CHIRON CORP
Form 10-K
March 16, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark one)

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

For the fiscal year ended December 31, 2005

OR

o 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: 0-12798

CHIRON CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**94-2754624**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
4560 Horton Street, Emeryville, California	**94608**
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code: **(510) 655-8730**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.01 Par Value

Warrant to Purchase Common Stock, $0.01 Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes: x No: o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes: o No: x

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: o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o	Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: o No: x

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, based upon the closing price of Common Stock on June 30, 2005 as reported on the NASDAQ National Market, was approximately $2.9 billion. Shares of Common Stock held by each executive officer and director and by each shareholder whose beneficial ownership exceeds 5% of the outstanding Common Stock at June 30, 2005 have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of January 31, 2006 was $3.4 billion. The number of shares outstanding of each of the registrant s classes of common stock as of January 31, 2006:

Title of Class	**Number of shares**
Common Stock, $0.01 par value	197,154,517

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement to be filed in connection with the solicitation of proxies for the Annual Meeting of Stockholders to be held on June 22, 2006 are incorporated by reference into Part III of this Report.

PART I

ITEM 1. BUSINESS

Our Policy on Forward-Looking Statements

This 10-K contains forward-looking statements regarding our expectations, hopes or intentions regarding the future, including statements relating to sales growth, product development initiatives, regulatory approval, new product marketing, acquisitions, litigation, competition, and licensing activities that involve risks and uncertainties and are subject to change. The forward-looking statements contained in this 10-K reflect our current expectations on the date of this 10-K. Actual results, performance or outcomes may differ materially from current expectations. Our actual performance may differ from current expectations due to many factors, including additional adverse developments resulting from the suspension from October 5, 2004 through March 2, 2005 of Chiron s UK license to manufacture FLUVIRIN® influenza virus vaccine, the announcement of such suspension and the litigation and investigations relating to these matters, the outcome of clinical trials, regulatory review and approvals, remediation activities, manufacturing capabilities, intellectual property protections and defenses, stock price volatility and marketing effectiveness. In particular there can be no assurance that we will increase sales of existing products, successfully develop and receive approval to market new products, or achieve market acceptance for such new products. No assurances can be given that the transaction contemplated by the merger agreement with Novartis AG will be consummated. In addition, we may engage in business opportunities, the successful completion of which is subject to certain risks, including approval by Novartis, other stockholders, regulatory approvals and the integration of operations. We have discussed the important factors that we believe could cause actual results to differ from what is expressed in the forward-looking statements, in Part II, Item 7, of this 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the caption Factors That May Affect Future Results. We do not undertake an obligation to update the forward-looking information contained in this 10-K.

Overview

We are a global biopharmaceutical company that participates in three healthcare markets: blood testing, vaccines, and biopharmaceuticals. Our revenues, which totaled $1.9 billion in 2005, consist of product sales, revenues from a joint business contractual arrangement, collaborative agreement revenues, royalty and license fee revenues and other revenues, primarily consisting of contract manufacturing and grant revenues. Our research and development efforts are focused on developing products for oncology and infectious and pulmonary disease.

Blood Testing

Our Blood Testing segment is dedicated to improving blood safety through the development and sale of novel blood-screening assays and equipment that protect the world s blood supply. Our Blood Testing segment, which reported total revenues of $555.7 million in 2005, is a world leader in nucleic acid testing, or NAT, blood screening with a leading position in the U.S, and a strong presence in Europe and Asia. The segment also generates revenues from a joint business contractual arrangement, a collaboration agreement, royalties and license fees.

Our Blood Testing segment consists of two separate collaborations: an alliance with Gen-Probe Incorporated (Gen-Probe) for NAT products, and a joint business contractual arrangement with Ortho-Clinical Diagnostics, Inc. (Ortho-Clinical Diagnostics) for immunodiagnostic products. Our collaboration with Gen-Probe was formed in 1998 and focuses on developing and commercializing NAT products to screen donated blood, plasma, organs and tissue for viral infection. We sell the collaboration s assays and instruments to blood banks under the PROCLEIX® brand name. Our joint business contractual arrangement with Ortho-Clinical Diagnostics was formed in 1989 to develop and sell immunodiagnostic

tests to detect retroviruses and hepatitis viruses in blood. Ortho-Clinical Diagnostics manufactures and sells the assays and instrument systems. Chiron shares equally in the profit of the contractual arrangement. Our Blood Testing segment also earns royalties and license fees from third parties based on their sales of immunodiagnostic and nucleic acid testing probe diagnostic products utilizing our hepatitis C virus and HIV-related patents, for use in blood screening and plasma fractionation markets.

Research and development is focused on programs to improve blood safety, including the development of an enzyme conversion system that converts groups A, B and AB red blood cells to enzyme-converted universal blood group O, and the development of a blood-screening assay for variant Creutzfeldt-Jakob disease (vCJD).

Vaccines

Our vaccines segment is the fifth largest vaccines business in the world with total revenues of $602.1 million in 2005. We offer approximately 20 pediatric and adult vaccines including influenza, meningococcal, travel and pediatric vaccines. These vaccines have protected millions of people globally from potentially fatal diseases such as influenza, polio, rabies and meningococcal disease. We market our vaccines primarily in the United States, Germany, Italy and the United Kingdom.

Our heritage in vaccines is traced to the three European manufacturers we acquired over the past two decades, all of which were originally founded 100 or more years ago: Italy-based Sclavo was acquired in 1992, Germany-based Behring was acquired in 1998 and United Kingdom-based PowderJect Pharmaceutical plc, or PowderJect, was acquired in July 2003. We acquired FLUVIRIN® influenza virus vaccine as part of our acquisition of PowderJect.

Our vaccines segment research and development is focused on developing next generation influenza manufacturing capability, including our cell culture derived influenza vaccine, developing new vaccines for pandemic preparedness, and broadening our meningococcal franchise.

Biopharmaceuticals

Our biopharmaceuticals segment researches, develops, manufactures and markets a range of therapeutic products for cancer and infectious and pulmonary disease. The biopharmaceutical segment, which includes both product sales and royalties, reported total revenues of $629.0 million for the year 2005. Our marketed products include TOBI® tobramycin solution for inhalation, USP for pseudomonal lung infections in cystic fibrosis patients; PROLEUKIN® (aldesleukin) for injection for metastatic melanoma and renal cell carcinoma; and BETASERON® (interferon beta-1b) for subcutaneous injection for multiple sclerosis. In January 2006, the European Commission granted marketing approval to Chiron for CUBICIN® (daptomycin), a first-in-class IV antibiotic, adding another commercial product to our portfolio. The marketing approval was granted in the 25 member states of the European Union, Iceland, Liechtenstein and Norway. Under the approval, CUBICIN® is indicated for the treatment of complicated skin and soft-tissue infections (cSSTI) caused by Gram-positive bacteria. Research and development efforts are focused in the areas of oncology and infectious and pulmonary disease including the development of tobramycin inhalation powder, or TIP, a new tobramycin product with an enhanced method of delivery and the clinical advancement of tifacogin for the treatment of severe community-acquired pneumonia. Our oncology pipeline includes CHIR-258, a growth factor kinase inhibitor, CHIR-12.12, an anti CD-40 monoclonal antibody and CHIR-265, a Raf kinase inhibitor.

Royalties and License Fee Revenue

We earn royalty and license fee revenue in all three segments by licensing some of our key intellectual property in areas such as hepatitis C and HIV. In addition, we generate royalties through agreements with development and marketing partners, including royalties from Schering AG s sales of BETAFERON®

(interferon beta-1b) for SC injection in Europe. Some royalties and license fees are not considered to be associated with any particular business segment and are recorded separately in the segment data as Other Royalty and License Fee Revenues. Financial information for the reportable segments is included in Note 18, Segment Information of Notes to Consolidated Financial Statements.

We were incorporated in California in 1981 and merged into a Delaware corporation in November 1986. Our principal executive offices are located at 4560 Horton Street, Emeryville, California 94608, and our main telephone number is (510) 655-8730.

Product Descriptions

Blood Testing

Our collaboration with Gen-Probe is focused on developing and commercializing NAT products using transcription-mediated amplification, or TMA, technology to screen donated blood, plasma, organs and tissue for viral infection. Compared to immunodiagnostic testing, where infection is determined by the presence of antibodies, testing directly for the presence of viral nucleic acids improves the sensitivity of testing and enables infection to be detected earlier than with previously approved technologies.

We sell assays and instrumentation under the PROCLEIX® brand name, and Gen-Probe receives a percentage of our sales revenues. Under the terms of the collaboration agreement, Gen-Probe performs certain product development and manufacturing functions, while Chiron and Gen-Probe jointly participate in new assay and instrument research and development.

Assays developed with Gen-Probe, and their status in the United States and the rest of world include:

	U.S.	**Ex-U.S.**
PROCLEIX® HIV-1/HCV Assay	Marketed	Marketed
PROCLEIX® WNV Assay (West Nile Virus)	Marketed	N/A
PROCLEIX® ULTRIO® Assay (HIV-1, HCV, and HBV)	Biologics License Application filed	Marketed

The PROCLEIX® HIV-1/HCV Assay is a NAT product that was co-developed with Gen-Probe for the simultaneous detection of HIV-1 and hepatitis C virus (HCV) in plasma, whole blood, organs and tissue donations. The global need for HIV-1 and HCV testing continues to increase. Last year, approximately 5 million people acquired HIV, bringing the number of people in the world living with HIV to 39 million, the highest level ever. Annually, approximately 3 million people die from AIDS, the disease caused by HIV infection. HCV is a major cause of acute hepatitis and chronic liver disease, including cirrhosis and liver cancer. Globally, an estimated 170 million persons are chronically infected with HCV and 3 to 4 million persons are newly infected each year. The major causes of HCV infection worldwide are use of unscreened blood transfusions, and re-use of needles and syringes that have not been adequately sterilized. The PROCLEIX® HIV-1/HCV Assay received FDA approval in February 2002 and CE (Conformité Européenne) Mark in Europe in January 2003 for use on the semi-automated PROCLEIX® System. The PROCLEIX® HIV-1/HCV Assay and System are commercially available in the United States and throughout Europe, Asia, Australia and New Zealand and are under evaluation in Latin America and several Asian countries.

The PROCLEIX® ULTRIO® Assay is a premium NAT product offering that adds the direct detection of hepatitis B virus (HBV) to the approved PROCLEIX® HIV-1/HCV Assay, allowing for three results to be obtained in the same amount of time using the same instrumentation. Over 350 million people worldwide are chronic carriers of HBV, with over 2 billion infected. HBV is the leading cause of liver

cancer in the world and is at its highest prevalence in Southeast Asia, Southern Europe, India and Africa. The PROCLEIX® ULTRIO® Assay received CE Mark Registration in Europe on the semi-automated PROCLEIX® System in January 2004 and on the fully automated, high-throughput PROCLEIX® TIGRIS® System in December 2004. We filed a Biologics License Application (BLA) in September 2004 in the United States for use of the PROCLEIX® ULTRIO® Assay on the PROCLEIX® System and the PROCLEIX® TIGRIS® System. On October 3, 2005, the FDA notified Gen-Probe that it considers the PROCLEIX® TIGRIS® System not substantially equivalent to the PROCLEIX® System for screening donated blood with the PROCLEIX® ULTRIO® Assay. Gen-Probe expects to file an amended BLA to respond to the FDA s questions contained in this complete review letter.

The PROCLEIX® WNV (West Nile Virus) Assay, a NAT product co-developed with Gen-Probe for the detection of WNV in plasma, whole blood, organs and tissue has been available for sale in the United States, under an Investigational New Drug, or IND, protocol and labeled For Investigational Use Only since June 2003. In December 2005, we received marketing approval for the PROCLEIX® WNV Assay on the semi-automated PROCLEIX® System. Since testing began under the IND application through December 2005, the PROCLEIX® WNV Assay has detected more than 1,500 West Nile virus contaminated units of donated blood, potentially preventing over 4,500 transfusion transmissions of the virus. The current market for this product is North America (the United States & Canada), although European and Latin American medical authorities have expressed interest in conducting epidemiological studies.

In addition to assays, we also sell equipment under the Gen-Probe collaboration. Blood Testing equipment includes:

- PROCLEIX® System;
- PROCLEIX® TIGRIS® System; and
- PROCLEIX® OPTIVA System

The PROCLEIX® System is a semi-automated instrument platform that is manufactured by Gen-Probe and marketed by Chiron and which has been commercially available since receiving FDA clearance in February 2002. The PROCLEIX® OPTIVA System, is a set of modular components that automate several of the steps performed manually with the PROCLEIX® System. A portion of the PROCLEIX® OPTIVA System, the Front-End Pipetor (FEP), received European CE Marking in June 2004. Another component, the PROCLEIX® OPTIVA Reagent Addition Station (RAS), received CE Marking in April 2005. The PROCLEIX® TIGRIS® System, a next generation, fully automated, high-throughput instrument platform, was launched in Europe in December 2004. It is also available under IND for use with the PROCLEIX® WNV Assay in the United States. The PROCLEIX® TIGRIS® System is manufactured for Gen-Probe and marketed by Chiron. By increasing throughput and automation, the PROCLEIX® TIGRIS® System is designed to allow smaller pool sizes and to enable individual donor testing (IDT) on a large scale, which is important for the detection of diseases with low viremic levels such as West Nile Virus and hepatitis B.

Through its joint business contractual arrangement with us, Ortho-Clinical Diagnostics sells a full line of immunodiagnostic tests for hepatitis viruses and retroviruses and provides supplemental tests and microplate and chemiluminescent instrument systems to automate test performance and data collection. We manufacture, and perform research on, viral antigens used by Ortho-Clinical Diagnostics to manufacture immunodiagnostic testing assays and supplemental hepatitis and HIV tests. Ortho-Clinical Diagnostics manufactures and sells the assays and instrument systems. Commercial products sold under the joint business contractual arrangement include RIBA® tests, which are immunodiagnostic

supplemental confirmatory tests for HIV and HCV developed and manufactured by us, and a line of immunodiagnostics screening tests for infectious diseases. We share equally in the pretax operating earnings generated under the contractual arrangement. The joint business contractual arrangement holds the immunodiagnostic rights to our hepatitis and retrovirus patents and receives royalties from hepatitis C virus and HIV tests sold by Abbott Laboratories, Inc. and from hepatitis C virus tests sold by Bio-Rad Laboratories, Inc. and certain other licensees.

Sales of nucleic acid testing products accounted for 14%, 14% and 11% of our consolidated total revenues in 2005, 2004 and 2003, respectively. Revenues related to our arrangement with Ortho-Clinical Diagnostics, including the joint business contractual arrangement, accounted for approximately 9%, 9% and 8% of our consolidated total revenues in 2005, 2004 and 2003, respectively.

Vaccines

Our vaccines segment offers approximately 20 influenza, meningococcal, travel, and pediatric and other vaccines. In our influenza franchise, our established brands include FLUVIRIN® vaccine, AGRIPPAL® vaccine, BEGRIVAC vaccine, and FLUAD® vaccine. Influenza, a contagious disease caused by the influenza virus, affects the respiratory tract, and can cause mild to severe illness, and sometimes death. Each year in the United States, on average 5% to 20% of the population get influenza, more than 200,000 people are hospitalized from influenza complications, and about 36,000 people die.

In July 2003, we acquired United Kingdom based PowderJect and commenced sales of FLUVIRIN® vaccine, a trivalent influenza vaccine. The vast majority of FLUVIRIN® vaccine production has been supplied to the U.S. market.

We manufacture AGRIPPAL® S1 and BEGRIVAC trivalent influenza vaccines and FLUAD® MF59 adjuvanted influenza vaccine in our Italian and German facilities and market them outside of the United States, largely in Europe. In 2005, we also distributed ENZIRA® influenza virus vaccine in the United Kingdom. ENZIRA® vaccine is manufactured by CSL Ltd. In July 2005, Chiron reported that it would be unable to supply any BEGRIVAC vaccine doses for the 2005-2006 influenza season due to a product sterility issue and wrote off its existing product inventory. Investigation of the product sterility issue has been completed and implementation of remedial measures and facility modifications is underway. In addition to our approved influenza virus vaccines, subsequent to December 31, 2005, we began to manufacture H5N1-strain candidate influenza virus vaccines under contract for various government pandemic stockpile programs.

In our meningococcal franchise, we sell MENJUGATE® vaccine, a conjugate vaccine against meningococcal disease caused by the bacterium *N. meningitidis* serogroup C, and MENZB , a meningococcal B vaccine developed to protect against a specific meningococcus B strain responsible for a 13-year epidemic in New Zealand. Invasive infection with the bacteria *N. meningitidis* can lead to meningococcal meningitis and septicemia (blood poisoning). Meningococcal meningitis can be caused by multiple serogroups (A, B, C, W, Y and others) and is associated with both mortality and morbidity. We have sold MENJUGATE® vaccine under a tender system to national governments and health systems in a variety of countries including various European countries, Canada, Argentina and Australia. We have sold MENZB in New Zealand.

Our travel vaccines franchise includes RABAVERT® and RABIPUR® rabies vaccines and ENCEPUR , a preservative-free tick-borne encephalitis vaccine.

Our pediatric and other vaccines include DTP, a diphtheria, tetanus and pertussis (whooping cough) vaccine; oral polio vaccine; and Vaxem Hib, glycoconjugate *Haemophilus Influenzae* vaccine. In 2000, we entered into agreements with Sanofi-Aventis (previously Aventis Pasteur MSD) for the distribution of FLUAD® vaccine and MENJUGATE® vaccine. Under the agreements, we market FLUAD® vaccine alone and we co-promote MENJUGATE® vaccine with Sanofi-Aventis in the United Kingdom and

Ireland. In the rest of Europe, Sanofi-Aventis distributes, co-markets and sells FLUAD® vaccine and MENJUGATE® vaccine under its own labels, ADIUGRIP and MENINVACT respectively. Our primary manufacturing facilities for vaccines are located in: Siena, Italy; Marburg, Germany; Liverpool, UK; and Ankleshwar, India. We mainly operate in India through a joint venture, Chiron Behring Vaccines Private Limited.

The principal markets for our manufactured vaccines and vaccines that we market under license are the United States, Germany, Italy, and the United Kingdom. We have two vaccines licensed in the United States: FLUVIRIN® influenza virus vaccine and RABAVERT® rabies vaccine. We also supply diphtheria and tetanus (DT) concentrate to GlaxoSmithKline for use in its DT-containing vaccines licensed by the FDA.

In addition, we market our vaccines in other European countries and in the Middle East, the Far East, Africa and South America, and to international health agencies such as UNICEF and the Pan American Health Organization.

In addition to revenues from the sale of the vaccines described above, we receive royalties from the sale of certain vaccines by Merck and Company, Inc. and GlaxoSmithKline, based upon technology developed by us. Merck s hepatitis B virus vaccine, based on Chiron technology, was the first genetically engineered vaccine licensed by the FDA for human use.

Sales of our influenza vaccine franchise products accounted for approximately 12%, 9%, and 19% of our consolidated total revenues in 2005, 2004 and 2003, respectively. In 2005, 2004, and 2003, sales of FLUVIRIN® vaccine accounted for 5%, 0%, and 12% of our consolidated total revenues. As a result of the MHRA s suspension of our license to manufacture FLUVIRIN® vaccine from October 5, 2004 through March 2, 2005, we had no sales of FLUVIRIN® vaccine in 2004 other than $2.3 million in late 2003-2004 season sales. Sales of pediatric and other vaccines accounted for approximately 9%, 12% and 11% of our consolidated revenues in 2005, 2004 and 2003, respectively. No other single vaccine product or class of vaccine product accounted for 10% or more of our consolidated total revenues in any of the last three fiscal years.

On March 16, 2006, we announced a recall and withdrawal of MORUPAR®, our measles, mumps and rubella (MMR) vaccine. We previously supplied MORUPAR® vaccine to customers in a limited number of developing countries, largely via the United Nations Children s Fund (UNICEF) and the Pan American Health Organization (PAHO), and to Italy. Results of pharmacovigilance surveillance in Italy suggest that MORUPAR® vaccine may be associated with a higher reported rate of adverse events following immunization than other MMR vaccine products. We expect to work with the World Health Organization (WHO) to assist it in conducting a risk-benefit analysis to determine whether UNICEF or PAHO will require a limited quantity of the existing inventory of MORUPAR® vaccine for their ongoing public health programs. We have written-off in 2005 approximately $6.0 million of MORUPAR® inventory as a result of the withdrawal and recorded approximately $1.7 million of product returns reserves in 2005 in connection with expected returns of 2005 product sales from the recall.

Biopharmaceuticals

Our biopharmaceutical segment discovers, develops, manufactures and markets a range of therapeutic products primarily for cancer and infectious and pulmonary disease. The following describes our primary marketed products.

TOBI® tobramycin solution for inhalation, USP *We* manufacture and market TOBI® solution, a stable, premixed, proprietary formulation of the antibiotic tobramycin for delivery by inhalation using a nebulizer. TOBI® solution has been tested and approved for cystic fibrosis patients with *Pseudomonas aeruginosa* lung infections and is the first and only inhaled antibiotic solution to be approved by the FDA

for cystic fibrosis. Cystic fibrosis is caused by a genetic mutation that prevents cells from building a special protein required for normal movement of sodium chloride (salt) in and out of cells lining the lungs and other organs. This abnormal movement causes secretion of thick, sticky mucus in the airways. This mucus is not cleared from the airways and, as a result, bacteria begin to grow, causing infection. *Pseudomonas aeruginosa* is the most common bacterium causing lung infections in people with cystic fibrosis. In cystic fibrosis patients with pseudomonal lung infections, tobramycin is the most commonly used intravenous antibiotic. The advantage of inhalation is that it permits higher antibiotic concentrations in the lung and reduces side effects by limiting systemic exposure. Treatment with TOBI® solution decreases the bacterial load and improves overall lung function. We market the TOBI® solution in the United States, the European Union, Canada, Switzerland, Norway, Israel, Argentina and Brazil.

PROLEUKIN® (aldesleukin) for injection *We* manufacture and market PROLEUKIN® (aldesleukin), a recombinant form of interleukin-2. Interleukin-2 is a protein produced naturally in the body in very small quantities, which stimulates the immune system to increase the production and function of immune cells.

While the precise anti-tumor mechanism of PROLEUKIN® (aldesleukin) is unknown, research has demonstrated that PROLEUKIN® (aldesleukin) induces the proliferation of immune cells, including natural killer and cytotoxic T cells that can recognize and mobilize against tumor-specific antigens on the surface of malignant cells. We market PROLEUKIN® (aldesleukin) directly or through distributors in the United States and over 50 other countries in North America, Europe, Asia and South America to treat metastatic renal cell carcinoma (a type of kidney cancer), and in the United States and Canada to treat metastatic melanoma (a form of skin cancer). Studies have demonstrated that PROLEUKIN® (aldesleukin) offers the possibility of a complete and long-lasting remission in these diseases.

BETASERON® (interferon beta-1b) for SC injection *We* manufacture BETASERON® (BETAFERON® in Europe) interferon beta-1b which is marketed by Schering AG and its affiliates, including Berlex Laboratories, Inc. (collectively, Schering). Boehringer Ingelheim also supplies BETAFERON® interferon beta-1b to Schering for sale in Europe. Multiple sclerosis is an autoimmune disease in which the patient s immune system attacks and destroys an element of the patient s own central nervous system. The active ingredient in BETASERON® is a modified form of a beta interferon produced naturally by the human body. Interferons help to regulate the immune system, and BETASERON® interferon beta-1b is thought to help slow down the immune system s attack on nerve tissue. While the ways in which BETASERON® interferon beta-1b actually affects multiple sclerosis are not clearly understood, it has been demonstrated clinically that BETASERON® interferon beta-1b may decrease the nerve damage associated with multiple sclerosis. It has been shown to reduce the overall frequency of multiple sclerosis relapses, which are also called exacerbations or attacks, as well as the number of moderate and severe relapses. BETASERON® interferon beta-1b is approved for relapsing/remitting multiple sclerosis in over 70 countries, including the United States and the nations of the European Union, and for secondary progressive multiple sclerosis in approximately 60 countries, including the nations of the European Union, Canada, Australia and New Zealand. In 2002, we and Schering AG launched a room temperature formulation of BETASERON® interferon beta-1b, which is the only beta interferon currently marketed in the United States that can be stored at room temperature long term up to two years. To further increase ease of use, Chiron and Schering AG introduced a diluent syringe presentation for BETASERON® interferon beta-1b in the United States in January 2004 and in Japan in December 2003. On February 24, 2006 Schering AG notified Chiron of its intention to exercise its option under the companies Regulatory Filing, Development and Supply Agreement to purchase or lease all assets used by Chiron in the manufacture for Schering of BETASERON® interferon beta-1b products and all contractual rights at their fair market or lease value. The purchase/lease option is subject to the closing of the

proposed acquisition of Chiron by Novartis AG. The agreement requires that the value be determined by an independent third party mutually agreed upon by both parties.

CUBICIN® (daptomycin) *In* January 2006, European Commission granted marketing approval to Chiron for CUBICIN®, a first-in-class IV antibiotic. The marketing approval was granted in the 25 member states of the European Union, Iceland, Liechtenstein and Norway. Under the approval, CUBICIN® is indicated for the treatment of complicated skin and soft-tissue infections (cSSTI) caused by Gram-positive bacteria. The CUBICIN® antibiotic is also approved by the FDA for the treatment of complicated skin and skin structure infections caused by Gram-positive bacteria, and is marketed in the United States by Cubist Pharmaceuticals, Inc. We acquired marketing rights to the antibiotic for certain countries outside of the United States from Cubist. CUBICIN® antibiotic is manufactured for us by Cubist Pharmaceuticals, Inc.

CARDIOXANE dexrazoxane (ICRF-187) *Dexrazoxane* is the only cardioprotectant indicated to prevent cardiac damage induced by anthracyclines, a group of chemotherapy medications used to treat a variety of cancers. CARDIOXANE dexrazoxane is currently approved in 31 countries in over four continents.

Our biopharmaceutical products are manufactured primarily in our Emeryville, California and Vacaville, California facilities. Sales of TOBI® formulation accounted for approximately 12%, 12% and 10% of our consolidated total revenues in 2005, 2004 and 2003, respectively. Revenues from BETASERON® interferon beta-1b, which include product sales to Schering and royalties earned on Schering s European sales of BETAFERON® interferon beta-1b, accounted for approximately 11% (7% product sales and 3% royalties), 11% (8% product sales and 3% royalties) and 11% (7% product sales and 4% royalties) of our consolidated total revenues in 2005, 2004 and 2003, respectively. No other biopharmaceutical product accounted for 10% or more of our consolidated total revenues in any of the last three fiscal years.

Research and Development

Our research and development focuses on the prevention and treatment of cancer and infectious and pulmonary diseases. In addition to our research and development activities, technologies that are developed in collaborations with third parties, as well as technologies licensed from outside parties, also are sources of potential products for our segments. Products or product candidates that are inappropriate for our commercial organization are often out-licensed to other companies.

Blood Testing

Chiron pursues research and development of assays for transfusion-transmitted diseases, such as variant Creutzfeldt-Jakob disease (vCJD). In August 2004, we supplemented our existing vCJD research and development program by acquiring Prion Solutions, Inc., a privately held company focused on research into vCJD and other prion-related diseases.

We also participate in the development of a range of hepatitis and retrovirus immunoassays for use in screening of donated blood, plasma, organs and tissue and in-vitro clinical diagnostics through our joint business contractual arrangement with Ortho-Clinical Diagnostics.

We moved beyond Blood Testing and into the broader realm of blood safety when we entered into a collaboration with ZymeQuest in 2003 to develop and commercialize ZymeQuest s enzyme conversion system. This system is designed to convert groups A, B and AB red blood cells to enzyme-converted universal blood group O (ECO). This technology could fill a critical need for blood and transfusion centers since between 5% and 10% of the global donated blood supply is discarded each year due to non-matches between donated blood and patients blood type requirements. We made an equity investment in

ZymeQuest and obtained worldwide marketing and commercial rights to the technology. In 2005 we initiated the pre-pivotal clinical trial for the conversion of type A red blood cells to ECO, or A-ECO.

Vaccines

Our vaccines segment research and development is focused on developing next generation influenza manufacturing capability, developing new vaccines for pandemic preparedness and broadening our meningococcal franchise. Next generation cell culture production technology may offer significant advantages over traditional methods of influenza vaccine manufacturing by eliminating the dependence on chicken eggs for production. The removal of egg supply lead times may enable a more flexible start-up of vaccine production in the event of an annual vaccine supply shortfall or an avian influenza pandemic. In Europe, we completed an initial Phase 3 study of our influenza cell culture vaccine in the 2004-2005 influenza season, in which the vaccine demonstrated satisfactory safety and immunogenicity, and we are conducting the remainder of the Phase 3 program during the 2005-2006 influenza season. In the United States we are conducting Phase 1 / Phase 2 studies during the 2005-2006 influenza season.

World health agencies are concerned about recent outbreaks of highly pathogenic avian influenza in poultry and a limited number of humans and are concerned that the present situation could give rise to another influenza pandemic. In 2004, we were awarded contracts by the National Institutes of Health (NIH) for production of H5N1 and H9N2 candidate vaccines, to be used by the National Institute of Allergy and Infectious Diseases (NIAID) in clinical studies of safety and immunogenicity. The H9N2 candidate vaccine study was completed, using H9N2 antigens with and without Chiron s adjuvant MF59, and preliminary data indicated that the vaccine formulations containing the adjuvant MF59 proved highly immunogenic, inducing antibody levels believed to confer protection against the influenza strain while the unadjuvanted vaccine induced significantly lower antibody titers. The NIAID study using our H5N1 candidate vaccine is ongoing. We have entered into supply contracts with several governments, including the U.S. and the UK governments, for influenza vaccines for stockpiles based on the H5N1 avian influenza strain. The commercial potential for stockpiling is unclear due to among other things, the fact that larger demands would require greater capacity, the fact that production for stockpiling can only occur between normal seasonal campaigns, and government pressure on pricing. There are also technical obstacles that need to be addressed in order to produce a commercial pandemic vaccine.

In our meningococcal franchise, we are expanding our product line beyond MENJUGATE® vaccine, our conjugate vaccine against Meningococcus C infection, through the development of other vaccines against additional Meningococcal strains responsible for human disease. Meningococcal disease is associated with infections affecting the membranes around the brain and spinal cord or the bloodstream, and can result in brain damage, blindness, deafness, limb amputations and death. Infection may be fatal even if diagnosed early, making prevention essential. Young children and persons in close living quarters such as college dorms or military facilities are at highest risk for meningococcal disease.

Serotype B, along with serotypes A, C, W and Y cause approximately 95% of the meningococcal infections worldwide. Multivalent vaccines are effective against more than one serotype. We are developing a tetravalent conjugated vaccine against serotypes A, C, W and Y and we are completing Phase 2 studies of this ACWY vaccine in a variety of age groups, including ages under two.

In 2004, we began distributing a meningococcal B vaccine in New Zealand, MENZB , to protect against the specific meningococcal B strain responsible for a 13-year epidemic in that country. While our current meningococcal B product, MENZB is efficacious against only a single strain of meningococcal B, we are also developing a second-generation vaccine candidate utilizing our novel genomic approach against Meningococcus B, a disease for which no broadly efficacious vaccine is currently available. Our meningococcal B vaccine was in a Phase 1 clinical trial in 2005.

Through collaborations, we are obtaining human safety and immunogenicity information on hepatitis C virus vaccine candidates, and our vaccine against HIV, which is in Phase 1 testing in collaboration with NIH. We are also developing novel adjuvants, compounds that amplify the immune response generated by vaccine antigens.

Biopharmaceuticals

Research and development in the biopharmaceutical segment focuses on protein and small molecule therapies for cancer and infectious and pulmonary disease.

Infectious and Pulmonary Disease

Tifacogin (recombinant Tissue Factor Pathway Inhibitor) *Tifacogin* a coagulation inhibitor, was developed in collaboration with Pfizer, Inc. In October 2003 we acquired all of Pfizer, Inc. s interest in tifacogin, in return for which Pfizer will receive royalties on sales of tifacogin. In 2004 we initiated CAPTIVATE, a Phase 3 trial for tifacogin in patients with severe community-acquired pneumonia (CAP). CAP is a serious infection of the lungs caused by various, well-defined pathogens. Severe CAP affects approximately 300,000 patients in the United States annually requiring ICU admission, of whom approximately 30 percent die. In December 2005 an independent Data Monitoring Committee completed an interim analysis of clinical data from the study and recommended the continuation of the study.

Tobramycin inhalation powder (TIP) *In* December 2001, we entered into a collaboration with Nektar Therapeutics Inc. (Nektar) to develop and register an inhalable dry-powder formulation of the antibiotic tobramycin as an extension of our TOBI® formulation franchise. TIP is used with Nektar s new hand-held, fully portable device. We are currently conducting Phase 3 clinical trials of the product.

Oncology

Using a translational-medicine approach to drug development, Chiron s research department continues to feed a growing oncology pipeline, which includes CHIR-258, CHIR-12.12 and CHIR-265.

CHIR-258 (growth factor kinase inhibitor) *CHIR-258* is a novel, orally available, highly selective, multi-targeted receptor tyrosine kinase inhibitor, which acts on both tumor cell growth and angiogenesis. As of January 2006, disease-specific Phase 1 studies of CHIR-258 are ongoing in acute myelogenous leukemia (AML), multiple myeloma and melanoma.

CHIR-12.12 *CHIR-12.12 is a novel, highly potent, fully human antagonist monoclonal antibody that targets the CD40 antigen*. In 2005, we initiated two Phase 1 studies of CHIR-12.12 - one in patients with chronic lymphocytic leukemia and a second in patients with multiple myeloma, both types of cancer that are associated with expression of the CD40 antigen on the cancer cell surface. This is the first project being developed under our collaboration agreement with XOMA Ltd. for the commercialization of therapeutic antibodies for cancer.

CHIR-265 In December 2005 we filed an IND for CHIR-265, a novel, orally available, highly selective Raf kinase inhibitor.

Research and Development Expenses and Related Revenues

Research and development expenses for the years ended December 31, 2005, 2004 and 2003 for Chiron-sponsored research, including payments to collaboration partners, were $433.9 million, $431.1 million and $409.8 million, respectively. Under contracts where we recognize revenue based upon research and development work performed, the revenues amounted to $16.3 million, $20.9 million and $16.8 million in 2005, 2004 and 2003, respectively. We recorded these revenues in Collaborative agreement revenues and Other revenues in the Consolidated Statements of Operations. Generally,

these revenues include fees for research services as they are performed or completed and milestone payments upon attainment of specified benchmarks.

Business Relationships

We have important business relationships with various companies, including the following.

Gen-Probe Incorporated

We have a collaboration with Gen-Probe relating to the development and commercialization of NAT products under the PROCLEIX® brand name to screen donated blood, plasma, organs and tissue for viral infection. PROCLEIX® assays and systems incorporate NAT technology to detect viral RNA and DNA in donated blood and plasma during the very early stages of infection, when those infectious agents are present but cannot be detected by immunodiagnostic tests. Gen-Probe manufactures the NAT assays and certain instruments, and Chiron sells both assays and instruments under the PROCLEIX® brand name. Effective January 1, 2004, under an amendment to the worldwide blood screening collaboration agreement with Gen-Probe, permanent, fixed revenue sharing percentages were adopted for each party. Gen-Probe s share was set at 45.75% of net revenues for assays that include a test for the hepatitis C virus. For commercial assays, that do not test for hepatitis C virus, such as the West Nile Virus assay, each party receives 50% of the net revenues after deduction of specified expenses.

Ortho-Clinical Diagnostics, Inc.

We have a joint business contractual arrangement with Ortho-Clinical Diagnostics relating to the development and commercialization of immunodiagnostic tests using recombinant DNA and antibody technologies to detect retroviruses and hepatitis viruses in blood. Under the terms of the arrangement, Ortho-Clinical Diagnostics manufactures and sells the assays and instrument systems, and Chiron supplies raw materials for the assays. Chiron and Ortho-Clinical Diagnostics share equally in the pretax operating earnings generated by the joint business contractual arrangement. Our joint business arrangement with Ortho-Clinical Diagnostics is operated under a contractual arrangement and is not a separate and distinct legal entity. The joint business contractual arrangement holds the immunodiagnostic rights to our hepatitis and retrovirus patents and receives royalties from the sale of hepatitis C virus and HIV tests sold by Abbott Laboratories, Inc. and from sales of hepatitis C virus tests by Bio-Rad Laboratories, Inc. and certain other licensees.

Cubist Pharmaceuticals

In October 2003, we entered into a license agreement for the development and commercialization of Cubist s antibiotic, CUBICIN® daptomycin, in Western and Eastern Europe, Australia, New Zealand, India and certain Central American, South American and Middle Eastern countries. Under the agreement, we are obligated to pay upfront payments, regulatory and sales milestones, and a tiered royalty on CUBICIN® daptomycin sales in the territories.

Schering AG and Berlex Laboratories, Inc.

Chiron and Berlex, Inc., a subsidiary of Schering AG of Germany, jointly developed BETASERON® (BETAFERON® in Europe) interferon beta-1b. Under the terms of the Regulatory Filing, Development and Supply Agreement with Schering AG, BETASERON® product is manufactured by us and sold in the United States and Canada by Berlex. BETAFERON® interferon beta-1b is manufactured by us and Boehringer Ingelheim and is sold by Schering AG in Europe. BETAFERON® and BETASERON® revenues recognized under this agreement contributed 11% of our consolidated total revenues in each of 2005, 2004 and 2003. Under the agreement, for product manufactured by us and marketed by Schering AG

and its affiliates, including Berlex, we receive revenue, which is recorded as product sales. For product manufactured by Boehringer Ingelheim and marketed by Schering in Europe under the trade name BETAFERON®, we receive royalties net of Schering s supply costs. The Regulatory Filing, Development and Supply Agreement expires in October 2008 unless renewed. On February 24, 2006 Schering AG notified Chiron of its intention to exercise its option under the Regulatory Filing, Development and Supply Agreement to purchase or lease all assets used by Chiron in the manufacture for Schering of BETASERON® interferon beta-1b products and all contractual rights at their fair market or lease value. The purchase/lease option is subject to the closing of the proposed acquisition of Chiron by Novartis AG. The agreement requires that the value be determined by an independent third party mutually agreed upon by both parties.

Nektar Therapeutics, Inc.

In December 2001, we entered into a collaboration with Nektar (then operating as Inhale Therapeutic Systems) to develop and register an inhalable dry-powder formulation of the antibiotic tobramycin as an extension of our TOBI® formulations franchise. Under the terms of the collaboration, Nektar is responsible for development of the dry powder formulation and inhalation device, as well as supplying drug product for clinical trials and the market. Chiron is responsible for all other aspects of drug development including clinical trial conduct, regulatory submissions, preparation for product launch and sales and marketing of the final drug product. Under the agreement, we are obligated to pay upfront payments and development milestones, and we will pay royalties when the product is commercialized.

XOMA Ltd.

We have a worldwide, exclusive, multi-product, collaborative agreement with XOMA for the development and commercialization of antibody products for the treatment of cancer. Under the terms of the agreement, we and XOMA agreed to jointly research, develop, and commercialize multiple antibody product candidates. Under the agreement, we also share development and commercialization expenses, including preclinical and clinical development, manufacturing and worldwide marketing costs, as well as revenues, generally on a 70-30 basis, with Chiron s share being 70% and XOMA s share being 30%. We made an initial payment of $10.0 million, and have made a loan facility of up to $50.0 million available to XOMA, starting on January 1, 2005 to fund 75% of XOMA s share of development expenses. Under this arrangement, we made $12.1 million in loan advances to XOMA as of December 31, 2005.

Commercialization

Technologies arising out of our research and development efforts are commercialized in various ways:

- We market and distribute certain products, either directly or through distributors. See Sales and Marketing below.

- We develop other products in collaboration with third parties. Under collaboration agreements, marketing rights may be assigned to us or to the collaborator or shared by both parties. In the event rights are assigned to us, we generally pay royalties to or enter into revenue split agreements with our collaborator. In the event marketing rights are assigned to the collaborator, we often retain the right to manufacture and supply key raw materials.

- We license other technologies to third parties, with the licensee assuming responsibility for further development. We generally receive royalties on sales of the resulting product. Selected agreements under which we currently derive royalty revenues for technologies licensed to third parties include:

- Licenses to F. Hoffmann-La Roche Ltd. and Roche Molecular Systems, Inc. under our hepatitis C virus and HIV related patents for use in nucleic acid amplification in *in vitro* diagnostics and in blood screening.

- An agreement with Schering AG relating to BETASERON® (BETAFERON® in Europe) interferon beta-1b as described above.

- An agreement with Bayer Corporation relating to, among other things, use of our hepatitis C virus and HIV technologies for nucleic acid amplification in *in vitro* diagnostics.

- A license agreement with Laboratory Corporation of America Holdings (LabCorp) and its affiliates, for our HCV intellectual property for nucleic acid testing (NAT).

- A non-exclusive license agreement with the Blood Transfusion Centers of the German Red Cross (Blutspendediensten des Deutsche Rotes Kreuz, or DRK), for the use of our HCV technology for use in molecular probe homebrew blood screening.

Sales and Marketing

Blood Testing

Global marketing and distribution and our U.S. sales organization for nucleic acid testing products are based in Emeryville, California. Blood Testing has representatives around the world. International sales are conducted out of regional offices, including our primary offices located in Paris, France and Hong Kong, China. We sell products to the public sector through tenders (a bid solicitation process) and to private sector blood banks directly and through distributors.

In 2002, we signed a multi-year agreement with the American Red Cross, which collects approximately 50% of the 14 to 15 million units of blood collected in the United States each year. Under that agreement, the American Red Cross purchases from Chiron certain products, instrumentation and services that enable the American Red Cross to perform amplified nucleic acid screening on the blood it collects. Currently we are a party to multi-year contracts awarded through the tender process with the public sector blood services of many countries outside the United States, with the most significant in terms of donations being Australia, Italy, South Africa and the United Kingdom.

Vaccines

Our vaccines marketing and sales organization is based in Marburg, Germany for the German market, in Siena, Italy for the Italian market, and in Oxford, United Kingdom for the United Kingdom market. In 2004, we established a U.S. Vaccines headquarters in Philadelphia, Pennsylvania. In general, we market our influenza and rabies vaccines in the United States through a network of wholesalers and distributors. In the United States our direct sales efforts are focused on public health, distributor channels, and non-traditional channels, e.g., employers, chain drug headquarters and service providers. Internationally, our direct sales efforts are focused on pediatricians and general practitioners. We also sell products to the public sector through tenders and to private sector pharmacies directly and through wholesalers and distributors.

BioPharmaceuticals

Our biopharmaceutical marketing and sales organization for the United States is headquartered in Emeryville, California, and European operations are headquartered in Uxbridge, United Kingdom. We focus our sales efforts on specialist physicians, principally oncologists, urologists and pulmonologists, who are based in hospitals and large clinics. Generally, we sell products to wholesalers, distributors, clinics and hospital pharmacies.

Competition

We operate in a highly competitive environment, and we expect competition to increase. Competitors include large pharmaceutical and blood testing companies, and biotechnology companies. Some of these competitors, particularly large pharmaceutical and blood testing companies, have greater resources than we have. We and our competitors apply rapidly evolving technologies and new developments that frequently result in price competition and product obsolescence. Substantial consolidation is underway in the global healthcare industry and is expected to produce greater efficiencies and even more intense competition. To compete effectively, we invest heavily in research and development, maintain specialized sales forces that concentrate on individual classes of customers and spend significant amounts on marketing, promotion and selling.

Important biotechnology research is performed in universities and nonprofit research organizations. These entities are becoming more active in seeking patent protection and licensing revenues for their discoveries. The competition among large pharmaceutical companies and smaller biotechnology companies to acquire technologies from these entities also is intensifying. We actively collaborate with such entities in research, and have and will continue to license their technologies for further development. However, these institutions also compete with us to recruit scientific personnel and to establish proprietary positions in technology.

Blood Testing

The PROCLEIX® product line is based on proprietary Transcription Mediated Amplification (TMA) technology developed by Gen-Probe. The primary competition is with polymerase chain reaction (PCR) based products. PCR-based products are supplied to the market by F. Hoffmann-La Roche, a Chiron licensee, or developed in-house by blood banks (referred to as homebrew). The commercial market for nucleic acid testing products in the blood banking and plasma industries has developed rapidly as regulatory agencies in developed countries began in 1999 to introduce policies and mandates that require this new technology to be implemented as an additional measure to improve blood safety. In developing countries there has been a move to implement nucleic acid based tests in the private health care sector and we anticipate this expanding to the public arena over the next several years. Competition in this sector is the same as in the developed countries.

We are the sole manufacturer of hepatitis C virus antigens for use in immunodiagnostic assays sold by the joint business contractual arrangement with Ortho-Clinical Diagnostics. We also manufacture hepatitis C virus antigens for Abbott Laboratories, Inc. s immunodiagnostic assays. In the immunodiagnostic blood testing market, the Ortho-Clinical Diagnostics joint business contractual arrangement competes with Abbott Laboratories. The joint business contractual arrangement has experienced increased competitive pressures from Abbott Laboratories ABBOTT PRISM® instrument system. The joint business contractual arrangement also develops and sells immunodiagnostic instruments and assays to detect hepatitis, retrovirus and other agents in clinical diagnostic applications. Many other companies, including F. Hoffmann-LaRoche Limited and Bayer Corporation, are significant competitors with respect to these products.

Vaccines

Four large companies hold the majority share of the worldwide vaccines business: Merck, GlaxoSmithKline, Wyeth and Sanofi-Aventis. We are the world s fifth largest vaccines company. Sanofi-Aventis has a strategic alliance with Merck in Europe. All of these companies have substantial research and development programs. Additionally, there is a number of biotechnology companies involved in research programs, primarily involving a limited range of vaccines. We are aware of a variety of companies that are developing influenza vaccine cell culture manufacturing technology.

The competitive factors in vaccines are proven ability to supply product, price, the introduction of new products including vaccines against diseases for which no vaccine was previously available and new combination vaccines which can prevent several diseases in a single product. Public health authorities, medical practitioners and patients frequently favor combination vaccines, particularly in pediatric vaccines, because they eliminate the need for multiple injections and may increase overall compliance with recommended vaccination schedules. As new combination vaccines are introduced, older combinations and single products often become obsolete. We may be limited in our ability to develop and market certain combination vaccines if one of the vaccines, which would otherwise be included in the combination, is covered by valid and enforceable patents or other proprietary rights held by third parties.

Prior to the suspension of our Liverpool manufacturing license from October 5, 2004 through March 2, 2005, we were one of two primary suppliers of influenza vaccine to the United States. Although the license suspension has been lifted, our inability to supply FLUVIRIN® vaccine during the 2004-2005 influenza season has led a competitor to introduce an influenza vaccine product in the United States during the 2005-2006 season and we expect competition to continue to increase. Our influenza vaccines approved in Europe also remain competitive there. Competition varies by region according to product license approvals. All influenza vaccines producers, including us, face an annual change in influenza strains, which can act as a barrier for new competitors.

MENJUGATE®, our meningococcal C vaccine, faces competition from vaccines produced by two other companies, Baxter International, Inc. and Sanofi-Aventis. These companies are also competing for future meningococcal vaccine business worldwide.

Biopharmaceuticals

TOBI® tobramycin solution for inhalation is the first and only inhaled antibiotic solution to be approved by the FDA for the treatment of infection associated with cystic fibrosis. The use of oral and intravenous antibiotics to treat pseudomonal and other bacterial infections is well established and in cystic fibrosis patients with pseudomonal lung infections, tobramycin is the most commonly used intravenous antibiotic. The advantage of inhalation is that it permits higher antibiotic concentrations in the lung and reduces side effects by limiting systemic exposure. Competitive medical therapies include generic antibiotics, anti-inflammatory drugs, pharmacist compounded tobramycin solutions, oral replacement enzymes to maintain nutrition and mucolytics to clear pulmonary secretions. In 2005, Chiesi, a competitor, obtained MRP positive opinion and local approval in Italy for their cystic fibrosis product.

PROLEUKIN® (aldesleukin) for injection is one of two products approved by the FDA to treat metastatic renal cell carcinoma and also one of two approved treatments for metastatic melanoma. In addition to longstanding competition for products, such as alpha interferons sold by Schering-Plough Corporation, recent years have been marked by heightened clinical trial activity that has expanded treatment options for patients, particularly in the area of kidney cancer. Enrollment in these trials and related off-label use has reduced the new patient population available for PROLEUKIN® (aldesleukin) in 2005. In December 2005, an orally available kinase inhibitor, Nexavar, jointly sold by Bayer HealthCare and Onyx Pharmaceuticals, was the first of these products previously available in clinical trials to obtain marketing approval from the FDA to treat kidney cancer patients. This was followed by FDA approval, in January 2006, of Pfizer s Sutent (sunitinib), an anti-cancer treatment for patients advanced kidney cancer and with gastrointestinal stromal tumors (GIST), a rare stomach cancer. We expect competitive pressures from newly approved products and products currently in clinical trials to continue in the future.

BETASERON® (interferon beta-1b) for SC injection, as a treatment for multiple sclerosis, competes with AVONEX®, a recombinant beta interferon, sold by Biogen Idec, Inc., REBIF®, a recombinant beta interferon, from Serono, S.A. (Serono), marketed and sold in the United States by Pfizer Inc., and COPAXONE® glatiramer acetate injection from Teva Pharmaceutical Industries, Ltd. NOVANTRONE®

mitoxantrone for injection concentrate is marketed and sold by Serono for the treatment of secondary progressive multiple sclerosis. In addition, BETASERON® interferon beta-1b competed for a number of months with TYSABRI®, a humanized monoclonal antibody which was marketed by Biogen Idec, Inc. and Elan Pharmaceuticals until marketing was suspended by these companies in February 2005. The multiple sclerosis market is highly competitive, and will remain so as various other companies have treatments for multiple sclerosis in clinical development.

Government Regulation

Regulation by governmental authorities in the United States and other important locations is a significant factor in the manufacture, marketing and sale of our products and in our research and development activities.

For all of our products, the time and expense needed to complete the required clinical studies, prepare and submit the required applications and supporting documentation and respond to inquiries generated by regulatory review can far exceed the time and expense of the research initially required to create the product. These factors largely determine the speed with which a successful research program is translated into a marketed product.

Blood Testing

In the United States, Blood Testing products, whether based upon nucleic acid testing or immunodiagnostic testing technologies, may only be commercially sold pursuant to the terms of approval of specific license applications in which the product s safety and effectiveness must be demonstrated based upon well-controlled studies. Upon approval of the license application, the product may be marketed for the specific uses, which were identified in the approval. Facilities, processes and operations used for the manufacture, testing, storage and distribution of our Blood Testing products in the United States are subject to FDA approval and periodic inspection.

In Europe, our Blood Testing products are regulated through the In Vitro Diagnostic Medical Devices Directive. In other geographic areas, such as Australia, Canada and Mexico, local regulatory authorities regulate Blood Testing products.

Vaccines and Biopharmaceuticals

In the United States, our therapeutic and vaccine products (both commercial and investigational) are primarily regulated under federal law and are subject to rigorous FDA approval procedures. No product can be marketed in the United States until an appropriate application is approved by the FDA. The FDA applies the approval procedures on a product-by-product basis and typically requires, among other things, an extensive three-phase human clinical testing program. In Phase 1, studies are conducted with a relatively small number of subjects to assess the safety of the product. In Phase 2, the product is evaluated in a larger group of subjects to begin to assess efficacy and appropriate dosing. Phase 3 studies are conducted in the target population with a number of subjects that is large enough to provide sufficient data to establish statistically the safety and efficacy of the product. The FDA approves products to treat specified medical conditions or disorders. Further studies would be required to market the product for other uses. The FDA must inspect and approve all facilities used to manufacture, fill, test and distribute biologic products. If any change in manufacturing facilities or processes occurs after FDA approval, additional regulatory review and possibly additional clinical studies may be required. In addition to standard regulatory procedures, many governments have provisions for use of otherwise unapproved medical products in a public health emergency.

Licensing procedures in Europe are comparable to those in the United States. In 1995, the European Union established a centralized procedure for licensing of products derived from the use of high

technology/biotechnology processes. This procedure leads to the grant of a single license for the entire European Union. Effective January 1, 1998, the European Union has also adopted a decentralized procedure under which a license granted in one member state is mutually recognized by the other member states, leading to a grant of licenses in member states recognizing the original license. This procedure is replacing independent national licensing of products in the European Union. In addition, products must receive country-pricing approvals in some territories before they can be marketed in that country.

Patents and Intellectual Property Rights

Patents are very important to our business. We have a policy of seeking patents on inventions arising from our research and development activities. The time and expense required to develop and obtain regulatory approval to market human healthcare products is significant. Without the protection of patents or trade secrets, competitors may be able to use our inventions to manufacture and market competitive products without being required to undertake the lengthy and expensive development efforts made by us. We also receive significant revenue through the licensing of these patents to third parties. We have a substantial number of granted patents and pending patent applications in the United States and other important markets. Additionally, we have licensed a number of patents and patent applications from third parties. Additional information is provided below on the certain patents held or licensed by us that relate to our key products. The existence of such patents does not mean they are valid or can be enforced against competitive products. We seek term extensions for some patents, which are available in certain countries based on delays in the grant of regulatory approvals for the sale of products covered by these patents. For these reasons the expiration dates provided below are not definitive.

We consider our trademarks and registered trademarks and those of our subsidiaries, in the aggregate, to be of material importance. All are covered by registrations or pending applications for registration in the U.S. Patent and Trademark Office and in other countries. Trademark protection continues in some countries for as long as the mark is used and, in other countries, for as long as it is registered. Registrations generally are for fixed, but renewable price terms.

Trade secrets and confidential information are also important to our commercial success. Although we seek to protect trade secrets and confidential information, others may obtain access to such information or develop the same or similar information independently. Also, third parties may obtain patent protection that precludes us from using our trade secrets or confidential information.

This report also includes trademarks, service marks and trade names of other companies.

Blood Testing

The PROCLEIX® HIV-1/HCV Assay is covered by numerous patents held by us in the United States and worldwide. These patents contain claims directed to methods of hybridization and methods for determining the presence of the hepatitis C virus in a sample and to probes/primers utilized in such a process. The hepatitis C virus patent family for NAT expires in the United States in 2015 and ex-U.S. in 2010. The HIV patent family expires in the United States in 2020. The HIV patent family expired ex-U.S. in 2005. The PROCLEIX® System product line is also covered by several patents held by Gen-Probe and licensed to us for use in blood testing.

The PROCLEIX® ULTRIO® Assay is covered by several patents held by Gen-Probe and licensed to us for use in Blood Testing. The PROCLEIX® WNV Assay is covered by several patents and pending applications held by Gen-Probe and licensed to us for use in Blood Testing.

The hepatitis C virus immunoassay diagnostic products sold by our joint business contractual arrangement with Ortho-Clinical Diagnostics are covered by numerous patents in the United States and worldwide. These patents contain claims directed to hepatitis C virus immunoassay methods, kits and

hepatitis C virus polypeptides. In the United States, certain patents expire between 2011 and 2017. The corresponding European family of patents expires in 2010.

The HIV immunoassay diagnostic products sold by our joint business contractual arrangement with Ortho-Clinical Diagnostics are covered by numerous patents in the United States and worldwide. The earliest patents expire in 2009 in the United States and expired in 2005 in Europe.

We own additional HCV and HIV patent families and pending applications.

We hold the registered trademark PROCLEIX® and ULTRIO®, and the trademark OPTIVA . TIGRIS® is a trademark of Gen-Probe Incorporated.

Vaccines

FLUAD®, our adjuvanted influenza vaccine, contains the proprietary adjuvant MF59. The U.S. patents containing claims related to MF59 expire in 2018. Patents for MF59 in Canada, Japan, Germany, Ireland, Portugal and Hungary expire in 2010. Widely registered trademarks of Chiron and our subsidiaries include AGRIPPAL®, FLUAD®, FLUVIRIN®, MENJUGATE®, RABAVERT®, RABIPUR®, and RIBA®. Other trademarks of Chiron and our subsidiaries include BEGRIVAC , ENCEPUR , POLIORAL and TRIACELLUVAX .

Biopharmaceuticals

The patent family related to our first generation TOBI® tobramycin solution for inhalation product includes claims related to product formulation and methods of treating *pseudomonas aeruginosa* infections. The U.S. and European patents expire in 2014 and 2015, respectively.

We own or are the exclusive licensee of various patent families related to PROLEUKIN®, the serine-125 interleukin-2 mutein product, and uses thereof. The patents related to the PROLEUKIN® product will expire in the United States in 2012 and they expired in Europe in 2005.

One of the earliest patent families that relate to BETASERON® and BETAFERON® interferon beta-1b in the United States and Europe, respectively, relate to serine-17 interferon-beta protein used in manufacturing the product. The U.S. patent in this family expires in 2007. The terms of the European patent in this family has been extended to 2008 through Supplementary Protection Certificates.

We own additional pending patent applications directed to the use of IL-2 in combination therapy in cancer or infectious disease.

We own patent applications related to the use of tifacogin in severe pneumonia. Any eventual patent in this family will expire in 2022.

We have widely registered the trademarks PROLEUKIN® and TOBI® in addition to holding the trademark CARDIOXANE for dexrazoxane, a cardioprotectant for doxorubicin cancer treatment. The trademarks BETASERON® and BETAFERON® are trademarks of Schering AG. CUBICIN® is a trademark of Cubist Pharmaceuticals.

Seasonality

Sales of certain of our products, particularly influenza vaccines, are seasonal, with higher sales in the third and fourth quarters of the year. ENCEPUR , our vaccine against tick-borne encephalitis, is also seasonal with higher sales in the first half of the year.

Manufacturing and Raw Materials

Gen-Probe and Ortho-Clinical Diagnostics manufacture the products sold by our Blood Testing business segment. In the case of instrumentation, third party subcontractors perform manufacturing. We have engaged both Gen-Probe and Ortho-Clinical Diagnostics in extensive business continuity planning to limit any disruption to our current source of these blood safety products in the event of a loss of manufacturing capability. We maintain several months supply of NAT reagents in inventory. Ortho maintains similar inventories of immunodiagnostics products.

The vaccines segment primarily manufactures product in our facilities in the United Kingdom, Germany, Italy and India. In connection with the production of our influenza vaccine products, we must purchase large quantities of chicken eggs. For FLUVIRIN® vaccine, we purchase those eggs from a single supplier in the United Kingdom, and pursuant to the contract with that supplier we have agreed to make specified purchases from that supplier through 2012, subject to our right to terminate this agreement earlier upon payment of a termination fee.

Biopharmaceutical products are generally manufactured in our facilities in the United States. In addition, we perform some limited contract manufacturing for other organizations. Raw materials and supplies are generally available from various suppliers in quantities adequate to meet our needs, although we have single source suppliers for some components and value-add steps, including the pre-filled diluent syringe for BETASERON® interferon beta-1b. We purchase bulk powdered tobramycin, the primary basic raw material in TOBI® tobramycin, from two of the principal worldwide suppliers of the drug. We anticipate that either one of these suppliers alone will be able to supply sufficient quantities to meet current needs.

Our manufacturing facilities as well as those of our third-party service providers, suppliers and manufacturers are subject to continuing inspection by the FDA or comparable agencies in other jurisdictions.

We believe that our existing manufacturing facilities and outside sources will allow us to meet near-term manufacturing needs for our commercial products and our other products in clinical trials. In 2003, our Board of Directors approved $50.7 million in expenditures for a 25-year building lease and $42.2 million for capital improvements, both of which are part of a $97.0 million project for expansion and replacement of our influenza vaccines primary manufacturing facility in Liverpool, United Kingdom. The new manufacturing facility will replace a portion of the existing influenza vaccines manufacturing facilities in Liverpool, United Kingdom and is anticipated to be available in 2009 for the manufacture of influenza vaccines, subject to regulatory approval.

Employees

Our employees are the core of Chiron and are vital to our success. As of December 31, 2005, Chiron and its subsidiaries had approximately 5,500 employees, approximately 2,500 of whom were located in the United States. The company has experienced no work stoppages and we consider our employee relations to be good.

Relationship with Novartis AG

On October 30, 2005, Chiron entered into an Agreement and Plan of Merger (the Merger Agreement) with Novartis Corporation, Novartis Biotech Partnership, Inc. (Novartis Biotech), an indirect wholly owned subsidiary of Novartis AG (Novartis) and an indirect subsidiary of Novartis Corporation, and Novartis, as guarantor. Pursuant to the terms of the Merger Agreement, Novartis Biotech will merge with and into Chiron, with Chiron as the surviving corporation and becoming an indirect subsidiary of Novartis Corporation and an indirect wholly owned subsidiary of Novartis. Upon

completion of the merger, each share of Chiron common stock not held by Novartis or any of its subsidiaries, Chiron or any of its subsidiaries or a stockholder of Chiron who perfects appraisal rights, will be converted into the right to receive $45.00 per share in cash, without interest. The merger is subject to stockholder approval and satisfaction of other customary conditions, including governmental and regulatory approvals. On February 6, 2006, the European Commission adopted a decision pursuant to Article 6(1)(b) of the Council Regulation (EC) No. 139/2004 declaring the combination compatible with the common market. This follows approval by the U.S. Federal Trade Commission in December 2005 and clearance by the Committee on Foreign Investment in the United States under Exon-Florio in January 2006. We expect that the transaction will be completed in the second quarter of 2006.

Chiron and Novartis have been in an alliance since January 1995. We have entered into a series of agreements with Novartis, which provide, among other things and subject to certain conditions and exceptions:

- Novartis has the right to designate for nomination to our Board of Directors three individuals. The number of directors that Novartis may nominate declines if Novartis ownership interest in us is less than 30%.

- As long as Novartis owns at least 40% of our common stock, we may not engage in certain transactions, including significant debt or equity issuances, debt or equity repurchases, most mergers and acquisitions, the payment of cash dividends, amendments to Chiron s Restated Certificate of Incorporation or Bylaws, without Novartis approval.

- Novartis will not increase its ownership interest in us above 55% unless it either acquires all of our outstanding capital stock in a buy-out transaction or it increases its ownership interest in us up to 79.9% in a transaction approved by a majority of the independent members of our Board of Directors.

- Novartis provided certain funding to us for research on certain adult and pediatric vaccines, Insulin-like Growth Factor-I, Factor VIII gene therapy and Herpes Simplex Virus-thymidine kinase. Funding under this agreement ended December 31, 2001. In exchange for providing this funding, Novartis has certain co-promotion rights for certain vaccines and an interest in certain royalties on sales of certain products resulting from the funded research.

- Novartis will guarantee certain indebtedness on behalf of us until January 2008.

- Novartis has an option to purchase newly issued shares of our common stock directly from us at fair market value, subject to certain conditions, including the standstill restrictions described above.

- Novartis and we will cooperate and collaborate in research, development, manufacturing and marketing of biotechnology products on an arm s-length basis while remaining independent to pursue our respective corporate strategies and opportunities.

For more information on certain of these agreements, see Note 10, Related Party Transactions of Notes to Consolidated Financial Statements.

Available Information

The following documents can be found free of charge on our website at *http://www.chiron.com*, by contacting our Investor Relations department at (510) 923-2300 or by sending an e-mail message to *investor relations@chiron.com*:

- our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to these reports as soon as reasonably practicable after such filings are electronically filed with the Securities and Exchange Commission;

- our Corporate Governance Guidelines and our Code of Conduct and Commitment to Ethical Conduct; and

- the charters of the Audit Committee, Compensation Committee, Nominating and Corporate Governance Committee and Finance Committee of our Board of Directors.

The information contained on our website, or other websites linked to our website, is not part of and is not incorporated by reference into this report.

ITEM 1A. RISK FACTORS

We have discussed the most significant factors that may adversely affect our business and operations in Part II, Item 7, of this 10-K, Management s Discussion and Analysis of Financial Condition and Results of Operations, under the caption Factors That May Affect Future Results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Emeryville Campus

Our principal executive offices are located in Emeryville, California. As of December 31, 2005, our campus consisted of 24 buildings, of which 14 are leased and 10 are owned. Our Emeryville facilities include research and development, manufacturing and administrative facilities and a parking structure for our biopharmaceutical, vaccine and Blood Testing businesses.

Other Facilities

In 2003, our Board of Directors approved $50.7 million in expenditures for a 25-year building lease and $42.2 million for capital improvements, both of which are part of a $97.0 million project for expansion and replacement of our influenza vaccines primary manufacturing facility in Liverpool, United Kingdom. The new manufacturing facility will replace a portion of the existing influenza vaccines manufacturing facilities in Liverpool, United Kingdom and is anticipated to be available in 2009 for the manufacture of influenza vaccines, subject to regulatory approval.

We also own and lease manufacturing facilities in Vacaville, California used principally for our biopharmaceutical business. The owned facility has available capacity due to lower than expected demand for certain of our products and improved production yields from other facilities. As a result, we have entered into contract manufacturing agreements to utilize this available capacity (see the Biopharmaceuticals section in Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations below).

We have the following facilities for our vaccines operations:

Owned

- Manufacturing, administrative and development facilities in Rosia, Italy,

- Manufacturing, administrative and research and development facilities in Siena, Italy,

- Manufacturing facilities in Liverpool, United Kingdom and

- Manufacturing facilities in Ankleshwar, India.

Leased

- Manufacturing facilities in Liverpool, United Kingdom,
- Administrative office in Oxford, United Kingdom,
- Manufacturing, research and development and administrative facilities in Marburg, Germany,
- Administrative and sales offices in Mumbai, India,
- Sales office in Philadelphia, Pennsylvania,
- Sales office in Malaysia,
- Sales offices in Moscow, Russia,
- Sales offices in Szentendre, Hungary,
- Sales offices in Sao Paolo, Brazil,
- Sales office in China and
- Sales office in Brno-Slatina, Czech Republic.

We lease the following facilities for our biopharmaceutical operations:

- Research and development and administrative facilities in Seattle, Washington,
- Manufacturing and distribution facilities in Annandale, New Jersey,
- Administrative and sales offices in Amsterdam and Rijswijk, The Netherlands,
- Administrative and sales offices in Suresnes, France,
- Sales offices in Madrid, Spain,
- Sales offices in Lisbon, Portugal,
- Administrative and warehouse facilities in Munich, Germany,
- Sales offices in Milan, Italy,
- Sales and administrative offices in Dublin, Ireland,
- Sales offices in Quebec, Canada and
- Sales, marketing and administrative facility in Uxbridge, United Kingdom.

We lease sales and administrative offices for our Blood Testing operations:

- Suresnes, France and
- Hong Kong, China

We lease facilities in North America and Europe primarily for sales and service offices.

We believe that our other current facilities are in good operating condition and are adequate for our current needs. However, we are expanding to meet future requirements. We continually evaluate future requirements for our facilities.

ITEM 3. LEGAL PROCEEDINGS

Average Wholesale Price Litigation

In November 2004, the County of Nassau filed a complaint in the United States District Court for the Eastern District of New York against numerous biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products, including TOBI® solution, which are reimbursed by Medicaid. In March 2005, the County of Nassau filed an amended complaint with the In Re Pharmaceutical Industry Average Wholesale Price Litigation pre-trial proceedings in the United States District Court for the District of Massachusetts. Plaintiff alleges that defendants violated federal racketeering laws, federal and state laws on Medicaid fraud, and state laws on unfair trade practice, breach of contract, fraud and unjust enrichment by devising and implementing a fraudulent pricing scheme against Medicaid beneficiaries, and seeks declaratory relief, as well as compensatory and punitive damages.

In February 2005, the State of Illinois through its Attorney General filed a complaint in the Circuit Court of Cook County, Illinois, County Department, Chancery Division, against numerous biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products that are reimbursed by Medicare and Illinois Medicaid. The Attorney General alleges that defendants violated the Illinois Consumer Fraud and Deceptive Business Practices Act, the Illinois Public Assistance Fraud Act, and the Illinois Whistleblower Reward and Protection Act, and seeks declaratory relief as well as damages. In August 2005, the matter was transferred to the In Re Pharmaceutical Industry Average Wholesale Price Litigation in the United States District Court for the District of Massachusetts.

In June 2005, the City of New York and several New York State counties filed a complaint in the In Re Pharmaceutical Industry Average Wholesale Price Litigation in the United States District Court for the District of Massachusetts against numerous biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products reimbursed by Medicaid, including TOBI®, PROLEUKIN®, and certain generic oncology drugs sold by the Cetus-Ben Venue Therapeutics partnership. Plaintiffs allege that defendants violated federal and state laws regarding Medicaid fraud, and state laws regarding social services fraud, health regulations, breach of contract, unfair trade practices, and unjust enrichment, and seek declaratory relief, as well as compensatory and punitive damages.

In October 2005, the State of Mississippi through its Attorney General filed a complaint in the Chancery Court of Hinds County, Mississippi, First Judicial District, against numerous biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products that are reimbursed by Medicare and Mississippi Medicaid. The Attorney General alleges that defendants violated the Mississippi Medicaid Fraud Control Act, the Mississippi Regulation of Business for Consumer Protection Act, and certain Mississippi state common law provisions, and seeks declaratory relief as well as damages.

In November 2005, seven New York State counties filed complaints in the United States District Courts for the Northern, Southern and Western Districts of New York against numerous biotechnology and pharmaceutical companies, including Chiron, in connection with setting average wholesale prices for various products reimbursed by Medicaid, including TOBI® and certain generic oncology drugs sold by the Cetus-Ben Venue Therapeutics partnership. Plaintiffs allege that defendants violated federal and state laws regarding Medicaid fraud, and state laws regarding social services fraud, health regulations, breach of contract, unfair trade practices, and unjust enrichment, and seek declaratory relief, as well as compensatory and punitive damages.

It is not known when nor on what basis these matters will be resolved.

F. Hoffmann-La Roche A.G. and Roche Diagnostics GmbH HCV

In September 1999, F. Hoffman-LaRoche AG (Roche) filed an appeal with the Court of Appeals in Dusseldorf, Germany, regarding a Regional Court s decision to enjoin Roche from the import, use, possession and sale of certain hepatitis C virus immunoassay products in Germany based on Chiron s EP 0 318 216 (the 216 patent). After withdrawing certain claims from the 216 patent, Chiron rescinded that injunction and substituted EP 0 450 931 (the 931 patent) and Chiron s German Patent Nos. DD 298 527, DD 298 524 and DD 287 104 (collectively, the German Patents) in the appellate proceeding. In October 2003, the Court of Appeals ruled that Roche s HCV immunoassay kits containing a certain antigen infringe all three German Patents. Accordingly, the Court of Appeals granted Chiron requested injunction. Chiron has enforced the injunction. Roche is attempting to appeal this decision to the German Federal Supreme Court.

In July 2000, Chiron filed suit against Roche Diagnostics GmbH (Roche Diagnostics) in the German Federal Court (Landgericht) in Dusseldorf, Germany, asserting that Roche Diagnostics manufacture and sale of hepatitis C immunoassay products infringe Chiron s German Patent No. DD 298 524 (the 524 patent). In July 2003, the Landgericht decided that Roche Diagnostics HCV immunoassay kits containing a certain antigen infringe Chiron s 524 patent. Accordingly, the Landgericht granted Chiron the right to enjoin Roche Diagnostics from the import, use, possession and sale of such kits in Germany. In August 2003, Chiron enforced the injunction against Roche Diagnostics. In November 2003, Roche Diagnostics filed an appeal with the Court of Appeals. In January 2005, the Court of Appeals denied Roche Diagnostics appeal and denied Roche Diagnostics leave to appeal as a matter of right to the Supreme Court.

In December 2000, Roche Diagnostics initiated nullity proceedings before the German Federal Patent Court (Bundespatentgericht) regarding Chiron s 931 patent and the German Patents. In August 2002, the Bundespatentgericht upheld the validity of the German Patents, but nullified the German portion of the 931 patent. In November 2002, both Chiron and Roche Diagnostics filed appeals before the Federal Supreme Court regarding the Bundespatentgericht s nullity decisions. Certain infringement actions related to the 931, 104 and 527 nullity proceedings are currently stayed pending the outcome of these appeals.

It is not known when nor on what basis these matters will be resolved.

FLUVIRIN® influenza virus vaccine

For a discussion of developments related to FLUVIRIN® influenza virus vaccine, see Part II, Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations, Factors That May Affect Future Results.

A. FLUVIRIN® vaccine Securities Class Actions

Between October 2004 and December 2004, five securities class action lawsuits were filed against Chiron and certain Chiron officers on behalf of purchasers of Chiron securities for class periods ranging from July 23, 2003 through October 13, 2004. Four of the suits were filed in the United States District Court for the Northern District of California. One action, although originally filed in the United States District Court for the Eastern District of Pennsylvania, was later transferred to the United States District Court for the Northern District of California. In March 2005, the Court named lead counsel and plaintiff, and in April 2005, lead plaintiff filed a consolidated complaint. The consolidated complaint alleges, among other things, that the defendants violated certain provisions of the federal securities laws by making false and misleading statements from July 23, 2003 through October 5, 2004 concerning the amount of FLUVIRIN® vaccine Chiron projected to produce and Chiron s historical and forecasted financial results,

and seeks unspecified monetary damages and other relief from all defendants. The trial is scheduled to begin on May 1, 2006.

B. FLUVIRIN® vaccine Shareholder Derivative Actions

Between October 2004 and November 2004, six shareholder derivative complaints were filed in the Superior Court of the State of California for the County of Alameda, naming Chiron as a nominal party and naming certain current and former Chiron officers and directors and Novartis AG as defendants in connection with the suspension of Chiron s license to manufacture FLUVIRIN® vaccine. One complaint also named Chiron as a defendant and sought relief from Chiron, including an equitable accounting. In December 2004, the six derivative actions were consolidated for discovery and trial under the caption In re Chiron Corporation Derivative Litigation (the Derivative Action). In February 2005, lead plaintiff filed a consolidated complaint, and in May 2005 filed an amended consolidated complaint alleging that defendants are liable for breach of their fiduciary duties of loyalty and care and other duties allegedly owed to Chiron in connection with Chiron s acquisition of its Liverpool, United Kingdom facility and the British regulatory agency s decision to suspend temporarily Chiron s license to manufacture FLUVIRIN® vaccine at the Liverpool facility, and seeking unspecified monetary damages and other relief from all defendants. The complaints did not seek any affirmative relief from Chiron. In July 2005, the Court granted without prejudice Chiron s and Novartis motions to dismiss the amended consolidated complaint based on three agreements entered in 1994 between Chiron and Novartis, all of which contain mandatory forum selection clauses requiring that any claims arising out of or relating to the agreements must be adjudicated in Delaware. Regarding the directors and officers, the Court also dismissed those claims implicated by the 1994 agreements, and stayed the remaining claims pending resolution of the action it is anticipated plaintiffs will file in Delaware. In September 2005, plaintiffs filed an appeal before the Superior Court of the State of California for the County of Alameda.

C. Other FLUVIRIN® vaccine Legal Matters

In October 2004, Chiron received a grand jury subpoena issued by the U.S. Attorney s Office for the United States District Court for the Southern District of New York requesting production of certain documents and materials relating to the suspension of our license. Also in October 2004, the U.S. Securities and Exchange Commission (SEC) notified Chiron that it would conduct an informal inquiry into the suspension with respect to potential violations of federal securities laws. The SEC also requested copies of related records. In February 2005, the SEC issued a formal order of investigation with respect to potential violations of federal securities laws. In February 2006, the SEC notified Chiron that it was terminating its investigation of whether Chiron violated any federal securities laws in connection with the previous suspension by the UK MHRA of Chiron s license to manufacture FLUVIRIN® influenza virus vaccine, and that no enforcement action would be recommended against the company.

In August 2005, Celltech Pharma (Celltech) filed a complaint against Chiron Vaccines and Chiron Behring GmbH & Co. KG (collectively, Chiron) in the Tribunal de Commerce of Nanterre in France. Celltech alleges that Chiron breached its alleged undertaking to provide FLUVIRIN® to Celltech for the 2004/2005 influenza season in France, and seeks damages.

It is not known when nor on what basis these matters will be resolved.

Institut Pasteur

In April 2003, Institut Pasteur filed a complaint in the United States District Court for the District of Columbia against Chiron seeking reversal of certain judgments entered by the Board of Patent Appeals and Interferences (the Board) of the United States Patent and Trademark Office in Patent Interference No. 103,659 (the 659 Interference). The 659 Interference involved claims in Chiron s U.S. Patent

No. 5,156,949 (the 949 patent) and in certain U.S. patent applications assigned to Institut Pasteur (the Chang applications), relating to HIV immunodiagnostic methods. In the 659 Interference, the Board decided that the inventors of Chiron s 949 patent were the first to invent the technology at issue. Chiron asserted that Institute Pasteur was barred from bringing claims per the 1993 HIV Cross-License Agreement between Chiron and Institut Pasteur (the Agreement), and that Institut Pasteur s standing to bring its appeal was a matter for arbitration under the terms of the Agreement. In February 2005, the Court ordered the parties to arbitrate the standing issue and the case was administratively dismissed. In March 2005, Chiron sent Institut Pasteur a notice of arbitration, and the arbitration commenced in January 2006.

It is not known when nor on what basis this matter will be resolved.

Investigation of Employees of Italian Subsidiary

Two sales employees of an indirect wholly owned Italian subsidiary of Chiron were the subject of an investigation by Italian authorities in Genoa, Italy in connection with a larger investigation into the purchasing activities of a Genoa hospital and alleged undue influence by the sales employees in the bidding process for the supply of blood testing products to the hospital. In August 2004, the hospital awarded Chiron a contract for the supply of blood testing products. Italian authorities also conducted an investigation in Milan, Italy concerning alleged corruption and undue influence by one of the sales employees implicated in the Genoa investigation. In February 2006, the Public Prosecutor of the Tribunal of Genoa concluded the investigation for the alleged offense of undue interference in public tenders, and has asked the Tribunal of Genoa to dismiss charges with respect to one of the employees. At this time, we are not aware of any investigation of Chiron with respect to these matters. Although Chiron is not the subject of any criminal charge, no assurance can be given that Chiron will not become the subject of civil charges, fines or penalties, or incur other damages or costs, in connection with these matters.

It is not known when nor on what basis these matters will be resolved.

Laboratory Corporation of America Holdings

In August 2003, Chiron filed a complaint in the United States District Court for the Northern District of California against Laboratory Corporation of America Holdings, Laboratory Corporation of America and National Genetics Institute (collectively, the Defendants), seeking damages and an injunction against Defendants manufacture, use and sale of certain HIV assays for infringing Chiron s U.S. Patent No. 6,531,276 (the 276 patent). In February 2004, Chiron voluntarily dismissed this case without prejudice and refiled the complaint before the United States District Court for the Central District of California. In April 2005, the Court stayed the case pending the outcome of two interferences declared by the U.S. Patent and Trademark Office regarding the 276 patent.

It is not known when nor on what basis this matter will be resolved.

Novartis AG Proposed Acquisition Shareholder Suits

Between September 1 and September 13, 2005, twelve class action lawsuits were filed by Chiron shareholders against Chiron, Novartis AG (Novartis), and members of Chiron s Board of Directors (collectively, the Defendants) regarding Novartis September 1, 2005 offer to acquire the approximately 58% of Chiron shares that Novartis does not already own for $40 per share (the Novartis Offer). Eight of the suits were filed in the Superior Court of the State of California in Alameda County (the California Court) by i) Ronald Abramoff, Harold Adelson, Beverly McCalla, Joan Weisberg, and David Jaroslawicz; ii) Edith Auman; iii) Joseph Fisher, MD, P.C. New Profit Sharing Trust, Trustee Joseph Fisher, MD; iv) William Lattarulo; v) Steven Rosenberg and The Harold Grill IRA; vi) Tracie Scotto; vii) Albert Stein; and viii) William Steiner (the California Plaintiffs). The remaining four suits were filed in the Court of

Chancery of the State of Delaware in and for New Castle County (the Delaware Court) by ix) Judy Longcore; x) Paulena Partners L.L.C.; xi) Sylvia Piven; and xii) the Thomas Stone Irrevocable Trust (the Delaware Plaintiffs). The eight California Actions were consolidated, as were the four Delaware Actions. In January 2006, the California Plaintiffs filed a consolidated complaint in the California Court, and in March 2006, the California Plaintiffs and certain of the Delaware Plaintiffs (together, Plaintiffs) filed a second amended consolidated complaint in the California Court against the Defendants alleging, among other things, that the Company and the Defendants breached their fiduciary duties in connection with the merger because the merger price is inadequate, unfair, and the result of an unfair process. The Plaintiffs also allege that Chiron s definitive proxy materials omit material information, include materially misleading statements and are unfairly coercive. In their prayer for relief, the Plaintiffs seek: (i) to enjoin the merger under the terms presently proposed; (ii) to rescind any transaction or be granted rescissory damages if a transaction is consummated prior to entry of final judgment; and (iii) to direct the individual defendants and Novartis to account to Plaintiffs and members of the purported class for all damages caused to them and to account for all profits and any special benefits obtained as a result of their alleged misconduct. A hearing on the California Plaintiff s anticipated motion for a preliminary injunction is currently scheduled for April 4, 2006.

It is not known when nor on what basis these matters will be resolved.

Senate Finance Committee Information Request

In June 2005, Chiron received a voluntary request for information from the U.S. Senate Committee on Finance (the Committee) in connection with the Committee s review of issues relating to the Medicare and Medicaid programs coverage of prescription drug benefits. The Committee requested information from Chiron as to our practices regarding educational grants. In January 2006, Chiron received a supplementary information request. Chiron, like the other pharmaceutical companies to whom the Committee has directed similar requests, is cooperating with the Committee.

It is not known when nor on what basis these matters will be resolved.

Sorin Biomedica/Snia

In January 2002, Chiron filed a complaint against Snia in the Court of Milan asserting that Snia s manufacture and sale of certain hepatitis C virus immunodiagnostics in Italy infringe the 931 patent. Chiron sought a declaration of infringement based on the 931 patent, as well as damages. In July 2005, the Court rejected Chiron s claims. This judgment is subject to appeal.

It is not known when nor on what basis these matters will be resolved.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were brought to a vote of Chiron s stockholders in the quarter ended December 31, 2005.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of Chiron are as follows, in alphabetical order:

Name	Age	Title
Ursula B. Bartels	48	Vice President; General Counsel and Secretary
Jack Goldstein	58	President and Chief Operating Officer
Anne Hill	46	Vice President, Human Resources
Jessica M. Hoover	48	Vice President; Head of Corporate Business Development
Meghan B. Leader	40	Vice President, Business Support Services and Chief Information Officer
Howard H. Pien	48	Chief Executive Officer and Chairman of the Board
Rino Rappuoli	53	Vice President; Chief Scientific Officer
David V. Smith	46	Vice President; Chief Financial Officer
Daniel B. Soland	47	Vice President; President, Chiron Vaccines
Bryan L Walser	40	Vice President, Corporate Strategy
Gene W. Walther	51	Vice President; President, Chiron Blood Testing
Craig A. Wheeler	45	Vice President; President, Chiron BioPharmaceuticals

Ms. Bartels joined Chiron as Vice President and General Counsel in August 2004. In March 2005, she was designated the Company s Secretary. Prior to joining Chiron, Ms. Bartels served as Vice President of Boehringer Ingelheim Corporation and Senior Vice President, General Counsel and Secretary of Boehringer Ingelheim Pharmaceuticals, Inc., where she was responsible for all legal functions for the corporation and its five U.S. subsidiaries. Boehringer s primary business focus was branded human pharmaceuticals (primarily respiratory) and multi-source pharmaceuticals (comprised of subsidiaries, Roxane Laboratories and Ben Venue Laboratories). Prior to joining Boehringer in 1999, Ms. Bartels worked at SmithKline Beecham Corporation (now GlaxoSmithKline) from 1988 to 1999, where she progressed from Counsel, Litigation to Vice President and Associate General Counsel, responsible for the full range of legal operations in North America for its two U.S. divisions, Pharmaceuticals, and Healthcare Services (including clinical laboratory and pharmacy benefit management businesses). Ms. Bartels was a member of the PhRMA Law Section Executive Committee from 1994 to 2004, and served as Chair of the Law Section in 2001-2002. Ms. Bartels assembled and led the group that wrote the PhRMA Code. Ms. Bartels began her legal career as a litigation associate at Stradley Ronan Stevens and Young, in Philadelphia. She graduated in 1979 from Bryn Mawr College, A.B. *cum laude*, and attended the University of Virginia School of Law, graduating in 1983.

Dr. Goldstein joined Chiron as Vice President and President, Chiron Blood Testing Division in September 2002. In February 2005, Dr. Goldstein was appointed to the position of President and Chief Operating Officer. He had served as interim Chief Operating Officer of Chiron since November 2004. From 2000 to 2002, Dr. Goldstein was General Partner at Windamere Venture Partners, L.L.C., a venture fund making investments in early stage biotechnology, pharmaceutical, medical device and diagnostic companies. From 1997 to 2001, Dr. Goldstein was President and CEO of Applied Imaging Corporation, a leading supplier of instrument systems for prenatal and cancer genetics. From 1999 until 2002, Dr. Goldstein also served as Chairman of the Board of Applied Imaging and continues to serve as a director of one of Applied Imaging s subsidiaries. From 1986 to 1997, Dr. Goldstein worked for Johnson & Johnson in various executive management positions, including President of Ortho Diagnostic Systems and Executive Vice President of Professional Diagnostics at Johnson & Johnson World Headquarters. Dr. Goldstein holds a B.A. degree in Biology from Rider University, an M.S. in Immunology and a Ph.D. in Microbiology from St. John s University.

Ms. Hill is responsible for human resources at Chiron. She joined Chiron in November 2004 from Baxter International Inc., where she served in a variety of executive positions of increasing responsibility from 1991 to 2004. From 1998 to 2004, she was global vice president of human resources for the Bioscience division of Baxter International in Westlake Village, California. Prior to relocating to the United States, Ms. Hill worked in human resources for the John Lewis Partnership, a large British retailer, from 1980 to 1990. Ms. Hill holds a BSc Econ degree in Industrial Relations from the University of Wales.

Ms. Hoover is responsible for corporate business development, including mergers, acquisitions, product licensing and other strategic transactions. She joined Chiron in 1994 as a member of the law department, most recently serving as vice president and assistant general counsel, where her responsibilities included strategic corporate transactions as well as business development initiatives within each of the company s business units. Before joining Chiron, Ms. Hoover was a partner with Brobeck, Phleger & Harrison. Ms. Hoover holds an A.B., with highest honors, from the University of California, Berkeley, and a J.D. from the Yale Law School.

Ms. Leader joined Chiron in 1992, and is the Vice President, Business Support Services and Chief Information Officer. She is responsible for information technology, corporate facilities, global security and corporate risk-mitigation services, including environmental health and safety, and business continuity planning. Since joining Chiron, Ms. Leader has held various positions in treasury, corporate development and information management. Prior to joining Chiron, she worked in treasury management for both Security Pacific Bank and Bank of America. Ms. Leader holds a B.A. degree in government and an M.B.A. from Saint Mary s College of California.

Mr. Pien joined Chiron as President and Chief Executive Officer, and a director, in April 2003. Upon the resignation of Seán P. Lance as Chiron s Chairman of the Board following the annual meeting of stockholders in May 2004, Mr. Pien also was elected Chairman of the Board. In February 2005, Mr. Pien s title of President was transferred to Dr. Goldstein in connection with the formalization of the role of Chief Operating Officer assumed by Dr. Goldstein. Mr. Pien joins Chiron from GlaxoSmithKline (GSK), which resulted from the merger of GlaxoWellcome and SmithKline Beecham, where he spent over twelve years in positions of international and global management responsibility, including: President of Pharmaceuticals International GSK from December 2000 to March 2003, including service as a member of the Corporate Executive Team; President, Pharmaceuticals, SmithKline Beecham (1998 to 2000); President, Pharmaceuticals-North America, SmithKline Beecham (1998); Senior Vice President and Director-North Asia (1997); Managing Director and Senior Vice President-UK (1995 to 1997); Vice President and Director, Marketing-US (1993 to 1995); Vice President and Director, Product Marketing-US, heading the arthritis, cardiovascular and vaccine groups (1992 to 1993); and Vice President and Director of New Product Development-US (1991 to 1992). Prior to joining SmithKline Beecham, Mr. Pien worked six years for Abbott Laboratories and five years for Merck & Co., in positions of sales, marketing research licensing and product management. Mr. Pien served as a director of ViroPharma Incorporated from 1998 to 2003. He currently serves as a director of two non-profit organizations: Oakland Children s Hospital and Bio-Tech Industry Trade Association.

Dr. Rappuoli joined Chiron as head of European vaccines research in 1992 with the acquisition of Italian vaccines company, Sclavo SpA, where he served as head of research and development. He was responsible for Chiron Infectious Disease and Vaccine Research, serving as Vice President, Vaccine Research, Research and Development from February 2000 to January 2004. At Chiron, he led the development of MENJUGATE® conjugate vaccine against meningococcus C and the first recombinant bacterial vaccine, against pertussis. In February 2004, he was promoted to Vice President, Chief Scientific Officer of Chiron. Dr. Rappuoli earned his doctoral and bachelor s degrees in biological sciences at the University of Siena, and also served as a visiting scientist at the Rockefeller University in New York and at the Harvard Medical School. Dr. Rappuoli is co-founder of the field of cellular microbiology, a discipline combining cell biology and microbiology, and has pioneered the genomic approach to vaccine development

termed reverse vaccinology . He is member of numerous international associations, including the European Molecular Biology Organization and the American Society for Microbiology. Dr. Rappuoli also has served on many committees, among which the NIH Search Committee for the Director of the Vaccine Research Center (Bethesda, Maryland). He is co-chairman of the R/D Task Force of the Global Alliance for Vaccines and Immunization. He has won several prestigious international awards including the Paul Ehrlich, Ludwig Darmstaedter Prize; and IUMS Arima award. Dr. Rappuoli currently serves as a director of Fondazione Monte Dei Paschi di Siena, a private organization in Siena, Italy. He was appointed as a foreign associate to the U.S. National Academy of Sciences in May 2005.

Mr. Smith joined Chiron as Vice President, Controller in February 1999 and was designated Chiron s principal accounting officer. In February 2002, Mr. Smith was appointed Vice President, Finance. In April 2003, Mr. Smith was appointed interim Chief Financial Officer. In November 2003, Mr. Smith was appointed Chief Financial Officer. Prior to joining Chiron, Mr. Smith served as the Vice President, Finance and Chief Financial Officer of Anergen, Inc. from 1997 until he joined Chiron. From 1988 to 1997, Mr. Smith held various financial management positions with Genentech, Inc., in both the United States and Europe.

Mr. Soland joined Chiron as Vice President and President, Chiron Vaccines in late February 2005. He is responsible for the operations of Chiron s global vaccine business. From 2003 until joining Chiron, Mr. Soland served as the President and Chief Executive Officer of Epigenesis Pharmaceuticals, a privately-held biopharmaceutical company that develops inhaled respiratory medicines for the treatment of asthma, chronic obstructive pulmonary disease and allergic rhinitis, from 2003 to 2005. From 1993 to 2003, Mr. Soland spent ten years with GlaxoSmithKline Biologicals in a variety of executive positions, including Vice President and Director, Worldwide Marketing Operations from 1998-2003, and Vice President and Director of SmithKline Beecham Pharmaceuticals, Vaccine Business Unit-U.S., from 1995 to 1998. Prior to joining GlaxoSmithKline, Mr. Soland spent eight years with Connaught Laboratories, a Pasteur Mérieux company with assignments in sales, sales management and product management. Mr. Soland holds a B.S. degree in Pharmacy from the University of Iowa, and was a licensed pharmacist (1981).

Dr. Walser joined Chiron as Division Vice President, Corporate Strategy in November 2001. Prior to joining Chiron, Dr. Walser was a principal in WRW, a Los-Angeles-based management consultancy working with The Rockefeller Foundation and the Boston Consulting Group on a variety of issues in biotechnology and healthcare. Before that, Dr. Walser trained in the Emergency Medicine program at UCLA, and worked for several years in Los Angeles with the healthcare practice of the Boston Consulting Group. Dr. Walser earned his undergraduate degree from Stanford, his medical degree from the University of Virginia School of Medicine and his law degree, *magna cum laude*, from Harvard Law School.

Mr. Walther initially joined Chiron as a consultant in August 1998, and was appointed as Vice President, Commercial Development, North America and Asia Pacific in January 2001. In February 2005, Mr. Walther was appointed to the position of President, Chiron Blood Testing. He had served as Acting President , Chiron Blood Testing since November 2004. Mr. Walther has over two decades of experience in the health care industry in various executive management positions. From 1995 to 1998, Mr. Walther was Vice President, Global Marketing and International Sales for Gen-Probe, Incorporated. From 1991 to 1995, Mr. Walther owned and operated a Seattle-based manufacturing company involved in producing equipment for the outdoor recreational industry. He was head of sales and marketing for Seattle-based Genetic Systems from 1984 to 1991. Prior to that, Mr. Walther worked for Abbott Diagnostics and American Hospital Supply Corporation in a variety of sales, marketing and business development positions. Mr. Walther holds a B.S. degree in microbiology and immunology from Michigan State University and a Masters of Business Administration from the University of Washington.

Mr. Wheeler joined Chiron as Vice President, President of Chiron BioPharmaceuticals, responsible for the commercial operations of Chiron s biopharmaceuticals business, in August 2001. Prior to joining Chiron, Mr. Wheeler was a senior member of The Boston Consulting Group s health care practice and a key contributor to the firm s practice in hospital strategy, disease management, and pharmaceutical capabilities. Based in Boston, he joined the firm in 1988. Before joining The Boston Consulting Group, Mr. Wheeler worked for Merck s MSDRL research unit, where he served as a senior engineer in process development. He recently served as the leader of The Boston Consulting Group s Scientist s Network. In partnership with the Rockefeller Foundation, he has joined the Global Alliance for TB Drug Development, a public-private partnership to develop new anti-tuberculosis drugs. Mr. Wheeler was appointed to the board of directors of Avanir Pharmaceuticals, an AMEX company, in September 2005.

PART II

ITEM 5. MARKET FOR THE REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is quoted on the NASDAQ National Market System under the symbol CHIR. As of December 31, 2005, there were 3,543 holders of record of Chiron common stock. We have declared no cash dividends since our inception and do not expect to pay any dividends in the foreseeable future. Pursuant to an agreement with Novartis, Novartis must approve our declaration and payment of dividends. See Relationship with Novartis AG above.