, we will need to sell additional equity or debt securities or obtain additional credit arrangements. Additional financing may not be available on terms acceptable to us or at all. The sale of additional equity or convertible debt securities may result in additional dilution to our stockholders.

DISCLOSURE ABOUT MARKET RISK

We are exposed to limited market and credit risk on our cash equivalents, which have maturities of three months or less. We maintain a short-term investment portfolio which consists of U.S. government agency debt obligations and investment grade commercial paper that mature three to twelve months from the time of purchase, which we believe are subject to limited market and credit risk. Additionally, we hold long-term investments consisting of U.S. government agency debt obligations with a maturity of greater than twelve months from the time of purchase. These investments are also subject to market and credit risk. A hypothetical one percent increase in market rates would result in a decrease of approximately $0.5 million in the fair value of our long-term investments as of September 30, 2002. We currently do not hedge interest rate exposure or hold any derivative financial instruments in our investment portfolio.

We have operated primarily in the United States and substantially all sales to date have been made in U.S. dollars. Accordingly, we have not had any material exposure to foreign currency rate fluctuations.

RISK FACTORS

Our business is subject to certain risks and uncertainties, including those referenced below:

Risks Related to Our Business

- we have a history of net losses, and we expect to continue to incur net losses and may not achieve or maintain profitability
- our quarterly operating results have been and likely will continue to fluctuate, and we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance
- we are an early-stage company with an unproven business strategy
- we will need additional capital in the future and, if it is not available, we will have to curtail or cease operations
- we face substantial competition in the discovery of the functions of genes and in our drug discovery and product development efforts
- we rely heavily on collaborators to develop and commercialize pharmaceutical products based on genes that we identify as promising candidates for development as drug targets
- any cancellation by or conflicts with our collaborators could harm our business
- we have no experience in developing and commercializing pharmaceutical products on our own
- we may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits
- if we lose our key personnel or are unable to attract and retain additional personnel, we may be unable to pursue collaborations or develop our own products

- we may encounter difficulties in managing our growth, which could increase our losses

- because our entire OmniBank mouse clone library is located at a single facility, the occurrence of a disaster could significantly disrupt our business

Risks Related to Our Industry

- our ability to patent our discoveries is uncertain because patent laws and their interpretation are highly uncertain and subject to change

- our patent applications may not result in enforceable patent rights

- if other companies and institutions obtain patents claiming the functional uses of genes and gene products based upon gene sequence information and predictions of gene function, we may be unable to obtain patents for our discoveries of biological function in knockout mice

- we may become involved in patent litigation and other disputes regarding intellectual property rights, and can give no assurance that we will prevail in any such litigation or other dispute

- issued patents may not fully protect our discoveries, and our competitors may be able to commercialize products similar to those covered by our issued patents

- our rights to the use of technologies licensed by third parties are not within our control

- we may be unable to protect our trade secrets

- we may become subject to regulation under the Animal Welfare Act, which could subject us to additional costs and permit requirements

- we and our collaborators are subject to extensive and uncertain government regulatory requirements, which could increase our operating costs or adversely affect our ability to obtain government approval of products based on genes that we identify in a timely manner or at all

- the uncertainty of pharmaceutical pricing and reimbursement may decrease the commercial potential of our products and affect our ability to raise capital

- security risks in electronic commerce or unfavorable internet regulation may deter future use of our products and services

- we use hazardous chemicals and radioactive and biological materials in our business; any disputes relating to improper handling, storage or disposal of these materials could be time consuming and costly

- we may be sued for product liability

- public perception of ethical and social issues may limit or discourage the use of our technologies, which could reduce our revenues

For additional discussion of the risks and uncertainties that affect our business, see "Item 1. Business - Risk Factors" included in our annual report on Form 10-K for the year ended December 31, 2001, as filed with the Securities and Exchange Commission.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See "Disclosure about Market Risk" under "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations for quantitative and qualitative disclosures about market risk.

ITEM 4. CONTROLS AND PROCEDURES

Lexicon's chief executive officer and chief financial officer have concluded that the Company's disclosure controls and procedures (as defined in Securities Exchange Act of 1934 (the "Exchange Act") Rules 13a-14 (c) and 15d-14(c)) are sufficiently effective to ensure that the information required to be disclosed by the Company in the reports it files under the Exchange Act is gathered, analyzed and disclosed with adequate timeliness, accuracy and completeness, based on an evaluation of such controls and procedures conducted within 90 days prior to the date hereof.

Subsequent to the Company's evaluation, there were no significant changes in internal controls or other factors that could significantly affect internal controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II - OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

EXHIBIT NO.		DESCRIPTION
99.1	--	Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K:

None.

SIGNATURES

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

LEXICON GENETICS INCORPORATED

Date: November 6, 2002

By: /s/ ARTHUR T. SANDS

Arthur T. Sands, M.D., Ph.D.
President and Chief Executive Officer

Date: November 6, 2002

By: /s/ JULIA P. GREGORY

Julia P. Gregory
Executive Vice President and
Chief Financial Officer

CERTIFICATIONS

I, Arthur T. Sands, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lexicon Genetics Incorporated;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 6, 2002

/s/ ARTHUR T. SANDS

Arthur T. Sands, M.D., Ph.D.
President and Chief Executive Officer

CERTIFICATIONS

I, Julia P. Gregory, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lexicon Genetics Incorporated;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

   d) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   e) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 6, 2002

/s/ JULIA P. GREGORY

Julia P. Gregory
Executive Vice President and Chief Financial Officer

INDEX TO EXHIBITS

EXHIBIT NO.		DESCRIPTION
99.1	--	Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

EXHIBIT 99.1

CERTIFICATION

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350, as adopted), Arthur T. Sands, M.D., Ph.D., Chief Executive Officer of Lexicon Genetics Incorporated ("Lexicon"), and Julia P. Gregory, Chief Financial Officer of Lexicon, each hereby certify that:

1. Lexicon's Quarterly Report on Form 10-Q for the period ended September 30, 2002, and to which this Certification is attached as Exhibit 99.1 (the "Periodic Report"), fully complies with the requirements of section 13(a) or section 15(d) of the Securities Exchange Act of 1934, and

2. The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of Lexicon.

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 6th day of November, 2002.

Date: November 6, 2002 By: /s/ ARTHUR T. SANDS

Arthur T. Sands, M.D., Ph.D.
President and Chief Executive Officer

Date: November 6, 2002 By: /s/ JULIA P. GREGORY

Julia P. Gregory
Executive Vice President and
Chief Financial Officer