CHIRON CORP
Form 10-Q/A
April 06, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Mark one)

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2004

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 (State or other jurisdiction of incorporation or organization)	**94-2754624** (I.R.S. Employer Identification No.)
4560 Horton Street, Emeryville, California (Address of principal executive offices)	**94608** (Zip code)

(510) 655-8730
(Registrant s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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 ý No o

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

Yes ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Title of Class	**Outstanding at July 30, 2004**
Common Stock, $0.01 par value	187,718,517

EXPLANATORY NOTE

This Form 10Q/A (the Report) is being filed to amend Chiron Corporation s (the Company) Quarterly Report on Form 10-Q filed on August 9, 2004 (the Original Report) for the quarterly period ended June 30, 2004 to reflect the restatement of the Company s previously issued financial statements as of and for the three and six month periods ended June 30, 2004, and the notes related thereto, as described below, and to make related changes. The information in this Report presented as of the date of the Original Report does not reflect subsequent results, events or developments. Such subsequent results, events or developments include, among others, the information and events subsequently described in our Quarterly Reports on Form 10-Q, our Annual Reports on Form 10-K and our Current Reports on Form 8-K. For a description of such subsequent results, events or developments, please read our Exchange Act Reports filed with the Securities and Exchange Commission since the date of the Original Report, which update and supersede information contained in the Original Report and this Report.

Chiron has determined that certain sales of a travel vaccine recorded as revenues in the second quarter of 2004 should not have been recorded as revenue at that time, and that portions of those sales should have been recorded as revenues in the third and fourth quarters of 2004 and possibly in later quarters. See Note 1 to Chiron s Condensed Consolidated Financial Statements, included herein, for additional discussion.

Chiron has reflected the results of the restatement for the fiscal year ended December 31, 2004 in its Annual Report on Form 10-K for such year, filed with the SEC on March 16, 2005, and has restated its interim financial statements in this Report and in an additional Quarterly Report on Form 10-Q/A for the quarterly period ended September 30, 2004.

In 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 04-8 The Effect of Contingently Convertible Instruments on Diluted Earnings per Share, that the dilutive effect of contingently convertible debt instruments (CoCo s) must be included in diluted earnings per share regardless of whether the triggering contingency has been satisfied, if dilutive. Adoption of Issue No. 04-8 would be on a retroactive basis and would require restatement of prior period diluted earnings per share. Chiron adopted EITF Issue No. 04-08 in the fourth quarter of 2004. The adoption of EITF Issue No. 04-08 did not result in additional dilution to our diluted earnings per share from our $500.0 million convertible debentures due 2033 nor from our $385.0 million convertible debentures due 2034 for the three and six months ended June 30, 2004, as discussed in Note 2 to Chiron s Condensed Consolidated Financial Statements.

CHIRON CORPORATION

TABLE OF CONTENTS

Item 1. Financial Statements

CHIRON CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share data)

		June 30, 2004 Restated		December 31, 2003
ASSETS				
Current assets:				
Cash and cash equivalents	$	595,023	$	364,270
Short-term investments in marketable debt securities		235,964		174,212
Total cash and short-term investments		830,987		538,482
Accounts receivable, net of allowances		329,856		382,933
Current portion of notes receivable		500		1,479
Inventories, net of reserves		275,574		199,625
Assets held for sale		3,044		2,992
Current net deferred income tax assets		59,992		50,204
Derivative financial instruments		3,871		9,463
Other current assets		78,217		72,471
Total current assets		1,582,041		1,257,649
Noncurrent investments in marketable debt securities		202,979		560,292
Property, plant, equipment and leasehold improvements, at cost:				
Land and buildings		368,791		366,275
Laboratory, production and office equipment		614,178		615,814
Leasehold improvements		114,377		112,200
Construction-in-progress		175,956		144,162
		1,273,302		1,238,451
Less accumulated depreciation and amortization		(544,635)		(548,701)
Property, plant, equipment and leasehold improvements, net		728,667		689,750
Purchased technologies, net		226,297		236,707
Goodwill		806,759		787,587
Other intangible assets, net		464,695		486,889
Investments in equity securities and affiliated companies		114,633		121,576
Equity method investments		889		953
Noncurrent notes receivable		7,500		7,500
Noncurrent derivative financial instruments				7,391
Other noncurrent assets		51,030		38,875
	$	4,185,490	$	4,195,169

The accompanying Notes to Condensed Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)

(Unaudited)

(In thousands, except share data)

	June 30, 2004 Restated	December 31, 2003
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 112,778	$ 102,201
Accrued compensation and related expenses	64,296	83,311
Current portion of capital lease	244	570
Current portion of unearned revenue	72,681	47,873
Income taxes payable	13,099	15,270
Other current liabilities	124,940	187,688
Total current liabilities	388,038	436,913
Long-term debt	938,087	926,709
Capital lease	157,075	157,677
Noncurrent derivative financial instruments	3,677	
Noncurrent net deferred income tax liabilities	90,848	107,496
Noncurrent unearned revenue	35,330	45,564
Other noncurrent liabilities	85,776	69,448
Minority interest	7,984	7,002
Total liabilities	1,706,815	1,750,809
Commitments and contingencies		
Stockholders equity:		
Common stock	1,917	1,917
Additional paid-in capital	2,527,313	2,503,195
Deferred stock compensation	(18,929)	(12,871)
Accumulated deficit	(1,719)	(46,634)
Accumulated other comprehensive income	171,805	216,302
Treasury stock, at cost (4,063,000 shares at June 30, 2004 and 4,567,000 shares at December 31, 2003)	(201,712)	(217,549)
Total stockholders equity	2,478,675	2,444,360
	$ 4,185,490	$ 4,195,169

The accompanying Notes to Condensed Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended June 30, 2004 Restated	Three Months Ended June 30, 2003	Six Months Ended June 30, 2004 Restated	Six Months Ended June 30, 2003
Revenues:				
Product sales, net	$ 281,221	$ 245,928	$ 562,287	$ 464,548
Revenues from joint business arrangement	28,532	27,475	58,893	53,927
Collaborative agreement revenues	3,828	3,624	10,343	7,738
Royalty and license fee revenues	55,196	66,876	109,988	120,300
Other revenues	10,975	6,369	17,913	24,794
Total revenues	379,752	350,272	759,424	671,307
Operating expenses:				
Cost of sales	129,228	97,420	255,929	183,009
Research and development	100,326	89,915	198,736	172,045
Selling, general and administrative	106,857	80,226	211,597	153,268
Amortization expense	21,179	7,701	42,511	15,314
Other operating expenses	4,644	1,259	6,760	2,950
Total operating expenses	362,234	276,521	715,533	526,586
Income from operations	17,518	73,751	43,891	144,721
Interest expense	(6,452)	(2,839)	(12,377)	(6,301)
Interest and other income, net	19,809	11,613	35,883	25,931
Minority interest	(459)	(581)	(1,079)	(981)
Income from continuing operations before income taxes	30,416	81,944	66,318	163,370
Provision for income taxes	7,604	20,485	16,579	40,842
Income from continuing operations	22,812	61,459	49,739	122,528
Gain from discontinued operations	12,459	538	25,304	1,964
Net income	$ 35,271	$ 61,997	$ 75,043	$ 124,492
Basic earnings per share:				
Income from continuing operations	$ 0.12	$ 0.33	$ 0.26	$ 0.66
Net income	$ 0.19	$ 0.33	$ 0.40	$ 0.67
Diluted earnings per share:				
Income from continuing operations	$ 0.12	$ 0.32	$ 0.26	$ 0.65
Net income	$ 0.18	$ 0.33	$ 0.39	$ 0.66

The accompanying Notes to Condensed Consolidated Financial Statements are integral to this statement.

CHIRON CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004 Restated	2003	2004 Restated	2003
Net income	$ 35,271	$ 61,997	$ 75,043	$ 124,492
Other comprehensive income (loss):				
Change in foreign currency translation adjustment during the period	(15,784)	35,823	(37,412)	45,118
Unrealized gains (losses) from investments:				
Net unrealized holding gains (losses) arising during the period, net of tax (provision) benefit of $4,610 and ($1,541) for the three months ended June 30, 2004 and 2003, respectively, and $2,112 and ($1,284) for the six months ended June 30, 2004 and 2003, respectively	6,267	3,083	7,544	2,640
Reclassification adjustment for net gains included in net income, net of tax provision of $2,965 and $1,834 for the three months ended June 30, 2004 and 2003, respectively, and $9,353 and $3,626 for the six months ended June 30, 2004 and 2003, respectively	(11,361)	(2,940)	(14,629)	(5,744)
Net unrealized gains (losses) from investments	(5,094)	143	(7,085)	(3,104)
Other comprehensive income (loss)	(20,878)	35,966	(44,497)	42,014
Comprehensive income	$ 14,393	$ 97,963	$ 30,546	$ 166,506

The accompanying Notes to Condensed Consolidated Financial Statements are integral to this statement.

6

CHIRON CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Six Months Ended June 30, 2004 Restated	Six Months Ended June 30, 2003
Net cash provided by operating activities	$ 74,730	$ 112,706
Cash flows from investing activities:		
Purchases of investments in marketable debt securities	(218,815)	(277,514)
Proceeds from sales and maturities of investments in marketable debt securities	508,121	917,794
Capital expenditures	(93,770)	(52,371)
Purchases of equity securities and interests in affiliated companies	(4,349)	(36,889)
Proceeds from sale of equity securities and interests in affiliated companies	16,277	7,428
Cash paid for acquisitions, net of cash acquired	(19,548)	(1,180)
Other, net	783	(777)
Net cash provided by investing activities	188,699	556,491
Cash flows from financing activities:		
Net repayment of short-term borrowings		(71)
Repayment of debt and capital leases	(380,035)	(95)
Payments to acquire treasury stock	(71,726)	(68,079)
Proceeds from reissuance of treasury stock	45,001	24,526
Proceeds from issuance of debt	2,317	
Payment of bond issuance costs	(7,766)	
Proceeds from issuance of convertible debentures	385,000	
Proceeds from put options		2,144
Net cash used in financing activities	(27,209)	(41,575)
Effect of exchange rate changes on cash and cash equivalents	(5,467)	471
Net increase in cash and cash equivalents	230,753	628,093
Cash and cash equivalents at beginning of the period	364,270	247,950
Cash and cash equivalents at end of the period	$ 595,023	$ 876,043

The accompanying Notes to Condensed Consolidated Financial Statements are integral to this statement.

7

CHIRON CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2004

(Unaudited)

Note 1 Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The information presented in the Condensed Consolidated Financial Statements at June 30, 2004, and for the three and six months ended June 30, 2004 and 2003, is unaudited but includes adjustments, consisting only of all normal recurring adjustments, which Chiron Corporation believes to be necessary for fair presentation of the periods presented.

The Condensed Consolidated Balance Sheet amounts at December 31, 2003, have been derived from audited financial statements. Historically, Chiron s operating results have varied considerably from period to period due to the nature of Chiron s collaborative, royalty and license arrangements and the seasonality of certain vaccine products. In addition, the mix of products sold and the introduction of new products will affect comparability from quarter to quarter. As a consequence, Chiron s interim results in any one quarter are not necessarily indicative of results to be expected for a full year. This information should be read in conjunction with Chiron s audited Consolidated Financial Statements as of and for the year ended December 31, 2003, which are included in the Annual Report on Form 10-K filed by Chiron with the Securities and Exchange Commission.

Restatement of Financial Statements

Chiron determined that certain sales of a travel vaccine recorded as revenues in the second quarter of 2004 should not have been recorded as revenue at that time, and that portions of those sales should have been recorded as revenues in the third and fourth quarters of 2004 and possibly in later quarters.

As a result of the restatement, for the three and six months ended June 30, 2004, product sales were reduced by $13.9 million, cost of sales were reduced by $1.5 million and income taxes were reduced by $3.1 million. This resulted in a $9.3 million reduction in income from continuing operations and net income and a $0.05 reduction of diluted income from continuing operations per share ($0.12 per share instead of the $0.17 per share as previously reported). On the June 30, 2004 consolidated balance sheet, the current portion of unearned revenue was increased by $12.3 million and income taxes payable was reduced by $3.1 million.

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of Chiron and its majority-owned subsidiaries. For consolidated majority-owned subsidiaries in which Chiron owns less than 100%, Chiron records minority interest in the Condensed Consolidated Financial Statements to account for the ownership interest of the minority owner. Investments in limited partnerships and interests in which Chiron has an equity interest of 50% or less are accounted for using either the equity or cost method. All significant intercompany accounts and transactions have been eliminated in consolidation.

On July 8, 2003, Chiron acquired PowderJect Pharmaceuticals plc, a company based in Oxford, England that develops and commercializes vaccines. Chiron included PowderJect Pharmaceuticals operating results in its consolidated operating results beginning July 8, 2003. PowderJect Pharmaceuticals is part of Chiron s vaccines segment.

Chiron is a limited partner in several venture capital funds. Chiron is obligated to pay up to $60.0 million over ten years in equity contributions to these venture capital funds, of which approximately $36.5 million was paid through June 30, 2004. Chiron accounts for these investments under the equity method of accounting.

Adoption of New Accounting Pronouncements

Financial Accounting Standards Board (or FASB) Interpretation No. 46 (or FIN 46), Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51 as revised, requires a variable interest entity (or VIE) to be consolidated by a company if that company absorbs a majority of the VIEs expected losses, receives a majority of the entity s expected residual returns, or both, as a result of ownership, contractual or other financial interest in the VIE. Prior to the adoption of FIN 46, VIEs were generally consolidated by companies owning a majority voting interest in the VIE. The consolidation requirements of FIN 46 applied immediately to VIEs created after January 31, 2003, however, the FASB deferred the effective date for VIEs created before February 1, 2003 to the quarter ended March 31, 2004 for calendar year companies. Adoption of the provisions of FIN 46 prior to the deferred effective date was permitted.

We adopted the remaining provisions of FIN 46 in the first quarter of 2004. The adoption of these provisions did not have a material effect on our Condensed Consolidated Financial Statements.

Use of Estimates and Reclassifications

The preparation of financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, management evaluates its estimates, including those related to investments; inventories; derivatives; capital leases; intangible assets; goodwill; purchased in-process research and development; product discounts, rebates and returns; bad debts; collaborative, royalty and license arrangements; restructuring; pension and other post-retirement benefits; income taxes; and litigation and other contingencies. Chiron bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates under different assumptions or conditions.

Chiron s blood-testing segment includes Chiron s one-half share in the pretax operating earnings generated by the joint business contractual arrangement with Ortho-Clinical Diagnostics, Inc., a Johnson & Johnson company. Chiron accounts separately for research and development and manufacturing cost reimbursements and certain product sale revenues received from Ortho-Clinical Diagnostics, but relating to the joint business contractual arrangement. Chiron s joint business arrangement with Ortho-Clinical Diagnostics is a contractual arrangement and is not a separate and distinct legal entity. Through Chiron s joint business contractual arrangement with Ortho-Clinical Diagnostics, Chiron sells a line of immunodiagnostic tests to detect hepatitis viruses and retroviruses and provides supplemental tests and microplate and chemiluminescent instrument systems to automate test performance and data collection. Prior to the first quarter 2003, Chiron had accounted for revenues relating to Ortho-Clinical Diagnostics non-U.S. affiliate sales on a one-quarter lag, with an adjustment of the estimate to actual in the subsequent quarter. More current information of Ortho-Clinical Diagnostics non-U.S. affiliate sales became available in the first quarter 2003, and as a result, Chiron is able to recognize revenues relating to Ortho-Clinical Diagnostics non-U.S. affiliate sales on a one-month lag. The effect of this change, net of tax, was an increase to net income by $3.2 million for revenue from the joint business contractual arrangement for the six months ended June 30, 2003.

Chiron currently owns a facility in London, England for international operations. This facility became available for sale in the fourth quarter of 2003 and Chiron expects to complete the sale of this facility within one year of the date it became available for sale. Chiron has committed to a plan to sell this facility and is actively marketing this facility. This facility is classified as Assets held for sale in the Condensed Consolidated Balance Sheet at June 30, 2004.

Chiron, prior to filing its financial statements on Form 10-Q, publicly releases an unaudited condensed balance sheet and statement of operations. Between the date of Chiron s earnings release and the filing of Form 10-Q, reclassifications may be required. These reclassifications, when made, have no effect on income from continuing operations, net income or earnings per share. There has been no such reclassification in the second quarter 2004.

Certain previously reported amounts have been reclassified to conform to the current year presentation.

Inventories

Inventories, net of reserves, are stated at the lower of cost or market using the moving weighted-average cost method. Chiron maintains inventory reserves primarily for product failures, expiration and obsolescence. Inventory that is obsolete (inventory that will no longer be used in the manufacturing process), expired, or in excess of forecasted usage is written down to its market value, if lower than cost.

Inventories, net of reserves, consisted of the following:

	June 30, 2004	December 31, 2003
Finished goods	$ 49,734	$ 38,640
Work-in-process	169,715	105,359
Raw materials	56,125	55,626
	$ 275,574	$ 199,625

Income Taxes

The effective tax rate for the three and six months ended June 30, 2004 and 2003 was 25% of pretax income from continuing operations. The effective tax rate may be affected in future periods by changes in Chiron s estimates with respect to the deferred tax assets, acquisitions and other items affecting the overall tax rate.

Put Options

Chiron has, in the past, used written put options to reduce the effective costs of repurchasing its common stock. After expiration of existing put options in the second quarter of 2003, Chiron discontinued the use of put options. Chiron had no put options outstanding at June 30, 2004.

Stock-Based Compensation

Chiron measures compensation expense for its stock-based employee compensation plans using the intrinsic value method. Compensation expense is based on the difference, if any, between the fair value of Chiron s common stock and the exercise price of the option or share right on the measurement date, which is typically the date of grant. This amount is recorded as Deferred stock compensation in the Condensed Consolidated Balance Sheets and amortized as a charge to operations over the vesting period of the applicable options or share rights. Compensation expense is included primarily in Selling, general and administrative in the Condensed Consolidated Statements of Operations.

The following table illustrates the effect on net income and related net income per share, had compensation cost for stock-based compensation plans been determined based upon the fair value method:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	**2003**	**2004**	**2003**
	(in thousands, except per share data)			
Net income:				
As reported	$ 35,271	$ 61,997	$ 75,043	$ 124,492
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	1,349	1,750	2,689	2,651
Less: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	22,769	19,933	44,277	38,045
Pro forma	$ 13,851	$ 43,814	$ 33,455	$ 89,098
Basic net income per share:				
As reported	$ 0.19	$ 0.33	$ 0.40	$ 0.67
Pro forma	$ 0.07	$ 0.24	$ 0.18	$ 0.48
Diluted net income per share:				

As reported	$	0.18	$	0.33	$	0.39	$	0.66
Pro forma	$	0.07	$	0.23	$	0.18	$	0.47

Comprehensive Income

For the three and six months ended June 30, 2004 and 2003, the foreign currency translation component of comprehensive income relates to permanent investments in non-U.S. subsidiaries, and accordingly, was not adjusted for income taxes.

Treasury Stock

Treasury stock is stated at cost. Gains on reissuance of treasury stock are credited to Additional paid-in capital. Losses on reissuance of treasury stock are charged to Additional paid-in capital to the extent of available net gains on reissuance of treasury stock. Otherwise, losses are charged to Accumulated deficit. Chiron charged losses of $4.7 million and $30.1 million for the three and six months ended June 30, 2004, respectively, and $16.3 million and $23.8 million for the three and six months ended June 30, 2003, respectively, to Accumulated deficit in the Condensed Consolidated Balance Sheets.

Note 2 Earnings Per Share

Basic earnings per share is based upon the weighted-average number of common shares outstanding. Diluted earnings per share is based upon the weighted-average number of common shares and dilutive potential common shares outstanding. Dilutive potential common shares could result from (i) the assumed exercise of outstanding stock options, warrants and equivalents, which are included under the treasury-stock method; (ii) performance units to the extent that dilutive shares are assumed issuable; (iii) the assumed exercise of outstanding put options, which are included under the reverse treasury-stock method; and (iv) convertible notes and debentures, which are included under the if-converted method. Due to rounding, quarterly amounts may not sum fully to yearly amounts.

Contingently convertible debt instruments (CoCos) are included in diluted earnings per share, if dilutive. For the three and six months ended June 30, 2004, Chiron s $500.0 million contingently convertible debentures due 2033 (2033 Debentures) and Chiron s $385.0 million contingently convertible debentures due 2034 (2034 Debentures) were excluded from the computations of diluted earnings per share as each of these CoCos were not dilutive.

The following table sets forth the computations for basic and diluted earnings per share on income from continuing operations (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Income (Numerator):				
Income from continuing operations	$ 22,812	$ 61,459	$ 49,739	$ 122,528
Shares (Denominator):				
Weighted-average common shares outstanding	188,275	186,408	187,952	186,584
Effect of dilutive securities:				
Stock options and equivalents	2,710	3,550	3,450	3,294
Put options		5		3
Weighted-average common shares outstanding, plus impact from assumed conversions	190,985	189,963	191,402	189,881
Basic earnings per share	$ 0.12	$ 0.33	$ 0.26	$ 0.66
Diluted earnings per share	$ 0.12	$ 0.32	$ 0.26	$ 0.65

The following table sets forth the computations for basic and diluted earnings per share on net income (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Income (Numerator):				
Net income	$ 35,271	$ 61,997	$ 75,043	$ 124,492
Shares (Denominator):				
Weighted-average common shares outstanding	188,275	186,408	187,952	186,584
Effect of dilutive securities:				
Stock options and equivalents	2,710	3,550	3,450	3,294
Put options		5		3

Weighted-average common shares outstanding, plus impact from assumed conversions	190,985	189,963	191,402	189,881
Basic earnings per share	$ 0.19	$ 0.33	$ 0.40	$ 0.67
Diluted earnings per share	$ 0.18	$ 0.33	$ 0.39	$ 0.66

For the three months ended June 30, 2004 and 2003, stock options to purchase 11.8 million and 16.8 million shares, respectively, and for the six months ended June 30, 2004 and 2003, stock options to purchase 7.6 million and 17.1 million shares, respectively, with exercise prices greater than the average market prices of common stock, were excluded from the respective computations of diluted earnings per share as their inclusion would be antidilutive.

The dilutive effect of CoCos must be included in diluted earnings per share regardless of whether the triggering contingency has been satisfied, if dilutive. For the three and six months ended June 30, 2004, 7.3 million shares of common stock issuable upon conversion of the 2033 Debentures were excluded from the computations of diluted earnings per share as their inclusion would be antidilutive. If the 2034 Debentures are tendered for conversion, the value (Conversion Value) of cash and shares of Chiron s common stock, if any, to be received by a holder converting $1,000 principal amount of the debentures will be determined by multiplying the applicable conversion rate by a weighted average price. Chiron will deliver the Conversion Value to debenture holders as follows: (1) an amount in cash (Principal Return) equal to the lesser of (a) the aggregate Conversion Value of the debentures to be converted and (b) the aggregate principal amount of the debentures to be converted and (2) if the aggregate Conversion Value of the debentures to be converted is greater that the Principal Return, an amount in shares (Net Shares) equal to the aggregate Conversion Value less the Principal Return (Net Share Amount). The number of Net Shares to be paid will be determined by dividing the Net Share Amount by a weighted average price. If dilutive, common shares to be added to the diluted shares outstanding would be determined by the net share settlement of the 2034 Debentures. For the three and six months ended June 30, 2004, the assumed conversion of the 2034 Debentures was not dilutive.

For the three and six months ended June 30, 2004, 4.1 million and 6.2 million shares of common stock that would be issued upon conversion of the Liquid Yield Option Notes (LYONs) were excluded from the computations of diluted earnings per share, as their inclusion would be antidilutive. For each of the three and six months ended June 30, 2003, 5.2 million shares of common stock that would be issued upon conversion of the LYONs were excluded from the computation of diluted earnings per share, as their inclusion would be antidilutive. During the second quarter of 2004, Chiron was required to purchase a significant portion of the LYONs as discussed in Note 7 Debt Obligations .

Note 3 Discontinued Operations

In a strategic effort to focus on its core businesses of blood-testing, vaccines and biopharmaceuticals, Chiron completed the sale of Chiron Diagnostics and Chiron Vision in 1998 and 1997, respectively.

In the first quarter 2003, Chiron and Bayer Corporation reached a settlement agreement relating to certain claims raised by Bayer under the Stock Purchase Agreement dated September 17, 1998, between Chiron and Bayer for Chiron Diagnostics. Under this settlement agreement, Chiron was required to make a payment to Bayer during the first quarter 2003. Pursuant to this settlement, Chiron recorded a charge, net of adjustment to its previously provided reserve for indemnity obligations, of $7.6 million, offset by an income tax benefit of $9.0 million, resulting in a net gain of $1.4 million which was reported as a Gain from discontinued operations for the six months ended June 30, 2003.

In the second quarter 2003, we reversed approximately $0.5 million related to unutilized reserves of Chiron Diagnostics and Chiron Vision, which were recorded as a Gain from discontinued operations for the three and six months ended June 30, 2003.

Chiron and Bayer also were involved in a separate dispute with respect to their respective rights to certain royalty refunds receivable for which a settlement was reached in 2004. Under this settlement agreement, Chiron made a payment to Bayer in 2004. This settlement includes an agreement that all outstanding items with Bayer related to the sale of Chiron Diagnostics are resolved and no future indemnity obligations are required. Chiron released previously established reserves in excess of the required payments for the indemnity obligations in the first quarter of

2004. This settlement resulted in a benefit of $0.3 million and an income tax benefit of $12.5 million, resulting in a net gain of $12.8 million, which was reported as a Gain from discontinued operations for the six months ended June 30, 2004.

In the second quarter 2004, Chiron and the IRS entered into a settlement agreement closing the open tax years 1996 to 1998. Pursuant to this settlement agreement Chiron recognized a tax benefit of approximately $12.5 million, which was reported as a Gain from discontinued operations for the three and six months ended June 30, 2004.

Note 4 Acquisitions