

HYSEQ INC
Form PRER14A
May 09, 2002

Table of Contents

**SCHEDULE 14A
(Rule 14a-101)**

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

**Proxy Statement Pursuant to Section 14(A) of The Securities
Exchange Act of 1934 (Amendment No. 1)**

Filed by the Registrant [X]

Filed by a Party other than the Registrant []

Check the appropriate box:

[X] Preliminary Proxy Statement
 [] Confidential,
for Use of the
Commission Only
(as permitted by
Rule 14a-6(e)(2)) []
Definitive Proxy
Statement []
Definitive
Additional
Materials []
Soliciting
Material Under
Rule 14a-12

HYSEQ, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

[X] No fee required.
 [] Fee
computed on
table below per
Exchange Act
Rules 14a-6(i)(1)
and 0-11.
(1) Title of each
class of securities
to which
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applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials. Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount previously paid:

(2) Form,
Schedule or
Registration
Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

June , 2002

Dear Stockholder:

Please join us for the 2002 Annual Meeting of Stockholders of Hyseq Pharmaceuticals, Inc. The meeting will be held on Tuesday, August 6, 2002, at 11:00 a.m. in our offices at 675 Almanor Ave., Sunnyvale, CA 94085.

At this year's meeting, you will have the opportunity to elect two directors, approve our new employee stock plan, approve the issuance of securities to officers and directors under several different circumstances, approve the appointment of our independent auditors, and transact any other business properly presented at the meeting. If you own shares of our common stock at the close of business on June 12, 2002, you will be entitled to vote at the Annual Meeting. In addition, you will have the opportunity to hear what has happened in our business in the past year and to ask questions. Additional information about the items of business to be discussed at our Annual Meeting is given in the enclosed Proxy Statement. You will find other detailed information about Hyseq Pharmaceuticals and our operations in the enclosed package which includes Hyseq Pharmaceutical's 2001 Annual Report in summary form with my letter to stockholders, and the Annual Report on Form 10-K for 2001, which contains Hyseq Pharmaceutical's audited consolidated financial statements.

We hope you can join us on August 6, but whether or not you can attend, please read the enclosed Proxy Statement. When you have done so, please mark your votes on the enclosed proxy card, sign and date the proxy card, and return it to us in the enclosed envelope. Your vote is important, so please return your proxy card promptly.

Sincerely,

Ted W. Love, M.D.
President and Chief Executive Officer

Table of Contents

HYSEQ, INC.

d/b/a Hyseq Pharmaceuticals, Inc.

**670 Almanor Avenue
Sunnyvale, CA 94085**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held on August 6, 2002**

To The Stockholders:

NOTICE IS HEREBY GIVEN, that the annual meeting of stockholders of Hyseq, Inc. will be held on Tuesday, August 6, 2002, at 11:00 a.m. Pacific time, at Hyseq, Inc., 675 Almanor Avenue, Sunnyvale, California, for the following purposes:

to elect two directors to hold office until the 2005 annual meeting of stockholders or until the election and qualification of their respective successors;

to approve the Hyseq, Inc. 2002 Equity Incentive Plan;

to ratify the sale and issuance to some of our officers and directors of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants;

to approve the grant in August 2001 of an option to our Chairman, Dr. George B. Rathmann, for 1,000,000 shares of our common stock, including the issuance of our common stock upon exercise of the option;

to approve the issuance of shares of our common stock, other equity securities or both to Dr. Rathmann in repayment of amounts owing, from time to time, under his \$20.0 million line of credit to us;

to ratify the selection of KPMG LLP as our independent auditors for the fiscal year 2002; and

to transact any other business which is properly brought before the meeting or any adjournment or postponement thereof.

Please refer to the attached proxy statement, which forms a part of this Notice and is incorporated herein by reference, for further information with respect to the business to be transacted at the annual meeting.

Stockholders of record at the close of business on June 12, 2002 are entitled to receive notice of, and to vote at, the annual meeting or any adjournment or postponement thereof. You may inspect a complete list of stockholders eligible to vote at the meeting at our offices during the ten days prior to the meeting. All stockholders are cordially invited to attend the annual meeting.

By order of the Board of Directors:

Li-Hsien Rin-Laures
Secretary

, 2002
670 Almanor Avenue
Sunnyvale, California 94085

TABLE OF CONTENTS

ELECTION OF NOMINEES TO BOARD OF DIRECTORS

PROPOSAL NO. 2: APPROVAL OF THE HYSEQ, INC. 2002 EQUITY INCENTIVE PLAN

PROPOSAL NO. 3

PROPOSAL NO. 4 APPROVAL OF THE GRANT IN AUGUST 2001 OF AN OPTION TO OUR CHAIRMAN, DR. GEORGE B. RATHMANN, FOR 1,000,000 SHARES OF OUR COMMON STOCK, INCLUDING THE ISSUANCE OF OUR COMMON STOCK UPON EXERCISE OF THE OPTION

PROPOSAL NO. 5: APPROVAL OF ISSUANCE OF SHARES OF OUR COMMON STOCK, OTHER EQUITY SECURITIES OR BOTH TO OUR CHAIRMAN DR. GEORGE B. RATHMANN, IN REPAYMENT OF AMOUNTS OWING, FROM TIME TO TIME, UNDER HIS \$20.0 MILLION LINE OF CREDIT TO US

PROPOSAL NO. 6: RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT
CERTAIN INFORMATION WITH RESPECT TO EXECUTIVE OFFICERS

Summary Compensation Table

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

COMPENSATION COMMITTEE REPORT

AUDIT COMMITTEE REPORT

STOCK PERFORMANCE GRAPH

OTHER INFORMATION

Table of Contents

HYSEQ, INC.

**PROXY STATEMENT
FOR
ANNUAL MEETING OF STOCKHOLDERS
August 6, 2002**

INTRODUCTION

General

This proxy statement is furnished to our stockholders in connection with the solicitation of proxies for use at our annual meeting of stockholders to be held on August 6, 2002 at 11:00 a.m. Pacific time, for the following purposes:

to elect two directors to hold office until the 2005 annual meeting of stockholders or until the election and qualification of their respective successors;

to approve the Hyseq, Inc. 2002 Equity Incentive Plan;

to ratify the sale and issuance to some of our officers and directors of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants;

to approve the grant in August 2001 of an option to our Chairman, Dr. George B. Rathmann, for 1,000,000 shares of our common stock, including the issuance of our common stock upon exercise of the option;

to approve the issuance of shares of our common stock, other equity securities or both to Dr. Rathmann in repayment of amounts owing, from time to time, under his \$20.0 million line of credit to us;

to ratify the selection of KPMG LLP as our independent auditors for the fiscal year 2002; and

to transact any other business which is properly brought before the meeting or any adjournment or postponement thereof.

A copy of our Annual Report to Stockholders for the year ended December 31, 2001 and this proxy statement and accompanying proxy card will be first mailed to stockholders on or about June 17, 2002.

This solicitation is made on behalf of our Board of Directors and we will pay the costs of solicitation. Our directors, officers and employees may also solicit proxies by telephone, telegraph, fax or personal interview. We will not pay any additional compensation to directors, officers or other employees for such services, but may reimburse them for reasonable out-of-pocket expenses in connection with such solicitation. We will reimburse banks, brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy material to our stockholders. We have retained U.S. Stock Transfer to assist in the solicitation of proxies with respect to shares of our common stock held of record by brokers, nominees and institutions for a customary fee, estimated to be approximately \$15,000, plus reimbursement of expenses.

Our principal executive offices are located at 670 Almanor Avenue, Sunnyvale, California 94085, telephone (408) 524-8100.

Shares Entitled to Vote and Required Vote

Our outstanding common stock constitutes the only class of securities entitled to vote at the meeting. Stockholders of record of our common stock at the close of business on June 12, 2002 are entitled to notice of,

Table of Contents

and to vote at, the meeting. On that date, _____ shares of our common stock were issued and outstanding, including 3,764,306 shares beneficially owned by our executive officers and directors and outstanding (which does not include any securities covered by the proposals in this proxy statement, none of which are eligible to vote for the proposals), or 16.4% of the outstanding shares of our common stock as of May 2, 2002. The presence at the meeting, in person or by proxy, of a majority of those shares will constitute a quorum. Each share of common stock is entitled to one vote. Our executive officers and directors have informed us that they intend to vote, or cause to be voted, all 3,764,306 shares of common stock held by them for all of the proposals in this proxy statement.

There are no statutory or contractual rights of appraisal or similar remedies available to those stockholders who dissent from any matter to be acted on at the meeting.

Voting Procedures

A proxy card is enclosed for your use. We ask that you sign, date and return the proxy card in the accompanying envelope, which is postage prepaid if you mail it in the United States.

You have choices on each of the matters to be voted upon at the meeting. Concerning the election of the directors, by checking the appropriate box on your proxy card you may:

vote for the director nominees; or

withhold authority to vote for some or all of the director nominees.

Concerning the approval of the Hyseq, Inc. 2002 Equity Incentive Plan, you may:

approve the plan;

disapprove the plan; or

abstain from voting for or against the plan.

Concerning the ratification of sale and issuance to some of our officers and directors of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants, you may:

approve the sale and issuance;

disapprove the sale and issuance; or

abstain from voting for or against the sale and issuance.

Concerning the approval of the grant in August 2001 of an option to our Chairman, Dr. George B. Rathmann, for 1,000,000 shares of our common stock, including the issuance of our common stock upon exercise of the option, you may:

approve the issuance;

disapprove the issuance; or

abstain from voting for or against the issuance.

Concerning the approval of the issuance of shares of our common stock, other equity securities or both to our Chairman, Dr. George B. Rathmann, in repayment of his \$20.0 million line of credit to us, you may:

ratify the issuance;

not ratify the issuance; or

abstain from voting for or against ratification of the issuance.

Table of Contents

Concerning the ratification of the selection of KPMG LLP as our independent auditors for the fiscal year 2002, you may:

ratify the selection;

not ratify the selection; or

abstain from voting for or against the ratification of the selection.

Unless there are different instructions on the proxy, all shares represented by valid proxies (and not revoked before they are voted) will be voted at the meeting **FOR** (1) the election of the director nominees listed in Proposal No. 1, (2) the Hyseq, Inc. 2002 Equity Incentive Plan as set forth in Proposal No. 2, (3) the ratification of the sale and issuance to some of our officers and directors of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants, as set forth in Proposal No. 3, (4) the approval of the grant in August 2001 of an option to our Chairman, Dr. George B. Rathmann, for 1,000,000 shares of our common stock, including the issuance of our common stock upon exercise of the option as set forth in Proposal No. 4, (5) the approval of the issuance of shares of our common stock, other equity securities or both to our Chairman, Dr. Rathmann, in repayment of his \$20.0 million line of credit to us as set forth in Proposal No. 5 and (6) the ratification of the selection of KPMG LLP as our independent auditors for the fiscal year 2002 as set forth in Proposal No. 6. With respect to any other business that may properly come before the meeting and be submitted to a vote of stockholders, proxies will be voted in accordance with the best judgment of the designated proxy holders.

Shares represented by proxies that reflect abstentions or broker non-votes (*i.e.*, shares held by a broker or nominee which are represented at the meeting, but with respect to which the broker or nominee is not empowered to vote on a particular proposal) will be counted as shares that are present and entitled to vote for purposes of determining the presence of a quorum but are counted as votes against a particular proposal in determining whether a matter has been approved. The election of the director nominees, the approval of the Hyseq, Inc. 2002 Equity Incentive Plan, to ratify the sale and issuance to some of our officers and directors of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants, to some of our officers and directors, the grant in August 2001 of an option to our Chairman, Dr. George B. Rathmann, for 1,000,000 shares of our common stock, including the issuance of our common stock upon exercise of the option and the issuance of our common stock upon exercise of the option, the issuance of the securities to Dr. Rathmann in repayment of his \$20.0 million line of credit to us and the ratification of the selection of KPMG LLP as our independent auditors, each require the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

Stockholders of record may vote by either completing and returning the enclosed proxy card prior to the meeting, voting in person at the meeting, or submitting a signed proxy card at the meeting.

Your vote is important. Accordingly, please sign and return the accompanying proxy card whether or not you plan to attend the meeting in person.

You may revoke your proxy at any time before it is actually voted at the meeting by:

delivering written notice of revocation to our Secretary at 670 Almanor Avenue, Sunnyvale, California 94085;

submitting a later dated proxy; or

attending the meeting and voting in person.

Your attendance at the meeting will not, by itself, constitute revocation of your proxy. You may also be represented by another person present at the meeting by executing a form of proxy designating that person to act on your behalf. Shares may only be voted by or on behalf of the record holder of shares as indicated in our stock transfer records. If you are a beneficial owner but your shares are held of record by another person, such

Table of Contents

as a stock brokerage firm or bank, that person must vote the shares as the record holder in accordance with the beneficial holder's instructions.

All votes cast at the meeting will be tabulated by the persons appointed by us to act as inspectors of election for the meeting.

PROPOSAL NO. 1:**ELECTION OF NOMINEES TO BOARD OF DIRECTORS****General Information**

Our Amended and Restated By-Laws provide for three classes of directors that serve staggered, terms of one, two or three years as is designated at the time of a director's election. There are currently two Class I directors, whose terms expire at the annual stockholders' meeting in 2003, two Class II directors, whose terms expire at the annual stockholders' meeting in 2004, and two Class III directors, whose terms expire at this meeting. One of our prior directors, Ms. Greta Marshall, died in May 2001. Another of our prior directors, Dr. Radoje Drmanac, resigned in October 2001 to focus on being Senior Vice President, Chief Scientific Officer and director of our subsidiary Callida Genomics, Inc. The Board of Directors has nominated the current Class III directors, Dr. George B. Rathmann and Mr. Thomas N. McCarter, III, for re-election. Each Class III director elected at the annual meeting will serve a three-year term ending on the date of the annual meeting in 2005 or until a successor is duly elected or appointed. Proxies cannot be voted for more than two persons.

Each nominee for director has consented to being named in this proxy statement and has indicated his or her willingness to serve if elected. Proxies received by us will be voted for the nominees. Although we do not anticipate that any nominee will be unavailable for election, if a nominee is unavailable for election, we will vote the proxies for any substitute nominee we may designate.

Each nominee for election to the Board of Directors currently serves as one of our directors and has continually served as a director since the date such person initially became a director, which is set forth below. In 2001, our Board of Directors met six times and each director attended at least 75% of those meetings. The following table sets forth information as of May 2, 2002 with respect to our directors, including the two persons nominated for election at the meeting.

| Name of Nominee or Director | Age | Position | Director Since |
|------------------------------------|------------|---|-----------------------|
| George B. Rathmann, Ph.D.(1) | 74 | Chairman of the Board | 2000 |
| Thomas N. McCarter, III(2) | 72 | Director | 1996 |
| Ted W. Love, M.D. | 43 | President and Chief Executive Officer, Director | 2001 |
| Robert D. Weist(1)(2)(3) | 62 | Vice Chairman of the Board | 1993 |
| Raymond F. Baddour, Sc.D.(2)(3) | 77 | Director | 1993 |
| Ernst Schweizer, Ph.D. | 67 | Director | 1999 |

(1) member of nominating committee

(2) member of audit committee

(3) member of compensation committee

The principal occupations and positions for at least the past five years of the director nominees named above are as follows:

George B. Rathmann, Ph.D. has served as Chairman and a director since February 2000. Dr. Rathmann served as our Chief Executive Officer from May 2000 to March 2001, and also served as our President from

Table of Contents

May 2000 to January 2001. Prior to joining us, Dr. Rathmann was a founder of ICOS Corporation, a publicly held biopharmaceutical company, in 1990 and served as its Chairman until January 2000. While at ICOS, he also served as Chief Executive Officer and President from September 1991 until June 1999. In 1980, he co-founded Amgen, Inc., a publicly-held biotechnology company. He was a director of Amgen until 1993 and at various times also served as its Chairman of the Board, President and Chief Executive Officer. Dr. Rathmann was also associated with Abbott Laboratories, Inc., a healthcare products manufacturer, where from 1975 to 1977 he was Director of Research and Development and from 1977 to 1980 he was Divisional Vice President. Dr. Rathmann received his Ph.D. in physical chemistry from Princeton University.

Thomas N. McCarter, III has served as a director since October 1996. Mr. McCarter currently serves as Chairman of the Ramapo Land Company, a real estate company, and is a general partner of Miles Timber Properties, a land company, positions he has held for more than five years. Mr. McCarter was a former Chairman of Stillrock Management, Inc., an investment company, was a director of Parock Group, a diversified investment company, and is currently a director of other closely held companies. Mr. McCarter attended Princeton University from 1948 to 1951 and has been a certified investment counselor since 1972.

Directors continuing in office until the Annual Meeting of Stockholders in 2003.

Ted W. Love, M.D. has served as our President since January 2001, our Chief Executive Officer since March 2001, and as a director since February 2001. Dr. Love served as our President and Chief Operating Officer from January 2001 until March 2001. Prior to joining us, Dr. Love served as Senior Vice President of Development at Advanced Medicine, Inc. Dr. Love served as a Research Physician and Vice President of Product Development at Genentech from 1992 to 1998. Dr. Love holds a B.A. in Molecular Biology from Haverford College and a M.D. from Yale Medical School.

Robert D. Weist has served as a director since May 1993 and as Vice Chairman since February 2000. Mr. Weist served as Chairman from March 1994 until February 2000 and as President from May 1993 until March 1994. Mr. Weist has been President of Weist Associates, a management consulting firm, since April 1992. Prior to joining us, from January 1986 to April 1992, Mr. Weist was a consultant to Amgen, Inc., a publicly-held biotechnology company, and served as Senior Vice President, Administration, General Counsel and Secretary, and from May 1982 to January 1986, he served as Amgen's Vice President, General Counsel and Secretary. Mr. Weist also serves as a director of BioSource International Inc., a biological products supplier. Mr. Weist holds a B.S. in chemical engineering from Purdue University, a J.D. from New York University and an M.B.A. from the University of Chicago.

Directors continuing in office until the Annual Meeting of Stockholders in 2004.

Raymond F. Baddour, Sc.D. has served as a director since December 1993. Since July 1989, Dr. Baddour has served as the Lamot du Pont Professor of Chemical Engineering, Emeritus, at the Massachusetts Institute of Technology where he formerly served as the Lamot du Pont Professor of Chemical Engineering from 1973 to 1989. Dr. Baddour also serves as a director of ActivBiotics, Inc., a pharmaceutical company, Scully Signal Co., an equipment manufacturing company, and MatTek Corporation, a bio-materials company. He was a director of Amgen from 1980 to 1997. Dr. Baddour holds a B.S. in chemical engineering from Notre Dame University and an M.S. and Sc.D. from the Massachusetts Institute of Technology.

Ernst Schweizer, Ph.D. has served as a director since March 1999. Since January 2002, Dr. Schweizer has been Head of Business Development and a director of Genmab A/S, a company also focused on the development of antibodies. In addition, he is a director of Speedel Holding and of the Biopharma Fund. In January 1999, Dr. Schweizer joined Medarex, Inc., a biopharmaceutical company focused on the development of antibodies, as President of Medarex Europe and Managing Director of Medarex, Inc., positions he held until the end of 2001. Formerly, Dr. Schweizer served as the Deputy Head of Business Development and Licensing at Novartis, a pharmaceutical company, and was the Chief Scientific and Technical Officer in Business Development and Licensing at CIBA-Geigy, before its consolidation into Novartis in 1997, during a

Table of Contents

37 year tenure with these companies. Dr. Schweizer received his Ph.D. from the University of Stuttgart and holds numerous patents.

Director Compensation

During 2001, we paid all non-employee directors a fee of \$6,250 for each Board meeting attended in person or by telephone, subject to an overall cap of \$25,000 per year. Each non-employee director earned \$25,000 in 2001. During 2001, all non-employee directors also received fees of \$1,000 for each Committee meeting attended in person. Also, all Committee chairpersons received fees of \$6,000 per annum. Committee fees were not subject to the \$25,000 cap. Our directors who are also employees do not receive any director or committee fees. All directors are reimbursed for reasonable expenses incurred in attending Board and committee meetings.

We grant options to purchase shares of our common stock to our directors under our Directors Plan. Under the Directors Plan, each non-employee director receives an initial grant of options when they join our Board, and annual grants thereafter on the day of each annual meeting of stockholders. The initial grant, and each annual grant, gives each non-employee director the right to purchase up to 10,000 shares of our common stock. At each grant, the number of shares is determined by the lesser of (i) the number determined by dividing \$200,000 by the fair market value of our common stock on the date of grant or (ii) 10,000 shares. A non-employee director's initial award vests as to one-half of the underlying shares on the date of grant, and one-half of the remaining portion of the award vests on the dates of the next two annual stockholders meetings. If a new non-employee director has not been a director for a year at the time of his or her first subsequent grant, then it becomes exercisable on the first anniversary of the date he or she joined our Board. All other subsequent option grants are exercisable in full on the date of grant.

Accordingly, Mr. Weist, Dr. Baddour, Dr. Schweizer and, if elected to our Board of Directors at the stockholders' meeting, Mr. McCarter, will each receive options to purchase up to 10,000 shares of our common stock immediately following this year's meeting.

Committees of the Board of Directors

Our Board of Directors has three standing committees, the compensation committee, the audit committee and the nominating committee.

Compensation Committee

In April 1994, our Board established a compensation committee. The compensation committee reviews, and makes recommendations to our Board regarding, our compensation policies, practices and procedures designed to contribute to our success. The compensation committee administers the 1995 Stock Option Plan, the Directors Plan and the Scientific Advisory Board/ Consultants Stock Option Plan. No member of the compensation committee was at any time during the past three fiscal years an officer or employee of ours or any of our subsidiaries. Dr. Baddour, as the Chairperson, and Mr. Weist presently serve on the compensation committee, which met two times during 2001, and each member attended both meetings.

Audit Committee

In March 1997, our Board established an audit committee. The audit committee reviews our annual audit and meets with our independent auditors to review our internal controls and financial management practices. Our Board has adopted a written charter for the audit committee. Mr. McCarter, as the Chairperson, Dr. Baddour and Mr. Weist presently serve on the audit committee, which met four times during 2001. Mr. Weist joined the Audit Committee in August 2001 as a replacement for Ms. Greta Marshall after her death. Mr. McCarter and Mr. Baddour attended all four meetings; Ms. Marshall attended two of the meetings and Mr. Weist attended one of the meetings. All three committee members are independent directors, as determined in accordance with Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards. Please see the report of our audit committee beginning on page 30 of this proxy statement.

Table of Contents

Nominating Committee

In October 1996, we established a nominating committee. The nominating committee considers and recommends individuals for Board membership and senior management positions. The nominating committee will consider stockholders' nominations for directors only if notice is timely received by the Secretary of the company. To be timely, notice must be received not less than 60 days nor more than 90 days prior to the anniversary date of the immediately preceding annual meeting, unless the date of the annual meeting is more than 30 days earlier or more than 60 days later than such anniversary date, in which case notice must be received not earlier than the 90th day prior to such annual meeting and not later than the close of business on the later of the 60th day prior to such annual meeting or the 10th day following the day on which public announcement of the date of such meeting is first made. Dr. Rathmann and Mr. Weist presently serve on the nominating committee, which met twice during 2001, and each member attended both meetings.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934 (the "Exchange Act") requires our directors and officers and persons who beneficially own more than 10% of our common stock to file with the Securities and Exchange Commission initial reports of beneficial ownership and reports of changes in beneficial ownership of our common stock and other equity securities of ours. Officers, directors and greater than 10% beneficial owners are required by Securities and Exchange Commission regulation to furnish us with copies of all Section 16(a) forms they file.

Based solely on review of the copies of such reports furnished to us and written representations from certain reporting persons, we believe that during the fiscal year ended December 31, 2001, all Section 16(a) filing requirements applicable to our officers, directors and greater than 10% beneficial owners were met.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

THE BOARD OF DIRECTORS RECOMMENDS

**A VOTE *FOR* THE DIRECTORS
NOMINATED IN THIS PROPOSAL NO. 1.**

PROPOSAL NO. 2:

APPROVAL OF THE HYSEQ, INC.

2002 EQUITY INCENTIVE PLAN

Description of Plan and Vote Required

On March 14, 2002 the compensation committee of the Board of Directors recommended that the Board of Directors adopt the Hyseq, Inc. 2002 Equity Incentive Plan (the "2002 Plan"). On March 14, 2002, the Board of Directors adopted the 2002 Plan and directed that the 2002 Plan be submitted to the shareholders for approval. The number of shares of our common stock reserved for issuance under the 2002 Plan is 1,500,000. We will continue to make awards under the Hyseq, Inc. Non-Employee Director Stock Option Plan, as amended. We will no longer make awards under the Hyseq, Inc. 1995 Stock Option Plan, as amended, and the Hyseq, Inc. Scientific Advisory Board Option Plan.

The purposes of the 2002 Plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to our employees and consultants and to promote the success of our business.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

Table of Contents

Summary Description of the 2002 Plan

The following summary of the 2002 Plan is qualified in its entirety by reference to the text of the 2002 Plan, which is attached as Appendix A. The 2002 Plan will be administered by the compensation committee of the Board of Directors. Eligibility requirements for the members of the compensation committee shall comply with the provisions of Rule 16b-3 promulgated pursuant to the 1934 Act or any successor rule or regulation. The compensation committee has full and final authority, in its discretion, to select the employees and consultants who will be granted stock options or restricted stock awards under the 2002 Plan and will determine the number of shares subject to each option or restricted stock award, the duration of each option or restricted stock award and the terms and conditions of each option or restricted stock award granted.

The 2002 Plan provides that the compensation committee may, but need not, delegate from time to time to a committee consisting of one or more members of the Board of Directors some or all of the compensation committee's authority to grant awards under the 2002 Plan to eligible recipients; provided that each such recipient must be an individual other than an officer, director or beneficial owner of more than ten percent of any class of any equity security within the meaning of each such term as it is used under Section 16(b) of the Exchange Act. Any delegation of authority will be subject to the restrictions and limits that the compensation committee specifies at the time of the delegation of authority and may be rescinded at any time by the compensation committee.

The major provisions of the 2002 Plan are as follows:

Eligibility. The compensation committee is authorized to grant stock options or make restricted stock awards to any employee (including any officer or employee director) or consultant of the Company or any parent or subsidiary of the Company. The 2002 Plan authorizes the grant to our employees of incentive stock options and restricted stock awards and to our employees and consultants of non-qualified stock options and restricted stock awards. Incentive stock options are intended to be incentive stock options, as that term is defined in Section 422 of the Internal Revenue Code of 1986, as amended (the Code). No person is entitled to participate in the 2002 Plan as a matter of right. Only those employees and consultants who are selected to receive grants by the compensation committee may participate in the 2002 Plan.

Award Limits. The 2002 Plan provides that no individual may be granted options or restricted stock awards to purchase more than 1,000,000 shares of common stock in any calendar year. In addition, the 2002 Plan provides that the aggregate fair market value (determined at the time of grant) of shares with respect to which an incentive stock option is first exercisable during any calendar year may not exceed \$100,000.

Terms and Vesting of Options. The compensation committee determines:

the number of shares subject to option grants to employees and consultants;

whether the option grants are incentive stock options or non-qualified stock options; and

the terms and conditions of the option grants.

The compensation committee may not grant an incentive stock option under the 2002 Plan to any person who owns more than 10% of the total combined voting power of all classes of our stock (a 10% Owner) unless the stock option conforms to the applicable provisions of Section 422 of the Code.

Each option will be evidenced by a written agreement. The term of an option is set by the compensation committee. In the case of an incentive stock option, the term of the option may not be longer than 10 years from the date the incentive stock option is granted, or if granted to a 10% Owner, five years from the date of the grant.

Table of Contents

Exercise Price. The exercise price for the shares of common stock subject to each option will be specified in each option agreement. The compensation committee sets the exercise price at the time the option is granted. In certain instances, the exercise price is also subject to additional rules as follows:

In the case of options intended to qualify as performance-based compensation, or as incentive stock options, the exercise price may not be less than the fair market value for the shares of common stock subject to such option on the date the option is granted.

In the case of incentive stock options granted to a 10% Owner, the exercise price may not be less than 110% of the fair market value of the shares of common stock subject to such option on the date the option is granted.

For purposes of the 2002 Plan, the fair market value of a share of our common stock as of a given date will be the closing sales price of our common stock (or the closing bid, if no sales were reported) on the most recent trading day as reported in The Wall Street Journal or such other source as the compensation committee deems reliable.

Exercisability. The compensation committee determines when options become exercisable, including any restrictions or limitations such as those based on continued employment. An option is exercisable when it vests. Each option agreement will contain the period during which the right to exercise the option in whole or in part vests in the optionee. Unless the compensation committee provides otherwise, no option will be exercisable by any optionee who is then subject to Section 16 of the Exchange Act within the period ending six months and one day after the option is granted. At any time after the grant of an option, the compensation committee may accelerate the period during which an option vests. No portion of an option which is unexercisable at an optionee's termination of employment or termination of consulting relationship will subsequently become exercisable, except as may be otherwise provided by the compensation committee either in the agreement relating to the stock option or by action following the grant of the option.

An option may be exercised by delivering to the Secretary of the Company a written or electronic notice of exercise on a form provided by us, together with full cash payment for the shares in the form of cash or a check payable to us in the amount of the aggregate option exercise price. However, the compensation committee may, in its discretion:

allow payment through the delivery of shares of common stock already owned by the optionee;

subject to certain timing requirements, allow payment through the surrender of shares of common stock which would otherwise be issuable on exercise of the option;

allow payment through the delivery of property of any kind which constitutes good and valuable consideration;

allow payment by use of a full recourse loan from us;

allow payment through the delivery of a notice that the optionee has placed a market sell order with a broker with respect to shares of common stock then issuable on exercise of the option, and that the broker has been directed to pay a sufficient portion of the net proceeds of the sale to us in satisfaction of the option exercise price; or

allow payment through any combination of the foregoing.

In the case of a loan from us, the compensation committee may prescribe the form of the loan and the security to be given for the loan.

Table of Contents

Restricted Stock Awards. The compensation committee may issue restricted stock awards to our employees and consultants either alone, in addition to or in tandem with the issuance of options under the 2002 Plan. The compensation committee determines:

- the number of shares of restricted stock to be issued to employees and consultants;
- the price per share for the restricted stock to be issued to an employee or consultant pursuant to a stock purchase right;
- the time period within which an employee or consultant to whom a restricted stock award has been issued must accept such offer; and
- the terms and conditions of the restricted stock.

Restricted stock issued pursuant to the exercise of a restricted stock award will be evidenced by a written restricted stock purchase agreement. The restricted stock purchase agreement will contain such restrictions as the compensation committee provides, including restrictions concerning voting rights, transferability and restrictions based on duration of employment and the satisfaction of performance thresholds. We may typically repurchase from the holder of restricted stock the restricted stock immediately upon the termination of employment or consultancy for any reason (including death or disability) for an amount equal to the price paid for the restricted stock.

Adjustment Upon Changes in Capitalization or Merger. In the event of a change in our capitalization or merger, the compensation committee will appropriately adjust:

- the aggregate number of shares of common stock subject to the 2002 Plan;
- the number of shares of common stock subject to outstanding options and restricted stock awards; and
- the price per share of outstanding options and stock purchase rights, if there is any stock dividend, stock split, recapitalization, or other subdivision, combination or reclassification of shares of common stock.

The compensation committee may also provide for the acceleration, cash-out, assumption or substitution of common stock subject to outstanding options and restricted stock awards in the event of certain changes in the capitalization of the Company or certain corporate transactions.

In addition, in the event of an acquisition, the vesting of all options and restricted stock awards outstanding under the 2002 Plan will be accelerated and such awards will be fully exercisable. For purposes of the 2002 Plan, the term acquisition means:

- the acquisition by any entity, person, or group of beneficial ownership, as that term is defined in Rule 13d-3 under the Exchange Act, of more than 50% of the outstanding capital stock of the Company entitled to vote for the election of directors (Voting Stock);
- the effective time of (1) a merger or consolidation of the Company with one or more corporations as a result of which the holders of the outstanding Voting Stock of the Company immediately prior to such merger hold less than 50% of the Voting Stock of the surviving or resulting corporation, or (2) a transfer of substantially all of the property or assets of the Company other than to an entity of which the Company owns at least 50% of the Voting Stock; or
- the election to the Board, without the recommendation or approval of the incumbent Board of Directors, of directors constituting a majority of the number of directors of the Company then in office.

Transferability. An optionee cannot assign or transfer any option or stock purchase right granted under the 2002 Plan, except by will, the laws of descent and distribution or, in the case of non-qualified stock options or restricted stock, pursuant to a qualified domestic relations order. Each option may be exercised, during the lifetime of the optionee, only by such optionee or a permitted transferee.

No Repricing. The 2002 Plan does not permit the reduction of the exercise price of awards granted under the 2002 Plan.

Table of Contents

Amendment and Termination of the 2002 Plan. The Board of Directors may not, without prior stockholder approval:

amend the 2002 Plan so as to increase the number of shares of stock that may be issued under the 2002 Plan; or

extend the term of the 2002 Plan.

If not terminated earlier, the 2002 Plan will terminate on March 14, 2012. The Board of Directors may terminate the 2002 Plan at any time with respect to any shares not then subject to an option under the 2002 Plan. Except as indicated above, the Board of Directors may also modify the 2002 Plan from time to time.

Tax Information

The following is a general summary under current law of the material federal income tax consequences to us and participants in the 2002 Plan with respect to the grant and exercise of options under the 2002 Plan. The summary does not discuss all aspects of income taxation that may be relevant to an optionee in light of his or her personal investment circumstances. This summarized tax information is not tax advice. We advise all optionees to consult their own tax advisor as to the specific tax consequences of participating in the 2002 Plan.

Non-Qualified Stock Options. For federal income tax purposes, if an optionee is granted non-qualified stock options under the 2002 Plan, the optionee will not have taxable income on the grant of the option, nor will we be entitled to any deduction. Generally, on exercise of non-qualified stock options an optionee will recognize ordinary income, and we will be entitled to a deduction, in an amount equal to the difference between the option exercise price and the fair market value of the common stock on the date of exercise. An optionee's basis for the stock for purposes of determining the gain or loss on subsequent disposition of such shares will generally be the fair market value of the common stock on the date the optionee exercises the option. Any subsequent gain or loss will be generally taxable as capital gains or losses.

Incentive Stock Options. There is no taxable income to an optionee when he or she is granted an incentive stock option or when that option is exercised. However, the amount by which the fair market value of the shares at the time of exercise exceeds the option price will be an item of adjustment for the optionee for purposes of the alternative minimum tax. Gain realized by an optionee on the sale of an incentive stock option is taxable at capital gains rates, and no tax deduction is available to us, unless the optionee disposes of the shares within (1) two years after the date of grant of the option or (2) one year of the date the shares were transferred to the optionee. If the shares of common stock are sold or otherwise disposed of before the end of the one-year and two-year periods specified above, the difference between the option exercise price and the fair market value of the shares on the date of the option's exercise will be taxed at ordinary income rates, and we will be entitled to a deduction to the extent the optionee must recognize ordinary income. An incentive stock option exercised more than three months after an optionee retires, other than by reason of death or disability, will be taxed as a non-qualified stock option, and the optionee will be deemed to have received income on the exercise taxable at ordinary income rates. We will be entitled to a tax deduction equal to the ordinary income, if any, realized by the optionee.

Restricted Stock Awards. Generally, on the purchase of restricted stock, an optionee will not have taxable income, nor will we be entitled to a deduction, unless the optionee makes a valid election under Section 83(b) of the Code. However, when restrictions on shares of restricted stock lapse, such that the shares are no longer subject to a substantial risk of forfeiture, the optionee generally will recognize ordinary income, and we will be entitled to a corresponding deduction, for an amount equal to the difference between the fair market value of the shares at the date such restrictions lapse over the purchase price for the restricted stock. If the optionee makes a valid election under Section 83(b) with respect to restricted stock, the optionee generally will recognize ordinary income at the date of issuance of the restricted stock in an amount equal to the difference, if any, between the fair market value of the shares at that date over the purchase price for the restricted stock, and we will be entitled to a deduction for the same amount.

Table of Contents

Section 162(m) of the Code. In general, under Section 162(m) of the Code, income tax deductions of publicly-held corporations may be limited to the extent total compensation (including base salary, annual bonus, stock option exercises and non-qualified benefits) for certain executive officers exceeds \$1.0 million (less the amount of any excess parachute payments as defined in Section 280G of the Code) in any taxable year of the corporation. However, under Section 162(m), the deduction limit does not apply to certain performance-based compensation. Stock options will satisfy the performance-based exception if (1) the awards are made by a qualifying compensation committee, (2) the plan sets the maximum number of shares that can be granted to any person within a specified period and (3) the compensation is based solely on an increase in the stock price after the grant date. The 2002 Plan has been designed to permit the compensation committee to grant awards which will qualify as performance-based compensation.

Other Tax Consequences. We recommend that optionees consult their personal tax advisors with respect to the federal, foreign (if applicable), state and local tax aspects of option grants, option exercises and any subsequent dispositions of common stock acquired under the 2002 Plan.

THE BOARD OF DIRECTORS RECOMMENDS

**A VOTE FOR THE APPROVAL OF THE ADOPTION
OF THE HYSEQ, INC. 2002 EQUITY INCENTIVE PLAN
AS SET FORTH IN THIS PROPOSAL NO. 2.**

PROPOSAL NO. 3

RATIFICATION OF THE SALE AND ISSUANCE TO

**GEORGE B. RATHMANN AND FRANCES JOY RATHMANN, CO-TRUSTEES,
TED W. LOVE, PETER S. GARCIA,
WILLIAM BENNETT AND ROBERT D. WEIST OF 3,040,733
SHARES OF OUR COMMON STOCK AND
WARRANTS TO PURCHASE 1,520,369 SHARES OF OUR
COMMON STOCK, INCLUDING ISSUANCE OF OUR COMMON STOCK
UPON EXERCISE OF THE WARRANTS**

To raise additional capital to fund our operations, on August 28, 2001, we completed a private placement of an aggregate of 3,040,733 shares of newly issued common stock at \$7.00 per share and issued warrants to purchase an aggregate of 1,520,369 shares of common stock at \$10.50 per share, subject to adjustment to \$7.95 per share as described below. On August 28, 2001 the closing sales price of our common stock was \$7.57 per share, with an intra-day high of \$7.70 per share and a low of \$7.44 per share. We received gross proceeds of \$21,285,131 in the private placement. The proceeds were used to meet working capital needs, including funding our research and development efforts, and to fund improvements in our leased facilities. The securities were sold to certain institutional and individual accredited investors pursuant to Section 4(2) under the Securities Act of 1933, as amended. Resale of the common stock issued and sold and underlying the warrants are covered by a registration statement on Form S-3 filed with the Securities and Exchange Commission on September 21, 2001. The 3,040,733 shares issued in the private placement and the 1,520,369 shares issuable upon exercise of the warrants represents 18.6% of the outstanding shares of our common stock as of May 2, 2002, determined in accordance with Rule 13d-3 under the Exchange Act.

In addition to 11 other investors who purchased an aggregate of 2,396,435 shares of common stock and warrants to acquire 1,198,219 shares of common stock in the offering, the following individuals, purchased and were issued the following:

George B. Rathmann, Chairman of our Board of Directors, and Frances Joy Rathmann, Co-Trustees of The Rathmann Family 1989 Revocable Trust U/A dated 08/04/89 purchased 571,428 shares of our common stock and were issued a warrant for the purchase of 285,714 shares of our common stock;

Ted W. Love, our President and Chief Executive Officer and a director, purchased 14,290 shares of our common stock and was issued a warrant for the purchase of 7,145 shares of our common stock;

Table of Contents

Peter S. Garcia, our Senior Vice President and Chief Financial Officer, purchased 14,290 shares of our common stock and was issued a warrant for the purchase of 7,145 shares of our common stock;

William F. Bennett, our Senior Vice President of Research and Development, purchased 14,290 shares of our common stock and was issued a warrant for the purchase of 7,145 shares of our common stock; and

Robert D. Weist, one of our directors and Trustee of the Weist Family Trust, purchased 30,000 shares of our common stock and was issued a warrant for the purchase of 15,000 shares of our common stock.

If this stockholder proposal is approved, Dr. Rathmann will beneficially own an additional 857,142 shares of our common stock (including 285,714 shares issuable upon exercise of warrants), or an additional 3.7% of the outstanding shares of our common stock as of May 2, 2002, and our directors and executive officers as a group will beneficially own an additional 966,447 shares of our common stock (including 322,149 shares issuable upon exercise of warrants), or an additional 4.2% of the outstanding shares of common stock as of May 2, 2002. For purposes of the foregoing, beneficial ownership is determined in accordance with Rule 13d-3 under the Exchange Act. The foregoing sales will render it easier for our officers and directors to obtain the requisite number of votes for passage of actions that are put to stockholder vote in the future and may give them sufficient control to ensure passage of such actions.

Based on then current market conditions and our then current financial condition, our Board of Directors determined that the private placement of common stock provided us with the most certainty that we could obtain the capital we desired to raise at that time. We believe that our ability to raise the amount of capital we desired to raise at that time in a timely manner was significantly enhanced by the investments made by Dr. Rathmann, Dr. Love, Mr. Garcia, Dr. Bennett and Mr. Weist.

Preemption Rights

Under the terms of the private placement, we agreed not to offer, sell, grant or dispose of, or announce any offer, sale, grant or other disposition of, any of our securities convertible into common stock until six months after the date on which the registration statement covering the resale of our common stock and warrants for purchase of common stock is declared effective unless we provide written notice to each investor describing the terms, amount of proceeds, parties and effect of the proposed placement and no investor has timely notified us of its willingness to provide financing to us on the same terms. If any investor shall fail to notify us of its willingness to participate in a subsequent placement, we may effect a subsequent placement on the terms and with the parties set forth in our notice and to those investors that have elected to participate in the subsequent placement. If the subsequent placement is not consummated within 30 days of our notice, we must provide another notice of the placement to the investor who will again have the right of first refusal. If all the investors indicate a willingness to provide financing in excess of the amount set forth in the notice of the subsequent placement, then each investor will be entitled to provide financing up to an amount equal to such investor's pro rata portion of the aggregate purchase price paid for our common stock issued under this private placement transaction, but we shall not be required to accept financing from the investors in an amount in excess of the amount set forth in the notice.

Description of Warrants

We issued to the investors warrants to purchase an aggregate of 1,520,369 shares of common stock. The following is a summary of the principal terms of the warrants that were issued together with shares of common stock under the private placement. The following summary is qualified in its entirety by reference to the form of warrant, which is attached as Appendix B to this proxy statement and is considered a part of this document.

Term. The warrants are exercisable for common stock at any time and from time to time from the date of issuance until and including August 28, 2006.

Exercise Price. The warrants initially had an exercise price of \$10.50 per share, which has since been adjusted downwards to \$7.95 per share pursuant to the terms of the warrants. The adjustment was required because in April of this year we completed another private placement of common stock, as described under

Table of Contents

Subsequent Offering below, at a price per share that was less than the closing sales price of our common stock on August 28, 2001. The exercise price is also subject to adjustment (and the number of shares issuable upon exercise of the warrant is subject to a corresponding adjustment) in the event of any dividend, stock split, reclassification or consolidation of or on our common stock or any distribution of evidence of indebtedness, any security other than common stock, any rights or warrants to subscribe for or purchase any security or any other asset.

Change of Control. If any merger or consolidation, sale of substantially all of our assets, tender or exchange offer, or reclassification of our common stock results in a change of control, then at the request of the warrant holder delivered before the 90th day after the event, we will purchase the warrant from the holder for a purchase price equal to the Black Scholes value of the remaining unexercised portion of the warrant on the date of the request.

Method of Exercise. The warrants may be exercised by delivering to us a form of election to purchase and a warrant shares exercise log, properly completed and executed, together with payment of the exercise price. Payment of the exercise price by a holder may be made in the form of immediately available funds or, to effect a cashless exercise, by the surrender of unexercised warrants, together with a written notice of election to effect such a cashless exercise. Upon delivery of the required documents and payment of the exercise price, we will deliver or cause to be delivered, to or upon the written order of such holder, stock certificates representing the number of shares of common stock to which such holder is entitled pursuant to such exercise. If less than all of the warrants evidenced by a warrant are to be exercised, a new warrant will be issued for the remaining number of warrants. After August 28, 2003, the warrants may only be exercised on a cashless exercise basis.

Limitation on Exercise. The number of shares of common stock that may be acquired by each investor upon any exercise of the warrant is limited to the extent necessary to insure that, following such exercise, the total number of shares of common stock then beneficially owned by such investor and its affiliates and any other persons whose beneficial ownership of common stock would be aggregated with the investor's for purposes of Section 13(d) of the Exchange Act, does not exceed 4.999% of our outstanding shares of common stock. The warrants contain a similar prohibition on exercise if beneficial ownership would exceed 9.999%. Both limitations are subject to the right of the investor exercising the warrant to waive the limitation (as to itself only) upon not less than 61 days prior notice to us.

Requirement of Stockholder Approval

We are seeking stockholder approval to ratify the sale and issuance in the private placement of 644,298 shares of our common stock and warrants to purchase 322,149 shares of our common stock, including issuance of our common stock upon exercise of the warrants, to Dr. Rathmann, Dr. Love, Mr. Garcia, Dr. Bennett and Mr. Weist. Stockholder ratification for the issuances to our officers and directors is required pursuant to Rule 4350(i)(1)(A) of the Nasdaq Stock Market. However, stockholder ratification is not required for issuances to other investors in the private placement. If we do not obtain stockholder ratification, our officers and directors will not be permitted to retain ownership of the shares and we will have to repurchase the shares or seek some other acceptable resolution with the staff of the Nasdaq Stock Market in order to divest our officers and directors of their ownership. The 2,396,435 shares of common stock and warrants to acquire 1,198,219 shares of common stock issued to investors not affiliated with us in the offering will remain outstanding regardless of whether stockholders ratify the issuance and sale of our common stock and warrants to some of our officers and directors.

Subsequent Offering

On April 5, 2002 we completed another private placement in which we sold 3,575,691 shares of our common stock at \$4.20 per share, and issued warrants to purchase 893,927 shares of our common stock at \$5.67 per share. The warrants are not exercisable until October 2002 and expire on April 5, 2007. The exercise price of the warrants is subject to weighted average priced based anti-dilution adjustments in the event of future issuances below the closing sales price of the common stock on April 5, 2002, or \$4.09 per share,

Table of Contents

subject to exceptions that are identical to the exceptions set forth in Section 9(d)(iii) of the warrant attached as Appendix B to this proxy statement (which includes issuances to company employees, officers, directors and consultants, pursuant to strategic transactions, to Dr. Rathmann for additional financing, and pursuant to a public offering not at a discount to market for net proceeds in excess of \$40 million). The exercise price of the warrants and the number of shares issuable upon exercise have customary adjustment provisions in the event of pro-rata issuances, which provisions are similar to those set forth in Section 9 of the warrant attached as Appendix B. None of our officers or directors purchased any securities in the April private placement. We are not seeking stockholder approval or ratification for the April private placement in this proxy statement.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

THE BOARD OF DIRECTORS RECOMMENDS

**A VOTE FOR THE RATIFICATION OF THE ISSUANCE
OF OUR COMMON STOCK AND WARRANTS TO PURCHASE
OUR COMMON STOCK IN THE PRIVATE PLACEMENT
AS SET FORTH IN THIS PROPOSAL NO. 3.**

PROPOSAL NO. 4

APPROVAL OF THE GRANT IN AUGUST 2001 OF AN OPTION

**TO OUR CHAIRMAN, DR. GEORGE B. RATHMANN,
FOR 1,000,000 SHARES OF OUR COMMON STOCK,
INCLUDING THE ISSUANCE OF OUR COMMON STOCK
UPON EXERCISE OF THE OPTION**

Dr. Rathmann has made important contributions to us as Chief Executive Officer from May 2000 to March 2001, as President from May 2000 to January 2001, and as Chairman of the Board, a position in which he maintains a very important active role with us. He did not and does not receive cash compensation for his service to us. While Dr. Rathmann did not wish to receive cash compensation, our Board of Directors determined that Dr. Rathmann should receive appropriate non-cash compensation for his personal commitment as Chairman of the Board. As a result, on August 21, 2001, our Board of Directors, subject to stockholder approval, granted Dr. Rathmann an option to purchase 1,000,000 shares of our common stock with an exercise price equal to the then-current market price of \$8.635 per share.

Subject to stockholder approval, the option vests and becomes exercisable over four years at a rate of one-fourth upon the one year anniversary of the date of grant and 1/48th of the total number of shares upon each monthly anniversary thereafter. In the event of a change in control of our company, the option shall become immediately exercisable. The option shall expire ten years from the date of grant. The exercise price may be paid in cash, shares of our common stock or any combination thereof. The exercise price and the number and kind of shares issuable upon exercise of the option is subject to adjustment in the event of any reorganization or merger in which we are the surviving entity, or any combination, recapitalization, reclassification, stock split, stock dividend, or stock consolidation. Upon the termination of Dr. Rathmann's directorship with us for any reason or no reason, except as a result of Dr. Rathmann's death or disability, the unvested portion of the option shall be forfeited, and the vested unexercised portion of the option shall be exercisable for a period of thirty days following termination or the expiration of the term of the option if earlier. The option shall be exercisable only by Dr. Rathmann or his legal representative, and in the event of his death only by his beneficiary. The option shall not otherwise be transferable by Dr. Rathmann or by operation of law, and any attempted transfer or other disposition of the option shall be void and shall result in the cancellation of the option. Our Board of Directors has the right to amend or terminate the provisions of the option in any manner it may deem necessary or advisable to carry out the purpose of the grant as the result of, or to comply with, any change in applicable regulations, interpretation or statutory enactment.

We are seeking stockholder approval for grant of the option because under the terms of the option, the option will not vest or become exercisable until stockholder approval has been obtained. Under

Table of Contents

Rule 4350(i)(1)(B) of the Nasdaq Stock Market, stockholder approval of issuances of securities is required when the issuance may result in a change of control of the issuer. Officials of the Nasdaq Stock Market, National Listing Qualifications, have informed us that they start to consider whether a change of control may occur for purposes of the rule when the issuance will result in beneficial ownership of in excess of 20% of the outstanding shares of an issuer's common stock. Given Dr. Rathmann's level of beneficial ownership at the time the option was granted, it was considered prudent to condition vesting and exercise of the option upon obtaining stockholder approval. If we do not obtain stockholder approval, the option will not vest or become exercisable.

If this stockholder proposal is approved, when the option has fully vested Dr. Rathmann will beneficially own (determined in accordance with Rule 13d-3 under the Exchange Act) an additional 1,000,000 shares of our common stock, or an additional 4.2% of the outstanding shares of our common stock as of May 2, 2002. If Dr. Rathmann exercises this option, his purchase of shares upon exercise will render it easier for our officers and directors to obtain the requisite number of votes for passage of actions that are put to stockholder vote in the future and may give them sufficient control to ensure passage of such actions.

Currently, we grant to Dr. Rathmann fully vested options to purchase 3,000 shares of our common stock at the end of each month during which Dr. Rathmann is our Chairman at the then-current market price of our common stock. On February 1, 2000, we granted Dr. Rathmann an option to purchase 1,000,000 shares of our common stock at an exercise price equal to the then-current market price on the day before the date of grant of \$31.688 per share, which option has now vested and become exercisable.

The above summary of the August 2001 stock option grant is qualified in its entirety by reference to the form of stock option agreement, which is attached as Appendix C to this proxy statement and is considered a part of this document.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy. If stockholders do not approve the grant of the option to Dr. Rathmann as described above, we may not be able to retain the services of Dr. Rathmann. The departure of Dr. Rathmann could be disruptive to our operations, it would be difficult and time consuming for us to replace him, and we would be unlikely to find another person of comparable talents, knowledge and experience.

THE BOARD OF DIRECTORS RECOMMENDS

**VOTING FOR THE APPROVAL OF THE GRANT
IN AUGUST 2001 OF THE STOCK OPTION TO DR. RATHMANN
AND THE ISSUANCE OF COMMON STOCK
ISSUABLE UPON EXERCISE OF THE OPTION AS SET FORTH
IN THIS PROPOSAL NO. 4.**

PROPOSAL NO. 5:

APPROVAL OF ISSUANCE OF SHARES OF OUR COMMON

**STOCK, OTHER EQUITY SECURITIES OR BOTH TO OUR
CHAIRMAN DR. GEORGE B. RATHMANN, IN REPAYMENT
OF AMOUNTS OWING, FROM TIME TO TIME, UNDER
HIS \$20.0 MILLION LINE OF CREDIT TO US**

On August 6, 2001, we received a commitment from Dr. George B. Rathmann, our Chairman, to provide a line of credit to us of up to \$20.0 million in aggregate principal amount, available for draw down through July 24, 2003. The line of credit agreement was amended and restated as of April 3, 2002, and this description refers to the agreement as so amended and restated. Amounts outstanding under the line of credit are to bear interest at prime plus 1% and are payable in 48 equal monthly installments beginning upon the expiration date of the line of credit of August 5, 2003. The promissory note issued pursuant to the line of credit is convertible by mutual agreement by us and Dr. Rathmann into either (a) that number of shares of our common stock as shall equal the quotient obtained by dividing the aggregate principal and interest then outstanding under the

Table of Contents

note (i) by the average closing price of our common stock on the Nasdaq National Market as reported in *The Wall Street Journal* for the twenty trading days ending on the second trading day immediately prior to the day of such conversion, or (ii) in connection with an offering of our equity securities, by the per share price of the common stock at which such equity securities shall be offered for sale by us or (b) if within one month of the closing of any equity financing by us for aggregate gross proceeds in excess of \$10,000,000, the same equity securities issued by us in the financing, at the same purchase price, with the same exercise price, if any, at the same discount, if any, and otherwise on substantially the same terms and conditions.

In February 2002, we drew down \$4.0 million of the \$20.0 million line of credit. As of May 2, 2002, this amount, together with accrued and unpaid interest in the amount of \$46,958.33, remains outstanding. By way of illustration, if we had converted this amount into shares of common stock on May 2, 2002, Dr. Rathmann would have received 1,108,755 shares based on the trailing 20-day trading average of \$3.65 per share. This would represent approximately 4.6% of the outstanding shares of our common stock. Alternatively, on May 2 we would have had the ability to convert the outstanding balance into securities that we sold in a private placement on April 6 (described beginning on page 14 above), on the same terms as the private placement. Had we done so, Dr. Rathmann would have received 963,561 shares of common stock and a warrant to purchase 240,890 shares of common stock, which would represent 5.0% of the outstanding shares of our common stock (determined in accordance with Rule 13d-3 under the Exchange Act). While as of the date of this proxy statement no common stock or other equity securities have been issued pursuant to the line of credit, shares of common stock, other equity securities or both may be issued pursuant to the line of credit in the future. If we convert amounts outstanding under the line of credit, Dr. Rathmann will increase his beneficial ownership of our common stock, which will render it easier for our officers and directors to obtain the requisite number of votes for passage of actions that are put to stockholder vote in the future and may give them sufficient control to ensure passage of such actions.

The line of credit which Dr. Rathmann extended to our company is necessary to finance our continuing operations. If we were not able to repay our debt to Dr. Rathmann with shares of our common stock or other equity securities, we may need to borrow money from a third-party source to satisfy our obligation when it comes due. Such funds may not be available to us on favorable terms, or at all. We believe that it is in our best interests and the best interests of our stockholders to approve the issuance of shares of our common stock, other equity securities or both, to Dr. Rathmann in repayment of amounts owing, from time to time, under his \$20.0 million line of credit to us.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR THE
APPROVAL OF THE ISSUANCE OF SHARES OF OUR COMMON
STOCK, OTHER EQUITY SECURITIES OR BOTH, TO OUR
CHAIRMAN, DR. GEORGE B. RATHMANN IN REPAYMENT
OF HIS \$20.0 MILLION LINE OF CREDIT TO US
AS SET FORTH IN THIS PROPOSAL NO. 5.**

PROPOSAL NO. 6:

RATIFICATION OF

SELECTION OF INDEPENDENT AUDITORS

The Board of Directors has selected KPMG LLP as our independent auditors for the fiscal year ending December 31, 2002 and has further directed that management submit the selection of independent auditors for ratification by the stockholders at the annual meeting. KPMG LLP audited our financial statements for the fiscal year ended December 31, 2001. Representatives of KPMG LLP are expected to be present at the annual meeting, will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

Table of Contents

Stockholder ratification of the selection of KPMG LLP as the company's independent auditors is not required by our By-Laws or otherwise. However, the Board of Directors is submitting the selection of KPMG LLP to the stockholders for ratification as a matter of good corporate practice. If the stockholders fail to ratify the selection, the audit committee and the Board of Directors will reconsider whether or not to retain that firm. Even if the selection is ratified, the audit committee and the Board of Directors in their discretion may direct the appointment of different independent auditors at any time during the year if they determine that such a change would be in the best interests of our company and our stockholders.

The following table presents fees for professional audit services rendered by KPMG LLP for the audit of the Company's annual financial statements for 2001, and fees billed for other services rendered by KPMG LLP.

| | |
|---|-----------|
| Audit fees, excluding audit related | \$319,300 |
| Financial information systems design and implementation | None |
| All other fees: | |
| Audit related fees(1) | \$ 33,900 |
| Other non-audit services(2) | \$ 55,800 |
| | <hr/> |
| Total all other fees | \$ 89,700 |
| | <hr/> |

(1) Audit related fees consisted principally of review of registration statements and issuance of consents, as well as due diligence assistance.

(2) Other non-audit fees consisted of tax compliance and tax consulting services.

Our audit committee has considered whether the independent auditor's provision of non-audit services to our company is compatible with maintaining the auditor's independence, and concluded that such independence has not been impaired.

Approval of this proposal requires the affirmative vote of the holders of a majority of the shares of our stock entitled to vote, present in person or represented by proxy.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE *FOR* THE

**RATIFICATION OF THE SELECTION OF
KPMG LLP AS THE COMPANY'S
INDEPENDENT AUDITORS AS SET
FORTH IN THIS PROPOSAL NO 6.**

Table of Contents**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth certain information regarding the beneficial ownership of our common stock as of May 2, 2002 by: (1) each of our directors; (2) each of our named executive officers (as listed on page 23); (3) by each person known by us to be the beneficial owner of more than 5% of our outstanding common stock; and (4) all of our directors and executive officers as a group. As of May 2, 2002, we had 22,949,987 shares of our common stock outstanding.

| Name and Address of Beneficial Owner(1) | Shares Beneficially Owned(1) | |
|--|------------------------------|------------|
| | Number of Shares | Percentage |
| George B. Rathmann(2) | 3,836,935 | 16.0 |
| Robert D. Weist(3) | 250,314 | 1.1 |
| Raymond F. Baddour(4) | 59,539 | * |
| Thomas N. McCarter, III(5) | 67,219 | * |
| Ernst Schweizer(6) | 40,759 | * |
| David M. Rosen(7) | 32,866 | * |
| Ted W. Love(8) | 242,409 | 1.1 |
| William F. Bennett(9) | 7,511 | * |
| Linda A. Fitzpatrick(10) | 37,500 | * |
| Peter S. Garcia(11) | 51,217 | * |
| Radoje T. Drmanac(12) | 990,209 | 4.3 |
| Snezana Drmanac(12) | 990,209 | 4.3 |
| All Directors and Executive Officers as a Group (11 persons) | 5,616,478 | 22.7 |

* Represents beneficial ownership of less than 1% of our common stock.

- (1) Beneficial ownership is determined in accordance with Rule 13d-3 under the Exchange Act and generally includes voting or investment power with respect to securities. Shares of common stock subject to options and warrants which are currently exercisable, or will become exercisable within 60 days of May 2, 2002, are deemed outstanding for computing the percentage of the person or entity holding such securities but are not outstanding for computing the percentage of any other person or entity. Excludes shares and warrants issued to certain of our executive officers and directors in connection with the August 2001 private placement for which we require stockholder ratification (please see proposal no. 3). Except as indicated by footnote, and subject to the community property laws where applicable, to our knowledge the persons named in the table above have sole voting and investment power with respect to all shares of common stock shown as beneficially owned by them. Unless otherwise indicated, the address for each person is our address at 670 Almanor Avenue, Sunnyvale, California 94085.
- (2) Represents: (i) 2,755,935 shares of common stock held in trust for the benefit of the Rathmann family, for which Dr. Rathmann and his spouse serve as co-trustees, and (ii) 1,081,000 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002. Excludes 1,000,000 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002, and shares of our common stock issuable in repayment of Dr. Rathmann's line of credit to us and which issuance our stockholders are being asked to approve, as described more fully in Proposal No. 5 of this proxy statement.
- (3) Represents: (i) 206,675 shares held in trust for the benefit of the Weist family for which Mr. Weist and his spouse serve as co-trustees, and (ii) 43,639 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002.
- (4) Represents 59,539 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002.

Table of Contents

- (5) Represents: (i) 19,200 shares of common stock owned by Mr. McCarter, and (ii) 48,019 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002.
- (6) Represents: (i) 23,040 shares of common stock owned by Dr. Schweizer, and (ii) 17,719 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002.
- (7) Represents: (i) 4,658 shares of common stock owned by Dr. Rosen, and (ii) 28,208 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002. Excludes 32,964 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.
- (8) Represents: (i) 4,909 shares of common stock owned by Dr. Love, and (ii) 237,500 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002. Excludes 337,500 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.
- (9) Represents: (i) 7,511 shares of common stock owned by Dr. Bennett. Excludes 250,000 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.
- (10) Represents 37,500 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002. Excludes 137,500 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.
- (11) Represents: (i) 1,217 shares of common stock owned by Mr. Garcia, and (ii) 50,000 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002. Excludes 175,000 shares issuable upon the exercise of options which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.
- (12) Represents: (i) 100,000 shares of common stock held in trust for the benefit of one of the Drmanac children for which the Drs. Drmanac serve as co-trustees; (ii) 100,000 shares of common stock held in trust for the benefit of one of the Drmanac children for which the Drs. Drmanac serve as co-trustees; (iii) 122,496 shares of common stock held by in trust for the benefit of the Drmanac family for which the Drs. Drmanac serve as co-trustees; (iv) 413,667 shares of common stock held individually by Dr. R. Drmanac; (v) 162,012 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002 held by Dr. R. Drmanac; (vi) 4,998 shares of common stock held individually by Dr. S. Drmanac; and (vii) 87,036 shares of common stock issuable upon the exercise of options that are currently exercisable or exercisable within 60 days of May 2, 2002 held by Dr. S. Drmanac. Excludes 41,803 shares issuable upon the exercise of options held by the Drs. Drmanac which are not currently exercisable and will not be exercisable within 60 days of May 2, 2002.

Table of Contents**Increases in Beneficial Ownership as a Result of Approval of Stockholder Proposals**

Proposals 3, 4 and 5 relate to the issuance of securities to some of our executive officers and directors. The following table illustrates the effect that approval of the proposals will have on the ownership of our executive officers and directors:

| Name | Ownership Immediately Prior to Annual Meeting ⁽¹⁾ | | Ownership Immediately After Annual Meeting ⁽¹⁾ | | | |
|--------------------|--|---|---|--------------|---|---|
| | Common Stock | Options and Warrants Exercisable Within 60 Days | Options and Warrants not Exercisable Within 60 Days | Common Stock | Options and Warrants Exercisable Within 60 Days | Options and Warrants not Exercisable Within 60 Days |
| George B. Rathmann | 2,755,935 | 1,081,000 | (2) | 4,436,118(3) | 1,649,547 | 729,167 |
| Ted W. Love | 4,909 | 237,500 | 337,500 | 19,199 | 266,520 | 315,625 |
| Peter S. Garcia | 1,217 | 50,000 | 175,000 | 15,507 | 64,437 | 167,708 |
| William F. Bennett | 7,511 | | 250,000 | 21,801 | 80,062 | 177,083 |
| Robert D. Weist | 206,675 | 43,639 | | 236,675 | 58,639 | |

- (1) Assumes no additional securities of Hyseq are acquired by the named individuals and no shares of common stock are issued by Hyseq between May 2, 2002 and the date of our Annual Meeting, other than the periodic option grants received by Dr. Rathmann and described under proposal no. 4. The securities issued in the August 2001 private placement are not treated as owned by the named officers and directors prior to obtaining the stockholder ratification in proposal no. 3.
- (2) The 1,000,000 share option grant made on August 21, 2001 and the subject of proposal no. 4 is excluded because it will not vest or become exercisable until stockholder approval is obtained.
- (3) Assumes that the outstanding principal and interest as of May 2, 2002 of \$4,046,958.33 under the \$20.0 million line of credit, which is the subject of proposal no. 5, is converted into shares of common stock at a price of \$3.65 per share (please see hypothetical on page 17). No assumption is made with respect to future amounts that may be drawn down under the line of credit.

For example, based on 22,949,987 shares of common stock outstanding as of May 2, 2002, Dr. Rathmann would hold 12.0% of the outstanding shares of common stock and would be the beneficial owner of 16.0% of the outstanding shares of common stock, determined in accordance with Rule 13d-3 under the Exchange Act. If the proposals in this proxy statement are approved, based on the 22,949,987 shares of common stock outstanding as of May 2, 2002 and assuming issuance of an additional 1,108,755 shares of common stock in accordance with footnote (3) in the above table, Dr. Rathmann would hold 18.4% of the outstanding shares of common stock and would be the beneficial owner of 23.7% of the outstanding shares of common stock, determined in accordance with Rule 13d-3 under the Exchange Act.

As illustrated by the foregoing table, approval of proposals 3, 4 and 5 will render it easier for our officers and directors to obtain the requisite number of votes for passage of actions that are put to stockholder vote in the future and may give them sufficient control to ensure passage of such actions.

Proposals 2 through 5 may give our officers and directors the opportunity to acquire shares in the future below the market price at the time of purchase. Outstanding balances under the line of credit that is the subject of proposal number 5 are convertible by mutual agreement of Hyseq and Dr. Rathmann into (1) common stock based on either the 20-day trailing average closing prices or the price in connection with an equity offering, or (2) securities issued by us in an equity financing, on substantially the same terms as the financing. Conversion in any of these scenarios may result in the issuance of common stock to Dr. Rathmann at prices below the then-prevailing market prices. In addition, to the extent proposals 2 through 5 relate to the issuance to our officers and directors of options or warrants, when vested and exercisable these options or warrants may give the holder the right to acquire shares at a price below then-prevailing market prices.

Table of Contents**CERTAIN INFORMATION WITH RESPECT TO EXECUTIVE OFFICERS**

Set forth below is information regarding each of our executive officers as of May 1, 2002. Further information with regard to Dr. Rathmann and Dr. Love is presented under Proposal No. 1: Election of Nominees to Board of Directors.

| Name | Age | Position |
|----------------------|-----|--|
| George B. Rathmann | 74 | Chairman of the Board of Directors |
| Ted W. Love | 43 | President, Chief Executive Officer and Director |
| William F. Bennett | 53 | Senior Vice President of Research and Development |
| Linda A. Fitzpatrick | 45 | Senior Vice President of Human Resources |
| Peter S. Garcia | 41 | Senior Vice President and Chief Financial Officer |
| Li-Hsien Rin-Laures | 35 | Senior Vice President, General Counsel and Secretary |
| Walter Funk | 42 | Vice President of Research |
| David M. Rosen | 46 | Vice President of Operations |

William F. Bennett, Ph.D. joined us in July 2001 as our Senior Vice President of Research and Development. Dr. Bennett has twenty years experience in drug development, having served as Senior Vice President, Research and Manufacturing at Sensus Drug Development Corporation from 1996 to 2000, Senior Vice President, Product Development at BigBearBio, Inc. from 2000 to 2001, and Vice President, Research at COR Therapeutics from 1995 to 1996. Before holding those positions, Dr. Bennett worked at Genentech, Inc. for thirteen years where he held various positions in Research and Development, including research and development project team leader of the TNKase project. Dr. Bennett received his Ph.D. from University of Texas Southwestern Medical School, is the author of fifty scientific publications, and holds nineteen issued U.S. patents.

Linda A. Fitzpatrick joined us in April 2001 as our Senior Vice President of Human Resources. Prior to joining us, Ms. Fitzpatrick served as Senior Advisor at Advanced Medicine, Inc from April 1999 to January 2001 and Vice President, Human Resources, Corporate Communications and Operations at Gilead Sciences, Inc. from 1992 to 1998. Prior to her tenure at Gilead Sciences, Ms. Fitzpatrick served eight years at Genentech, Inc. where her positions included Director, Investor Relations and Director, Compensation, Benefits and Systems. Ms. Fitzpatrick graduated with honors with a Bachelor of Science degree in Sociology and Psychology from San Francisco State University.

Peter S. Garcia joined us in May 2001 as our Senior Vice President and Chief Financial Officer. Prior to joining us, Mr. Garcia served as Chief Financial Officer at Novacept, Inc., from May 2000 to April 2001, Chief Financial Officer and Consultant at IntraBiotics Pharmaceuticals, Inc. from January 1999 to April 2000 and Chief Financial Officer at Dendreon Corporation from July 1996 to December 1998. Prior to this experience, Mr. Garcia worked at Amgen Inc. from 1990 to 1996 in a variety of financial executive positions, including Assistant Corporate Controller. Mr. Garcia graduated with honors with a Bachelor of Arts degree in Economics and Sociology from Stanford University, and earned his Master of Business Administration from the University of California at Los Angeles.

Li-Hsien Rin-Laures joined us in August 2001 as our Senior Vice President and General Counsel. Prior to joining us, Dr. Rin-Laures was a partner from 1999 to 2001 in the law firm of Marshall, Gerstein and Borun, which she joined in 1993 after completing a judicial clerkship at the Court of Appeals for the Federal Circuit. Dr. Rin-Laures graduated with honors from Johns Hopkins University with a Bachelors of Arts in Chemistry, received an M.D. from Northwestern University Medical School and received her J.D., cum laude, from Harvard Law School.

Walter Funk, Ph.D. joined us in August 2000 and currently holds the position of Vice President of Research. Prior to joining us, Dr. Funk was a founding scientist at Geron Corp. from 1993 to 2000 where he was project leader on molecular biology projects focused on telomerase biology, cell immortalization and senescence. He later led the company's genomics efforts in human stem cell biology. Dr. Funk did post-doctoral work at the University of Texas Southwestern Medical Center at Dallas in the labs of Woodring

Table of Contents

Wright and Jerry Shay and received his Ph.D. and B.Sc. (Hon) degrees in Biochemistry from the University of British Columbia. He has published over thirty journal papers and is an assignee on 7 U.S. patents.

David M. Rosen, Ph.D. joined us in March 1999 as Vice President of Operations. Prior to joining us, Dr. Rosen was Vice President, and then Senior Vice President of Research and Development, responsible for product development and manufacturing operations at Celtrix Pharmaceuticals from May 1995 to October 1998. During his seven years at Celtrix, and an additional nine years at Celtrix's parent company, Collagen Corporation, Dr. Rosen held several other managerial positions in research and development, including Director of Research and Project Leader for a variety of biopharmaceutical projects involving the evaluation of protein therapeutics in the areas of osteoporosis and orthopedics. Dr. Rosen holds a Ph.D. and B.S. in biochemistry from the University of California, Riverside.

Executive Compensation

The following table sets forth the compensation paid or accrued by us for the three fiscal years ended December 31, 2001, to or on behalf of our Chief Executive Officer and the four other most highly compensated executive officers (collectively referred to as our named executive officers).

Summary Compensation Table

| Name and Principal Position | Year | Annual Compensation(\$) | | | Long Term Compensation Securities Underlying Options/SAR(#)(2) | All Other Compensation(\$) |
|---|------|-------------------------|--------|------------------------------|--|----------------------------|
| | | Salary | Bonus | Other Annual Compensation(1) | | |
| George B. Rathmann(3) Chairman of the Board and Chief Executive Officer | 2001 | | | | 1,036,000 | |
| | 2000 | | | | 1,033,000 | |
| Ted W. Love(4) President and Chief Executive Officer | 2001 | 491,221 | | | 575,000 | |
| David M. Rosen Vice President of Operations | 2001 | 189,792 | | | 13,000 | |
| | 2000 | 170,961 | | | 4,200 | |
| | 1999 | 120,398 | | | 58,630 | |
| Peter S. Garcia(5) Senior Vice President and Chief Financial Officer | 2001 | 159,167 | 34,000 | | 225,000 | |
| Linda A. Fitzpatrick (6) Senior Vice President of Human Resources | 2001 | 130,449 | 26,250 | | 175,000 | |
| William F. Bennett(7) Senior Vice President of Research and Development | 2001 | 126,042 | 41,250 | | 250,000 | |
| Radoje T. Drmanac(8) Chief Scientific Officer | 2001 | 265,000 | | | | |
| | 2000 | 253,750 | 65,000 | | 6,020 | |
| | 1999 | 215,000 | 53,250 | | 30,290 | |
| Snezana Drmanac(9) Vice President of SBH Biochemistry | 2001 | 189,167 | | | | |
| | 2000 | 173,000 | | | 4,200 | |
| | 1999 | 154,125 | | | 19,990 | |

(1) Excludes perquisites and other personal benefits, securities or property aggregating less than \$50,000 or 10% of the total annual salary and bonus reported for each named executive officer.

(2) The securities underlying the options are shares of our common stock.

(3) Dr. Rathmann served as our Chief Executive Officer from May 2000 to March 2001. Salary and bonus information for the year 2001 represents compensation paid to Dr. Rathmann through March 2001. Dr. Rathmann received a grant of options to purchase 3,000 shares of

our common stock each month, with an exercise price per share equal to the fair market value of our common stock on date of each grant,
23

Table of Contents

in lieu of cash compensation for his services as our employee. Salary and bonus information for the year 2000 represents compensation paid to Dr. Rathmann since February 2000, when he joined our company.

- (4) Dr. Love has served as our President since January 2001 and as Chief Executive Officer and a director since March 2001. Salary and bonus information for the year 2001 represents compensation paid since January 2001.
- (5) Mr. Garcia joined us in May 2001 as our Senior Vice President and Chief Financial Officer. Salary and bonus information for the year 2001 represents compensation paid since May 2001.
- (6) Ms. Fitzpatrick joined us in April 2001 as our Senior Vice President of Human Resources. Salary and bonus information for the year 2001 represents compensation paid since April 2001.
- (7) Dr. Bennett joined us in July 2001 as our Senior Vice President of Research and Development. Salary and bonus information for the year 2001 represents compensation paid since July 2001.
- (8) Dr. R. Drmanac resigned as our Chief Scientific Officer to become Chief Scientific Officer of our subsidiary Callida in October 2001 and remained employed with us through December 2001. Salary and bonus information for the year 2001 represents compensation paid through December 2001.
- (9) Dr. S. Drmanac resigned as our Vice President of SBH Biochemistry to become Vice President of SBH and Research and Development of our subsidiary Callida in October 2001 and remained employed with us through December 2001. Salary and bonus information for the year 2001 represents compensation paid through December 2001.

During the periods indicated above, none of the named executive officer received any awards under any long-term incentive plan, and we do not have a pension plan.

Employment Agreements

In February 2000, we entered into our standard form of Employment and Confidential Information Agreement with Dr. Rathmann, providing for his services in capacities to be determined. Dr. Rathmann served as our President from May 2000 to January 2001, as our Chief Executive Officer from May 2000 to March 2001, and as our Chairman and a director since February 2000. Pursuant to that agreement, and as determined by our Board, Dr. Rathmann receives a monthly stock option grant to purchase 3,000 shares of our common stock with an exercise price per share equal to the fair market value of our common stock on the date of each grant in lieu of cash compensation for his services.

In January 2001, we entered into an employment agreement with Dr. Love. Pursuant to the agreement, we are obligated to pay Dr. Love an initial annual salary of \$485,000. In addition, Dr. Love is entitled to participate in our management bonus pool, employee benefit plans maintained by us and in other benefits provided to our senior executives, including retirement and 401(k) plans, deferred compensation, medical and dental, annual vacation, paid holidays, sick leave and similar benefits. In connection with Dr. Love's employment agreement, we also granted him options to purchase an aggregate of 500,000 shares of our common stock. In the event Dr. Love's employment with us terminates other than for cause or there exists good reason for Dr. Love to terminate his employment with us:

any options granted to Dr. Love in connection with this agreement or otherwise over the first four years of his employment, beginning January 11, 2001, will immediately become vested and exercisable;

Dr. Love's right to exercise his options will be extended by eighteen months;

Dr. Love will immediately receive a lump sum payment equal to twelve months of his then-current base salary; and

Dr. Love's health, disability and life insurance benefits and those for his family will continue for an additional twelve months.

In the event of Dr. Love's death, the benefits described above shall be paid to his heirs. In the event Dr. Love is disabled for at least six consecutive months while employed by us we may terminate Dr. Love, but must pay him the benefits described above. In the event of a change of control, if Dr. Love is not employed as

Table of Contents

the surviving entity's Chief Executive Officer and President for at least one year, beginning with the effective date of the change of control and ending on the one-year anniversary thereof, unless Dr. Love is terminated for cause, he shall receive the benefits described above.

As provided by the terms of Dr. Love's employment agreement, we have entered into a loan agreement with Dr. Love, pursuant to which he may borrow up to \$2.0 million from us. The loan agreement with Dr. Love provides for interest on outstanding balances to accrue at the lowest applicable federal interest rate or such other higher rate of interest, if required, to constitute a market rate of interest as contemplated by the Rules and Regulations of the Financial Accounting Standards Board and the U.S. Securities and Exchange Commission. Interest accrues but is deferred and all interest and principal is due in January 2006.

Management Stock Option Agreements

In connection with Dr. Love's employment agreement, we granted him options to purchase an aggregate of 500,000 shares of our common stock. Specifically, we have granted Dr. Love (i) an option under our 1995 Plan to purchase 31,840 shares at an exercise price of \$12.56 per share, the fair market value of our common stock on the date of grant as determined under that plan, which shares become exercisable in four equal annual installments commencing one year after the date of grant, and (ii) an option to purchase 468,160 shares at an exercise price of \$12.50 per share, the closing price on the date of grant, of which 150,000 shares became exercisable immediately and the remainder become exercisable in four equal annual installments commencing one year after the date of grant. Our employment agreement with Dr. Love also provides that, at any time following his first year of employment but before the third anniversary of beginning his employment, so long as Dr. Love has not exercised his option to purchase 150,000 of the 500,000 shares, he may forfeit that option, in exchange for \$2.0 million plus the accrued interest under the loan agreement and the loan then becomes immediately due and payable. The guaranteed value of the 150,000 options at \$2.0 million will be recognized ratably as compensation expense over the service period of one year. As of the date of this proxy statement, no amounts were outstanding under the loan agreement.

Option Grants in 2001

We granted options to our executive officers under our 1995 Stock Option Plan, with the exception of the following option grants, which were granted pursuant to separate option agreements:

grant on February 1, 2000 to Dr. Rathmann of an option to purchase 1,000,000 shares of our common stock at an exercise price equal to the then-current market price on the day before the date of grant of \$31.688 per share;

grant on August 21, 2001 to Dr. Rathmann of an option to purchase 1,000,000 shares of our common stock with an exercise price equal to the then-current market price of \$8.635 per share;

grant on January 11, 2001 to Dr. Love of an option to purchase 468,160 shares of our common stock with an exercise price equal to the then-current market price of \$12.500 per share

grant on July 16, 2001 to Dr. Bennett of an option to purchase 250,000 shares of our common stock with an exercise price equal to the then-current market price of \$10.400 per share

grant on May 1, 2001 to Mr. Garcia of an option to purchase 200,000 shares of our common stock with an exercise price equal to the then-current market price of \$11.665 per share

grant on August 1, 2001 to Dr. Rin-Laures of an option to purchase 200,000 shares of our common stock with an exercise price equal to the then-current market price of \$10.440 per share

grant on April 24, 2001 to Ms. Fitzpatrick of an option to purchase 150,000 shares of our common stock with an exercise price equal to the then-current market price of \$9.955 per share

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Table of Contents

The following tables show for the fiscal year ended December 31, 2001, certain information regarding options granted to, exercised by, and held at year end by our named executive officers:

| Name | Individual Grants | | | | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2) | |
|----------------------|--|---|---|--------------------|--|------------|
| | Number of Securities Underlying Options Granted(#) | % of Total Options Granted to Employees in 2001 | Exercise of Base Price (\$/Sh)(1) | Expiration Date | 5%(\$) | 10%(\$) |
| | | | | | | |
| George B. Rathmann | 1,036,000 | 45.3 | (3) | (4) | 5,655,628 | 14,331,344 |
| Ted W. Love | 575,000 | 25.1 | (5) | (6) | 4,470,391 | 11,283,071 |
| William F. Bennett | 250,000 | 10.9 | 10.40 | 7/15/11 | 1,634,560 | 4,141,970 |
| Linda A. Fitzpatrick | 175,000 | 7.6 | (9) | (10) | 1,102,857 | 2,794,635 |
| Peter S. Garcia | 225,000 | 9.8 | (7) | (8) | 1,630,788 | 4,132,411 |
| David M. Rosen | 13,000 | 0.6 | 10.44 | 7/31/11 | 85,324 | 216,211 |
| Radoje T. Drmanac | | | | | | |
| Snezana Drmanac | | | | | | |

- (1) All options have a per share exercise price equal to the fair market value of our common stock on the date of grant, with the exception of the initial option granted to Dr. Rathmann to purchase 1,000,000 shares of our common stock, which has a per share exercise price equal to the closing price of a share of our common stock on the day prior to the date of the grant.
- (2) Reflects the value of the stock option on the date of grant assuming (i) for the 5% column, a five-percent annual rate of appreciation in our common stock over the ten-year term of the option, and (ii) for the 10% column, a ten-percent annual rate of appreciation in our common stock over the ten-year term of the option, in each case without discounting to net present value and before income taxes associated with the exercise. The 5% and 10% assumed rates of appreciation are based on the rules of the Securities and Exchange Commission and do not represent our estimate or projection of the future price of our common stock. The amounts in this table may not be achieved.
- (3) On August 21, 2001, we granted an option to purchase 1,000,000 shares of our common stock to Dr. Rathmann with an exercise price of \$8.635 per share. He received a monthly option grant of 3,000 shares at exercise prices ranging from \$6.0825 to \$15.125 per share.
- (4) The option granted on August 21, 2001 will expire August 20, 2011. The monthly options granted will expire on January 30, 2011, February 27, 2011, March 29, 2011, April 29, 2011, May 30, 2011, June 28, 2011, July 30, 2011, August 30, 2011, September 27, 2011, October 30, 2011, November 29, 2011 and December 30, 2011, respectively.
- (5) On January 11, 2001, we granted an option to purchase 468,160 shares of our common stock to Dr. Love with an exercise price of \$12.50 per share; an option to purchase 31,480 shares with an exercise price of \$12.5625 per share. On August 1, 2001, Dr. Love received an option grant to purchase 75,000 shares of our common stock at exercise price of \$10.44 per share.
- (6) The options granted will expire on January 10, 2011 and July 31, 2011, respectively.
- (7) On May 1, 2001, we granted an option to purchase 200,000 shares of our common stock to Mr. Garcia with an exercise price of \$11.665 per share. On August 1, 2001, Mr. Garcia received an option grant to purchase 25,000 shares of our common stock at exercise price of \$10.44 per share.
- (8) The options granted will expire on April 30, 2011 and July 31, 2011, respectively.
- (9) On April 24, 2001, we granted an option to purchase 150,000 shares of our common stock to Ms. Fitzpatrick with an exercise price of \$9.955 per share. On August 1, 2001, Ms. Fitzpatrick received an option grant to purchase 25,000 shares of our common stock at exercise price of \$10.44 per share.

(10) The options granted will expire on April 23, 2011 and July 31, 2011, respectively.

Table of Contents

Aggregate Option Exercises in 2001; 2001 Year-End Option Values

| Name | Shares | | Option Values at December 31, 2001 | | | |
|--------------------|-------------------------|--------------------|---|---------------|--|---------------|
| | Acquired at Exercise(#) | Value Realized(\$) | Number of Securities Underlying Unexercised Options at Fiscal Year End(1) | | Value of Unexercised In-The-Money Options at Fiscal Year End(\$) | |
| | | | Exercisable | Unexercisable | Exercisable | Unexercisable |
| George B. Rathmann | | | 735,666 | 1,333,334 | 5,903 | |
| Ted W. Love | | | 150,000 | 425,000 | | |
| William F. Bennett | | | | 250,000 | | |