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

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2003

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  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

76-0474169  
(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  No

As of May 6, 2003, 52,495,423 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 MARCH 31, 2003	AS OF DECEMBER 31, 2002
	----- (UNAUDITED)	-----
ASSETS		
-----		
Current assets:		
Cash and cash equivalents.....	\$ 39,177	\$ 39,362
Restricted cash.....	44,831	29,487
Short-term investments, including restricted investments of \$12,879 and \$28,223, respectively .....	23,579	54,247
Accounts receivable, net of allowance for doubtful accounts of \$109.....	3,809	5,143
Prepaid expenses and other current assets.....	4,590	4,893
	-----	-----
Total current assets.....	115,986	133,132
Property and equipment, net of accumulated depreciation of \$22,303 and \$19,768, respectively.....	35,516	37,362
Goodwill.....	25,798	25,798
Intangible assets, net of amortization of \$2,060 and \$1,760, respectively	3,940	4,240
Other assets.....	727	1,240
	-----	-----
Total assets.....	\$ 181,967	\$ 201,772
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
-----		
Current liabilities:		
Accounts payable.....	\$ 2,752	\$ 4,378
Accrued liabilities.....	3,534	4,161
Current portion of deferred revenue.....	10,503	12,760
	-----	-----
Total current liabilities.....	16,789	21,299
Deferred revenue, net of current portion.....	5,137	5,887
Long-term debt.....	4,000	4,000
Other long-term liabilities.....	720	684
	-----	-----
Total liabilities.....	26,646	31,870
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; 52,374 and 52,367 shares issued and outstanding.....	52	52
Additional paid-in capital.....	330,666	330,701
Deferred stock compensation.....	(8,507)	(11,106)
Accumulated deficit.....	(166,890)	(149,745)
	-----	-----
Total stockholders' equity.....	155,321	169,902
	-----	-----
Total liabilities and stockholders' equity.....	\$ 181,967	\$ 201,772
	=====	=====

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 MARCH 31,	
	2003	2002
Revenues:		
Subscription and license fees.....	\$ 3,102	\$ 3,395
Collaborative research.....	4,993	4,256
Compound libraries and other.....	11	5
Total revenues.....	8,106	7,656
Operating expenses:		
Research and development, including stock-based compensation of \$1,270 and \$1,307, respectively.....	19,834	16,864
General and administrative, including stock-based compensation of \$1,276 and \$1,282, respectively.....	5,804	5,969
Total operating expenses.....	25,638	22,833
Loss from operations.....	(17,532)	(15,177)
Interest and other income.....	468	1,120
Interest expense.....	(81)	(2)
Net loss .....	\$ (17,145)	\$ (14,059)
Net loss per common share, basic and diluted.....	\$ (0.33)	\$ (0.27)
Shares used in computing net loss per common share, basic and diluted.....	52,371	52,126

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

LEXICON GENETICS INCORPORATED  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(IN THOUSANDS)  
(UNAUDITED)

	THREE MONTHS ENDED MARCH 31,	
	2003	2002
Cash flows from operating activities:		
Net loss.....	\$ (17,145)	\$ (14,059)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation.....	2,535	1,920
Amortization of intangible assets, other than goodwill.....	300	300
Amortization of deferred stock compensation.....	2,547	2,589
Changes in operating assets and liabilities:		
Decrease in accounts receivable.....	1,334	262
(Increase) decrease in prepaid expenses and other current assets..	303	(684)
Decrease in other assets.....	513	2,307
Decrease in accounts payable and other liabilities.....	(2,217)	(113)
Decrease in deferred revenue.....	(3,007)	(1,752)
Net cash used in operating activities.....	(14,837)	(9,230)
Cash flows from investing activities:		
Purchases of property and equipment.....	(689)	(8,735)
Increase in restricted cash.....	(15,344)	(17,949)
Purchases of short-term investments.....	(15,386)	(14,161)
Maturities of short-term investments.....	46,054	56,352
Net cash provided by investing activities.....	14,635	15,507
Cash flows from financing activities:		
Proceeds from issuance of common stock.....	17	267
Net cash provided by financing activities.....	17	267
Net increase (decrease) in cash and cash equivalents.....	(185)	6,544
Cash and cash equivalents at beginning of period.....	39,362	16,355
Cash and cash equivalents at end of period.....	\$ 39,177	\$ 22,899
	=====	=====
Supplemental disclosure of cash flow information:		
Cash paid for interest.....	\$ 1	\$ 2
Supplemental disclosure of non-cash investing and financing activities:		
Unrealized loss on long-term investments.....	\$ --	\$ (322)
Cancellation of equity securities issued in connection with acquisition	\$ --	\$ (78)
Reversal of deferred stock compensation in connection with stock options.....	\$ 52	\$ 309

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 three-month period ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003.

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, 2002, as filed with the SEC.

2. RECLASSIFICATION

The accompanying statement of cash flows for the three months ended March 31, 2002, has been revised to reflect the reclassification of restricted cash from cash and cash equivalents into a separate line item.

3. RESTRICTED CASH AND INVESTMENTS

Lexicon is required to maintain restricted cash or investments to collateralize borrowings made under the synthetic lease agreement under which it leases its office and laboratory facilities in The Woodlands, Texas, as well as to collateralize standby letters of credit for the leases on its office and laboratory facilities in East Windsor and Hopewell, New Jersey (see Note 7). As of March 31, 2003 and December 31, 2002, the Company maintained restricted cash and investments of \$57.7 million under these agreements.

4. 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 period ended March 31, 2002 was \$14.4 million, which includes a \$0.3 million unrealized loss on long-term investments. During 2002, Lexicon sold its available-for-sale securities. As a result there was no difference between net loss and comprehensive loss in the three-month period ended March 31, 2003.

5. 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.

#### 6. STOCK-BASED COMPENSATION

Lexicon's stock-based compensation plans are accounted for under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees, and Related Interpretations." Under the intrinsic value method described in APB Opinion No. 25, no compensation expense is recognized if the exercise price of the employee stock option equals the market price of the underlying stock on the date of grant. Lexicon recognized \$2.5 million and \$2.6 million of stock-based compensation during the three-month periods ended March 31, 2003 and 2002, respectively, which was primarily related to option grants made prior to Lexicon's April 2000 initial public offering. The following table illustrates the effect on net loss and net loss per share if the fair value recognition provisions of Financial Accounting Standards Board (FASB) No. 123 "Accounting for Stock Based Compensation," had been applied to all outstanding and unvested awards in each period:

	----- THREE MONTHS ENDED MARCH 31, -----	
	2003	2002
	-----	-----
Net loss, as reported.....	\$ (17,145)	\$ (14,059)
Add: Stock-based employee compensation expense included in reported net loss.....	2,546	2,589
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards.....	(6,443)	(6,150)
	-----	-----
Pro forma net loss.....	\$ (21,042)	\$ (17,620)
	=====	=====
Net loss per common share, basic and diluted		
As reported.....	\$ (0.33)	\$ (0.27)
	=====	=====
Pro forma.....	\$ (0.40)	\$ (0.34)
	=====	=====

#### 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 1.3% at March 31, 2003 the Company's total lease payments would be approximately \$0.9 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 equal to the \$55.0 million funded under the synthetic lease for property and improvements plus the amount of any accrued but unpaid lease payments. 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 amounts funded under the synthetic lease agreement. In addition, Lexicon has agreed to maintain cash and investments of at least \$12.0 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 \$55.0 million funded under the synthetic lease for property and improvements and would likely be less than 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. As of March 31, 2003 and December 31, 2002, the Company maintained restricted cash and investments of \$57.2 million to collateralize funding for property and improvements under the synthetic lease of \$55.0 million.

Lexicon's subsidiary leases laboratory and office space in East Windsor and Hopewell, New Jersey under agreements which expire in January 2004 and May 2012, respectively. The Hopewell lease is a ten-year lease for a 76,000 square-foot facility in 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 an 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 its subsidiary under the lease. The Company is required to maintain restricted investments to collateralize the East Windsor and Hopewell leases. As of March 31, 2003, the Company had \$0.5 million in restricted investments to collateralize standby letters of credit for these leases.



## 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 Genentech, Inc. for the discovery of therapeutic proteins and antibody targets; 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 March 31, 2003, we had an accumulated deficit of \$166.9 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, facility costs, depreciation on property and equipment, 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. 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

We recognize revenues when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed and determinable, and collectability is reasonably assured. Payments received in advance under these arrangements are recorded as deferred revenue until earned.

Fees for access to our databases and other functional genomics resources are recognized ratably over the subscription or access period. Collaborative research payments are recognized as revenue as we perform our obligations related to such research to the extent such fees are non-refundable. 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.

Revenues recognized from multiple element contracts are allocated to each element of the arrangement based on the relative fair value of the elements. The determination of fair value of each element is based on objective evidence. When revenues for an element are specifically tied to a separate earnings process, revenue is recognized when the specific performance obligation associated with the element is completed. When revenues for an element are not specifically tied to a separate earnings process, they are recognized ratably over the term of the agreement.

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: \$7.6 million during the remaining nine months of 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.

## Goodwill Impairment

Goodwill is not amortized, but is tested at least annually for impairment at the reporting unit level. Impairment is the condition that exists when the carrying amount of goodwill exceeds its implied fair value. The first step in the impairment process is to determine the fair value of the reporting unit and then compare it to the carrying value, including goodwill. If the fair value exceeds the carrying value, no further action is required and no impairment loss is recognized. Additional impairment assessments may be performed on an interim basis if we encounter events or changes in circumstances that would indicate that, more likely than not, the carrying value of goodwill has been impaired.

## RECENT ACCOUNTING PRONOUNCEMENTS

In November 2002, the Emerging Issues Task Force, or EITF, reached a consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." This consensus requires that revenue arrangements with multiple deliverables be divided into separate units of accounting if the delivered items have value to the customer on a standalone basis, there is objective and reliable evidence of fair value of the undelivered items and, if the arrangement includes a general right of return, performance of the undelivered item is considered probable and substantially in our control. The final consensus will be applicable to agreements entered into in fiscal periods beginning after June 15, 2003, with early adoption permitted.

In December 2002, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." This statement amends SFAS 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based accounting for employee

compensation and the effect of the method used on reported results. The Company is currently evaluating whether to adopt the fair value based method.

In January 2003, the FASB issued Interpretation, or FIN, No. 46, "Consolidation of Variable Interest Entities." FIN 46 requires that unconsolidated variable interest entities be consolidated by their primary beneficiaries. A primary beneficiary is the party that absorbs a majority of the entity's expected losses or residual benefits. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to existing variable interest entities in the periods beginning after June 15, 2003. We are evaluating whether the adoption of FIN 46 will require us to consolidate the lessor under our synthetic lease. 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, less accumulated depreciation, and a similar amount as a liability. In addition, we will be required to depreciate such improvements over their useful lives. We may, however, elect to restructure or replace the synthetic lease prior to the adoption of FIN 46, whether or not such consolidation would be required. We believe that the consolidation of the lessor or restructuring of the synthetic lease will not have a material adverse effect on our financial condition or results of operations.

## RESULTS OF OPERATIONS

Three Months Ended March 31, 2003 and 2002

**Revenues.** Total revenues increased 6% to \$8.1 million in the three months ended March 31, 2003 from \$7.7 million in the corresponding period in 2002. The increase of \$0.4 million was primarily the result of revenues recognized under our drug discovery alliance with Genentech, entered in December 2002, offset in part by reduced revenues under technology license agreements.

**Research and Development Expenses.** Research and development expenses increased 18% to \$19.8 million in the three months ended March 31, 2003 from \$16.9 million in the corresponding period in 2002. The increase of \$2.9 million was primarily attributable to increased personnel costs and facilities 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 decreased 3% to \$5.8 million in the three months ended March 31, 2003 from \$6.0 million in the corresponding period in 2002. 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.** Interest and other income decreased to \$0.5 million in the three months ended March 31, 2003 from \$1.1 million in the corresponding period in 2002. The decrease resulted from lower average cash and investment balances and lower average interest rates during the 2003 period.

**Net Loss and Net Loss Per Common Share.** Net loss increased to \$17.1 million in the three months ended March 31, 2003 from \$14.1 million in the corresponding period in 2002. Net loss per common share increased to \$0.33 in the three months ended March 31, 2003 from \$0.27 in the corresponding period of 2002. As a complement to reporting net loss and net loss per common share in accordance with generally accepted accounting principles, or GAAP, Lexicon provides net loss and net loss per common share excluding non-cash, stock-based compensation. Lexicon uses these results in

establishing budgets and believes it is useful in measuring the performance of the Company's business. Excluding stock-based compensation expense of \$2.5 million and \$2.6 million in the three months ended March 31, 2003 and 2002, respectively, we would have had a net loss of \$14.6 million and net loss per common share of \$0.28 in the three months ended March 31, 2003, as compared to a net loss of \$11.5 million and net loss per common share of \$0.22 in the corresponding period in 2002.

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.

#### 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 March 31, 2003, we had received net proceeds of \$242.7 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 March 31, 2003, we received \$108.1 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 \$96.6 million had been recognized as revenues through March 31, 2003.

As of March 31, 2003, we had \$107.6 million in cash, cash equivalents and short-term investments (including \$57.7 million of restricted cash and investments), as compared to \$123.1 million as of December 31, 2002. We used cash of \$14.8 million in operations in the three months ended March 31, 2003. This consisted primarily of the net loss for the period of \$17.1 million offset by non-cash charges of \$2.5 million related to stock-based compensation expense, \$2.5 million related to depreciation expense and \$0.3 million related to amortization of intangible assets other than goodwill. Investing activities provided cash of \$14.6 million in the three months ended March 31, 2003, principally as a result of net maturities of short-term investments, offset in part by an increase in restricted cash.

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 1.3% at March 31, 2003, our total lease payments would be approximately \$0.9 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 equal to the \$55.0 million funded under the synthetic lease for property and improvements plus the amount of any accrued but unpaid lease payments. 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 amounts funded under the synthetic lease agreement. In addition, we have agreed to maintain cash and investments of at least \$12.0 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 \$55.0 million funded under the synthetic lease for property and improvements and would likely be less than 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 March 31, 2003 and December 31, 2002, we maintained restricted cash and investments of \$57.2 million to collateralize funding for property and improvements under the synthetic lease of \$55.0 million.

In May 2002, our subsidiary Lexicon Pharmaceuticals (New Jersey), Inc. signed a ten-year lease for a 76,000 square-foot facility in Hopewell, 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 our subsidiary 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. We are the guarantor of the obligations of our subsidiary under the lease.

In December 2002, we borrowed \$4.0 million under a note agreement with Genentech. The proceeds of the loan are to be used to fund research efforts under our alliance with Genentech for the discovery of therapeutic proteins and antibody targets. The note matures on or before December 31, 2005, but we may prepay it at any time. We may repay the note, at our option, in cash or in shares of our common stock valued at the then-current market value, or in a combination of cash and shares, subject to certain limitations. The note accrues interest at an annual rate of 8%, compounded quarterly.

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 next 12 months. 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, restructure or replace our synthetic lease to reduce the required amount of restricted cash and investments, 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, investment grade commercial paper, corporate debt securities and certificates of deposit that mature three to 12 months from the time of purchase, which we believe are subject to limited market and credit risk. 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

- o we have a history of net losses, and we expect to continue to incur net losses and may not achieve or maintain profitability
- o 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
- o we will need additional capital in the future and, if it is not available, we will have to curtail or cease operations
- o we are an early-stage company with an unproven business strategy
- o we face substantial competition in the discovery of the DNA sequences of genes and their functions and in our drug discovery and product development efforts
- o 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
- o any cancellation by or conflicts with our collaborators could harm our business
- o we have no experience in developing and commercializing pharmaceutical products on our own
- o we lack the capability to manufacture compounds for preclinical studies and clinical trials and will rely on third parties to manufacture our potential products
- o we may engage in future acquisitions, which may be expensive and time consuming and from which we may not realize anticipated benefits
- o 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
- o we may encounter difficulties in managing our growth, which could increase our losses
- o because all of our functional genomics operations are located at a single facility, the occurrence of a disaster could significantly disrupt our business

### Risks Related to Our Industry

- o our ability to patent our discoveries is uncertain because patent laws and their interpretation are highly uncertain and subject to change
- o our patent applications may not result in enforceable patent rights

- o 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
- o we may be 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
- o 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
- o our rights to the use of technologies licensed by third parties are not within our control
- o we may be unable to protect our trade secrets
- o 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
- o the uncertainty of pharmaceutical pricing and reimbursement may decrease the commercial potential of our products and affect our ability to raise capital
- o security risks in electronic commerce or unfavorable Internet regulation may deter future use of our products and services
- o 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
- o we may be sued for product liability
- o 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, 2002, 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 -----
10.1	-- Consulting Letter Agreement, dated March 31, 2003, with Robert J. Lefkowitz, M.D.
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: May 9, 2003

By: /s/ ARTHUR T. SANDS

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

Date: May 9, 2003

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: May 9, 2003

/s/ Arthur T. Sands

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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):
  - 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: May 9, 2003

/s/ Julia P. Gregory  
-----  
Julia P. Gregory  
EXECUTIVE VICE PRESIDENT AND CHIEF  
FINANCIAL OFFICER

INDEX TO EXHIBITS

EXHIBIT NO. -----	DESCRIPTION -----
10.1	-- Consulting Letter Agreement, dated March 31, 2003, with Robert J. Lefkowitz, M.D.
99.1	-- Certification of CEO and CFO Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

March 31, 2003

VIA FEDERAL EXPRESS  
Dr. Robert J. Lefkowitz  
Duke University Medical Center  
Box 3821  
Durham, North Carolina 27710

Dear Bob:

We are delighted that you, an investigator of the Howard Hughes Medical Institute (the "Institute") at the Institute's laboratory at Duke University ("Duke"), will be able to provide consulting services to Lexicon Genetics Incorporated (which, together with its subsidiaries and affiliates, is referred to as the "Company" or "Lexicon"). The purpose of this letter agreement (this "Agreement") is to set forth our mutual understanding of the terms and conditions of your service as consultant to the Company, as set forth below.

1. Consulting Services. Under this agreement, you will provide such consulting and advisory services as may be requested by Arthur T. Sands, M.D., Ph.D., the Company's President and Chief Executive Officer, relating to: (i) evaluation of the Company's drug discovery and development programs; (ii) identification of key personnel, consultants and service providers to assist in the Company's drug discovery and development efforts; (iii) provision of assistance and advice relating to the establishment of drug discovery collaborations and alliances; and (iv) such other consulting and advisory services relating to the Company's drug discovery and development efforts as you and the Company may agree. We agree, however, that your consulting and advisory services shall be limited to the exchange of ideas only, and that you shall not direct or conduct research for or on behalf of the Company. You will devote up to 10 days annually (inclusive of your time attending scientific review meetings held on the day prior to meetings of the Company's Board of Directors) to providing services to the Company under this Agreement, on a schedule and at times mutually agreed upon by you and Dr. Sands. Your services will be rendered by means of correspondence, telephone calls, submitted reports, information, visits and by other means and manner as may be reasonably requested by Dr. Sands and agreed to by you.

2. Compensation. As full consideration for your services as a consultant to the Company and your obligations under this Agreement, you will receive fees of \$50,000 per year, payable in 12 monthly installments. In addition, you will be reimbursed for your reasonable, ordinary and necessary travel expenses incurred by you at the Company's prior request in connection with your performance of your services under this Agreement.

3. Confidential Information.

(a) In the course of your services for the Company, you may learn or be exposed, orally, visually, electronically or in writing, to inventions, discoveries, improvements, materials, data, technology, processes, formulas, know-how, trade secrets, ideas and other information which we consider proprietary or confidential ("Confidential

Information"). You agree to hold any Confidential Information disclosed to you by the Company or learned by you from the Company in conjunction with your services for the Company in strict confidence and to take all reasonable precautions to protect such Confidential Information, not to disclose any such Confidential Information to any third party, and to use such Confidential Information only in furtherance of your service as an Advisory Panel member; provided that your nondisclosure obligation shall not apply to the extent such Confidential Information (i) is already in the public domain or hereafter enters the public domain other than through your acts or omissions in violation of this Agreement; (ii) is already known to you, as may be shown by competent written records; and (iii) is hereafter received by you without restriction as to confidentiality or use from a third party lawfully entitled so to disclose same in such manner. Information shall not be deemed to be within the foregoing exceptions merely because such information is embraced by more general information in the public domain or in your possession. Information generated by you, alone or with others, shall not constitute Confidential Information subject to the foregoing restrictions unless that information (x) is generated solely as a direct result of the performance of your services under this Agreement and (y) is not generated in the course of the your activities as an employee of the Institute or as a Duke faculty member. All Confidential Information (and any copies and notes thereof) shall remain the sole property of the Company.

(b) You agree not to disclose or otherwise make available to the Company any information that you possess under an obligation of confidentiality to a third party. You may disclose to the Company any information that you would normally freely disclose to other members of the scientific community at large, whether by publication, by presentation at seminars or in informal scientific discussions. However, you shall not disclose to us information that is proprietary to the Institute or Duke and is not generally available to the public other than through formal technology transfer procedures.

#### 4. Inventions and Discoveries.

(a) You hereby assign and transfer to the Company all of your right, title and interest throughout the world in all inventions, discoveries, improvements and other intellectual property, whether or not patentable or subject to copyright, which may be made, written or conceived by you, alone or with others, (i) solely as a direct result of the performance of your services for the Company under this Agreement and (ii) not in the course of your activities as an Institute employee or Duke faculty member (collectively, "Lexicon Intellectual Property"). All such Lexicon Intellectual Property shall be the sole property of the Company or its nominee. The Company agrees that it shall have no rights by reason of this Agreement in any inventions, discoveries, improvements or other intellectual property, whether or not patentable or subject to copyright, which may be made, written or conceived by you, alone or with others, in the course of your activities as an Institute employee or Duke faculty member or as a result of a program of research financed, in whole or in part, by funds provided by or under the control of the Institute or Duke. The Company further acknowledges and agrees that it will enjoy no priority or advantage as a result of the consultancy created by this Agreement in gaining access, whether by license or otherwise, to any proprietary information or intellectual property that arises from any research you undertake in your capacity as an Institute employee or Duke faculty member.

(b) You shall promptly disclose any Lexicon Intellectual Property in writing to the Company in order to permit the Company to claim rights to which it may be entitled under this Agreement. The Company shall have full power and authority to file and prosecute patent applications and copyright registrations throughout the world with respect to all Lexicon Intellectual Property, and to procure and maintain patents and copyrights with respect thereto. You agree, at the Company's reasonable request and expense, to sign, execute and acknowledge, or cause to be signed, executed and acknowledged, any applications, assignments, instruments and other documents, and to perform such other acts, as the Company may deem necessary, useful or convenient to confirm and vest in the Company or its nominee all right, title and interest throughout the world in and to any Lexicon Intellectual Property and all patent, copyright and other intellectual property rights and protections therein, and to assist the Company in procuring, maintaining, enforcing and defending such patent, copyright and other intellectual property rights and protections throughout the world. You agree to treat all such Lexicon Intellectual Property as Confidential Information under this Agreement.

#### 5. Indemnification.

(a) The Company agrees, at its sole expense, to defend you, the Institute and Duke against, and to indemnify and hold you, the Institute and Duke, and their respective trustees, directors, officers, employees, and agents (collectively, "Indemnitees") harmless from, any liability, claim, judgment, cost, expense, damage, deficiency, loss, or obligation, of any kind or nature (including without limitation reasonable attorneys' fees and other costs and expenses of defense) relating to a claim or suit by a third party against you, the Institute, or Duke, or any liabilities or judgments based thereon, either arising from this Agreement, your performance of services for the Company under this Agreement, or any products or services of the Company which result from your services under this Agreement ("Claims"); provided, however, that the Company shall have no obligation to indemnify you for any liability, damage, loss or expense to the extent that it is attributable to: (i) your negligent or wrongful acts or omissions, reckless misconduct or intentional misconduct; (ii) your failure to comply with the terms of this Agreement; (iii) your failure to comply with applicable governmental or legal requirements; (iv) any breach by you of a contractual or fiduciary obligation owed to a third party; and/or (v) misappropriation of trade secrets by you.

(b) As a condition precedent to Lexicon's obligations under Section 5(a) above, each affected Indemnitee must:

(i) reasonably promptly following actual receipt of written notice thereof by you (in the case of a Claim against you) or by an officer or attorney of any other Indemnitee (in the case of a Claim against such other Indemnitee), you or any other Indemnitee (as the case may be) will notify the Company in writing of any such Claim for which such Indemnitee intends to seek indemnification under Section 5(a) above; provided, however, that the delay or failure of an Indemnitee to give reasonably prompt notice to the Company of any Claim shall not affect the Indemnitee's rights unless, and then only to the extent that, such delay or failure is prejudicial to or otherwise adversely affects the Company;



(ii) permit and authorize the Company to conduct and exercise sole control of the defense and disposition of any such Claim (including, without limitation, all decisions to litigate, settle or appeal) and to represent the Indemnitee in connection therewith (and, as necessary and if prior written notice is given to the Indemnitee and the Indemnitee consents to the use of Indemnitee's name, which consent shall not unreasonably be withheld, to use such Indemnitee's name in connection with such defense and disposition); and

(iii) cooperate with the Company in the handling of any such Claim by providing and permitting the Company reasonable access to and copies of pertinent records and documents and by making themselves (and other relevant individuals whom an Indemnitee may control) reasonably available for interview and testimony.

Subject to the foregoing: (x) the Company agrees, at its own expense, to provide attorney(s) to defend against any such Claims, whether or not such actions are rightfully brought (the Company agrees to select attorneys reasonably acceptable to any Indemnitee), (y) the Company will pay all costs necessary to defend against such Claims, and (z) an Indemnitee may, at its/his/her own expense, participate in any such Claim using attorneys of its/his/her choice. In no event may any Indemnitee settle any such Claim for which it/he/she intends to seek indemnification from the Company hereunder without the Company's prior written consent, to be given or withheld in the Company's discretion. The Company agrees not to settle any Claim against an Indemnitee without such Indemnitee's written consent, where such settlement would include any admission of liability on the part of the Indemnitee or where the settlement would impose any restriction on the Indemnitee's conduct of its/his/her activities or where such settlement would not include an unconditional release of the Indemnitee from all liability for claims that are the subject matter of the settled Claim.

6. Term and Termination. You will render your advisory and consulting services to the Company for an initial period of one year commencing upon the date of your signature accepting the provisions of this Agreement on the signature page. The term of this Agreement shall be automatically renewed for additional one-year terms on each anniversary unless either party gives 30 days' advance written notice of non-renewal. This Agreement may be terminated (i) at any time by either party, with or without cause, upon 30 days' advance written notice to the other party and (ii) by either party for breach of this Agreement by the other party that, where curable, is not cured within 10 business days after written notice of such breach is delivered to the breaching party.

7. Independent Contractor. For purposes of this Agreement, you will be deemed an independent contractor and not an employee or agent of the Company. In this connection, you will not be eligible for, nor entitled to, any employee benefits that we normally extend to our employees, and we will not withhold any taxes from the compensation paid to you, all of which shall be your responsibility. The manner in which you render your services under this Agreement will be within your reasonable control and discretion. You have no express or implied authority to incur any liability, or to make any decision or to create any binding obligation, on our behalf.

8. Reference to Affiliation. The Company may use your name, and in doing so may make reference to your affiliation with the Institute and Duke, so long as any such usage is limited to reporting factual events or occurrences (including your relationship with the Company) and is made in a manner that could not reasonably constitute an endorsement of the Company or of any of its programs, products or services. However, the Company shall not use your name or the name of the Institute or Duke in any press release, quote you in any Lexicon materials, or otherwise use your name or the name of the Institute or Duke in a manner not specifically permitted by the preceding sentence, unless in each case the Company obtains your consent and the advance written consent of the Institute or Duke, as applicable.

9. Compliance with Laws and Procedures. To the extent you provide your services under this Agreement on our premises, you agree to observe our business hours, as well as our rules, policies and security procedures concerning conduct and the health, safety and protection of persons and property. You will comply with all applicable governmental laws, ordinances, rules and regulations applicable to the performance of your services under this Agreement. The Company acknowledges that you are an employee of the Institute and a faculty member of Duke and are subject to the Institute and Duke's policies, including policies concerning consulting, conflicts of interest, and intellectual property.

10. No Implied Grants, Options, or Licenses. Except for the express provisions contained herein, nothing in this Agreement shall be deemed as constituting, a grant, option, license, or sublicense to make, use, sell, disclose, or otherwise disseminate any of the Company's patents, Confidential Information or other intellectual property presently in force or existence, or which may be acquired by, issued to, granted upon, invented by, licensed or sublicensed by the Company at a future date.

11. Governing Law. This Agreement shall be governed by, and construed and enforced in accordance with, the laws of the State of Texas as they apply to contracts entered into and wholly to be performed in Texas.

12. Enforcement. You agree that a breach of any of the restrictions set forth in the provisions of this Agreement would cause the Company irreparable injury and damage, and that, in the event of any breach or threatened breach, the Company, in addition to all other rights and remedies at law or in equity, shall have the right to enforce the specific performance of such restrictions and to apply for injunctive relief against their violation.

13. Survival of Terms. The provisions of Sections 3, 4, 5 and 11 through 20 hereof shall survive termination of this Agreement.

14. Successors and Assigns. You may not assign this Agreement without the written consent of the Company. This Agreement shall be binding on your heirs, executors, administrators and legal representatives and the Company's successors and assigns.

15. Severability. The invalidity or unenforceability of any provision of this Agreement (or portion thereof) shall not affect the validity or enforceability of any other provision of this Agreement, and if such provision (or portion thereof) is so broad as to be unenforceable, it shall be interpreted to be only as broad as is enforceable; provided that, if any provision of this Agreement affecting the rights or property of the Institute is adjudicated to be

invalid, unenforceable, contrary to or prohibited under applicable laws or regulations of any jurisdiction, this Agreement shall terminate as of the date such adjudication is effective.

16. Entire Agreement. This Agreement constitutes the sole and complete agreement of the parties with respect to the matters included herein, and supersedes any previous oral or written agreement, if any, relating to the subject matters included herein.

17. Amendment and Waiver. This Agreement may not be amended or supplemented in any way, nor may the benefit of any provision hereof be waived, except by a written agreement duly executed by both you and the Company. The Company and you acknowledge and agree that any amendment of this Agreement (including, without limitation, any change from the terms of Section 2 in the consideration to be provided to you with respect to services to be provided hereunder or any extension of this Agreement other than as set forth in Section 6) or any departure from the terms or conditions hereof with respect to your services for the Company is subject to the Institute's prior written approval.

18. No Conflict. You represent that you have the right under the terms of your relationship with the Institute and Duke to enter into and perform this Agreement, and that the performance of your obligations and duties under this Agreement does not conflict with the Institute or Duke's policies or with any obligations or duties, express or implied, that you may have to third parties. You further represent that you have provided a copy of this Agreement to the Institute and that the Institute has provided written confirmation to you that this Agreement does not violate its policies. We acknowledge and agree that nothing in this Agreement shall affect your obligations to, or research on behalf of, the Institute or Duke, including, without limitation, your obligations or research in connection with a transfer by the Institute or Duke of materials or intellectual property developed in whole or in part by you, or in connection with research collaborations.

19. Individual Capacity; Third Party Beneficiary. You and the Company acknowledge that (i) you are entering into this Agreement in your individual capacity and not as an employee or agent of the Institute, (ii) the Institute is not a party to this Agreement and has no liability or obligation hereunder, and (iii) the Institute is an intended third-party beneficiary of this Agreement and certain provisions of this Agreement are for the benefit of the Institute and are enforceable by the Institute in its own name.

20. Construction. Each party to this Agreement has had the opportunity to review this Agreement with legal counsel. This Agreement shall not be construed or interpreted against any party on the basis that such party drafted or authored a particular provision, parts of or the entirety of this Agreement.

If the foregoing correctly sets forth our mutual understanding, please so indicate by signing this letter in the space provided below and return it to the Company at the above address, whereupon this Agreement shall constitute a binding contract between us and our legal representatives, successors, and assigns.

Very truly yours,

LEXICON GENETICS INCORPORATED

By: /s/ Arthur T. Sands  
-----  
Arthur T. Sands, M.D., Ph.D.  
President and Chief Executive Officer

ACCEPTED AND AGREED TO AS OF THE DATE SET FORTH BELOW:

By: /s/ Robert J. Lefkowitz, M.D.  
-----  
Robert J. Lefkowitz, M.D.

Social Security No.: -----

Date: March 31, 2003

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 March 31, 2003, 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 9th day of May, 2003.

Date: May 9, 2003

By: /s/ ARTHUR T. SANDS

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

Date: May 9, 2003

By: /s/ JULIA P. GREGORY

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Julia P. Gregory  
Executive Vice President and  
Chief Financial Officer