ACACIA RESEARCH CORP Form S-4/A November 08, 2002

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON NOVEMBER 8, 2002

REGISTRATION NO. 333-87654

SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549

AMENDMENT NO. 6 TO FORM S-4 REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

ACACIA RESEARCH CORPORATION (EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE6282954405754(STATE OR OTHER JURISDICTION(PRIMARY STANDARD INDUSTRIAL
CLASSIFICATION CODE NUMBER)(I.R.S. EMPLOYEROF INCORPORATION OR ORGANIZATION)CLASSIFICATION CODE NUMBER)IDENTIFICATION NUMBER)

500 NEWPORT CENTER DRIVE NEWPORT BEACH, CA 92660 (949) 480-8300 (ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

PAUL R. RYAN ACACIA RESEARCH CORPORATION 500 NEWPORT CENTER DRIVE NEWPORT BEACH, CA 92660 (949) 480-8300 (NAME AND ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF AGENT FOR SERVICE)

COPIES TO: MARK J. KELSON D. STANLEY ROWLAND ALLEN MATKINS LECK GAMBLE & MALLORY LLP 1901 AVENUE OF THE STARS SUITE 1800 LOS ANGELES, CA 90067-6019

APPROXIMATE DATE OF COMMENCEMENT OF PROPOSED SALE TO PUBLIC: As soon as practicable after the registration statement becomes effective.

If the securities being registered on this form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box: $[_]$

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [_]

If this form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: [_]

CALCULATION OF REGISTRATION FEE

| TITLE OF SECURITIES TO BE REGISTERED | AMOUNT TO BE REGISTERED | PROPOSED MAXIMUM OFFERING PRICE PER SHARE | OF |
|--|----------------------------|---|----|
| Acacia Research Corporation-Acacia Technologies Common Stock, par value \$0.001 per share (1) | 19,640,808 | N/A | |
| Acacia Research Corporation-CombiMatrix Common Stock, par value \$0.001 per share (2) | 10,963,277 | N/A | |
| Acacia Research Corporation-CombiMatrix Common Stock, par value \$0.001 per share (3) | 11,987,274 | N/A | |
| TOTAL | | | |

- (1) Represents the maximum number of shares of Acacia Research Corporation-Acacia Technologies Common Stock to be issued in connection with the recapitalization, based on 19,640,808 shares of the Common Stock of Acacia Research Corporation outstanding.
- (2) Represents the maximum number of shares of Acacia Research Corporation-CombiMatrix Common Stock to be issued in connection with the recapitalization, based on 19,640,808 shares of the Common Stock of Acacia Research Corporation outstanding.
- (3) Represents the maximum number of shares of Acacia Research Corporation-CombiMatrix Common Stock to be issued in connection with the merger of Acacia Research Corporation and CombiMatrix Corporation, based on 11,987,274 shares of the Common Stock of CombiMatrix Corporation outstanding, excluding shares held by Acacia Research Corporation and its affiliates.
- (4) Pursuant to Rule 457(f)(1) and 457(c) under the Securities Act, this portion of the registration fee has been calculated based on per share

prices of the Common Stock of Acacia Research Corporation of \$9.585 and \$4.175 (the average of the high and low price per share of the Common Stock of Acacia Research Corporation on the Nasdaq National Market on April 29, 2002 and October 22, 2002, respectively). \$17,309.58 of this fee has been previously paid.

(5) Pursuant to Rule 457(f)(2) under the Securities Act and Rule 0-11(a)(4) and 0-11(c)(1)(i) under the Securities Exchange Act of 1934, this portion of the registration fee has been calculated, as of April 29, 2002 and as of October 22, 2002, based upon the then-current book values of CombiMatrix Corporation of \$19,425,072 and \$5,393,484, respectively, and the percentage of the outstanding shares of CombiMatrix Corporation Common Stock that will be exchanged in the merger for the shares of AR-CombiMatrix Common Stock being included in this registration statement on such dates, 41.6% and 17.5%, respectively. \$1,616.17 of this fee has been previously paid.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PROXY STATEMENT OF ACACIA RESEARCH CORPORATION

SPECIAL MEETING OF STOCKHOLDERS TO BE HELD AT 610 NEWPORT CENTER DRIVE, SUITE 130, NEWPORT BEACH, CALIFORNIA AT 1:30 P.M., PACIFIC TIME, ON DECEMBER 11, 2002

> PROSPECTUS OF ACACIA RESEARCH CORPORATION

ACACIA RESEARCH CORPORATION - COMBIMATRIX COMMON STOCK

ACACIA RESEARCH CORPORATION -ACACIA TECHNOLOGIES COMMON STOCK

TO OUR STOCKHOLDERS:

You are invited to attend a special meeting of our stockholders at which you will be asked to consider and adopt a recapitalization proposal recommended by our board of directors.

We propose to create two new classes of common stock called "AR-CombiMatrix stock" and "AR-Acacia Technologies stock." AR-CombiMatrix stock is intended to reflect separately the performance of our subsidiary CombiMatrix Corporation, and to benefit from its research and development efforts. AR-Acacia Technologies stock is intended to reflect separately the performance of our media technology business and to benefit from the licensing of its technology and sale of its

products. Although the AR-CombiMatrix stock and the AR-Acacia Technologies stock are intended to reflect the performance of different business groups within our company, they are both classes of common stock of Acacia Research Corporation and are not stock issued by the respective groups.

If stockholders approve the recapitalization, each share of your existing common stock would be converted into approximately 0.5582 of a share of AR-CombiMatrix stock (subject to adjustment as described in this proxy statement) and one share of AR-Acacia Technologies stock.

At the special meeting, you will also be asked to consider and approve a merger proposal pursuant to which we would acquire the outstanding shares of CombiMatrix Corporation not already held by us, and CombiMatrix Corporation would become our wholly-owned subsidiary. In the merger, the stockholders of CombiMatrix Corporation other than Acacia Research would receive one share of AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock which they own immediately prior to the merger.

At the special meeting, you will also be asked to consider and approve related proposals to adopt separate new stock incentive plans for each business group.

We have applied to list the AR-CombiMatrix stock and the AR-Acacia Technologies stock on the NASDAQ National Market under the symbols "CBMX" and "ACTG", respectively.

Our board unanimously recommends that you vote in favor of the recapitalization proposal, the merger proposal and the adoption of the new stock incentive plans. None of the proposals will be implemented unless all proposals are approved. This proxy statement and prospectus provides you with detailed information about the proposals. We encourage you to read this entire document carefully.

/S/ PAUL R. RYAN

Paul R. Ryan CHAIRMAN AND CHIEF EXECUTIVE OFFICER

THE RECAPITALIZATION, MERGER AND RELATED PROPOSALS INVOLVE CERTAIN RISKS. PLEASE READ THE "RISK FACTORS" BEGINNING ON PAGE 41.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROXY STATEMENT AND PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

This proxy statement and prospectus is dated November 8, 2002 and is first being mailed to stockholders on or about November 12, 2002.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission. You may read and copy the materials we file at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Rooms. Our Commission filings are also available to the public from the SEC's World Wide Web site on the Internet at HTTP://WWW.SEC.GOV. This site contains reports, proxy and information statements and other information regarding issuers that file

electronically with the SEC. You may also read and copy this information at the National Association of Securities Dealers, Inc., 1735 K Street, N.W., Washington, D.C. 20006.

We maintain a site on the Internet at HTTP://WWW.ACACIARES.COM. The information contained in our website is not part of this prospectus/proxy statement and you should not rely on it in deciding whether or not to vote in favor of the proposals set forth herein.

The SEC allows us to "incorporate by reference" the information that we file with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC under the Securities Exchange Act of 1934 (the "Exchange Act"). The information incorporated by reference is deemed to be part of this prospectus/proxy statement, except for any information superseded by information in this prospectus. We have filed with the SEC and incorporate by reference:

- o our annual report on Form 10-K for the fiscal year ended December 31, 2001;
- o our current report on Form 8-K, dated June 11, 2002, filed with the SEC on June 11, 2002;
- o our quarterly report on Form 10-Q for the quarter ended March 31, 2002; and
- o our quarterly report on Form 10-Q for the quarter ended June 30, 2002.

Any documents we file pursuant to Section 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus/proxy statement until the special meeting will automatically be deemed to be incorporated by reference in this prospectus/proxy statement and to be part hereof from the date of filing those documents. Any statement contained in this prospectus/proxy statement or in a document incorporated by reference shall be deemed to be modified or superseded for all purposes to the extent that a statement contained in this prospectus/proxy statement or in any other document which is also incorporated by reference modifies or supersedes that statement.

We will provide without charge to each person to whom a copy of this prospectus/proxy statement is delivered, upon such person's written or oral request, a copy of any and all of the information incorporated by reference in this prospectus/proxy statement, other than exhibits to such documents, unless such exhibits are specifically incorporated by reference into the information that this prospectus incorporates. Request should be directed to:

> Acacia Research Corporation 500 Newport Center Drive Newport Beach, California 92660 Attention: Secretary Telephone: (949) 480-8300

TO OBTAIN TIMELY DELIVERY, YOU MUST MAKE THIS REQUEST NO LATER THAN FIVE BUSINESS DAYS BEFORE DECEMBER 11, 2002, THE DATE OF THE SPECIAL MEETING.

You should rely only on the information provided in this prospectus/proxy statement (including the appendices) in considering how to vote your shares on the proposals discussed herein. We have authorized no one to provide you with different information. You should not assume that the information in this prospectus/proxy statement is accurate as of any date other than the date on the front of this document. ACACIA RESEARCH CORPORATION 500 NEWPORT CENTER DRIVE NEWPORT BEACH, CA 92660

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS TO BE HELD ON DECEMBER 11, 2002

November 8, 2002

Notice is hereby given that a special meeting of the stockholders of Acacia Research Corporation will be held at 1:30 p.m. on December 11, 2002, at 610 Newport Center Drive, Suite 130, Newport Beach, California 92660. The special meeting will be held for the following purposes and to transact such other business as may properly come before the meeting or any postponements or adjournments thereof:

1. To consider and act upon a proposal to amend our certificate of incorporation to create two new classes of common stock called "AR-CombiMatrix stock" and "AR-Acacia Technologies stock" and to divide each outstanding share of our common stock into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock.

2. To consider and act upon a proposal to approve and adopt an agreement and plan of reorganization pursuant to which (a) CombiMatrix Corporation will merge with and into a subsidiary which we have formed for this purpose and (b) we will issue to the stockholders of CombiMatrix Corporation, other than Acacia Research Corporation, one share of AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock that is outstanding on the effective date of the merger and held by such stockholder.

3. To consider and act upon a proposal to adopt the 2002 $\ensuremath{\mathsf{CombiMatrix}}$ Stock Incentive Plan.

4. To consider and act upon a proposal to adopt the 2002 Acacia Technologies Stock Incentive Plan.

Information relating to these proposals is contained in the attached proxy statement and prospectus. None of the proposals will be implemented unless all four are approved by our stockholders.

Our board of directors has fixed the close of business on November 1, 2002 as the record date for the determination of stockholders entitled to notice of and to vote at the special meeting. Only stockholders of record at the close of business on that date will be entitled to vote at the meeting. A list of those stockholders will be available for inspection before or at the meeting at the request of a stockholder. Our transfer books will not be closed.

By order of the Board of Directors,

/S/ ROBERT A. BERMAN

Robert A. Berman SENIOR VICE PRESIDENT OF BUSINESS DEVELOPMENT, GENERAL COUNSEL AND SECRETARY

TABLE OF CONTENTS

| QUESTIONS AND ANSWERS |
|---|
| PROXY STATEMENT SUMMARY |
| CONSOLIDATING SELECTED FINANCIAL INFORMATION |
| RISK FACTORS. Risks Relating to the Recapitalization. Risks Relating to the Merger. Risks Relating to the CombiMatrix Group. Risks Relating to the Acacia Technologies Group. |
| SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS |
| STOCKHOLDERS MEETING |
| THE RECAPITALIZATION PROPOSAL. Description of the Recapitalization. Background of and Reasons for the Recapitalization Proposal. Recommendation of Our Board of Directors. Opinion of A.G. Edwards. Management and Allocation Policies. Policies Subject to Change Without Stockholder Approval. Allocation of Assets. Fiduciary and Management Responsibilities. Dividend Policy. Financing Activities. Inter-Group Contracts and Access to Technology and Know-How. Review of Corporate Opportunities. Financial Statements; Allocation Matters. Taxes. Common Stock Ownership of Directors and Senior Officers. Description of AR-CombiMatrix Stock and AR-Acacia Technologies Stock. Material United States Federal Income Tax Consequences of the Recapitalization. Stock Exchange Listings. Exchange Procedures. Stock Transfer Agent and Registrar. Financial Advisors. Effect on Existing Options and Warrants. No Dissenters' Rights with Respect to Recapitalization Proposal. No Regulatory Approvals. |
| THE MERGER PROPOSAL. Description of the Merger. Issuance of Shares; Ownership Interests. Background of and Reasons for the Merger. Recommendation of Our Board of Directors. Table Regarding Security Ownership of Certain Beneficial Owners and Management. Accounting Treatment. Material United States Federal Income Tax Consequences of the Merger. |
| Federal Securities Laws Consequences; Stock Transfer Restriction Agreements |

i

| PRINCIPAL PROVISIONS OF THE MERGER AGREEMENT |
|--|
| General Description of the Merger |
| Effective Time |
| Conversion of Shares and Consideration to Be Received in the Merger |
| Exchange of CombiMatrix Corporation Stock Certificates |
| Treatment of CombiMatrix Corporation Stock Options |
| Treatment of CombiMatrix Corporation Warrants |
| Treatment of CombiMatrix Corporation Benefits and Other Employee Matters |
| Representations and Warranties |
| Principal Covenants |
| Conditions to the Consummation of the Merger |
| Termination |
| Effect of Termination |
| Amendments and Waivers |
| No Relief from Liability for Willful Breach |
| - |
| ACACIA RESEARCH CORPORATION |
| Business |
| Management |
| |
| COMBIMATRIX GROUP |
| Business |
| Management |
| |
| ACACIA TECHNOLOGIES GROUP |
| Business |
| Management |
| |
| ACACIA RESEARCH CORPORATION MANAGEMENT'S DISCUSSION AND ANALYSIS |
| |
| COMBIMATRIX GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS |
| |
| ACACIA TECHNOLOGIES GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS |
| |
| ADOPTION OF 2002 COMBIMATRIX STOCK INCENTIVE PLAN AND 2002 ACACIA |
| TECHNOLOGIES STOCK INCENTIVE PLAN |
| |
| OTHER ITEMS |
| |
| INDEX TO FINANCIAL INFORMATION |
| Acacia Research Corporation - Accountants' Report and Financial Statements |
| CombiMatrix Corporation - Accountants' Report and Financial Statements |
| Acacia Technologies Group - Accountants' Report and Financial Statements |
| CombiMatrix Group - Accountants' Report and Financial Statements |
| |
| ANNEXES |
| Annex A Agreement and Plan of Reorganization |
| Annex B Proposed Restated Certificate of Incorporation |
| |

- Annex C Proposed Common Stock Policies Annex D 2002 CombiMatrix Stock Incentive Plan Annex E 2002 Acacia Technologies Stock Incentive Plan

Annex F Tax Opinion of PricewaterhouseCoopers LLP Annex G Opinion of A.G. Edwards & Sons, Inc.

ii

QUESTIONS AND ANSWERS

THE PROPOSALS

1. WHY AM I RECEIVING THIS PROXY STATEMENT?

We are distributing this proxy statement and prospectus to you in connection with a special meeting of our stockholders. At the special meeting, you will be asked to consider and vote upon the following proposals:

- RECAPITALIZATION PROPOSAL: A proposal to amend and restate our certificate of incorporation to create two new classes of common stock, called "AR-CombiMatrix stock" and "AR-Acacia Technologies stock", and to divide each outstanding share of our existing common stock into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock.
- MERGER PROPOSAL: A proposal to approve the merger agreement with CombiMatrix Corporation, the merger of CombiMatrix Corporation into a wholly owned subsidiary of Acacia Research and the issuance of shares of AR-CombiMatrix stock to the stockholders of CombiMatrix Corporation other than Acacia Research in connection with the merger.
- ADOPTION OF 2002 COMBIMATRIX STOCK INCENTIVE PLAN: A proposal to adopt the 2002 CombiMatrix Stock Incentive Plan to provide for the granting of stock awards and options in AR-CombiMatrix stock.
- ADOPTION OF 2002 ACACIA TECHNOLOGIES STOCK INCENTIVE PLAN: A proposal to adopt the 2002 Acacia Technologies Stock Incentive Plan to provide for the granting of stock awards and options in AR-Acacia Technologies stock.

If any of these proposals is not approved, we will not implement any of the other proposals.

2. IF THE PROPOSED RECAPITALIZATION WERE APPROVED, WHAT WOULD BE THE NEW CLASSES OF COMMON STOCKS?

We refer to the two new classes of common stocks as AR-CombiMatrix stock and AR-Acacia Technologies stock. We refer to the AR-CombiMatrix stock and the AR-Acacia Technologies stock together as the "common stock."

- o The AR-CombiMatrix stock is intended to reflect the separate performance of our subsidiary CombiMatrix Corporation. We refer to this business group, or division, as the "CombiMatrix group."
- o The AR-Acacia Technologies stock is intended to reflect the separate performance of our media technology business. We refer to this business group, or division, as the "Acacia Technologies group."

All of our existing businesses will be attributed to the two groups. Although the two classes of stock are intended to reflect the separate performances of the respective groups, we cannot assure you that the market

values of the two classes will in fact reflect the performance of the respective groups as we intend because holders will not have a separate and exclusive interest in the respective groups. Holders will continue to be common stockholders of Acacia Research and will not hold a direct or exclusive interest in either group. As such, they will be subject to all risks associated with an investment in Acacia Research and all of our businesses, assets and liabilities.

3. HOW WILL I BENEFIT FROM THE PROPOSED RECAPITALIZATION?

You will be able to separately value the AR-CombiMatrix stock and the AR-Acacia Technologies stock. You will also be able to invest and trade in either or both stocks depending on your investment objectives.

-1-

4. WHAT KIND OF FINANCIAL INFORMATION WILL I RECEIVE IN THE FUTURE?

You will continue to receive our consolidated financial information for Acacia Research as a whole. In addition, you will receive separate audited financial statements and other business and financial information, including separate management's discussion and analysis, for both the CombiMatrix group and the Acacia Technologies group. The financial statements for the groups should be read in conjunction with the consolidated financial information for Acacia Research.

5. WHAT WILL HAPPEN TO MY EXISTING SHARES OF ACACIA RESEARCH IF THE RECAPITALIZATION TAKES PLACE AS PROPOSED?

In the recapitalization, each outstanding share of Acacia Research common stock will be converted into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock.

The fraction of a share of AR-CombiMatrix stock into which each outstanding share of Acacia Research common stock will be converted will be equal to the quotient obtained by dividing (a) the number of shares of CombiMatrix Corporation common stock owned by Acacia Research immediately prior to the effective time of the merger by (b) the total number of shares of Acacia Research common stock issued and outstanding immediately prior to the effective time. As of November 1, 2002, this fraction was 0.5582.

The percentage of the issued and outstanding shares of AR-CombiMatrix stock that will be received by the holders of Acacia Research common stock will be equal to the percentage of the issued and outstanding shares of CombiMatrix Corporation common stock held by Acacia Research immediately prior to the effective time of the merger. As of November 1, 2002, this percentage was 47.7%.

6. WILL THE RECAPITALIZATION PROPOSAL RESULT IN A CHANGE OF CONTROL OF ACACIA RESEARCH?

No.

7. WILL THE RECAPITALIZATION PROPOSAL RESULT IN A DISTRIBUTION OR SPIN-OFF?

No. This proposal will not result in a distribution or spin-off of our assets or liabilities. Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will continue to be stockholders of a single company and subject to all risks associated with an investment in Acacia Research and all of our businesses, assets and liabilities.

8. WHAT VOTING RIGHTS WILL I HAVE AFTER THE RECAPITALIZATION?

Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will vote together as a single class (except in certain limited circumstances). Each share of AR-CombiMatrix stock will entitle the holder to one vote. Each share of AR-Acacia Technologies stock will entitle the holder, for any particular vote, to a number of votes equal to the average market value of a share of AR-Acacia Technologies stock divided by the average market value of a share of AR-CombiMatrix stock over a specified 20-trading day period ending on the 10th trading day prior to the record date for determining the stockholders entitled to vote.

9. WHEN WILL YOU IMPLEMENT THE RECAPITALIZATION AND MERGER PROPOSALS?

We plan to implement the recapitalization and merger proposals as soon as practicable after stockholder approval.

10. SHOULD I SEND IN MY STOCK CERTIFICATES NOW?

No. We will send written instructions to you on how to exchange your stock certificates for new stock certificates after the recapitalization is completed.

-2-

THE SPECIAL MEETING

11. WHEN AND WHERE WILL THE SPECIAL MEETING BE HELD?

We will hold the special meeting at 1:30 p.m. on December 11, 2002, at 610 Newport Center Drive, Suite 130, Newport Beach, California 92660.

12. WHO IS ENTITLED TO VOTE AT THE SPECIAL MEETING?

You are entitled to vote at the special meeting if you owned shares of our common stock as of the record date for the special meeting, which was the close of business on November 1, 2002. On November 1, 2002, there were 19,640,808 shares of our common stock issued and outstanding. For each share of our common stock owned on that date, you will have one vote at the special meeting. The shares of existing common stock held in our treasury will not be entitled to vote or counted in determining the number of outstanding shares.

13. HOW DO I VOTE?

After you have carefully read this proxy statement, mail your signed proxy card in the enclosed return envelope as soon as possible so that your shares may be represented at the special meeting of stockholders. You may also attend the meeting in person instead of submitting a proxy. If your shares are held in "street name"' by your broker, your broker will vote your shares only if you provide instructions on how to vote. You should follow the directions provided by your broker regarding how to instruct your broker to vote your shares.

14. CAN I CHANGE MY VOTE AFTER MAILING MY PROXY?

Yes. You may change your vote by delivering a signed notice of revocation or a later-dated, signed proxy card to the corporate secretary of Acacia Research before the special meeting of stockholders or by attending the special meeting of stockholders and voting in person.

15. WHAT IS A "QUORUM" AT THE SPECIAL MEETING?

A "quorum" is a majority of the outstanding shares entitled to vote. The shares may be present or represented by proxy. For the purposes of determining a quorum, shares held by brokers or nominees will be treated as present even if the broker or nominee does not have discretionary power to vote on a particular matter or if instructions were never received from the beneficial owner. These shares are called "broker non-votes." Abstentions will be counted as present for quorum purposes.

16. WHAT VOTE IS REQUIRED TO APPROVE EACH PROPOSAL?

Amending our certificate of incorporation to create two new classes of common stock and adopting the agreement and plan of reorganization relating to the merger will each require the affirmative vote of a majority of our outstanding common stock. Adopting the 2002 CombiMatrix Stock Incentive Plan and the 2002 Acacia Technologies Stock Incentive Plan will each require the affirmative vote of a majority of the shares of our common stock present or represented and entitled to vote at the special meeting.

As of November 1, 2002, 2.2% of our outstanding common stock was owned by our executive officers, directors and their affiliates. As of November 1, 2002, 47.7% of CombiMatrix Corporation's outstanding common stock was owned by Acacia Research and its executive officers, directors and their affiliates and 10.0% by CombiMatrix Corporation's executive officers, directors and their affiliates.

17. WHAT IF I DO NOT PROVIDE MY BROKER WITH INSTRUCTIONS ON HOW TO VOTE MY SHARES?

If you do not provide your broker with instructions on how to vote your "street name" shares, your broker will not be permitted to vote them, and the shares will be considered "broker non-votes". However, the "street name" shares will be considered present for quorum purposes. For these broker non-votes and the merger proposal,

-3-

broker non-votes will have the effect of a "no" vote. For adopting the 2002 CombiMatrix Stock Incentive Plan and 2002 Acacia Technologies Stock Incentive Plan, broker non-votes will be treated as not present and as not entitled to vote and will have no effect on the result of the vote even though the same shares would be considered present for the purpose of establishing a quorum and would be considered as voting against the recapitalization proposal and the merger proposal. You should therefore be sure to provide your broker with instructions on how to vote your shares. Please check the voting form used by your broker to see if it offers telephone or internet voting.

18. WHAT HAPPENS IF I ABSTAIN FROM VOTING?

Proxies marked "abstain" will be counted as shares present for the purpose of determining the presence of a quorum, but for purposes of determining the outcome of a proposal, shares represented by such proxies will not be treated as affirmative votes. For all proposals, an abstention will have the effect of a "no" vote.

PROXY STATEMENT SUMMARY

THIS SUMMARY, TOGETHER WITH THE "QUESTIONS AND ANSWERS" ON THE PRECEDING PAGES, HIGHLIGHTS IMPORTANT SELECTED INFORMATION FROM THIS DOCUMENT. TO UNDERSTAND THE RECAPITALIZATION, THE MERGER AND THE PROPOSED NEW STOCK INCENTIVE PLANS FULLY AND FOR A MORE COMPLETE DESCRIPTION OF THE LEGAL TERMS OF THE RECAPITALIZATION, THE MERGER AND THE PROPOSED NEW STOCK INCENTIVE PLANS, YOU SHOULD CAREFULLY READ THIS ENTIRE DOCUMENT AND THE DOCUMENTS WE HAVE REFERRED YOU TO.

ACACIA RESEARCH CORPORATION

Our business consists of the businesses of the CombiMatrix group and the Acacia Technologies group, each of which are described below. Our principal executive offices are located at 500 Newport Center Drive, Newport Beach, California 92660, and our telephone number is (949) 480-8300.

COMBIMATRIX GROUP

The CombiMatrix group is principally comprised of our subsidiary CombiMatrix Corporation, which is engaged in the development of a proprietary universal biochip with applications in the genomics, proteomics and combinatorial chemistry markets. CombiMatrix Corporation's principal executive offices are located at 6500 Harbour Heights Parkway, Mukilteo, Washington 98275, and its telephone number is (425) 493-2000.

For the fiscal year ended December 31, 2001, the CombiMatrix group had net revenues of \$456,000 and a loss from continuing operations of \$46.8 million before amounts attributable to minority interests of \$18.8 million. The CombiMatrix group's loss from continuing operations after amounts attributable to minority interests was \$28.0 million for the fiscal year ended December 31, 2001. The CombiMatrix group's total assets at December 31, 2001 were \$48.0 million.

For the six months ended June 30, 2002, the CombiMatrix group had net revenues of \$687,000 and a loss from continuing operations of \$15.9 million before amounts attributable to minority interests of \$6.4 million. The CombiMatrix group's loss from continuing operations after amounts attributable to minority interests was \$9.5 million for the six months ended June 30, 2002. The CombiMatrix group's total assets at June 30, 2002 were \$37.7 million.

ACACIA TECHNOLOGIES GROUP

The Acacia Technologies group is principally comprised of our media technologies business and is engaged in the development, licensing and protection of its intellectual property and proprietary technologies in the media technologies industry.

For the fiscal year ended December 31, 2001, the Acacia Technologies group had net revenues of \$24.2 million and net income from continuing operations of \$7.0 million before amounts attributable to minority interests of \$1.3 million. Net income from the Acacia Technologies group's continuing operations after amounts attributable to minority interests was \$5.8 million. The Acacia Technologies group's total assets at December 31, 2001 were \$62.9 million.

For the six months ended June 30, 2002, the Acacia Technologies group recorded a net loss from continuing operations of \$6.6 million. Amounts attributable to minority interests were not material for the six months ended June 30, 2002. The Acacia Technologies group's total assets at June 30, 2002 were \$55.3 million.

-5-

THE RECAPITALIZATION PROPOSAL

REASONS FOR THE RECAPITALIZATION PROPOSAL

We believe that the recapitalization proposal will have the following benefits:

- o increase in market awareness of our two distinct businesses;
- attraction of industry-specific investors and improved analyst coverage by industry specific institutional analysts;
- creation of two new acquisition currencies to help us pursue strategic opportunities;
- realization of the potential values of our two distinct businesses; and
- increased liquidity and financing flexibility with respect to our existing businesses.

RISK FACTORS RELATED TO RECAPITALIZATION PROPOSAL

When evaluating the recapitalization proposal, you should be aware that there are many risks, including:

- o the risks associated with an investment in a single company and all of our businesses, assets and liabilities;
- limited separate stockholder rights granted to holders of each class of common stock;
- risks associated with the relative voting power of the two classes of common stock which will fluctuate based on their relative average market values;
- o the lack of legal precedent with respect to the fiduciary duties of the board of directors of a company having two classes of common stock, the rights of which are defined by reference to separate businesses of the company;
- o the potential for stockholders of each class of common stock to have diverging or conflicting interests;
- o the possibility that either class of stock, or both, will not meet the requirements for listing on the Nasdaq National Market, which could adversely affect the liquidity and share price of the stock;
- o the ability of our board of directors to change management and allocation policies without stockholder approval;
- o the ability to transfer funds between the groups;
- o the ability of our board of directors to allocate financing costs between groups that do not reflect the separate borrowing costs of the groups;
- o the possibility that one group could be charged a greater portion of

the total corporate tax liability;

- limits on consideration to be received upon disposition of assets of a group;
- the effects of our capital structure and variable vote per share on potential acquisitions of a group or class of common stock;
- o the effect of market values of a class of common stock on stockholder rights;

-6-

- no assurances as to the market price or liquidity of the AR-CombiMatrix stock or the AR-Acacia Technologies stock following the recapitalization; and
- o the lack of legal precedent with respect to the tax treatment of the recapitalization and the new classes of common stock.

COMPARISON OF EXISTING COMMON STOCK WITH AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK

If the recapitalization proposal is approved and the merger is consummated, our common stock will consist of two classes: AR-CombiMatrix stock and AR-Acacia Technologies stock. The terms of the two new classes of common stock are set forth in the proposed restated certificate of incorporation, which is attached as ANNEX B to this document. We encourage you to read the proposed restated certificate carefully in its entirety.

The following table provides a comparison of our existing common stock and the AR-CombiMatrix stock and the AR-Acacia Technologies stock. You should keep in mind that the AR-CombiMatrix stock and the AR-Acacia Technologies stock are both classes of common stock of Acacia Research, and are not stock issued by each respective group. Holders of a class of stock will not have a separate, direct legal interest in the assets attributed to the respective group. As a result, you will continue to be subject to all of the risks associated with an investment in Acacia Research and all of our businesses, assets and liabilities. Financial effects from one group that affect our consolidated results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group.

-7-

DT

| | EXISTING | THE RECAPITALIZA | | | | | |
|-----------|---|---|----------------------------|--|--|--|--|
| | COMMON STOCK | AR-COMBIMATRIX STOCK | AR | | | | |
| IVIDENDS: | We have not paid any cash dividends on our existing commonstock and we currently do not intend to pay cash dividends on | We currently do not intend to pay cash dividends on the AR-CombiMatrix stock. | We cur cash d Techno | | | | |

our existing common stock.

| | Any future dividends on our existing common stock will be paid at the discretion of our board of directors based primarily upon the financial condition, results of operations and business requirements of Acacia Research. Dividends cannot exceed the assets from which we can legally pay dividends under Delaware law. | Any future dividends on the AR-CombiMatrix stock will be paid at the discretion of our board of directors based primarily upon the financial condition, results of operations and business requirements of the CombiMatrix group and Acacia Research as a whole. Dividends can not exceed the lesser of (1) our funds from which we can legally pay dividends under Delaware law and (2) an amount similar to the funds from which the CombiMatrix group could legally pay dividends under Delaware law as a separate corporation. | Any fu AR-Aca be pai board upon t result requir Techno Resear not ex funds divide (2) an from w group under separa |
|----------------|---|---|--|
| VOTING RIGHTS: | One vote per share. | The AR-CombiMatrix stock will have one vote per share. | Each s Techno variab the av share stock AR-Com over a on the each r stockh Accord Techno than, per sh |

-8-

| EXISTING | THE RECAPITALIZATION | | | |
|-----------------|---|---|--|--|
| COMMON STOCK | AR-COMBIMATRIX STOCK | AR | | |
| | The holders of AR-CombiMatrix stock and AR-Acacia will generally vote together as a single stock will generally vote together as a single class. In limited circumstances, such as a proposed change limited circumstances, such as a proposed change in the rights in the rights of a class of stock, holders of one or both of a class of stock, holders of one or both classes of common classes of common stock may be entitled under | The ho Techno AR-Com will g single circum change as a p in the holder of sto classe stock | | |

| | | Delaware law or stock may be entitled under Delaware law or under stock under stock exchange regulations to vote as a separate class. | Delawa entitl under regula class. |
|---|-------|---|---|
| RIGHTS ON SALE OF ALL OR SUBSTANTIALLY ALL ASSETS OF A GROUP: | None. | If we sell all or substantially all of the properties and assets attributed to the CombiMatrix group, we must either (1) distribute through a dividend or redemption to holders of AR-CombiMatrix stock an amount equal to the net proceeds of the sale, or (2) convert each share of AR-CombiMatrix stock into a number of shares of AR-Acacia Technologies stock at a 10% premium over the then current value. We may, but will not be required to, distribute the net proceeds or convert the AR-CombiMatrix stock if we receive in the sale primarily equity securities of the acquirer or its parent and it is primarily engaged in one or more businesses similar or complementary to the business of the CombiMatrix group. | If we of the attrib Techno (1) di or red AR-Aca amount the sa of AR- into a AR-Com premiu value. requir procee Techno the sa securi parent in one or com |
| CONVERSION AT OPTION OF ACACIA RESEARCH: | None. | We may, at any time, convert each share of AR-CombiMatrix stock into a number of shares of AR-Acacia Technologies stock at a 10% premium over the average market values of such shares. | We may share stock AR-Com premiu values |
| REDEMPTION IN EXCHANGEFOR STOCK OF SUBSIDIARY: | None. | We may redeem the AR-CombiMatrix stock for all of the shares of the common stock of one or more of our wholly owned subsidiaries that hold all of the assets and liabilities attributed to the CombiMatrix group. | We may Techno shares or mor subsid assets to the |

-9-

| | EXISTING COMMON | THE RECAPITALIZA | | | | |
|--------------|--|--|-------------------------------------|--|--|--|
| | STOCK | AR-COMBIMATRIX STOCK | AR | | | |
| LIQUIDATION: | If we are liquidated, holders of our existing common stock will be entitled to receive our net assets remaining for | If we are liquidated, holders of AR-CombiMatrix stock will be entitled to a portion of any assets remaining for distribution to | If we AR-Aca be ent assets | | | |

distribution to holders of common stock.

holders of common stock on a per share basis in proportion to the liquidation units per share of AR-CombiMatrix stock.Each share of AR-CombiMatrix stock will have one liquidation unit. to hol share liquid AR-Aca share stock liquid ratio of one Techno AR-Com will b two mc recapi

-10-

HOW EACH NEW CLASS OF STOCK WILL REFLECT THE PERFORMANCE OF THE RESPECTIVE GROUP

Each new class of stock is designed to reflect the financial performance of the respective group, rather than the performance of Acacia Research as a whole. The chief mechanisms intended to cause the AR-CombiMatrix stock and the AR-Acacia Technologies stock to reflect the financial performance of the respective group are provisions in our proposed restated certificate of incorporation governing dividends and distributions to each class of stock. Under these provisions, we will:

- factor the assets and liabilities and income or losses attributable to the respective group into the determination of the amount available to pay dividends, if any, on the shares issued for the respective group; and
- o require Acacia Research to exchange, redeem or distribute a dividend on the stock of a group if all or substantially all of the assets allocated to the respective group are sold to a third party.

Hence, the market value of each new class of stock will reflect investors' expectations to participate in the earnings, growth and profits of their respective group through potential payment of dividends and distributions upon a sale of the group's assets. We cannot assure you, however, that the market values of AR-CombiMatrix stock and AR-Acacia Technologies stock will in fact reflect the performance of the CombiMatrix group and the Acacia Technologies group as we intend because holders of these stocks will not hold a direct or exclusive interest in the separate groups. In addition, we cannot assure you that we will ever pay dividends on the AR-CombiMatrix stock or the AR-Acacia Technologies stock. To date, we have not paid cash dividends on our existing common stock and do not anticipate paying cash dividends on the AR-CombiMatrix stock or the AR-Acacia Technologies stock for the foreseeable future. Future dividends, if any, on the AR-CombiMatrix stock and the AR-Acacia Technologies stock will be payable when, as and if declared by our board of directors.

LISTING OF SHARES

Our existing common stock is listed on the NASDAQ National Market under the symbol "ACRI". We have applied for the AR-CombiMatrix stock and AR-Acacia Technologies stock to be listed on the NASDAQ National Market under the symbols "CBMX" and "ACTG", respectively. There is a risk that even if the shares are

listed on the NASDAQ National Market, the shares may not continue to qualify for listing on the NASDAQ National Market if the trading prices do not meet minimum requirements. See below "Risk Factors - The AR-CombiMatrix stock might not qualify for listing on the NASDAQ National Market, which could adversely affect its liquidity and price". As soon as the recapitalization is effective, our existing common stock will be de-listed.

MANAGEMENT AND ALLOCATION POLICIES

We have established policies designed to accomplish the fundamental objective of the recapitalization proposal, which is to separate the business and operations of the Acacia Technologies group from those of the CombiMatrix group. These policies establish guidelines to help us allocate debt, corporate overhead, interest, taxes and other shared activities between the two groups on an objective basis and, generally, to ensure that transactions between the CombiMatrix group and the Acacia Technologies group are made on terms that approximate terms that could be obtained from unaffiliated third parties.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE RECAPITALIZATION

We believe, and we have received an opinion from PricewaterhouseCoopers LLP to the effect that, no gain or loss will be recognized by Acacia Research or you for U.S. federal income tax purposes as a result of the recapitalization except with respect to cash received by you instead of a fractional share of AR-CombiMatrix stock. However, there are no court decisions or other authorities bearing directly on transactions similar to the recapitalization proposal. In addition, the Internal Revenue Service has announced that it will not issue rulings on the characterization of stock with characteristics similar to the AR-CombiMatrix stock and the AR-Acacia Technologies stock. Therefore, the tax treatment of the recapitalization is subject to some uncertainty.

-11-

Tax matters are very complicated and the tax consequences of the recapitalization to you will depend on the facts of your own situation. We urge you to consult your tax advisors for a full description of the tax consequences of the recapitalization to you.

NO DISSENTERS' RIGHTS REGARDING RECAPITALIZATION PROPOSAL

Stockholders of Acacia Research will not have any dissenters' or appraisal rights with respect to the proposed recapitalization.

NO REGULATORY APPROVALS

No state or federal regulatory approvals are required for the recapitalization.

-12-

THE MERGER PROPOSAL

REASONS FOR THE MERGER

We believe that the merger will:

- o facilitate the implementation of the recapitalization proposal;
- o provide liquidity to the stockholders of CombiMatrix Corporation;
- enable us to benefit from a management and operational structure that can leverage our strength while retaining operating flexibility;
- allow the groups to leverage synergies of an integrated management team, streamlined operations and strengthened infrastructure; and
- permit certain major decisions regarding the CombiMatrix group to be made more quickly.

However, you should note that achieving these objectives is subject to particular risks which we discuss below in the section entitled "Risk Factors."

RISK FACTORS RELATED TO THE MERGER PROPOSAL

When evaluating the merger proposal, you should be aware that there are many risks, including:

- an exchange ratio that does not take into account any changes in the market price of our stock or the CombiMatrix Corporation common stock;
- o the risk that the merger will close despite material adverse changes to us or to the CombiMatrix Corporation;
- o potential adverse effects on our combined financial results;
- possible dilution as a result of change of control provisions in our option plans;
- risks associated with fluctuations in operating results, unpredictable revenues and stock price volatility;
- o the development stage nature of the CombiMatrix group and its unproven technology;
- o no assurances regarding the ability of either group or the combined company to obtain additional capital, if needed; and
- o the expiration of the Acacia Technologies group's patent on the V-chip technology.

WHAT OUR STOCKHOLDERS WILL HOLD AFTER THE MERGER

Holders of Acacia Research common stock will not receive any shares in connection with the merger. However, as a result of the recapitalization, each share of our common stock will be split into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. Based on the issued outstanding shares of CombiMatrix Corporation common stock as of November 1, 2002, the percentage interest in AR-CombiMatrix stock to be received by our stockholders will be approximately 47.7%.

We will not issue any fractional shares of AR-CombiMatrix stock or AR-Acacia Technologies stock in the recapitalization. Instead, you will receive cash for any fractional share of AR-CombiMatrix stock owed to you in an amount based upon the trading price of AR-CombiMatrix stock following the recapitalization. -13-

WHAT COMBIMATRIX CORPORATION STOCKHOLDERS WILL HOLD AFTER THE MERGER

In the merger, CombiMatrix Corporation stockholders, other than Acacia Research, will receive one share of the new AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock that they own immediately prior to the effective time of the merger. Their percentage ownership interest in the issued and outstanding shares of AR-CombiMatrix stock immediately after the effective time of the merger will be the same as their percentage ownership interest in the issued and outstanding shares of CombiMatrix Corporation common stock immediately prior to the effective time of the merger. Based on the issued and outstanding shares on November 1, 2002, this percentage interest would be approximately 52.3%.

Based upon the number of shares of CombiMatrix Corporation common stock outstanding on November 1, 2002, we will issue approximately 12,005,274 shares of AR-CombiMatrix stock to CombiMatrix Corporation stockholders in the merger. This number is subject to adjustment for any stock issuances by CombiMatrix Corporation between November 1, 2002 and the effective time of the merger.

CombiMatrix Corporation stockholders should not send in their stock certificates for exchange until instructed to do so after completion of the merger.

COMPARISON OF EXISTING COMBIMATRIX CORPORATION COMMON STOCK WITH AR-COMBIMATRIX STOCK

If the recapitalization proposal is approved and the merger is consummated, CombiMatrix Corporation's common stock will be converted into AR-CombiMatrix stock. The terms of the AR-CombiMatrix stock are set forth in the proposed restated certificate of incorporation, which is attached as Annex B to this document. We encourage you to read the proposed restated certificate carefully in its entirety.

The following table provides a comparison of CombiMatrix Corporation's existing common stock and the AR-CombiMatrix stock. You should keep in mind that the AR-CombiMatrix stock is a class of common stock of Acacia Research, and is not stock issued by the CombiMatrix group. Holders of AR-CombiMatrix stock will not have a separate, direct legal interest in the assets attributed to the CombiMatrix group. As a result, holders of CombiMatrix Corporation's common stock will become subject to all of the risks associated with an investment in Acacia Research and all of its businesses, assets and liabilities. Financial effects from one group that affect Acacia Research's consolidated results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group.

-14-

THE MERGER PROPOSAL

EXISTING COMBIMATRIX CORPORATION COMMON STOCK

K AR-COMBIMATRIX SI

DIVIDENDS: CombiMatrix Corporation has not paid any We currently do not intend cash dividends on its existing common stock and CombiMatrix Corporation currently does not intend to pay cash dividends on its existing common stock.

> Any future dividends on CombiMatrix Corporation's existing common stock will AR-CombiMatrix stock will b be paid at the discretion of CombiMatrix discretion of our board of Corporation's board of directors based based primarily upon the fi primarily upon the financial condition, condition, results of operation results of operations and business requirements of CombiMatrix Corporation. group and Acacia Research a Dividends cannot exceed the assets from Dividends can not exceed th which we can legally pay dividends under (1) our funds from which we Delaware law.

One vote per share.

We have applied to list the AR-CombiMatrix stock on the National Market under the s and are registering the iss AR-CombiMatrix stock with t and Exchange Commission pur registration statement of w proxy statement and prospec part.

dividends on the AR-CombiMa

Any future dividends on the business requirements of th pay dividends under Delawar an amount similar to the fu which the CombiMatrix group legally pay dividends under as a separate corporation.

The AR-CombiMatrix stock wi vote per share.

The holders of AR-CombiMatr AR-Acacia Technologies stoc generally vote together as class. In limited circumsta a proposed change in the ri class of stock, holders of classes of common stock may under Delaware law or under exchange regulations to vot separate class.

-15-

THE MERGER PROPOSAL _____

| | EXISTING | |
|--------|---|-----------------------------|
| | COMBIMATRIX CORPORATION | |
| | COMMON STOCK | AR-COMBIMATRIX SI |
| | | |
| OF ALL | If CombiMatrix Corporation were to sell | If we sell all or substanti |

RIGHTS ON SALE

VOTING RIGHTS:

LIQUIDITY:

| OR SUBSTANTIALLY ALL ASSETS OF A GROUP: | all or substantially all of its properties and assets, CombiMatrix Corporation would be required to receive the approval of a majority of its stockholders at a duly called meeting. | the properties and assets a the CombiMatrix group, we m (1) distribute through a di redemption to holders of AR stock an amount equal to th proceeds of the sale, or (2 each share of AR-CombiMatri a number of shares of AR-AC Technologies stock at a 10% the then current value. We not be required to, distrib proceeds or convert the AR- stock if we receive in the primarily equity securities acquirer or its parent and primarily engaged in one or businesses similar or compl the business of the CombiMa |
|--|---|---|
| CONVERSION AT OPTION OF ACACIA RESEARCH: | None. | Acacia Research may, at any convert each share of AR-Co stock into a number of shar AR-Acacia Technologies stoc premium over the average ma of such shares. |
| REDEMPTION IN EXCHANGE FOR STOCK OF SUBSIDIARY: | None. | Acacia Research may redeem AR-CombiMatrix stock for al shares of the common stock more of our wholly owned su that hold all of the assets liabilities attributed to t CombiMatrix group. |
| LIQUIDATION: | If CombiMatrix Corporation is liquidated, holders of its existing common stock will be entitled to receive its net assets remaining for distribution to holders of CombiMatrix Corporation common stock. | If Acacia Research is liqui holders of AR-CombiMatrix s entitled to a portion of an remaining for distribution common stock on a per share proportion to the liquidati share of AR-CombiMatrix sto share of AR-CombiMatrix sto one liquidation unit. |

-16-

THE MERGER AGREEMENT

We have attached a copy of the merger agreement as ANNEX A to this document. We encourage you to read the merger agreement carefully in its entirety because it is the legal document governing the merger.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

We believe, and have received an opinion from PricewaterhouseCoopers LLP to the effect that, no gain or loss will be recognized by Acacia Research or you for U.S. federal income tax purposes as a result of the merger except with respect to cash received by you instead of a fractional share of AR-CombiMatrix

stock. However, there are no court decisions or other authorities bearing directly on transactions similar to the merger proposal. In addition, the Internal Revenue Service has announced that it will not issue rulings on the characterization of stock with characteristics similar to the AR-CombiMatrix stock. Therefore, the tax treatment of the merger is subject to some uncertainty.

Tax matters are very complicated and the tax consequences of the merger to you will depend on the facts of your own situation. We urge you to consult your tax advisors for a full description of the tax consequences of the merger to you.

APPRAISAL OR DISSENTERS' RIGHTS IN CONNECTION WITH THE MERGER

Stockholders of Acacia Research will not have any dissenters' or appraisal rights under Delaware law in connection with the merger because they will own publicly traded securities both before and after the merger. CombiMatrix Corporation stockholders who object to the merger, however, will have dissenters' appraisal rights.

ACCOUNTING TREATMENT

We will account for the acquisition of the equity interest in CombiMatrix Corporation in the merger as a purchase of a business. Under this method of accounting, the assets acquired and liabilities assumed of CombiMatrix Corporation will be recorded at their fair value as of the date of their acquisition, and any excess of our purchase price over the fair value will be accounted for as goodwill.

REGULATORY MATTERS

We are not aware of any material governmental or regulatory requirements that must be complied with regarding the merger, other than federal securities laws and the filing of documents describing principal terms of the merger agreement with the Secretary of State of Delaware.

CONDITIONS TO THE MERGER

We will complete the merger only if specific conditions are satisfied or, in some cases, waived.

TERMINATION OF THE AGREEMENT AND PLAN OF REORGANIZATION

Our board of directors and the CombiMatrix Corporation board of directors can jointly agree to terminate the merger agreement at any time before the merger is completed. In addition, either company can terminate the merger agreement if the merger is not completed by December 31, 2002 and under certain other circumstances.

-17-

STOCK INCENTIVE PLANS

The 2002 CombiMatrix Stock Incentive Plan and the 2002 Acacia Technologies Stock Incentive Plan are intended to serve as successor plans to the existing stock option plans of Acacia Research and CombiMatrix Corporation.

At the time of the recapitalization, all outstanding options to purchase Acacia Research common stock will be converted into options to purchase

AR-CombiMatrix stock and AR-Acacia Technologies stock and transferred to the 2002 CombiMatrix Stock Incentive Plan and the 2002 Acacia Technologies Stock Incentive Plan, respectively. Upon the consummation of the merger, all outstanding options to purchase CombiMatrix Corporation common stock will be converted into options to purchase AR-CombiMatrix stock and transferred to the 2002 CombiMatrix Stock Incentive Plan. The replacement options will continue to be governed by the terms of the original options unless our compensation committee decides to extend one or more features of the new plans to these options. Adjustments will be made in the exercise price of the options to maintain the spread between the exercise price and the market price before and after the recapitalization and the merger.

After the recapitalization, no further options will be granted under the currently existing stock option plans of Acacia Research and CombiMatrix Corporation. Instead all new options will be granted under either the 2002 CombiMatrix Stock Incentive Plan or the 2002 Acacia Technologies Stock Incentive Plan. The terms of the proposed new plans are identical, except that AR-CombiMatrix stock can only be issued under the 2002 CombiMatrix Stock Incentive Plan and AR-Acacia Technologies stock can only be issued under the 2002 Acacia Technologies Stock Incentive Plan.

The individuals eligible to participate in the new plans include officers, employees, board members and consultants of Acacia Research and our subsidiaries. The number of shares of AR-CombiMatrix stock that will be authorized under the CombiMatrix Plan will be equal to 9,000,000 minus the sum of (i) the number of shares of CombiMatrix Corporation common stock issued under the CombiMatrix Corporation stock option plans prior to the time of the merger and (ii) a percentage of the number of shares of Acacia Research common stock issued under the Acacia Research stock option plans prior to the time of the merger. The number of shares of AR-Acacia Technologies stock that will be authorized under the Acacia Technologies Plan will be equal to 5,700,000 minus the number of shares of Acacia Research common stock issued under the Acacia Research stock option plans prior to the time of the merger. The share reserve under each plan will increase automatically in January of each year beginning in 2003 by three percent (3%) of the total number of shares of the related common stock outstanding on the last trading day of December in the prior calendar year. Unless otherwise provided in the documents evidencing an option, a change in control of Acacia Research will result in all discretionary options issued under the plans to vest immediately and become immediately exercisable.

RECENT DEVELOPMENTS

On September 30, 2002, CombiMatrix Corporation and Dr. Donald Montgomery, an officer and stockholder of CombiMatrix Corporation, entered into a settlement agreement with Nanogen, Inc. to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, CombiMatrix Corporation agreed to pay Nanogen \$500,000 within 30 days of the settlement and an additional \$500,000 within one year of the settlement. CombiMatrix Corporation also agreed to make quarterly payments to Nanogen equal to 12.5% of total sales of products developed by CombiMatrix Corporation and its affiliates and based on the patents that had been in dispute in the litigation, up to an annual maximum of \$1,500,000. The minimum quarterly payments under the settlement agreement will be \$37,500 per guarter for the period from October 1, 2003 through October 1, 2004, and \$25,000 per guarter thereafter until the patents expire. The patents at issue, U.S. Patent Nos. 6,093,302, 6,280,595 and 6,444,111, expire in 2018 and cover CombiMatrix Corporation's core technology. Also pursuant to the settlement agreement, CombiMatrix Corporation agreed to issue 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, to Nanogen, subject to antidilution provisions under specified circumstances, including the exercise of outstanding options and warrants and issuances of additional capital stock of CombiMatrix Corporation, for a period of up to three years.

-18-

In our subsidiary Soundview Technologies' pending litigation against certain television manufacturers, the Consumer Electronics Manufacturers Association and the Consumer Electronics Association in which Soundview Technologies has alleged that the defendants have infringed on Soundview Technologies' V-chip patent and committed antitrust violations, in September 2002, the court granted a motion for summary judgment filed by the defendants. In granting the motion, the court ruled that the defendants have not infringed on Soundview Technologies' patent. While we are currently exploring strategies in response to this ruling and intend to appeal it, litigation is inherently uncertain and we can give no assurance that we will be successful in any such appeal.

-19-

CONSOLIDATING SELECTED FINANCIAL INFORMATION

ACACIA RESEARCH CORPORATION

The historical consolidating selected financial data set forth below as of December 31, 2001 and 2000 and for the years ended December 31, 2001, 2000 and 1999 have been derived from our audited consolidated financial statements included elsewhere in this proxy statement, and should be read in conjunction with those financial statements (including notes thereto). The selected financial data as of December 31, 1999, 1998 and 1997 and for the years ended December 31, 1998 and 1997 have been derived from audited consolidated financial statements not included in this proxy statement, but which were previously filed with the SEC.

The historical consolidating selected financial data set forth below as of June 30, 2002 and 2001 and for the three and six months ended June 30, 2002 and 2001 have been derived from and should be read in conjunction with our unaudited interim consolidated financial statements included elsewhere herein. In the opinion of management, the unaudited interim consolidated financial statements include all material adjustments, consisting of only normal, recurring adjustments, necessary for a fair presentation of the financial position and results of operations for the periods presented.

We are providing the following consolidating financial information including amounts related to the Acacia Technologies group and the CombiMatrix group to assist you in your analysis of the financial aspects of the recapitalization and merger proposals. The selected financial information of the Acacia Technologies group and the CombiMatrix group is being provided so that you may have additional information regarding the historical financial performance of the two divisions and the performance, potential value and profitability of the respective businesses which may affect the respective share values.

Acacia Research derived the Acacia Technologies group and CombiMatrix group balance sheet data and statement of operations data from the separate audited financial statements of the Acacia Technologies group and CombiMatrix group for the years ended December 31, 2001, 2000 and 1999 included elsewhere herein, and the table should be read in conjunction with those financial statements and related notes. The historical selected financial data for the Acacia

Technologies group and the CombiMatrix group as of June 30, 2002 and 2001 and for the three and six months ended June 30, 2002 and 2001 have been derived from and should be read in conjunction with the unaudited interim financial statements of the Acacia Technologies group and the CombiMatrix group included elsewhere herein. In the opinion of management, the separate unaudited interim financial statements for the Acacia Technologies group and the CombiMatrix group include all material adjustments, consisting of only normal, recurring adjustments, necessary for a fair presentation of the financial position and results of operations for the periods presented.

The AR-Acacia Technologies stock and the AR-CombiMatrix stock is intended to reflect the separate performance of the respective divisions of Acacia Research, rather than the performance of Acacia Research Corporation as a whole. The chief mechanisms intended to cause the AR-Acacia Technologies stock and the AR-CombiMatrix stock to reflect the financial performance of the respective groups are provisions in our proposed restated certificate of incorporation and common stock policies governing dividends and distributions to each class of stock which specifically require the allocation of earnings to each class based upon the performance of the two groups determined in accordance with generally accepted accounting principles. Under these provisions, Acacia Research will factor the assets and liabilities and income or losses attributable to the respective groups, determined as described above, into the determination of the amounts available to pay dividends, if any, on the shares issued for the respective groups; and require Acacia Research to exchange, redeem or distribute a dividend on the stock of a group if all or substantially all of the assets allocated to the respective group are sold to a third party.

We expect that the market value of each new class of stock will reflect the performance of the respective groups primarily because we believe that the performance of a group and the possibility and amount of any dividend to stockholders, or distribution upon a sale of a group, will link the market price of the shares to the performance of the respective group. We cannot assure you, however, that the market values of AR-CombiMatrix stock and AR-Acacia Technologies stock will in fact reflect the performance of the CombiMatrix group and the Acacia Technologies group as we intend because holders of these stocks will not hold a direct or exclusive interest in the separate groups. The Acacia Technologies group and the CombiMatrix group are not separate legal entities.

-20-

Holders of AR-Acacia Technologies stock and AR-CombiMatrix stock will be stockholders of Acacia Research. As a result, they will continue to be subject to all of the risks of an investment in Acacia Research and all of its businesses, assets and liabilities. The assets Acacia Research Corporation attributes to one group could be subject to the liabilities of the other group.

This information is only a summary. You should read it in conjunction with the separate Acacia Research, Acacia Technologies group and CombiMatrix group historical financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained elsewhere herein.

CONSOLIDATING STATEMENT OF OPERATIONS DATA (IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA):

FOR THE YEARS ENDED DECEMBER 31,

| | | 2001 | | 2000 | | 1999 | | 1998 |
|--|--------|-------------------|-----|------------------|----------|----------------|--------|-----------|
| | | | | | | | | |
| REVENUES: Acacia Technologies Group | Ś | 24,180 | \$ | 40 | \$ | 122 | \$ | 38 |
| CombiMatrix Group | Ŷ | 456 | Ť | 17 | Ŷ | 144 | Ŷ | - |
| Eliminations | | | | | | | | - |
| ACACIA RESEARCH CORPORATION | \$ | 24,636 | \$ | 57 | \$ | 266 | \$ | 38 |
| OPERATING INCOME (LOCC) (E) - | === | | === | | | | === | |
| OPERATING INCOME (LOSS)(5): Acacia Technologies Group | Ś | 5,858 | Ś | (12,606) | Ś | (4,955) | \$ | (3,72 |
| CombiMatrix Group | | (49,056) | | (24,557) | | (2,625) | | (2,11 |
| Eliminations | | | | | | | | - |
| ACACIA RESEARCH CORPORATION | \$ | (43,198) | \$ | (37,163) | \$ | (7,580) | \$ | (5,84 |
| | === | | ==: | | === | | === | |
| OTHER INCOME (EXPENSE), NET: | ~ | 0 1 1 1 | ċ | (0.007) | ~ | (010) | ~ | () (|
| Acacia Technologies Group CombiMatrix Group | Ş | 2,111 2,055 | Ş | (2,897) 1,662 | Ş | (818) (224) | \$ | (48 (5 |
| Eliminations | | 2,055 | | 1,002 | | (224) | | (|
| ACACIA RESEARCH CORPORATION | \$ | 4,166 | | (1,235) | | (1,042) | \$ | (54 |
| | | | | | | | | |
| INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE MINORITY INTERESTS: | | | | | | | | |
| Acacia Technologies Group | \$ | 7,034 | \$ | (15,509) | \$ | (5,791) | \$ | (4,21 |
| CombiMatrix Group | | | | (22,816) | | (2,851) | | (2,17 |
| Eliminations | | | | | | | | - |
| ACACIA RESEARCH CORPORATION | | (20.012) | | (20 225) | | (0 642) | | 16 29 |
| ACACIA RESEARCH CORFORATION | | (39,812) | | (38,325) | | (0,042) | | (6,38 |
| MINORITY INTERESTS: | | | | | | | | |
| Acacia Technologies Group | \$ | (1,277) | \$ | 866 | \$ | (27) | \$ | 5 |
| CombiMatrix Group | | 18,817 | | 8,300 | | 1,248 | | 14 |
| Eliminations | | | | | | | | - |
| ACACIA RESEARCH CORPORATION | | 17,540 | | 9,166 | | 1,221 | \$ | 19 |
| | === | | ==: | | === | | === | |
| LOSS FROM CONTINUING OPERATIONS: | ć | 5,757 | ċ | (14 (42) | <i>c</i> | (5 010) | Ċ | (4 1 5 |
| Acacia Technologies Group CombiMatrix Group | | 5,757 (28,029) | | (14,643) | | . , , | \$ | (4,15 |
| Eliminations | | (20,029) | | (14,516) | | (1,603) | | (2,03 |
| | | | | | | | | |
| ACACIA RESEARCH CORPORATION | | (22,272) | | (29,159) | | | | (6,18 |
| LOSS FROM DISCONTINUED OPERATIONS (1): | | | | | | | | |
| Acacia Technologies Group | \$ | | \$ | (9,554) | \$ | (776) | \$ | - |
| CombiMatrix Group | | | | | | | | - |
| Eliminations | | | | | | | | - |
| ACACIA RESEARCH CORPORATION | \$ | | \$ | (9,554) | \$ | (776) | \$ | - |
| LOSS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE: | | | === | | === | ====== | === | |
| Accounting Principle: Acacia Technologies Group | S | 5,757 | Ś | (24,197) | ŝ | (6,594) | s | (4,15 |
| CombiMatrix Group | | (28,029) | | | | (1,603) | | (2,03 |
| Eliminations | | | | | | | | . , |
| ACACIA RESEARCH CORPORATION | Ś | (22 272) | | (38 713) | | (8 197) | | (6,18 |
| | | (22,272) | | ======= | | | | |
| | | | | | | | | |

-21-

| | FOR THE YEARS ENDED DECEMBER 31 | | | | | | | BER 31, |
|---|---------------------------------|------------------------|-----------|----------------------------|------|------------------------|-----------|----------------------|
| | 2001 | | 2000 | | 1999 | | | 1998 |
| CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE DUE TO BENEFICIAL CONVERSION FEATURE: | | | | | | | | |
| Acacia Technologies Group CombiMatrix Group Eliminations | Ş | | \$ | (246) | \$ | | Ş | - |
| ACACIA RESEARCH CORPORATION | \$ === | | \$ === | (246) | | | \$ === | |
| NET LOSS: Acacia Technologies Group CombiMatrix Group Eliminations | | 5,757 (28,029) | | | | (6,594) (1,603) | | (4,15 (2,03 |
| ACACIA RESEARCH CORPORATION | | (22,272) | | . , , | | (8,197) | \$ | (6,18 |
| Loss per common share: Basic and diluted Loss from continuing operations Loss from discontinued operations Cumulative effect of change in accounting principle | | (1.16) | | (1.78) (0.58) (0.02) | \$ | (0.59) (0.06) | === \$ | (0.5 |
| NET LOSS | \$ | (1.16) | • | (2.38) | • | (0.65) | | (0.5 |
| Weighted average number of common and potential shares outstanding used in computation of loss per common share(2): | | | | === | | | | : |
| Basic Diluted | | 9,259,256 9,259,256 | | 6,346,099 6,346,099 | | | |),748,98),748,98 |

| 2- |
|----|
| |

| | FOR THE | THREE | MONTHS | ENDED | JUNE | 30, | FOR | THE | SIX | MONT |
|--|-------------|-------|-----------|-------|------------|-----|-----|-------|------|---------|
| | | 2002 | | 2001 | | | | 2 | 2002 | |
| | (UNAUDITED) | | | | | | | (UNAU | | |
| Revenues Acacia Technologies Group CombiMatrix Group | \$ | | \$ 438 | 10, | ,000 91 | | | \$ | | 687 |

| | | | | | | 687 ====== |
|---------------|--|----------------------------|--|---|--|---|
| | | | | | \$ | (5,325) (16,216) |
| | | | | | | (10,210) |
| \$ | (13,064) | \$ | (9,937) | | \$ | (21,541) |
| | | | | | | |
| | 89 | | 558 | | | (1,547) 278 |
| \$ | (816) | \$ | 1,031 | | \$ | (1,269) |
| | | _ | | | _ | |
| \$ | | | | | Ş | (6,807) (15,859) |
| \$ | (13,805) | \$ | (9,134) | | \$ | (22,666) |
| | | | | | | |
| | 3,979 | | 5,321 | | · | 162 6,377 |
| \$ | 4,104 | \$ | 4,362 | | \$ | 6,539 |
| | | | | | | |
| | | | | | | (6,645) (9,482) |
| \$ === | | | | | \$ === | (16,127) |
| | | | | | | |
| \$ | (0.49) | \$ | (0.25) | | \$ \$ | (0.82) (0.82) |
| == | | ==- | | | ==- | |
| | | | | | | ,622,363 ,622,363 |
| | \$ == \$ == \$ \$ \$ == \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ \$ | \$ (3,062) (10,002) | $\begin{array}{cccccccccccccccccccccccccccccccccccc$ | $\begin{array}{c ccccccccccccccccccccccccccccccccccc$ | $\begin{array}{cccccccccccccccccccccccccccccccccccc$ | $\begin{array}{c ccccccccccccccccccccccccccccccccccc$ |

CONSOLIDATING BALANCE SHEET DATA (IN THOUSANDS):

| | | AT JUNE 30, | | | | |
|---|-----------------------------|-----------------------------|------------------------|------------------------------|--------------------|----------------------------|
| | 2001 | 2000 | 1999 | 1998 | 1997 | 2002 |
| | | | | | | (UNAUDITED) |
| TOTAL ASSETS(5): Acacia Technologies Group CombiMatrix Group Eliminations(4) | \$ 62,926 47,963 (30) | \$37,062 61,561 (107) | \$49,788 2,003 | \$19,267 3,648 (3,146) | \$8,497 357 | \$55,325 37,703 (88) |
| ACACIA RESEARCH CORPORATION | \$110,859 | \$98,516 | \$51 , 791 | | \$8,854 ===== | \$92,940 |
| LONG-TERM INDEBTEDNESS: Acacia Technologies Group CombiMatrix Group Eliminations | \$ | \$ | \$ | \$ 1,222 | \$ | \$ |
| ACACIA RESEARCH CORPORATION | \$ | \$ | \$ \$ | \$ 1,222 | \$ ====== | \$ \$ |
| TOTAL LIABILITIES(3)(5): Acacia Technologies Group CombiMatrix Group Eliminations(4) | \$ 5,723 14,131 (30) | \$ 5,075 15,880 (107) | \$ 1,304 229 100 | \$ 436 4,538 (3,146) | \$ 425 22 | \$ 5,472 15,424 (88) |
| ACACIA RESEARCH CORPORATION | \$ 19,824 | \$20,848 | \$ 1,633 | \$ 1,828 | \$ 447 ====== | \$20,808 |
| MINORITY INTERESTS(3): Acacia Technologies Group CombiMatrix Group Eliminations | \$ 2,194 30,109 | \$ 2,012 15,512 | \$ 3,992 904 | \$ | \$81 146 | \$ 1,899 27,480 |
| ACACIA RESEARCH CORPORATION | \$ 32,303 | \$17,524 | \$ 4,896 | \$ | \$ 227 ====== | \$29,379 |
| STOCKHOLDERS' EQUITY: Acacia Technologies Group CombiMatrix Group Eliminations | \$ 55,009 3,723 | \$29,975 30,169 | \$44,492 770 | \$18,845 (904) | \$7,991 189 | \$47,954 (5,201) |
| ACACIA RESEARCH CORPORATION | \$ 58,732 | \$60,144 | \$45,262 | | \$8,180 | \$42,753 |

⁽¹⁾ On February 13, 2001, the board of directors of Soundbreak.com, Inc., one of our majority-owned subsidiaries, resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the company. Operating results in 1999 have been restated to present Soundbreak.com as discontinued operations. See Note 9 to the 2001 consolidated financial statements.

(2) Potential common shares for the three months ended March 31, 2002 and 2001, and in 2001, 2000, 1999, 1998 and 1997 have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive. In addition, all share and per share information has been adjusted as appropriate for all periods presented to reflect a two-for-one

stock split effected in March 1998 and a ten percent (10%) stock dividend distributed on December 5, 2001 for stockholders of record as of November 21, 2001.

- (3) Effective January 1, 2001, we changed our accounting policy for balance sheet classification of employee stock-based compensation resulting from awards in consolidated subsidiaries. As a result, effective January 1, 2001, amortized non-cash stock compensation charges related to subsidiary stock options are included in minority interests in our consolidated balance sheet. Prior to the change in accounting policy, amortized non-cash stock compensation charges related to subsidiary stock options were reflected as "accrued stock compensation" in consolidated liabilities. There is no impact on previous consolidated statements of operations as a result of this change in accounting policy.
- (4) Represents intercompany receivables/payables between the groups. In 1998, the intercompany receivable/payable was \$3.1 million related to funds advanced by Acacia Research to fund CombiMatrix Corporation's operations. These amounts were repaid by CombiMatrix Corporation in 1999.
- (5) MANAGEMENT ALLOCATION POLICIES. The management and allocation policies applicable to the preparation of the financial statements of the Acacia Technologies group and the CombiMatrix group and as a result, to the measurement by which dividends or performance are determined for each group, may be modified or rescinded, or additional policies may be adopted, at the sole discretion of the Board at any time without approval of the stockholders. The Acacia Technologies group's and the CombiMatrix group's financial statements reflect the application of the management and allocation policies adopted by the Board to various corporate activities, as described below. Management has no plans to change allocation methods or the composition of the groups. The CombiMatrix group financial statements should be read in conjunction with the Acacia Research Corporation consolidated financial statements and related notes.

CORPORATE GENERAL AND ADMINISTRATIVE SERVICES AND FACILITIES. Acacia Research allocates the cost of corporate general and administrative services and facilities between the Acacia Technologies group and the CombiMatrix group, generally based upon utilization. Where determinations based on utilization alone are impracticable, Acacia Research uses other methods and criteria that management believes to be equitable and to provide a reasonable estimate of the cost attributable to each group. Direct salaries, payroll taxes and fringe benefits are allocated to the groups based on the percentage of actual time incurred by specific employees to total annual time available and direct costs including postage, insurance, legal fees, accounting and tax are allocated to the groups based on specific identification of costs

-24-

incurred on behalf of each group. Other direct costs, including direct depreciation expense, computer costs, general office supplies and rent are allocated to the groups based on the ratio of direct salaries to total salaries. Indirect costs, including indirect salaries and benefits, investor relations, rent, general office supplies and indirect depreciation are allocated to the groups based on the ratio of direct salaries allocated to each group to total direct salaries. For the CombiMatrix group the totals for these allocations were \$0.3 million and \$0.4 million and \$0.6 million for the three and six months ended June 30, 2002 and 2001, respectively, and \$1.4 million, \$0.9 million and \$0.4 million for 2001,

2000, and 1999, respectively. For the Acacia Technologies group the totals for these allocations were \$1.3 million and \$0.8 million and \$2.4 million and \$2.6 million for the three and six months ended June 30, 2002 and 2001, respectively; and \$4.6 million, \$7.7 million and \$3.1 million for 2001, 2000, and 1999, respectively.

ASSETS AND LIABILITIES. In general, Acacia Research Corporation's assets and liabilities have been attributed to the Acacia Technologies group and the CombiMatrix group based on the respective assets and liabilities of the businesses comprising each group. Net intangible assets recorded at the Acacia Research Corporation level, primarily consisting of acquired patents and goodwill balances, have been attributed to the respective businesses comprising each group to which the intangibles and goodwill relate.

ALLOCATION OF FEDERAL AND STATE INCOME TAXES. Acacia Research Corporation determines its federal income taxes and the federal income taxes of its subsidiaries that own assets allocated between the groups on a consolidated basis. Acacia Research Corporation allocates consolidated federal income tax provisions and related tax payments or refunds between the Acacia Technologies' group and CombiMatrix group based principally on the taxable income and tax credits directly attributable to each group. Such allocations reflect each group's contribution, whether positive or negative, to Acacia Research Corporation's consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research Corporation will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits.

TREASURY AND CASH MANAGEMENT POLICIES. Information regarding Treasury and Cash Management policies for the Acacia Technologies group and the CombiMatrix group are included in the notes to the separate financial statements for the Acacia Technologies group and the CombiMatrix group included elsewhere herein.

-25-

OTHER FACTORS AFFECTING COMPARABILITY:

- In 1997, we acquired a controlling interest in Soundview Technologies. The 1996 amounts have been restated for the effects of our increased interest in Soundview. Prior to this restatement, we reported loss of \$161,000 in equity in earnings of affiliates and net income of \$293,000.
- o The Acacia Technologies group revenues presented from 1999 to 1997 primarily relate to capital management fee income, including performance fee income, recorded by the Acacia Capital Management division. During the fourth quarter of 1999, Acacia Research closed its Acacia Capital Management division. Acacia Capital Management was a general partner in two private investment partnerships and was an investment advisor to two offshore private investment corporations.
- o In the fourth quarter of 2000, we recorded \$1.0 million in write-offs of other early-stage investments and \$2.6 million in write-offs of equity investments.
- During the year ended December 31, 2000, CombiMatrix Corporation, recorded deferred non-cash stock compensation charges aggregating approximately \$53.8 million in connection with the granting of stock

options. Deferred non-cash stock compensation charges are being amortized by the CombiMatrix group over the respective option grant vesting periods, which range from one to four years. Non-cash stock compensation charges totaled \$20.0 million and \$10.0 million in 2001 and 2000, respectively. Non-cash stock compensation charges were not significant in prior periods.

o In connection with Acacia Research's increased focus on the media technologies and life sciences sectors, certain of Acacia Research's businesses allocated to the Acacia Technologies group ceased operations and certain investments were written off in 2000. As a result, marketing, general and administrative costs related to salaries, benefits, consulting, legal and other professional costs were significantly reduced in 2001.

-26-

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL INFORMATION

The following unaudited pro forma consolidated financial information reflects the pro forma effect on Acacia Research's unaudited consolidated balance sheet as of June 30, 2002 and consolidated statements of operations for the year ended December 31, 2001 (audited) and for the six months ended June 30, 2002 (unaudited) from the recapitalization of Acacia Research and the merger and related acquisition by Acacia Research of the remaining 52.3% of the CombiMatrix Corporation common stock that Acacia Research does not already own. As such, the Acacia Research pro forma consolidated statements are based upon the consolidated financial statements of Acacia Research adjusted to give effect to the recapitalization and merger transactions.

The unaudited pro forma balance sheet gives effect to the proposed recapitalization and merger as if they had taken place on June 30, 2002 and reflects authorization and issuances of the two new share classes and the purchase adjustment to the carrying value of the acquired assets and liabilities of CombiMatrix Corporation based on a preliminary valuation. The unaudited pro forma statement of operations for the year ended December 31, 2001 and for the six months ended June 30, 2002 reflects the merger and recapitalization as if they had taken place on January 1, 2001.

Upon consummation of the recapitalization, each share of existing Acacia Research common stock will be converted into approximately 0.5582 of a share of AR-CombiMatrix stock (subject to adjustment as described in this proxy statement) and one share of AR-Acacia Technologies stock.

If the merger is approved, Acacia Research will account for the merger using the purchase method of accounting. Under this method of accounting, the acquired assets and liabilities assumed of CombiMatrix Corporation, including intangible assets, will be adjusted to their fair market values. Consistent with generally accepted accounting principles in the United States of America, amounts assigned to purchased in-process research and development -- i.e., CombiMatrix Corporation research and development projects that are still in process at the closing of the merger, but which, if unsuccessful, have no alternative future use -- must be charged as expenses on the date that the merger is consummated.

The unaudited pro forma consolidated statements are based upon information set forth in this document and assumptions included in the accompanying notes. After consummation of the merger, Acacia Research anticipates completion of the valuations and other studies of significant assets, liabilities and business

operations of CombiMatrix Corporation. Using this information, Acacia Research will make a final purchase price allocation between tangible assets and liabilities, identifiable intangible assets, in-process research and development and goodwill. The impact of these changes, principally affecting intangible assets, related amortization, goodwill and in-process research and development, could be material. Accordingly, the purchase price allocation adjustments made in connection with the development of Acacia Research's unaudited pro forma statements are preliminary and have been made solely for the purpose of developing the Acacia Research pro forma statements.

Upon consummation of the merger, CombiMatrix Corporation stockholders, other than Acacia Research, will receive one share of the AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock that they own. The shares of AR-CombiMatrix stock that will be issued to CombiMatrix Corporation stockholders, other than Acacia Research, in the merger are expected to represent approximately 52.3% of the outstanding shares of CombiMatrix Corporation common stock, excluding stock options.

Based upon the number of shares of CombiMatrix Corporation common stock outstanding on November 1, 2002, approximately 12.0 million shares of AR-CombiMatrix stock, including 4,016,364 shares of CombiMatrix Corporation common stock issued to Nanogen, Inc. on October 1, 2002, will be issued to CombiMatrix Corporation stockholders in the merger. See Note K to the unaudited pro forma financial statements.

The unaudited pro forma consolidated balance sheet and statements of operations are for informational purposes only. They do not purport to indicate the results that would have actually been obtained had the recapitalization and merger been completed on the assumed date or for the periods presented, or which may be obtained in the future. To produce the pro forma consolidated financial information, Acacia Research allocated the purchase price using its best estimates. The unaudited pro forma consolidated balance sheet and consolidated

-27-

statement of operations should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements, including the notes, of Acacia Research appearing in "Acacia Research Corporation - Accountant's Report and Financial Statement" on page F-2.

-28-

ACACIA RESEARCH CORPORATION UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET AS OF JUNE 30, 2002 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

| | | Acaci |
|-----------------|-------------|-------|
| Acacia Research | Pro Forma | Cor |
| Corporation | Adjustments | Pr |
| | | |

35

| Current assets: | | | |
|--|----------------------|-----------------|---------|
| Cash and cash equivalents | \$ 49,712 | | \$ |
| Short-term investments | 16,699 | | |
| Prepaid expenses, other receivables and other assets | 2,682 | | |
| Total current assets | 69,093 | | |
| Property and equipment, net of accumulated depreciation | 4,575 | | |
| Investment in affiliate, at cost | 3,000 | | |
| Patents, net of accumulated amortization | 10,857 | 7,800 (A) | |
| Goodwill, net of accumulated amortization | 4,627 | 37,900 (A) | |
| Other accets | 788 | (2,527)(G) | |
| Other assets | /88 | | |
| | \$ 92,940 | | \$ |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | == |
| Connect lishilities. | | | |
| Current liabilities: Accounts payable, accrued expenses and other | \$ 5 , 699 | 800 (A) | \$ |
| Current portion of deferred revenues | 8,842 | (2,527) (G) | Ŷ |
| Current portion of capital lease obligation | 976 | (2,) 32 /) (3) | |
| | | | |
| Total current liabilities | 15,517 | | |
| Deferred income taxes | 3,679 | 3,100 (A) | |
| Deferred revenues, net of current portion | 266 | | |
| Capital lease obligation, net of current portion | 1,346 | | |
| Total liabilities | 20,808 | | |
| iotal liabilities | | | |
| | | (7,800)(A) | |
| Minority interests | 29,379 | (18,900)(B) | |
| Stockholders' equity: | | | |
| Acacia Technologies common stock (Note H) | 20 | | |
| CombiMatrix common stock (Note H) | | 12 (A) | |
| | | | |
| Additional paid-in capital | 158,672 | 59,888 (A) | |
| | | 26,502 (B) | |
| | | 1,220 (C) | |
| Deferred stock compensation | | (7,602)(B) | |
| Warrante to purchase common steel | 199 | (1,220)(C) | |
| Warrants to purchase common stock Comprehensive loss | 199 | | |
| Accumulated deficit | (116,139) | (10,300)(A) | (|
| | | (,, (, | |
| Total stockholders' equity | 42,753 | | |
| | \$ 92,940 | | \$ |
| | \$ 92,940 ======= | | ې == |
| | | | |

See Notes to Unaudited Pro Forma Consolidated Financial Statements

-29-

ACACIA RESEARCH CORPORATION UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

FOR THE YEAR ENDED DECEMBER 31, 2001 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

| | | Acacia Research Corporation | |
|---|-----------|-----------------------------------|-----|
| Revenues: | | | |
| License fee income | \$ | 24,180 | |
| Grant revenue | | 456 | |
| Total revenues | | 24,636 | |
| Operating expenses: | | | |
| Research and development expenses | | 18,839 | |
| Marketing, general and administrative expenses | | 46,300 | |
| Amortization of patents and goodwill | | 2,695 | 1 |
| Loss on disposal of consolidated subsidiaries | | | |
| Total operating expenses | | 67,834 | |
| Operating loss | | (43,198) | |
| Other income (expense): | | | |
| Interest income | | 3,762 | |
| Realized gains on short-term investments | | 350 | |
| Unrealized gains on short-term investments | | 237 | |
| Interest expense | | (65) | |
| Equity in losses of affiliates | | (195) | |
| Other income | | 77 | |
| Total other income (expense) | | 4,166 | |
| Loss from operations before income taxes and minority interests | | (39,032) | |
| Provisions for income taxes | | (780) | |
| Loss from operations before minority interests | | (39,812) | |
| Minority interests | | 17,540 | (18 |
| | | | |
| Net loss | \$ === | (22,272) | |
| Loss per common share: | | | |
| Basic loss per share | \$ === | (1.16) | |
| Diluted loss per share | \$ === | (1.16) | |
| Weighted average number of common and potential common shares outstanding in computation of loss per share: | | | |
| Basic | 19 | ,592,459 | |
| Diluted | | ,592,459 | |
| Pro forma Earnings (loss) per common and potential common share: | | | |
| Net income (loss) attributed to AR-Acacia Technologies stock | | | |
| Per Basic share | | | |
| Per Diluted share | | | |

Net income (loss) attributed to AR-CombiMatrix stock

Per Basic share

Per Diluted share

Weighted average shares - AR-Acacia Technologies stock Basic Diluted

Weighted average shares - AR-CombiMatrix stock Basic Diluted

See Notes to Unaudited Pro Forma Consolidated Financial Statements

-30-

ACACIA RESEARCH CORPORATION UNAUDITED PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2002 (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

| | Acacia Research Pr Corporation Ady |
|--|--|
| Revenues: | |
| Grant revenue | \$ 413 |
| Product revenue | 274 |
| Total revenues | 687 |
| Operating expenses: | |
| Cost of sales | 253 |
| Research and development expenses | 8,807 |
| Marketing, general and administrative expenses | 12,040 |
| Amortization of patents and goodwill | 1,128 |
| Total operating expenses | 22,228 |
| Operating loss | (21,541) |
| Other income (expense): | |
| Interest income | 700 |
| Realized gains on short-term investments | (1,483) |
| Unrealized gains on short-term investments | (477) |
| Interest expense | (121) |
| Equity in losses of affiliates | |
| Other income | 112 |
| | |

Total other income (expense) (1,269) _____ (22,810) Loss from operations before income taxes and minority interests 144 Provisions for income taxes _____ Loss from operations before minority interests (22,666) Minority interests 6,539 _____ Net loss \$ (16,127) _____ Loss per common share: Basic loss per share \$ (0.82) _____ \$ (0.82) Diluted loss per share _____ Weighted average number of common and potential common shares outstanding in computation of loss per share: Basic 19,622,363 Diluted 19,622,363 Pro forma Earnings (loss) per common and potential common share: Net income (loss) attributed to AR-Acacia Technologies stock Per Basic share Per Diluted share Net income (loss) attributed to AR-CombiMatrix stock Per Basic share Per Diluted share Weighted average shares - AR-Acacia Technologies stock Basic Diluted Weighted average shares - AR-CombiMatrix stock Basic Diluted

Edgar Filing: ACACIA RESEARCH CORP - Form S-4/A

See Notes to Unaudited Pro Forma Consolidated Financial Statements

-31-

NOTES TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS (TABULAR DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

The Acacia Research unaudited pro forma consolidated statements are based upon the consolidated financial statements of Acacia Research adjusted to give effect to the proposed recapitalization of Acacia Research and the creation of two new classes of common stock and the merger and related acquisition by Acacia Research of the remaining 52% of the CombiMatrix Corporation common stock that Acacia Research does not already own. (6,

The unaudited pro forma consolidated balance sheet gives effect to the proposed recapitalization and merger as if it had taken place on June 30, 2002 and reflects the new capital structure and total purchase adjusted to the carrying value of assets and liabilities based on a preliminary valuation. The unaudited pro forma consolidated statements of operations for the year ended December 31, 2001 and the six months ended June 30, 2002 reflect these transactions as if they had taken place on January 1, 2001.

On March 20, 2002, Acacia Research Corporation's Board of Directors (the "Board") approved a plan that would create two new classes of common stock called "Acacia Research Corporation - CombiMatrix common stock" ("AR-CombiMatrix stock") and "Acacia Research Corporation - Acacia Technologies common stock" ("AR-Acacia Technologies stock"). AR-CombiMatrix stock is intended to reflect separately the performance of the CombiMatrix group and to benefit from its research and the development efforts. AR-Acacia Technologies stock is intended to reflect separately the performance of Acacia Research's media technology business and to benefit from the licensing of its technology and sales of its products. Each share of existing Acacia Research Corporation common stock will be converted into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. The fraction of a share of AR-CombiMatrix stock into which each outstanding share of Acacia Research common stock will be converted will be equal to the quotient obtained by dividing (a) the number of shares of CombiMatrix Corporation common stock owned by Acacia Research immediately prior to the effective time of the merger by (b) the total number of shares of Acacia Research common stock issued and outstanding immediately prior to the effective time. As of November 1, 2002, this fraction was 0.5582. Acacia Research has applied to list the AR-CombiMatrix stock and the AR-Acacia Technologies stock on the NASDAQ National Market under the symbols "CBMX" and "ACTG", respectively. The recapitalization does not have an impact on the pro forma consolidated statement of operations.

On March 20, 2002, Acacia Research and CombiMatrix Corporation entered into a merger agreement pursuant to which CombiMatrix Corporation stockholders, other than Acacia Research, will receive one share of AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock that they own. The merger will be accounted for using the purchase method of accounting. There is currently no quoted market price for CombiMatrix Corporation in order to value the equity interest to be acquired of that entity. There is also no quoted market price of the AR-CombiMatrix stock. The merger transaction will be valued at the date of acquisition when the registration is completed, using the AR-CombiMatrix stock (based on the quoted market price once that stock begins trading) multiplied by the actual number of AR-CombiMatrix shares to be issued by Acacia Research to the stockholders of CombiMatrix Corporation other than Acacia Research. Management believes, for the purposes of the unaudited pro forma information, the most indicative current value of AR- CombiMatrix stock is based upon management's estimate of the relative value of CombiMatrix Corporation as reflected in Acacia Research's stock price. Management believes that a reasonable estimate of the current relative fair value of CombiMatrix Corporation reflected in Acacia Research's current market value is approximately 60%. This estimate reflects management's assessment of the relative stages of Acacia Research's businesses and gives consideration to the current agreement between CombiMatrix Corporation and Roche Diagnostics GmbH and the current stage at which the Acacia Technologies licensing activities have progressed. Accordingly, management has used 60% of Acacia Research's recent average stock price of \$4.54, divided by the conversion rate of 0.5582 as the ascribed value of a share of AR-CombiMatrix for purposes of preparing the pro forma financial information ((0.60 x \$4.54) /0.5582 = \$5.00). The recent average stock price for Acacia Research of \$4.54 used in the unaudited pro forma information was based on a five-day average (September 24 - September 30, 2002) of Acacia Research's quoted closing market price per share as listed on the NASDAQ national market system. Accordingly, Acacia Research's cost to acquire the 52% of CombiMatrix

Corporation not already owned, calculated to be \$60.7 million assuming an AR-CombiMatrix stock price, once effective, of \$5.00 per share on the date of consummation, will be allocated on a pro rata basis to the assets acquired and liabilities assumed according to their respective fair values, with the excess

-32-

purchase price being allocated to goodwill. A 10%, 20% and 30% increase and decrease in the value of the Acacia Research stock price used in the preparation of the unaudited pro forma information would impact the ascribed value of a share of the AR-CombiMatrix stock and as a result, the estimated cost to acquire the 52% of CombiMatrix Corporation not already owned by approximately \$4.0 million and \$7.3 million, \$10.0 million and \$13.1 million, \$16.0 million and \$19 million, respectively. The total estimated cost to acquire the remaining 52% of CombiMatrix Corporation stock reflected in the accompanying unaudited pro forma financial statements is subject to change based on the actual market price of the AR-CombiMatrix stock once the AR-CombiMatrix stock begins trading. A change in total cost will result in a corresponding change in goodwill.

MANAGEMENT'S REASONABLE ESTIMATE OF THE RELATIVE CURRENT FAIR VALUE OF COMBIMATRIX CORPORATION AS REFLECTED IN ACACIA RESEARCH'S RECENT AVERAGE STOCK PRICE IS SOLELY FOR THE PURPOSES OF PREPARING THE UNAUDITED PRO FORMA CONSOLIDATED INFORMATION. NEITHER THE ESTIMATED PERCENTAGE NOR THE ASSUMED STOCK MARKET PRICE THAT CAN BE DERIVED THEREFROM ARE INTENDED TO BE INDICATIVE OF ACTUAL STOCK PRICES, THE RELATIVE VALUES OF THE SHARES AFTER THE RECAPITALIZATION AND MERGER, OR THE VALUE OF COMBIMATRIX CORPORATION OR EITHER OF THE TWO GROUPS. THE ASSUMED RELATIVE PERCENTAGE VALUE, THE ASSUMED STOCK MARKET PRICE, AND THE PURCHASE PRICE ALLOCATION ADJUSTMENTS MADE IN CONNECTION WITH THE DEVELOPMENT OF THE ACACIA RESEARCH UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS HAVE BEEN MADE SOLELY FOR THE PURPOSE OF DEVELOPING SUCH ACACIA RESEARCH UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS AND SHOULD NOT BE CONSIDERED INDICATIVE OF ACTUAL PRICES, VALUES OR PERFORMANCE FOLLOWING THE RECAPITALIZATION.

THE FINAL ALLOCATION OF THE PURCHASE CONSIDERATION IS ALSO DEPENDENT UPON VALUATIONS AND OTHER STUDIES THAT ARE NOT YET COMPLETE. ACCORDINGLY, THE PURCHASE PRICE ALLOCATION ADJUSTMENTS MADE IN CONNECTION WITH THE DEVELOPMENT OF THE ACACIA RESEARCH UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS HAVE BEEN MADE SOLELY FOR THE PURPOSE OF DEVELOPING SUCH ACACIA RESEARCH UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS AND SHOULD NOT BE CONSIDERED INDICATIVE OF ACTUAL STOCK PRICES FOLLOWING THE RECAPITALIZATION AND MERGER.

The Acacia Research unaudited pro forma consolidated financial statements are not necessarily indicative of what the actual financial results would have been had the transactions described above taken place on June 30, 2002 or January 1, 2001, nor do they purport to indicate results of future operations.

The Acacia Research unaudited pro forma consolidated statements have been prepared on the basis of assumptions described in the notes below, including assumptions relating to the allocation of the consideration paid for the 52% of CombiMatrix Corporation not already owned based on preliminary estimates of fair value. The actual allocation of the consideration may differ from that reflected in the Acacia Research unaudited pro forma consolidated financial statements after valuations and other procedures to be performed after the closing of the merger have been completed. Below is a table of the estimated acquisition cost, purchase price adjustment and annual amortization of the intangible assets acquired:

| | | | Annual |
|--|-------------------|--------------|----------------|
| | | Amortization | Amortization |
| | | Life | of Intangibles |
| | | | |
| Estimated Acquisition Costs: Exchange of AR-CombiMatrix tracking stock for CombiMatrix Corporation stock Acquisition expenses | \$59,900 800 | | |
| Total Estimated Acquisition Cost | \$60,700 ===== | | |
| Purchase Price Allocation: | | | |
| Fair value of 52.3% of CombiMatrix | | | |
| Corporation net tangible assets at | | | |
| June 30, 2002 | \$ 7 , 800 | | |
| Intangible assets acquired: | | | |
| Core technology/patent | 7,800 | 7 years | \$1,114 |
| Deferred Income Taxes (40%) | (3,100) | | |
| In-process research and development | 10,300 | | |
| Goodwill | 37,900 | | |
| Total | \$60,700 | | \$1,114 |
| | | | |

-33-

The total purchase price, the fair value of assets and liabilities acquired, the allocation of purchase price and the lives of the intangible assets will be determined upon completion of the merger and may vary from the amounts presented herein. The valuation is expected to be completed upon the consummation of the transaction.

As a result of the merger, Acacia Research expects to incur a write-off related to in-process research and development ("IPR&D") totaling approximately \$10.3 million. The unaudited pro forma consolidated balance sheet includes the effect of the write-off related to IPR&D. The pro forma statement of operations does not reflect this one-time charge. The charge related to in-process research and development will be reflected in Acacia Research's consolidated financial statements when the merger is consummated and will be allocated to the CombiMatrix group.

The fair value assigned to the IPR&D was estimated by discounting to present value the cash flows expected to result from our IPR&D project once it has reached technological feasibility. A discount rate consistent with the risks of the project was used to estimate the present value of future cash flows. In estimating future cash flows, Acacia Research management considered the contribution of its core technology (for which a United States patent was obtained in July 2000) that would be required for successful exploitation of purchased in-process technology in order to value the core and in-process technology discretely. As a result, future cash flows relating to the purchased IPR&D project were reduced in order to reflect the contribution of core technology to the IPR&D project. The cash flows from the project attributable to core technology were then separately valued to determine the intangible asset value of purchased core technology (listed in the table above). In determining the contribution of core technology to our in-process project, Acacia Research management analyzed their historical research and development efforts applicable

to obtaining their patent from the United States government versus their efforts to commercially develop the technology in various IPR&D projects. The ratio of core technology research and development spending to IPR&D spending at the time of the merger was applied to the IPR&D project cash flows to determine cash flows relating to core technology.

The nature of the efforts to develop the purchased IPR&D into commercially viable products principally relates to the completion and/or acceleration of existing development programs. These efforts include testing current and alternative materials used in microarray design, testing of existing and alternative methods for microarray synthesis, developing prototype machinery (including operating software) to synthesize, hybridize and read individual microarrays, and to perform numerous experiments, or assays, with actual target samples in order to determine customer protocols and procedures for using our microarray system. The costs of these efforts have been included in the projections to successfully launch the purchased IPR&D project. The resulting net cash flows from the project are based on Acacia Research and CombiMatrix Corporation's management estimates of revenues, cost of sales, research and development expenses, sales and marketing expenses, general and administrative expenses, the anticipated effect of income taxes, and required returns on working capital, fixed assets and other assets necessary to support the generation of these cash flows.

The discounting of net cash flows relating to core technology back to their present value is primarily based on CombiMatrix Corporation's weighted average cost of capital ("WACC"). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The weighted average discount rate was approximately 25% and is the rate used in discounting the net cash flows attributable to purchased core technology.

The forecast data employed in the valuation analyses was based upon product level forecast information obtained by Acacia Research from numerous internal and external resources. These resources included publicly available databases, external market research consultants, company-sponsored focus group data and internal market experts. Acacia Research senior management reviewed and challenged the forecast data and related assumptions and utilized the information in analyzing IPR&D. The forecast data and assumptions are inherently uncertain and unpredictable. However, based upon the information available at this time, Acacia Research management believes the forecast data and assumptions to be reasonable. These assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur. Accordingly, actual results may vary from the forecasted results. Any such variance may result in a material adverse effect on Acacia Research's financial condition and results of operations.

In the allocation of the purchase price to the IPR&D, the concept of alternative future use was specifically considered for the program under development. The acquired IPR&D consists of CombiMatrix Corporation's work

-34-

to complete each of the identified programs. The program is very specific to the research market for which it is intended. There are no alternative uses for the in-process program in the event that the program fails in its continued development or is otherwise not feasible. The development effort for the acquired IPR&D does not possess an alternative future use for Acacia as defined by generally accepted accounting principles.

Below is a brief description of the acquired IPR&D project including an estimation of when our management believes that we may realize revenues from the sale of these products.

GENOMICS BIOLOGICAL ARRAY SYSTEM.

As described elsewhere in this document, our genomics biological array processor system is being developed to discretely immobilize sequences of DNA or RNA within individual test sites on a modified semiconductor chip coated with a three-dimensional layer of porous material. The system also includes proprietary hardware units and related software applications to be able to synthesize materials onto the chips, apply target samples of genetic materials and interpret the results. The purpose of this system will be in gene expression profiling and SNP genotyping, which could lead to the better understanding of gene function and ultimately therapeutic discovery to fight disease. Our projected cash flow models from commercializing this system include servicing our existing relationship with Roche as well as other strategic partners, pharmaceutical, biotech and academic institutions. Our projected cash flows from commercializing this system assume that the majority of our revenues received will be in the form of royalties earned from licensing our genomics biological array system to certain strategic partners including Roche, and that royalty streams from these licensing arrangements will not commence until 2003. Although current research and development efforts in commercializing this system have been positive, there can be no assurance that the system will be successfully launched and broadly accepted by the pharmaceutical, biotech and academic research fields. The estimated stage of completion for this program as of the acquisition date is expected to be approximately 79%, and we estimate that future costs through commercial launch will be approximately \$12.0 million. A discount rate of 32% was utilized in discounting the estimated cash flows from commercialization of the genomics biological array system, yielding a value for our genomics IPR&D project of approximately \$19.7 million.

The Acacia Research pro forma consolidated statements give effect to the following pro forma adjustments:

A. Application of purchase accounting to the merger, reflecting the estimated acquisition cost noted above and the issuance of shares of AR-CombiMatrix stock. Components of the estimated acquisition cost reflect:

- Acquisition of the remaining 52% of CombiMatrix Corporation stock not already owned by Acacia Research through an exchange of one share of AR-CombiMatrix stock, for each share of CombiMatrix Corporation common stock, or approximately 12.0 million shares of AR-CombiMatrix stock in the aggregate. The merger transaction will be valued, at the date of acquisition when the registration is completed, using the AR-CombiMatrix stock (based on the quoted market price once that stock begins trading). The purchase price was based upon the ascribed AR-CombiMatrix common stock price of \$5.00 per share, multiplied by approximately 12.0 million shares acquired of which \$12,000 and \$59.9 million were reflected as common stock and additional paid-in capital, respectively. Upon consummation of the acquisition, CombiMatrix Corporation will be wholly owned by Acacia Research.
- Acquisition expenses of \$800,000, including investment banking fees, legal and accounting fees, filing and registration costs.
- o Elimination of the 52% of equity interest related to the net assets of CombiMatrix Corporation as of June 30, 2002, totalling \$7.8 million.

Components of the purchase price allocation listed above and reflected in the Acacia Research pro forma consolidated statements include the following:

- o Core Technology/Patents. To determine the value of the core technology/patents, the expected future cash flow attributable to the core technology/patents was discounted, taking into account risks related to the characteristics and applications of the technology, existing and future markets, and assessment of the life cycle stage of the technology. The analysis resulted in a valuation of approximately \$7.8 million for developed technology, which had reached technological feasibility and therefore was capitalizable. Core technology/patents is being amortized on a straight-line basis over a period of 7 years, which is management's estimate of the remaining economic useful life.
- o In-process Research and Development. The project identified as in-process research and development at CombiMatrix Corporation, as discussed above, is the project that will be underway at the time of the merger and would, after consummation of the merger, require additional effort to establish technological feasibility. As discussed above, the analysis resulted in a valuation of approximately \$10.3 million for in-process research and development.
- o Goodwill. The preliminary goodwill allocation of \$37.9 million was determined by subtracting the estimated values allocated to the identifiable tangible net assets, identifiable core technology, deferred income taxes and in-process research and development, acquired from the total estimated purchase price. Deferred income taxes are set up at an estimated effective tax rate of 40% of increased book basis in identifiable intangibles of \$7.8 million. In accordance with Statement of Financial Accounting Standards No. 142, the goodwill is not being amortized and will be reviewed for impairment annually.

B. To reflect CombiMatrix Corporation's unamortized deferred stock-based compensation of \$7.6 million (deduction from stockholder's equity). In consolidation, Acacia Research classified accrued subsidiary stock-based compensation charges as minority interest.

C. Exchange of approximately 3.5 million outstanding options exercisable to purchase shares of CombiMatrix Corporation common stock into options exercisable to purchase approximately 3.5 million shares of AR-CombiMatrix stock having the same terms and conditions as the CombiMatrix Corporation common stock options. As a result, the pro forma balance sheet includes deferred stock-based compensation of \$1.2 million related to the estimated increase in intrinsic value of the CombiMatrix Corporation options upon remeasurement using the assumed market price of the CombiMatrix Corporation common stock of \$5.00 per share. All of the CombiMatrix Corporation stock options were granted after Acacia Research first acquired control. As such, the exchange of awards is considered a modification (or settlement) of a stock-based compensation arrangement and not part of the purchase price.

D. Elimination of the 52% interest in CombiMatrix Corporation not already owned by Acacia Research related to the net loss of CombiMatrix Corporation for the year ended December 31, 2001, and the six months ended June 30, 2002 due to 100% ownership interest subsequent to the merger.

E. Incremental amortization of intangible assets resulting from the merger. Intangible assets are being amortized on a straight-line basis over periods described above. Tax provision adjusted by 40% of incremental amortization.

F. Estimated amortization of stock-based compensation expense related to the conversion of outstanding options exercisable to purchase shares of CombiMatrix Corporation common stock to options exercisable to purchase AR-CombiMatrix stock, as discussed in pro forma adjustment C. above.

G. To adjust deferred revenue recorded by CombiMatrix Corporation at June 30, 2002 and acquired in the merger, to reflect the fair value of the continuing obligations as of the assumed date of the merger. The reduction of deferred revenues results in a corresponding reduction in amounts assigned to goodwill.

-36-

H. If the recapitalization is implemented, the aggregate number of shares of stock which Acacia Research will have authority to issue is 110,000,000 shares, of which 50,000,000 shares shall be shares of a class of common stock designated as "AR-CombiMatrix stock," having a par value of \$0.001 per share, 50,000,000 shares shall be shares of a class of common stock designated as "AR-Acacia Technologies stock," having a par value of \$0.001 per share, and 10,000,000 shares shall be shares of a class of preferred stock having a par value of \$0.001 per share (the "Preferred Stock") and issuable in one or more series as determined by the board of directors pursuant to the proposed restated certificate of incorporation. Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will vote together as a single class (except in certain limited circumstances). Each share of AR-CombiMatrix stock will entitle the holder to one vote. Each share of AR-Acacia Technologies stock will entitle the holder, for any particular vote, to a number of votes equal to the average market value of a share of AR-Acacia Technologies stock divided by the average market value of a share of AR-CombiMatrix stock over a specified 20-trading day period ending on the 10th trading day prior to the record date for determining the stockholders entitled to vote.

Holders of each class of common stock are entitled to receive ratably such dividends, if any, as may be declared by the board of directors out of funds legally available therefore.

Under our restated certificate of incorporation, in the event of our dissolution, liquidation or winding up, after payment or provision for payment of the debts and other liabilities and full preferential amounts to which holders of any preferred stock are entitled, regardless of the group to which such shares of preferred stock were attributed, the holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be entitled to receive our assets remaining for distribution to holders of common stock on a per share basis in proportion to the liquidation units per share of such class. This provision provides for the distribution of assets upon a liquidation that reflects the initial relative economic interests of the respective classes of stock. Each share of AR-CombiMatrix stock will have one liquidation unit. Each share of AR-Acacia Technologies stock will have a number of liquidation units equal to the quotient of the average market value of a share of AR-Acacia Technologies stock over the 20-trading day period ending on the 40th trading day after the effective date of the recapitalization, divided by the average market value of a share of AR-CombiMatrix stock over the same period.

Holders of each class of common stock have no preemptive, subscription, redemption or conversion rights. Management, at its discretion may, at any time, convert each share of AR-CombiMatrix stock into a number of shares of AR-Acacia Technologies stock at a 10% premium over the average market price.

Each new class of stock is designed to reflect the financial performance of the respective group, rather than the performance of Acacia Research as a whole.

The chief mechanisms intended to cause the AR-CombiMatrix stock and the AR-Acacia Technologies stock to reflect the financial performance of the respective group are provisions in Acacia Research's proposed restated certificate of incorporation governing dividends and distributions. Under these provisions, Acacia Research will:

- o factor the assets and liabilities and income or losses attributable to the respective group into the determination of the amount available to pay dividends on the shares issued for the respective group; and
- o require Acacia Research to exchange, redeem or distribute a dividend on the stock of a group if all or substantially all of the assets allocated to the respective group are sold to a third party.

Management of Acacia Research cannot assure the holders of AR-CombiMatrix stock or AR-Acacia Technologies stock that the market values of the two share classes will in fact reflect the separate performance of each class of stock. Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be stockholders of Acacia Research and as a result, will be subject to all of the risks of an investment in Acacia Research and all of its businesses, assets and liabilities. Financial effects from one group that affect Acacia Research's consolidated results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group.

Acacia Research's board of directors, subject to state laws and limits in our proposed restated certificate of incorporation, including those discussed above, will be able to declare dividends on AR-CombiMatrix stock and AR-Acacia Technologies stock in its discretion. To date, Acacia Research has never paid or declared cash dividends

-37-

on shares of our stock, nor do we anticipate paying cash dividends on either of the two new classes of stock in the foreseeable future.

The allocation of corporate expenses is generally based on utilization and is in accordance with Acacia Research Corporation's proposed restated certificate of incorporation, for the purpose of measuring earnings available to stockholders of AR-CombiMatrix stock and AR-Acacia Technologies stock and does not necessarily reflect the financial condition, cash flows and operating results of each division as if it were a stand-alone entity. The management and allocation policies applicable to the preparation of the financial statements of the CombiMatrix group and the Acacia Technologies group may be modified or rescinded, or additional policies may be adopted, at the sole discretion of Acacia Research's board of directors at any time without approval of the stockholders. Acacia Research's management and board of directors have the ability to: transfer funds between the groups at the discretion of management and the board of directors; allocate financing costs between groups that may not reflect the separate borrowing costs of the groups; and charge a greater or lesser portion of the total corporate tax liability to the groups than that which would have been charged if the groups were stand-alone entities.

Acacia Research's management and board of directors do not presently intend to modify or rescind the methodologies and assumptions underlying the allocations in the pro forma financial statements.

I. The pro forma weighted average shares for both basic and diluted earnings (loss) per share was determined as follows:

| | FOR THE YEAR ENDED DECEMBER 31, 2001 | FOR MONT JUNE |
|---|--------------------------------------|---------------------|
| AR-Acacia Technologies stock: | | |
| Weighted Average Number of AR - Acacia Technologies shares Outstanding Used in Computation of Basic EPS (1): Dilutive Effect of Outstanding Stock Options and Warrants (2) | 19,640,808 536,154 | 19, |
| Weighted Average Number of AR - Acacia Technologies shares Outstanding Used in Computation of Diluted EPS: AR-CombiMatrix stock: | 20,176,962 | 19, === |
| AR-COMDIMATTIX SLOCK: Weighted Average Number of AR - CombiMatrix shares Outstanding Used in Computation of Basic LPS (3): Dilutive Effect of Outstanding Stock Options and Warrants (4) | 22,950,551 | 22, |
| Weighted Average Number of AR - CombiMatrix shares Outstanding Used in Computation of Diluted LPS: | 22,950,551 | 22, === |

- Represents number of shares that would be issued assuming the transaction occurred on June 30, 2002. Weighted average number of AR-Acacia Technologies shares outstanding determined as if shares were issued as of the beginning of 2001.
- (2) Represents potential AR-Acacia Technologies shares for 2001 calculated using the treasury method. Potential common shares of 536,154 at June 30, 2002 have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive.
- (3) Calculation of Weighted Average Number of AR CombiMatrix shares Outstanding:

-38-

| | AR-CombiMat |
|------------------|--|
| | Shares to |
| AR-CombiMatrix | Issued to |
| Shares to be | CombiMatri |
| Issued to Acacia | Corporatic |
| Research | Minority |
| Stockholders | Stockholde |
| | |
| | |
| 19,640,808 | |
| | |
| | 22,950,55 |
| 1 to .5582 | 1 to .522 |
| | Shares to be Issued to Acacia Research Stockholders 19,640,808 |

Acacia Research shares converted to AR-CombiMatrix shares 10,963,277 CombiMatrix Corporation shares converted to ARCombiMatrix shares

11,987,27

Total

- (4) Potential common shares of 3,791,942 at June 30, 2002 have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive.
- J. Net income attributed to the AR-CombiMatrix stock was determined as follows:

| | For the Year Ended December 31, 2001 | For the Six Months Ended June 30, 2002 |
|---|---|--|
| 2001 CombiMatrix group net loss before pro forma adjustments: | \$(28,029) | \$ (9,482) |
| Pro forma adjustments: | | |
| Stock based compensation amortization | (406) | (203) |
| Amortization of intangibles | (1,114) | (557) |
| Tax effects of amortization of intangibles | 442 | 221 |
| Elimination of minority interests share of losses | (18,757) | (6,334) |
| | | |
| Pro forma net loss attributed to the AR-CombiMatrix stock | \$(47,865) | \$(16,355) |
| | | ======= |

K. SUBSEQUENT EVENTS.

On September 30, 2002, CombiMatrix Corporation and Dr. Donald Montgomery, an officer and stockholder of CombiMatrix Corporation, entered into a settlement agreement with Nanogen, Inc. to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, CombiMatrix Corporation agreed to issue 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, to Nanogen, Inc., subject to antidilution provisions under specified circumstances for a period of up to three years. Due to the significant impact of the settlement agreement with Nanogen, Inc. on the number of shares of CombiMatrix Corporation that Acacia Research did not already own as of October 3, 2002 and on the purchase price of the CombiMatrix Corporation common stock that Acacia Research did not already own as of November 1, 2002, the unaudited pro forma financial statements as of and for the six months ended June 30, 2002 and for the year ended December 31, 2001 also give effect to the impact of the CombiMatrix Corporation common shares issued to Nanogen, Inc. pursuant to the settlement agreement executed on September 30, 2002. Accordingly, the purchase price for the CombiMatrix Corporation common stock that Acacia Research does not already own as of June 30, 2002 includes, on a pro forma basis, the 4,016,346 shares issued to Nanogen, Inc. pursuant to the settlement agreement as if the settlement was executed on June 30, 2002. Additionally, all pro forma share and per-share information presented reflects the impact of the settlement agreement with Nanogen, Inc. as if the settlement was executed on June 30, 2002.

The issuance of shares by CombiMatrix Corporation to Nanogen, Inc. decreases Acacia Research Corporations consolidated ownership interest in CombiMatrix Corporation from 58% to 48%. Acacia Research

-39-

Corporation continues to possess the ability to direct or cause the direction of the management and policies of CombiMatrix Corporation, primarily through Acacia Research Corporation's ability to elect the majority of the board of directors of CombiMatrix Corporation, pursuant to a stockholder agreement with an officer of CombiMatrix Corporation. This stockholder agreement stipulates that, collectively, Acacia Research Corporation and the officer who is party to the stockholder agreement, will vote their shares such that the board will be comprised of the directors nominated by Acacia Research Corporation and the stockholder. The stockholder is generally prohibited from selling his shares and Acacia Research Corporation has a right of first refusal should the stockholder wish to sell his shares. Accordingly, the Company will continue to account for its investment in CombiMatrix Corporation under the consolidation method of accounting.

The reflection, on a pro forma basis, of the issuance of common stock by CombiMatrix Corporation to Nanogen, Inc. as described above does not have any impact on the historical financial statements as of and for the six months ended June 30, 2002, or for the year ended December 31, 2001 presented in the unaudited pro forma financial statements herein.

The book value of CombiMatrix Corporation as of June 30, 2002 and September 30, 2002 was \$15,017,109 and \$5,393,484, respectively. Approximately \$1 million of the decrease in book value is due to the settlement of CombiMatrix Corporation's litigation with Nanogen, Inc. The remainder of such decrease is the result of operating losses incurred in the ordinary course of CombiMatrix Corporation's business, and not from any material adverse developments. CombiMatrix Corporation incurs substantial research and development in the ordinary course of its business, and defers the recognition of substantial portions of its revenue under its agreements with Roche until the achievement of all of the relevant milestones, resulting in operating losses and a decrease in book value.

-40 -

RISK FACTORS

The risk factors beginning on this page discuss risks arising from a capital structure with two separate classes of common stock. The risk factors beginning on page 48 discuss risks related to the merger. The risk factors beginning on page 50 discuss risks related to each group.

RISKS RELATING TO THE RECAPITALIZATION

YOU WILL REMAIN STOCKHOLDERS OF ONE COMPANY, AND THE FINANCIAL PERFORMANCE OF ONE GROUP COULD AFFECT THE OTHER, THUS EXPOSING THE HOLDERS OF EACH GROUP'S STOCK TO THE RISKS OF AN INVESTMENT IN THE ENTIRE COMPANY.

Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be stockholders of a single company. The CombiMatrix group and the Acacia

Technologies group are not separate legal entities. As a result, stockholders will continue to be subject to all of the risks of an investment in Acacia Research and all of our businesses, assets and liabilities. The issuance of the AR-CombiMatrix stock and the AR-Acacia Technologies stock and the allocation of assets and liabilities and stockholders' equity between the CombiMatrix group and the Acacia Technologies group will not result in a distribution or spin-off to stockholders of any of our assets or liabilities and will not affect ownership of our assets or responsibility for our liabilities or those of our subsidiaries. The assets we attribute to one group could be subject to the liabilities of the other group, whether such liabilities arise from lawsuits, contracts or indebtedness that we attribute to the other group. If we are unable to satisfy one group's liabilities out of the assets we attribute to it, we may be required to satisfy those liabilities with assets we have attributed to the other group.

Financial effects from one group that affect our consolidated results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group and the market price of the common stock relating to the other group. In addition, net losses of either group and dividends or distributions on, or repurchases of, either class of common stock will reduce the funds we can pay as dividends on each class of common stock under Delaware law. For these reasons, you should read our consolidated financial information with the financial information we provide for each group.

THE HOLDERS OF AR-COMBIMATRIX STOCK AND THE HOLDERS OF AR-ACACIA TECHNOLOGIES STOCK WILL HAVE ONLY LIMITED SEPARATE STOCKHOLDER RIGHTS.

Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will have the rights customarily held by common stockholders. They will have these specific rights related to their corresponding group:

- o certain rights with regard to dividends and liquidation;
- requirements for a mandatory dividend, redemption or conversion upon the disposition of all or substantially all of the assets of their corresponding group; and
- o a right to vote on matters as a separate voting class in the limited circumstances provided under Delaware law, by stock exchange rules or as determined by our board of directors (such as an amendment of our certificate of incorporation that changes the rights, privileges or preferences of the class of stock held by such stockholder).

We will not hold separate stockholder meetings for holders of AR-CombiMatrix stock and AR-Acacia Technologies stock.

-41-

THE HOLDERS OF AR-COMBIMATRIX STOCK AND THE HOLDERS OF AR-ACACIA TECHNOLOGIES STOCK WILL HAVE CERTAIN LIMITS ON THEIR RESPECTIVE VOTING POWERS.

GROUP COMMON STOCK WITH A MAJORITY OF VOTING POWER CAN CONTROL VOTING OUTCOMES.

The holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will vote together as a single class, except in limited circumstances. If a separate vote on a matter by the holders of either the AR-CombiMatrix stock or the AR-Acacia Technologies stock is not required under Delaware law or by stock

exchange rules, and if our board of directors does not require a separate vote, either class of common stock that is entitled to more than the number of votes required to approve such matter could control the outcome of such vote - even if the matter involves a divergence or conflict of the interests between the holders of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. In addition, if the holders of common stock having a majority of the voting power of all shares of common stock outstanding approve a merger, the terms of which did not require separate class voting under stock exchange rules, then the merger could be consummated -- even if the holders of a majority of either class of common stock were to vote against the merger.

GROUP COMMON STOCK WITH LESS THAN MAJORITY VOTING POWER CAN BLOCK ACTION IF A CLASS VOTE IS REQUIRED.

If Delaware law, stock exchange rules or our board of directors requires a separate vote on a matter by the holders of either the AR-CombiMatrix stock or the AR-Acacia Technologies stock, such as a proposal to amend the terms of one class of stock, those holders could prevent approval of the matter, even if the holders of a majority of the total number of votes cast or entitled to be cast, voting together as a class, were to vote in favor of it.

HOLDERS OF ONLY ONE CLASS OF COMMON STOCK CANNOT ENSURE THAT THEIR VOTING POWER WILL BE SUFFICIENT TO PROTECT THEIR INTERESTS.

Since the relative voting power per share of AR-CombiMatrix stock and AR-Acacia Technologies stock will fluctuate based on the market values of the two classes of common stock, the relative voting power of a class of common stock could decrease. As a result, holders of shares of only one of the two classes of common stock cannot ensure that their voting power will be sufficient to protect their interests. Please see page 80 for an example of the calculation of the number of votes and relative voting power of each stock at assumed trading prices.

THE RESTATED CERTIFICATE OF INCORPORATION MAY BE AMENDED TO INCREASE OR DECREASE THE AUTHORIZED SHARES OF EITHER CLASS OF COMMON STOCK WITHOUT THE APPROVAL OF EACH CLASS VOTING SEPARATELY.

The restated certificate of incorporation provides that an amendment to the restated certificate to increase or decrease the number of authorized shares of either class of common stock will require the approval of the holders of a majority of the voting power of all shares of common stock, voting together as a single class, and will not require the approval of each class of stock voting as a separate class. Accordingly, if the holders of one class of common stock hold a majority of the voting power of all shares of common stock, then that majority could approve an amendment to the restated articles to increase or decrease the authorized shares of stock of either class without the approval of the holders of the minority class of stock.

STOCKHOLDERS MAY NOT HAVE ANY REMEDIES FOR BREACH OF FIDUCIARY DUTIES IF ANY ACTION BY OUR DIRECTORS OR OFFICERS HAS A DISADVANTAGEOUS EFFECT ON EITHER CLASS OF COMMON STOCK.

Stockholders may not have any remedies if any action or decision of our directors and officers has a disadvantageous effect on either class of common stock compared to the other class of common stock. We are not aware of any legal precedent under Delaware law involving the fiduciary duties of directors and officers of corporations having two classes of common stock, or separate classes or series of capital stock, the rights of which, like the AR-CombiMatrix stock and AR-Acacia Technologies stock, are defined by reference to separate businesses of the corporation.

Principles of Delaware law established in cases involving differing

treatment of two classes of capital stock or two groups of holders of the same class of capital stock provide that a board of directors owes an equal duty to all

-42-

stockholders regardless of class or series. Under these principles of Delaware law and the related principle known as the "business judgment rule," absent abuse of discretion, a good faith business decision made by a disinterested and adequately informed board of directors, board of directors' committee or officer with respect to any matter having different effects on holders of AR-CombiMatrix stock and holders of AR-Acacia Technologies stock would be a defense to any challenge to such determination made by or on behalf of the holders of either class of common stock.

Following the completion of the recapitalization and the merger, our executive officers, directors and their affiliates will beneficially own approximately 5.1% of the outstanding AR-CombiMatrix stock and 8.8% of the outstanding AR-Acacia Technologies stock, assuming the conversion of each share of Acacia Research common stock into 0.5582 share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock.

NUMEROUS POTENTIAL CONFLICTS OF INTERESTS EXIST BETWEEN THE AR-COMBIMATRIX STOCK AND THE AR-ACACIA TECHNOLOGIES STOCK WHICH MAY BE DIFFICULT TO RESOLVE BY OUR BOARD OR WHICH MAY BE RESOLVED ADVERSELY TO ONE OF THE CLASSES.

The existence of separate classes of common stock could give rise to occasions when the interests of the holders of AR-CombiMatrix stock and AR-Acacia Technologies stock diverge or conflict. Examples include determinations by our directors or officers to:

- pay or omit the payment of dividends on AR-CombiMatrix stock or AR-Acacia Technologies stock;
- allocate consideration to be received by holders of each of the classes of common stock in connection with a merger or consolidation involving Acacia Research;
- o convert one class of common stock into shares of the other;
- o approve certain dispositions of the assets of either group;
- allocate the proceeds of future issuances of our stock either to the Acacia Technologies group or the CombiMatrix group;
- o allocate corporate opportunities between the groups; and
- o make other operational and financial decisions with respect to one group that could be considered detrimental to the other group.

When making decisions with regard to matters that create potential diverging or conflicting interests, our directors and officers will act in accordance with their fiduciary duties, the terms of the restated certificate of incorporation, and, to the extent applicable, the management and allocation policies described herein.

THE PERFORMANCE OF ONE GROUP OR THE DIVIDENDS PAID TO ONE GROUP MAY ADVERSELY AFFECT THE DIVIDENDS AVAILABLE FOR THE OTHER GROUP.

Our board of directors currently has no intention to pay dividends on the AR-CombiMatrix stock or the AR-Acacia Technologies stock. Determinations as to future dividends on the AR-CombiMatrix stock and the AR-Acacia Technologies stock will be based primarily on the financial condition, results of operations and business requirements of the relevant group and Acacia Research as a whole. Subject to the limitations referred to below, our board of directors has the authority to declare and pay dividends on the AR-CombiMatrix stock and the AR-Acacia Technologies stock in any amount and could, in its sole discretion, declare and pay dividends exclusively on the AR-CombiMatrix stock, exclusively on the AR-Acacia Technologies stock, or on both, in equal or unequal amounts. Our board of directors will not be required to consider the amount of dividends previously declared on each class, the respective voting or liquidation rights of each class or any other factor.

-43-

The performance of one group may cause our board of directors to pay more or less dividends on the common stock relating to the other group than if that other group was a stand-alone company. In addition, Delaware law and the new certificate of incorporation impose limitations on the amount of dividends which may be paid on each class of common stock.

PROCEEDS OF MERGERS OR CONSOLIDATIONS MAY BE ALLOCATED UNFAVORABLY.

The recapitalization proposal does not contain any provisions governing how consideration to be received by holders of common stock in connection with a merger or consolidation involving Acacia Research is to be allocated among holders of each class of common stock. Our board of directors will determine the percentage of the consideration to be allocated to holders of each class of common stock in any such transaction. Such percentage may be materially more or less than that which might have been allocated to such holders had our board of directors chosen a different method of allocation.

HOLDERS OF EITHER CLASS OF COMMON STOCK MAY BE ADVERSELY AFFECTED BY A CONVERSION OF GROUP COMMON STOCK.

Our board of directors could, in its sole discretion and without stockholder approval, determine to convert shares of AR-Acacia Technologies stock into shares of AR-CombiMatrix stock, or vice versa, at a time when either or both classes of common stock may be considered to be overvalued or undervalued. Any such conversion would dilute the interests in Acacia Research of the holders of the class of common stock being issued in the conversion. It could also give holders of shares of the class of common stock converted a greater or lesser premium than any premium that might be paid by a third-party buyer of all or substantially all of the assets of the group whose stock is converted.

HOLDERS OF EITHER CLASS OF COMMON STOCK COULD BE ADVERSELY AFFECTED BY A DISPOSITION OF THE ASSETS ALLOCATED TO THEIR RESPECTIVE GROUPS.

Our board of directors could, in its sole discretion and without stockholder approval, determine to dispose of all or substantially all the assets of a group. If a disposition of group assets occurs at a time when those assets are considered undervalued, then holders of that group's stock would receive less consideration than they could have received had the assets been disposed of at a time when they had a higher value.

PROCEEDS OF FUTURE ISSUANCES OF OUR STOCK COULD BE ALLOCATED UNFAVORABLY.

We may in the future issue a new class of stock, such as a class of preferred stock, or additional shares of AR-CombiMatrix stock or AR-Acacia Technologies stock. Proceeds from any future issuance of any class of stock would be allocated among the CombiMatrix or the Acacia technologies group as determined by our board of directors. There is no requirement that the proceeds from an issuance of AR-CombiMatrix stock or AR-Acacia Technologies stock be allocated to the corresponding group. Such allocations might be materially more or less for the respective groups than what might have been allocated had our board of directors chosen a different allocation method. Also, any designated preferred class may be designed to reflect the performance of Acacia Research as a whole, rather than the performance of the CombiMatrix group or the Acacia Technologies group.

ALLOCATION OF CORPORATE OPPORTUNITIES COULD FAVOR ONE GROUP OVER ANOTHER.

Our board of directors may be required to allocate corporate opportunities between the groups. In some cases, our directors could determine that a corporate opportunity, such as a business that we are acquiring, should be shared by the groups. Any such decisions could favor one group at the expense of the other.

OTHER OPERATIONAL AND FINANCIAL DECISIONS WHICH MAY FAVOR ONE GROUP OVER THE OTHER.

Our board of directors or our senior officers will review other operational and financial matters affecting the CombiMatrix group and the Acacia Technologies group, including the allocation of financing resources and capital, technology and know-how and corporate overhead, taxes, debt, interest and other matters. Any decision of our board of directors or our senior officers in these matters could favor one group at the expense of the other.

-44 -

OUR BOARD OF DIRECTORS MAY CHANGE OUR MANAGEMENT AND ALLOCATION POLICIES WITHOUT STOCKHOLDER APPROVAL TO THE DETRIMENT OF EITHER GROUP.

Our board of directors may modify or rescind our policies with respect to the allocation of corporate overhead, taxes, debt, interest and other matters, or may adopt additional policies, in its sole discretion without stockholder approval. However, our board of directors has no present intention to do so. A decision to modify or rescind these policies, or adopt additional policies could have different effects on holders of either class of common stock or could result in a benefit or detriment to one class of stockholders compared to the other class. Our board of directors will make any such decision in accordance with its good faith business judgment that the decision is in the best interests of Acacia Research and all of our stockholders as a whole.

EITHER GROUP MAY FINANCE THE OTHER GROUP ON TERMS UNFAVORABLE TO ONE OF THE GROUPS.

We may transfer cash and other property between groups to finance their business activities. The group providing the financing will be subject to the risks relating to the group receiving the financing. We will account for those transfers generally as a short-term or long-term loan between groups or as a repayment of a previous borrowing.

THERE ARE LIMITS ON THE CONSIDERATION WHICH MAY BE RECEIVED BY THE STOCKHOLDERS IN THE EVENT OF THE DISPOSITION OF ASSETS OF A GROUP.

The restated certificate of incorporation provides that if a disposition of all or substantially all of the properties and assets of either group occurs, we must, subject to certain exceptions:

- distribute through a dividend or redemption to holders of the class of common stock relating to such group an amount equal to the net proceeds of such disposition; or
- o convert at a 10% premium such common stock into shares of the class of common stock relating to the other group.

If the group subject to the disposition were a separate, independent company and its shares were acquired by another person, certain costs of that disposition, including corporate level taxes, might not be payable in connection with that acquisition. As a result, stockholders of the separate, independent company might receive a greater amount than the net proceeds that would be received by holders of the class of common stock relating to that group if the assets of such group were sold. In addition, we cannot assure you that the net proceeds per share of the common stock relating to that group will be equal to or more than the market value per share of such common stock prior to or after announcement of a disposition.

The term "substantially all of the properties and assets" of a group is subject to potentially conflicting interpretations. Resolution of such a dispute could adversely impact the holders of either the class of common stock related to the assets being disposed or the holders of the other class because the consideration, if any, to be received by the holders of the class related to the disposed assets may depend on whether the disposition involved "substantially all" of the properties and assets of that class.

HOLDERS OF EITHER CLASS OF COMMON STOCK MAY BE ADVERSELY AFFECTED BY A REDEMPTION OF THEIR COMMON STOCK.

We are entitled to redeem the outstanding common stock relating to a group when all or substantially all of that group's assets are sold. We can redeem the assets for cash, securities, a combination of cash and securities or other property at fair value. A disposition-related redemption could occur when the assets being disposed of are considered undervalued. If that is the case, the holders of our common stock related to that group would receive less consideration for their shares than they may deem reasonable.

We can also redeem on a pro rata basis all of the outstanding shares of a group's common stock for shares of the common stock of one or more of our wholly-owned subsidiaries. If this were to occur, the holders of the redeemed class of common stock would no longer have stockholder voting rights in Acacia Research or any other

-45-

benefits to be derived from holding a class of stock in Acacia Research. In addition, if the outstanding shares of a class of our common stock are redeemed for shares that are not publicly traded, the holders of such redeemed stock will no longer be able to publicly trade their shares and accordingly their investment will be substantially less liquid.

THE PROPOSED CAPITAL STRUCTURE AND THE VARIABLE VOTE PER SHARE COULD ENABLE A POTENTIAL ACQUIRER TO TAKE CONTROL OF ACACIA RESEARCH THROUGH THE ACQUISITION OF ONLY ONE OF THE CLASSES OF OUR COMMON STOCK.

A potential acquirer could acquire control of Acacia Research by acquiring shares of common stock having a majority of the voting power of all shares of common stock outstanding. Such a majority could be obtained by acquiring a sufficient number of shares of both classes of common stock or, if one class of common stock has a majority of such voting power, only shares of that class. We expect that initially the AR-CombiMatrix stock will have a majority of the voting power. As a result, initially, it might be possible for an acquiror to obtain control of Acacia Research by purchasing only shares of AR-CombiMatrix stock.

DECISIONS BY DIRECTORS AND OFFICERS THAT AFFECT DIFFERENTLY ONE CLASS OF OUR COMMON STOCK COMPARED TO THE OTHER COULD ADVERSELY AFFECT THE MARKET VALUE OF EITHER OR BOTH OF THE CLASSES OF OUR COMMON STOCK.

The relative voting power per share of the AR-CombiMatrix stock and the AR-Acacia Technologies stock and the number of shares of one class of common stock issuable upon the conversion of the other class of common stock will vary depending upon the relative market values of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. The market value of either or both classes of common stock could be affected by market reaction to decisions by our board of directors or our management that investors perceive to affect differently one class of common stock compared to the other. These decisions could involve changes to our management and allocation policies, allocations of corporate opportunities and financing resources between groups, and changes in dividend policies.

SINCE THERE HAS BEEN NO PRIOR MARKET FOR THE AR-COMBIMATRIX STOCK OR THE AR-ACACIA TECHNOLOGIES STOCK, WE CANNOT PROVIDE ANY ASSURANCES AS TO THE MARKET PRICE OR LIQUIDITY OF EACH OF THOSE STOCKS.

Because there has been no prior market for the AR-Acacia Technologies stock or the AR-CombiMatrix stock, we can not assure you of their respective market prices or liquidity following the recapitalization. If an active market does develop, we can not assure you that it will be maintained. Until an orderly market does develop for the AR-CombiMatrix stock and the AR-Acacia Technologies stock, their respective trading prices may fluctuate significantly.

MARKET VALUE OF AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK RECEIVED IN THE RECAPITALIZATION MAY BE LESS THAN MARKET VALUE OF OUR EXISTING COMMON STOCK.

We cannot assure you that the combined market values of the shares of AR-Acacia Technologies stock and AR-CombiMatrix stock received in the recapitalization will equal or exceed the market value of a share of our existing common stock prior to the recapitalization. The capital structure of having two separate classes of common stock for the two groups is more complex than having a single class of common stock and not directly comparable to common stock of companies that have been spun off by their parent companies. The complex nature of the two classes of stock, and the potential difficulty that investors may have in understanding these terms, may adversely affect the market price of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. Examples of these terms include:

- board discretion in making determinations affecting the two groups, such as handling potential conflicts of interest between the two groups and possibly changing allocation policies between the groups;
- redemption and conversion rights applicable upon the disposition of all or substantially all of the assets attributed to either group;

- o the ability of our board to convert shares of one class of common stock into shares of the other class of common stock; and
- o variable voting rights of the two classes of stock.

THE AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK MIGHT NOT QUALIFY FOR LISTING ON THE NASDAQ NATIONAL MARKET, WHICH COULD ADVERSELY AFFECT THE LIQUIDITY AND PRICE OF THE STOCK.

We have applied for listing of the AR-CombiMatrix stock on the NASDAQ National Market. Any approval would be conditioned upon the stock closing at a minimum bid price of five dollars per share on the first trading day following the closing of the merger and recapitalization. While we anticipate that the stock will meet this trading price requirement, if it does not, the stock would not qualify for continued listing on the NASDAQ National Market and would instead be listed on the NASDAQ SmallCap Market. If the closing bid price of the stock on the first trading day were less than four dollars per share, the stock would not qualify for the NASDAQ SmallCap Market and would trade on the OTC Bulletin Board or on another exchange on which we may apply for listing.

NASDAQ has informed us that the AR-Acacia Technologies stock will be treated as a continued listing on the NASDAQ National Market. In order to continue to qualify for NASDAQ National Market listing, the minimum bid price of the AR-Acacia Technologies stock must be one dollar per share or higher. If the minimum bid price requirement were not satisfied, the AR-Acacia Technologies stock would be listed on the NASDAQ SmallCap Market, the OTC Bulletin Board or on another exchange on which we may apply for listing.

If the AR-CombiMatrix stock or AR-Acacia Technologies stock does not qualify for listing or continued listing, as applicable, on the NASDAQ National Market , the liquidity and price of such stock could be adversely affected by internal policies of some institutional investors prohibiting the purchase of low-priced stocks. The failure of either class of stock to qualify for listing or continued listing on the NASDAQ National Market could also adversely affect analyst coverage of such class or classes of stock, which in turn could adversely affect the liquidity and share price of such stock. Additionally, transaction costs on low-priced stocks such as brokers' commissions generally represent a higher percentage of their total share value than would be the case with higher-priced stocks.

INVESTORS MAY NOT VALUE THE AR-COMBIMATRIX STOCK AND THE AR-ACACIA TECHNOLOGIES STOCK BASED ON GROUP FINANCIAL INFORMATION AND POLICIES.

We cannot assure you that investors will value the AR-CombiMatrix stock and the AR-Acacia Technologies stock based on the reported financial results and prospects of the separate groups or the dividend policies established by our board of directors with respect to those groups. Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will continue to be common stockholders of Acacia Research subject to all the risks associated with an investment in Acacia Research as a whole. Additionally, the separate stockholder rights related to each group are limited and relate to events that may never occur such as dividend and liquidation rights and the disposition of all or substantially all of the assets of a group. Accordingly, investors may discount the value of AR-CombiMatrix stock and AR-Acacia Technologies stock because both groups are part of a common enterprise rather than a stand-alone entity and each class of stock has limited separate stockholder rights.

HOLDERS OF AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK MAY NOT RECEIVE A PREMIUM FROM AN INVESTOR ACQUIRING CONTROL OF THEIR RESPECTIVE CLASSES OF

STOCK.

Control of AR-CombiMatrix stock or AR-Acacia Technologies stock may not provide control of Acacia Research as a whole. Accordingly, unlike many acquisition transactions, holders of AR-CombiMatrix stock and AR-Technologies stock may not receive a controlling interest premium from an investor acquiring control of their respective classes of stock.

-47-

THERE ARE CERTAIN PROVISIONS IN THE PROPOSED RECAPITALIZATION THAT COULD HAVE ANTITAKEOVER EFFECTS.

The existence of the two classes of common stock could, under certain circumstances, prevent stockholders from profiting from an increase in the market value of their shares as a result of a change in control of Acacia Research by delaying or preventing such change in control. The existence of two classes of common stock could present complexities and could, in certain circumstances, pose obstacles, financial and otherwise, to an acquiring person. We could, in the sole discretion of our board of directors and without stockholder approval, exercise the right to convert the shares of one class of common stock into shares of the other at a 10% premium over their respective average market values. This conversion could result in additional dilution to persons seeking control of Acacia Research.

Our board of directors could issue shares of preferred stock or common stock that could be used to create voting or other impediments to discourage persons seeking to gain control of Acacia Research, and preferred stock could also be privately placed with purchasers favorable to our board of directors in opposing such action.

THE INTERNAL REVENUE SERVICE COULD ASSERT THAT THE RECEIPT OF GROUP COMMON STOCK IS TAXABLE.

We have been advised by PricewaterhouseCoopers LLP that no income, gain or loss will be recognized by you or us for federal income tax purposes as a result of the recapitalization proposal, except for any cash received instead of fractional shares of AR-CombiMatrix stock. Nevertheless, there are no court decisions or other authorities bearing directly on the effect of the features of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. In addition, the Internal Revenue Service has announced that it will not issue rulings on the characterization of stock with characteristics similar to the AR-CombiMatrix stock and the AR-Acacia Technologies stock. It is possible, therefore, that the Internal Revenue Service could in the future assert that the receipt of the AR-CombiMatrix stock or the AR-Acacia Technologies stock as well as the subsequent exchange of such common stock could be taxable to you and to us.

RISKS RELATING TO THE MERGER

HOLDERS OF EXISTING COMBIMATRIX CORPORATION COMMON STOCK WILL RECEIVE A FIXED NUMBER OF SHARES OF AR-COMBIMATRIX STOCK DESPITE CHANGES IN THE MARKET VALUE OF OUR COMMON STOCK PRIOR TO THE MERGER.

Upon completion of the merger, each share of existing CombiMatrix Corporation common stock will be exchanged for one share of AR-CombiMatrix stock. This exchange ratio will not be adjusted for changes in the market price of either CombiMatrix Corporation common stock or Acacia Research common stock, and neither party to the merger agreement is permitted to terminate the merger agreement solely because of changes in the market price of either party's common stock.

THE MERGER MAY GO FORWARD EVEN THOUGH THERE IS A CHANGE THAT IS MATERIALLY ADVERSE TO THE BUSINESS, ASSETS, LIABILITIES OR FINANCIAL CONDITION OF ACACIA RESEARCH, THE ACACIA TECHNOLOGIES GROUP OR THE COMBIMATRIX GROUP.

In general, either Acacia Research or CombiMatrix Corporation can refuse to complete the merger if there is a material adverse change affecting the other party before the closing. Nevertheless, certain material changes, including a change in general economic conditions or changes affecting the industries generally in which the parties operate, an adverse change related to any change in accounting requirements or principles or any change in applicable laws, rules or regulations or in the interpretation of such accounting requirements or principles, or a decrease in the market price or trading volume of the parties' common stock or litigation relating to such decrease, will not prevent the merger from going forward, even if they would have a material adverse effect on the Acacia Technologies group or the CombiMatrix group.

-48-

THE MERGER COULD ADVERSELY AFFECT OUR COMBINED FINANCIAL RESULTS.

If the benefits of the merger do not exceed the costs associated with the merger, including any dilution to our stockholders resulting from the issuance of additional shares in connection with the merger, our financial results, including earnings per share, could be adversely affected.

The application of purchase accounting to the merger transaction will result in the recording of approximately \$13.5 million in identifiable intangibles and \$27.2 million in goodwill, based upon the assumed stock price of AR-CombiMatrix stock as set forth in the unaudited pro forma financial information included elsewhere herein. The assumed stock price is not intended to be indicative of the actual stock price and has been used solely for the purpose of developing the unaudited pro forma financial information. The actual stock price may be significantly different than the assumed stock price, and the estimate of intangible assets may therefore also be significantly different than the amounts set forth below. Intangible assets and goodwill recorded in connection with the merger transaction are subject to reviews for impairment. Identifiable intangibles are required to be reviewed for impairment whenever events or changes in circumstances, indicate that the carrying amount of an asset may not be recoverable. Examples of such events or changes in circumstances include: a significant decrease in the market value of an asset, a significant change in the extent or manner in which an asset is used or a significant adverse change in legal factors or in the business climate that could affect the value of an asset.

Goodwill is required to be tested for impairment on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances include: a significant adverse change in legal factors or in the business climate, an adverse action or assessment by a regulator, or unanticipated competition.

Intangible assets and or goodwill amounts recorded may be determined to be impaired resulting in the recording of a charge to income for the amount that the carrying value of such assets exceeds their fair value.

Costs associated with the merger transaction, including related legal, accounting, investment advisor and other consulting and administrative costs are

estimated to total \$800,000. In addition, consistent with generally accepted accounting principles in the United States of America, amounts assigned to purchased in-process research and development (related to CombiMatrix Corporation research and development projects that are still in process at the closing of the merger, but which, if unsuccessful, have no alternative future use) must be charged as expenses on the date that the merger is consummated. Estimated purchased in-process research and development costs associated with the merger transaction total approximately \$10.3 million and will be recorded as a charge to income in Acacia Research's consolidated statement of income and attributed to the CombiMatrix group immediately upon consummation of the merger transaction.

THE MERGER MAY TRIGGER CHANGE OF CONTROL PROVISIONS CONTAINED IN EMPLOYEE OPTION PLANS AS WELL AS IN AGREEMENTS ENTERED INTO BETWEEN OFFICER AND DIRECTORS.

As of November 1, 2002, the officers and directors of CombiMatrix Corporation owned stock options to purchase an aggregate of 1,399,000 shares of CombiMatrix Corporation common stock, 768,953 of which were not vested. As of November 1, 2002, the employees of CombiMatrix Corporation, excluding officers and directors, owned stock options to purchase an aggregate of 2,318,660 shares of CombiMatrix Corporation common stock, 722,099 of which were not vested.

Our board of directors believes that neither the merger nor the recapitalization will cause an acceleration of vesting of options to purchase CombiMatrix Corporation common stock pursuant to the terms of the CombiMatrix Corporation stock option plans or change of control agreements between CombiMatrix Corporation and its officers and directors. If it was determined, however, that the merger transaction triggered the change in control provisions included in the CombiMatrix Corporation stock option plans, CombiMatrix Corporation stock options currently outstanding to purchase 1,491,052 shares of CombiMatrix Corporation common stock would vest immediately upon consummation of the merger transaction. This would cause dilution of 6.5% to holders of AR-CombiMatrix stock following the recapitalization and merger.

-49-

THERE ARE NOT CURRENTLY ANY LOCK-UP AGREEMENTS WITH COMBIMATRIX CORPORATION STOCKHOLDERS.

The stockholders of CombiMatrix Corporation, including Nanogen, Inc., have not entered into any lock-up agreements restricting their ability to sell the shares of AR-CombiMatrix stock that they would receive in the merger. If they do not enter into such lock-up agreements, with the exception of "affiliates" (as defined in Rule 144 under the Securities Act) of Acacia Research and CombiMatrix Corporation, who will be subject to the resale restrictions contained in Rule 145 under the Securities Act, they will be able to freely sell their shares of AR-CombiMatrix stock immediately after merger and such sales could adversely affect the market price of the AR-CombiMatrix stock.

ENTERING INTO MARKET STANDOFF AGREEMENTS WILL RESTRICT THE ABILITY OF CERTAIN STOCKHOLDERS OF COMBIMATRIX CORPORATION TO SELL THEIR MERGER SHARES.

It is a condition to our obligation to complete the merger that each CombiMatrix Corporation stockholder who is an officer, director or employee of CombiMatrix Corporation enter into a market standoff agreement with us. The stockholders who enter into a market standoff agreement will be forced to hold the shares of AR-CombiMatrix stock that they receive in the merger for six months. This restriction will prevent such stockholders from selling their AR-CombiMatrix shares at potentially advantageous times during this six-month

period and may expose such stockholders to a substantial risk of loss of their investment.

THE PROPOSED INCREASE IN AUTHORIZED BUT UNISSUED SHARES COULD RESULT IN DILUTION TO EXISTING STOCKHOLDERS.

The recapitalization would result in increasing our authorized common stock from 60,000,000 to 100,000,000 shares. Those 100,000,000 shares could be issued in the form of up to 50,000,000 shares of AR-CombiMatrix stock and up to 50,000,000 shares of AR-Acacia Technologies stock. In the recapitalization, our authorized but unissued shares of common stock would increase from 40,359,192 shares of existing common stock to 57,408,641 shares of AR-CombiMatrix stock and AR-Acacia Technologies stock. Although we have no current plans to issue more stock after the recapitalization and merger, we could issue additional shares of common stock pursuant to our increased authorized capitalization. If we do so, the ownership interests held by our existing stockholders could decline and the trading price of the two new classes of common stock could be adversely affected.

RISKS RELATING TO THE COMBIMATRIX GROUP

THE RISK FACTORS BEGINNING ON THIS PAGE DISCUSS RISKS RELATING TO THE COMBIMATRIX GROUP. AS A HOLDER OF AR-COMBIMATRIX STOCK, YOU WILL BE A HOLDER OF THE COMMON STOCK OF ONE COMPANY, ACACIA RESEARCH, AND THE RISKS ASSOCIATED WITH THE ACACIA TECHNOLOGIES GROUP COULD AFFECT THE AR-COMBIMATRIX STOCK. AS SUCH, WE URGE YOU TO READ CAREFULLY THE SECTION "RISKS RELATING TO THE ACACIA TECHNOLOGIES GROUP" BEGINNING ON PAGE 56.THE COMBIMATRIX GROUP HAS A HISTORY OF LOSSES AND EXPECTS TO INCUR ADDITIONAL LOSSES IN THE FUTURE.

The CombiMatrix group has sustained substantial losses since its inception. The CombiMatrix group may never become profitable or if it does, it may never be able to sustain profitability. We expect the CombiMatrix group to incur significant research and development, marketing, general and administrative expenses. As a result, we expect the CombiMatrix group to incur significant losses for the foreseeable future.

THE COMBIMATRIX GROUP MAY FAIL TO MEET MARKET EXPECTATIONS BECAUSE OF FLUCTUATIONS IN ITS QUARTERLY OPERATING RESULTS, WHICH COULD CAUSE ITS STOCK PRICE TO DECLINE.

The CombiMatrix group's revenues and operating results have fluctuated in the past and may continue to fluctuate significantly from quarter to quarter in the future. It is possible that in future periods the CombiMatrix group's revenues could fall below the expectations of securities analysts or investors, which could cause the market price of the AR-CombiMatrix stock to decline. The following are among the factors that could cause the CombiMatrix group's operating results to fluctuate significantly from period to period:

o its unpredictable revenue sources, as described below;

-50-

- o the nature, pricing and timing of the CombiMatrix group's and its competitors' products;
- changes in the CombiMatrix group's and its competitors' research and development budgets;
- o expenses related to, and the CombiMatrix group's ability to comply

with, governmental regulations of its products and processes; and

o expenses related to, and the results of, patent filings and other proceedings relating to intellectual property rights.

The CombiMatrix group anticipates significant fixed expenses due in part to its need to continue to invest in product development. It may be unable to adjust its expenditures if revenues in a particular period fail to meet its expectations, which would harm its operating results for that period. As a result of these fluctuations, the CombiMatrix group believes that period-to-period comparisons of the CombiMatrix group's financial results will not necessarily be meaningful, and you should not rely on these comparisons as an indication of its future performance.

THE COMBIMATRIX GROUP'S REVENUES WILL BE UNPREDICTABLE, AND THIS MAY HARM ITS FINANCIAL CONDITION.

The amount and timing of revenues that the CombiMatrix group may realize from its business will be unpredictable because:

- whether any products are commercialized and generate revenues depends, in part, on the efforts and timing of its potential customers;
- o its sales cycles may be lengthy; and
- o it cannot be sure as to the timing of receipt of payment for its products.

As a result, the CombiMatrix group's revenues may vary significantly from quarter to quarter, which could make its business difficult to manage and cause its quarterly results to be below market expectations. If this happens, the price of the CombiMatrix group's common stock may decline significantly.

TECHNOLOGY COMPANY STOCK PRICES ARE ESPECIALLY VOLATILE, AND THIS VOLATILITY MAY DEPRESS THE PRICE OF THE AR-COMBIMATRIX STOCK.

The current stock price of Acacia Research may bear no relationship to the price at which the AR-CombiMatrix stock will trade upon completion of the recapitalization. The stock market has experienced significant price and volume fluctuations, and the market prices of technology companies, particularly biotechnology companies, has been highly volatile. We believe that various factors may cause the market price of the AR-CombiMatrix stock to fluctuate, perhaps substantially, including, among others, announcements of:

- o its or its competitors' technological innovations;
- o developments or disputes concerning patents or proprietary rights;
- supply, manufacturing or distribution disruptions or other similar problems;
- o proposed laws regulating participants in the biotechnology industry;
- developments in relationships with collaborative partners or customers;
- o its failure to meet or exceed securities analysts' expectations of its financial results; or
- a change in financial estimates or securities analysts' recommendations.

-51-

In the past, companies that have experienced volatility in the market price of their stock have been the objects of securities class action litigation. If the AR-CombiMatrix stock was the object of securities class action litigation, it could result in substantial costs and a diversion of management's attention and resources, which could materially harm the business and financial results of the CombiMatrix group.

THE COMBIMATRIX GROUP IS IN THE DEVELOPMENT STAGE DEPLOYING UNPROVEN TECHNOLOGIES WHICH MAKES EVALUATION OF ITS BUSINESS AND PROSPECTS DIFFICULT AND IT MAY BE FORCED TO CEASE OPERATIONS IF IT DOES NOT DEVELOP COMMERCIALLY SUCCESSFUL PRODUCTS.

The CombiMatrix group has not proven its ability to commercialize products. In order to successfully commercialize any products, it will have to make significant investments, including investments in research and development and testing, to demonstrate their technical benefits and cost-effectiveness. Problems frequently encountered in connection with the commercialization of products using new and unproven technologies might limit its ability to develop and commercialize its products. For example, the CombiMatrix group's products may be found to be ineffective, unreliable or otherwise unsatisfactory to potential customers. The CombiMatrix group may experience unforeseen technical complications in the processes it uses to develop, manufacture, customize or receive orders for its products. These complications could materially delay or limit the use of any products the CombiMatrix group attempts to commercialize, substantially increase the anticipated cost of its products or prevent it from implementing its processes at appropriate quality and scale levels, thereby causing its business to suffer.

THE COMBIMATRIX GROUP MAY NEED TO RAISE ADDITIONAL CAPITAL IN THE FUTURE, AND IF ADDITIONAL CAPITAL IS NOT AVAILABLE ON ACCEPTABLE TERMS, THE COMBIMATRIX GROUP MAY HAVE TO CURTAIL OR CEASE OPERATIONS.

The CombiMatrix group's future capital requirements will be substantial and will depend on many factors including how quickly it commercializes its products, the progress and scope of its collaborative and independent research and development projects, the filing, prosecution, enforcement and defense of patent claims and the need to obtain regulatory approval for certain products in the United States or elsewhere. Changes may occur that would cause the CombiMatrix group's available capital resources to be consumed significantly sooner than it expects.

The CombiMatrix group may be unable to raise sufficient additional capital on favorable terms or at all. If it fails to do so, it may have to curtail or cease operations or enter into agreements requiring it to relinquish rights to certain technologies, products or markets because it will not have the capital necessary to exploit them.

IF THE COMBIMATRIX GROUP DOES NOT ENTER INTO SUCCESSFUL PARTNERSHIPS AND COLLABORATIONS WITH OTHER COMPANIES, IT MAY NOT BE ABLE TO FULLY DEVELOP ITS TECHNOLOGIES OR PRODUCTS, AND ITS BUSINESS WOULD BE HARMED.

Since the CombiMatrix group does not possess all of the resources necessary to develop and commercialize products that may result from its technologies, it will need either to grow its sales, marketing and support group or make appropriate arrangements with strategic partners to market, sell and support its products. The CombiMatrix group believes that it will have to enter into strategic partnerships to develop and commercialize future products. If it does

not enter into adequate agreements, or if its existing arrangements or future agreements are not successful, its ability to develop and commercialize products will be impacted negatively, and its revenues will be adversely affected.

The current business of the CombiMatrix group is substantially dependent on its existing arrangement with Roche. The CombiMatrix group currently relies upon payments by Roche for a majority of its future revenues and expends a majority of its resources toward fulfilling its contractual obligations to Roche. Roche's primary service to the CombiMatrix group is to distribute and proliferate its technology platform. If the CombiMatrix group were to lose its relationship with Roche, the CombiMatrix group would be required to establish a distribution agreement with another partner or distribute its technology platform itself. This could prove difficult, time-consuming and expensive, and the CombiMatrix group may not be successful in achieving this objective.

-52-

THE COMBIMATRIX GROUP HAS LIMITED EXPERIENCE COMMERCIALLY MANUFACTURING, MARKETING OR SELLING ANY OF ITS POTENTIAL PRODUCTS, AND UNLESS IT DEVELOPS THESE CAPABILITIES, IT MAY NOT BE SUCCESSFUL.

Even if the CombiMatrix group is able to develop its products for commercial release, it has limited experience in manufacturing its products in the volumes that will be necessary for it to achieve commercial sales and in marketing or selling its products to potential customers. We cannot assure you that the CombiMatrix group will be able to commercially produce its products on a timely basis, in sufficient quantities or on commercially reasonable terms.

THE COMBIMATRIX GROUP FACES INTENSE COMPETITION AND WE CANNOT ASSURE YOU THAT IT WILL BE SUCCESSFUL.

The CombiMatrix group expects to compete with companies that design, manufacture and market instruments for analysis of genetic variation and function and other applications using established sequential and parallel testing technologies. The CombiMatrix group is also aware of other biotechnology companies that have or are developing testing technologies for the SNP genotyping, gene expression profiling and proteomic markets. The CombiMatrix group anticipates that it will face increased competition in the future as new companies enter the market with new technologies and its competitors improve their current products.

The markets for the CombiMatrix group's products are characterized by rapidly changing technology, evolving industry standards, changes in customer needs, emerging competition and new product introductions. One or more of the CombiMatrix group's competitors may offer technology superior to those of the CombiMatrix group and render its technology obsolete or uneconomical. Many of its competitors have greater financial and personnel resources and more experience in marketing, sales and research and development than it has. Some of its competitors currently offer arrays with greater density than it does and have rights to intellectual property, such as genomic information or proprietary technology, which provides them with a competitive advantage. If the CombiMatrix group is not able to compete successfully, its business and financial condition would be materially harmed.

IF THE COMBIMATRIX GROUP'S NEW AND UNPROVEN TECHNOLOGY IS NOT USED BY RESEARCHERS IN THE PHARMACEUTICAL, BIOTECHNOLOGY AND ACADEMIC COMMUNITIES, ITS BUSINESS WILL SUFFER.

The CombiMatrix group's products may not gain market acceptance. In that

event, it is unlikely that its business will succeed. Biotechnology and pharmaceutical companies and academic research centers have historically analyzed genetic variation and function using a variety of technologies, and many of them have made significant capital investments in existing technologies. Compared to existing technologies, the CombiMatrix group's technologies are new and unproven. In order to be successful, its products must meet the commercial requirements of the biotechnology, pharmaceutical and academic communities as tools for the large-scale analysis of genetic variation and function. Market acceptance will depend on many factors, including:

- o the development of a market for its tools for the analysis of genetic variation and function, the study of proteins and other purposes;
- o the benefits and cost-effectiveness of its products relative to others available in the market;
- its ability to manufacture products in sufficient quantities with acceptable quality and reliability and at an acceptable cost;
- its ability to develop and market additional products and enhancements to existing products that are responsive to the changing needs of its customers;
- o the willingness and ability of customers to adopt new technologies requiring capital investments or the reluctance of customers to change technologies in which they have made a significant investment; and
- o the willingness of customers to transmit test data and permit the CombiMatrix group to transmit test results over the Internet, which will be a necessary component of its product and services packages unless customers purchase or license its equipment for use in their own facilities.

-53-

IF THE MARKET FOR ANALYSIS OF GENOMIC INFORMATION DOES NOT DEVELOP OR IF GENOMIC INFORMATION IS NOT AVAILABLE TO THE COMBIMATRIX GROUP'S POTENTIAL CUSTOMERS, ITS BUSINESS WILL NOT SUCCEED.

The CombiMatrix group is designing its technology primarily for applications in the biotechnology, pharmaceutical and academic communities. The usefulness of the CombiMatrix group's technology depends in part upon the availability of genomic data. The CombiMatrix group is initially focusing on markets for analysis of genetic variation and function, namely SNP genotyping and gene expression profiling. These markets are new and emerging, and they may not develop as the CombiMatrix group anticipates, or at all. Also, researchers may not seek or be able to convert raw genomic data into medically valuable information through the analysis of genetic variation and function. If genomic data is not available for use by the CombiMatrix group's customers or if its target markets do not emerge in a timely manner, or at all, demand for its products will not develop as it expects, and it may never become profitable.

THE COMBIMATRIX GROUP'S FUTURE SUCCESS DEPENDS ON THE CONTINUED SERVICE OF ITS ENGINEERING, TECHNICAL AND KEY MANAGEMENT PERSONNEL AND ITS ABILITY TO IDENTIFY, HIRE AND RETAIN ADDITIONAL ENGINEERING, TECHNICAL AND KEY MANAGEMENT PERSONNEL.

There is intense competition for qualified personnel in the CombiMatrix group's industry, particularly for engineers and senior level management. Loss of the services of, or failure to recruit, engineers or other technical and key

management personnel could be significantly detrimental to the group and could adversely affect its business and operating results. The CombiMatrix group may not be able to continue to attract and retain engineers or other qualified personnel necessary for the development of its products and business or to replace engineers or other qualified personnel who may leave the group in the future. The CombiMatrix group's anticipated growth is expected to place increased demands on its resources and likely will require the addition of new management personnel.

THE EXPANSION OF THE COMBIMATRIX GROUP'S PRODUCT LINES MAY SUBJECT IT TO REGULATION BY THE UNITED STATES FOOD AND DRUG ADMINISTRATION AND FOREIGN REGULATORY AUTHORITIES, WHICH COULD PREVENT OR DELAY ITS INTRODUCTION OF NEW PRODUCTS.

If the CombiMatrix group manufactures, markets or sells any products for any regulated clinical or diagnostic applications, those products will be subject to extensive governmental regulation as medical devices in the United States by the FDA and in other countries by corresponding foreign regulatory authorities. The process of obtaining and maintaining required regulatory clearances and approvals is lengthy, expensive and uncertain. Products that CombiMatrix manufactures, markets or sells for research purposes only are not subject to governmental regulations as medical devices or as analyte specific reagents to aid in disease diagnosis. We believe that the CombiMatrix group's success will depend upon commercial sales of improved versions of products, certain of which cannot be marketed in the United States and other regulated markets unless and until the CombiMatrix group obtains clearance or approval from the FDA and its foreign counterparts, as the case may be. Delays or failures in receiving these approvals may limit our ability to benefit from new CombiMatrix group products.

AS THE COMBIMATRIX GROUP'S OPERATIONS EXPAND, ITS COSTS TO COMPLY WITH ENVIRONMENTAL LAWS AND REGULATIONS WILL INCREASE, AND FAILURE TO COMPLY WITH THESE LAWS AND REGULATIONS COULD HARM ITS FINANCIAL RESULTS.

The CombiMatrix group's operations involve the use, transportation, storage and disposal of hazardous substances, and as a result it is subject to environmental and health and safety laws and regulations. As the CombiMatrix group expands its operations, its use of hazardous substances will increase and lead to additional and more stringent requirements. The cost to comply with these and any future environmental and health and safety regulations could be substantial. In addition, the CombiMatrix group's failure to comply with laws and regulations, and any releases of hazardous substances into the environment or at its disposal sites, could expose the CombiMatrix group to substantial liability in the form of fines, penalties, remediation costs and other damages, or could lead to a curtailment or shut down of its operations. These types of events, if they occur, would adversely impact the group's financial results.

-54-

THE COMBIMATRIX GROUP'S BUSINESS DEPENDS ON ISSUED AND PENDING PATENTS, AND THE LOSS OF ANY PATENTS OR THE GROUP'S FAILURE TO SECURE THE ISSUANCE OF PATENTS COVERING ELEMENTS OF ITS BUSINESS PROCESSES WOULD MATERIALLY HARM ITS BUSINESS AND FINANCIAL CONDITION.

The CombiMatrix group's success depends on its ability to protect and exploit its intellectual property. The CombiMatrix group currently has two patents issued in the United States, one patent issued in Europe and more than 42 patent applications pending in the United Sates, Europe and elsewhere. The patent application process before the Unites States Patent and Trademark Office

and other similar agencies in other countries is initially confidential in nature. Patents that are filed outside the United States, however, are published approximately eighteen months after filing. The CombiMatrix group cannot determine in a timely manner whether patent applications covering technology that competes with its technology have been filed in the United States or other foreign countries or which, if any, will ultimately issue or be granted as enforceable patents. Some of the CombiMatrix group's patent applications may claim compositions, methods or uses that may also be claimed in patent applications filed by others. In some or all of these applications, a determination of priority of inventorship may need to be decided in a proceeding before the United States Patent and Trademark Office or a foreign regulatory body or a court. If the CombiMatrix group is unsuccessful in these proceedings, it could be blocked from further developing, commercializing or selling products. Regardless of the ultimate outcome, this process is time-consuming and expensive.

ANY INABILITY TO ADEQUATELY PROTECT THE COMBIMATRIX GROUP'S PROPRIETARY TECHNOLOGIES COULD MATERIALLY HARM THE COMBIMATRIX GROUP'S COMPETITIVE POSITION AND FINANCIAL RESULTS.

If the CombiMatrix group does not protect its intellectual property adequately, competitors may be able to use its technologies and erode any competitive advantage that it may have. The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant problems in protecting their proprietary rights abroad. These problems can be caused by the absence of rules and methods for defending intellectual property rights.

The patent positions of companies developing tools for the biotechnology, pharmaceutical and academic communities, including the CombiMatrix group's patent position, generally are uncertain and involve complex legal and factual questions. The CombiMatrix group will be able to protect its proprietary rights from unauthorized use by third parties only to the extent that its proprietary technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. The CombiMatrix group's existing patents and any future issued or granted patents it obtains may not be sufficiently broad in scope to prevent others from practicing its technologies or from developing competing products. There also is a risk that others may independently develop similar or alternative technologies or designs around the CombiMatrix group's patented technologies. In addition, others may oppose or invalidate its patents, or its patents may fail to provide it with any competitive advantage. Enforcing the CombiMatrix group's intellectual property rights may be difficult, costly and time-consuming and ultimately may not be successful.

The CombiMatrix group also relies upon trade secret protection for its confidential and proprietary information. While it has taken security measures to protect its proprietary information, these measures may not provide adequate protection for its trade secrets or other proprietary information. The CombiMatrix group seeks to protect its proprietary information by entering into confidentiality and invention disclosure and transfer agreements with employees, collaborators and consultants. Nevertheless, employees, collaborators or consultants may still disclose its proprietary information, and the CombiMatrix group may not be able to meaningfully protect its trade secrets. In addition, others may independently develop substantially equivalent proprietary information or techniques or otherwise gain access to its trade secrets.

ANY LITIGATION TO PROTECT THE COMBIMATRIX GROUP'S INTELLECTUAL PROPERTY OR ANY THIRD-PARTY CLAIMS OF INFRINGEMENT, COULD DIVERT SUBSTANTIAL TIME AND MONEY FROM THE COMBIMATRIX GROUP'S BUSINESS AND COULD SHUT DOWN SOME OF ITS OPERATIONS.

The CombiMatrix group's commercial success depends in part on its non-infringement of the patents or proprietary rights of third parties. Many

companies developing tools for the biotechnology and pharmaceutical industries use litigation aggressively as a strategy to protect and expand the scope of their intellectual property

-55-

rights. Accordingly, third parties may assert that the CombiMatrix group is employing their proprietary technology without authorization. In addition, third parties may claim that use of the CombiMatrix group's technologies infringes their current or future patents. The CombiMatrix group could incur substantial costs and the attention of its management and technical personnel could be diverted while defending ourselves against any of these claims. The CombiMatrix group may incur the same liabilities in enforcing its patents against others. The CombiMatrix group has not made any provision in its financial plans for potential intellectual property related litigation, and it may not be able to pursue litigation as aggressively as competitors with substantially greater financial resources.

If parties making infringement claims against the CombiMatrix group are successful, they may be able to obtain injunctive or other equitable relief, which effectively could block the CombiMatrix group's ability to further develop, commercialize and sell products, and could result in the award of substantial damages against it. If the CombiMatrix group is unsuccessful in protecting and expanding the scope of its intellectual property rights, its competitors may be able to develop, commercialize and sell products that compete with it using similar technologies or obtain patents that could effectively block its ability to further develop, commercialize and sell its products. In the event of a successful claim of infringement against it, the CombiMatrix group may be required to pay substantial damages and either discontinue those aspects of its business involving the technology upon which it infringed or obtain one or more licenses from third parties. While the CombiMatrix group may license additional technology in the future, it may not be able to obtain these licenses at a reasonable cost, or at all. In that event, it could encounter delays in product introductions while it attempts to develop alternative methods or products, which may not be successful. Defense of any lawsuit or failure to obtain any of these licenses could prevent it from commercializing available products.

NANOGEN, INC. WILL BE THE LARGEST HOLDER OF THE AR-COMBIMATRIX STOCK.

As part of a settlement of outstanding litigation among CombiMatrix Corporation, Dr. Donald Montgomery and Nanogen, Inc., CombiMatrix Corporation issued 4,016,346 shares of its common stock, or 17.5% of its total outstanding shares post-issuance. Following the merger and recapitalization, Nanogen, Inc. will hold approximately 17.5% of the outstanding AR-CombiMatrix stock, assuming the conversion of each share of Acacia Research common stock into 0.5582 share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock in the recapitalization. As a result, Nanogen, Inc. will be the largest stockholder of both the AR-CombiMatrix stock and Acacia Research, and may be able to exert greater influence than other stockholders over matters submitted to our stockholders for approval, including the election and removal of directors and the approval of any merger, consolidation or sale of all or substantially all of our assets. Nanogen, Inc. may make decisions that are adverse to the interests of other stockholders.

RISKS RELATING TO THE ACACIA TECHNOLOGIES GROUP

The risk factors beginning on this page discuss risks relating to the Acacia Technologies group. As a holder of AR-Acacia Technologies stock, you will

be a holder of the common stock of one company, Acacia Research Corporation, and the risks associated with the CombiMatrix group could affect the AR-Acacia Technologies stock. As such, we urge you to read carefully the section "Risks Relating to the CombiMatrix Group" beginning on page 50.

THE V-CHIP TECHNOLOGY PATENT HELD BY THE ACACIA TECHNOLOGIES GROUP WILL EXPIRE IN JULY 2003, AND IF THE GROUP DOES NOT DEVELOP OTHER RECURRING SOURCES OF REVENUE, ITS FINANCIAL CONDITION WILL BE ADVERSELY IMPACTED.

The Acacia Technologies group, and Acacia Research as a whole, has generated substantially all of its revenues from licensing the patented V-chip technology to television manufacturers. The Acacia Technologies group's patent on the V-chip technology will expire in July 2003. The Acacia Technologies group will not be able to collect royalties for televisions containing V-chip technology sold after the expiration of that patent, but it may still collect revenues from the sale of such televisions in the U.S. before that date. The Acacia Technologies group is beginning to market its digital media transmission technology and is developing other technologies and products. The eventual licensing and sale of these technologies is intended to replace the revenue currently being generated by licensing its V-chip technology. If the Acacia Technologies group does not succeed in developing such technologies or is unable to commercially license its existing and future technologies, its financial condition will be adversely impacted.

-56-

THE ACACIA TECHNOLOGIES GROUP MAY FAIL TO MEET MARKET EXPECTATIONS BECAUSE OF FLUCTUATIONS IN ITS QUARTERLY OPERATING RESULTS, WHICH COULD CAUSE THE PRICE OF AR-ACACIA TECHNOLOGIES STOCK TO DECLINE.

The Acacia Technologies group revenues and operating results have fluctuated in the past and may continue to fluctuate significantly from quarter to quarter in the future. It is possible that in future periods the Acacia Technologies group's revenues could fall below the expectations of securities analysts or investors, which could cause the market price of the AR-Acacia Technologies stock to decline. The following are among the factors that could cause the Acacia Technologies group's operating results to fluctuate significantly from period to period:

- o its unpredictable revenue sources, as described below;
- costs related to acquisitions, alliances, licenses and other efforts to expand its operations;
- o the timing of payments under the terms of any customer or license agreements into which the Acacia Technologies group may enter; and
- expenses related to, and the results of, patent filings and other proceedings relating to intellectual property rights.

THE ACACIA TECHNOLOGIES GROUP'S REVENUES WILL BE UNPREDICTABLE, AND THIS MAY HARM ITS FINANCIAL CONDITION.

The amount and timing of revenues that the Acacia Technologies group may realize from its business will be unpredictable because:

 whether the Acacia Technologies group generates revenues depends, in part, on the success of its licensing efforts;

- o its cycle of obtaining licensees may be lengthy; and
- o it cannot be sure as to the timing of receipt of payment.

As a result, the Acacia Technologies group's revenues may vary significantly from quarter to quarter, which could make its business difficult to manage and cause its quarterly results to be below market expectations. If this happens, the price of the AR-Acacia Technologies stock may decline significantly.

TECHNOLOGY COMPANY STOCK PRICES ARE ESPECIALLY VOLATILE, AND THIS VOLATILITY MAY DEPRESS THE PRICE OF AR-ACACIA TECHNOLOGIES STOCK.

The current stock price of Acacia Research common stock may bear no relationship to the price at which the AR-Acacia Technologies stock will trade upon completion of the recapitalization. The stock market has experienced significant price and volume fluctuations, and the market prices of technology companies have been highly volatile. We believe that various factors may cause the market price of the AR-Acacia Technologies stock to fluctuate, perhaps substantially, including, among others, announcements of:

- o its or its competitors' technological innovations;
- developments or disputes concerning patents or proprietary rights;
- o developments in relationships with licensees;
- its failure to meet or exceed securities analysts' expectations of its financial results; or
- a change in financial estimates or securities analysts' recommendations.

-57-

In the past, companies that have experienced volatility in the market price of their stock have been the objects of securities class action litigation. If the AR-Acacia Technologies stock was the object of securities class action litigation, it could result in substantial costs and a diversion of management's attention and resources, which could materially harm the business and financial results of the Acacia Technologies group.

THE ACACIA TECHNOLOGIES GROUP FACES INTENSE COMPETITION, AND WE CANNOT ASSURE YOU THAT IT WILL BE SUCCESSFUL.

The Acacia Technologies group believes that Soundview Technologies' V-chip technology is protected by enforceable patent rights. Other companies, however, may develop competing technologies that offer better or less expensive alternatives to those offered by Soundview Technologies. Many potential competitors, including television manufacturers, have significantly greater resources.

Although the Acacia Technologies group believes that Acacia Media Technologies has marketing and licensing rights to enforceable patents and other intellectual property relating to video and audio on demand, the Acacia Technologies group cannot assure you that other companies will not develop competing technologies that offer better or less expensive alternatives to those offered by Acacia Media Technologies. In the event a competing technology emerges, Acacia Media Technologies would expect substantial additional competition.

THE MARKETS SERVED BY THE ACACIA TECHNOLOGIES GROUP ARE SUBJECT TO RAPID TECHNOLOGICAL CHANGE, AND IF THE ACACIA TECHNOLOGIES GROUP IS UNABLE TO DEVELOP AND INTRODUCE NEW PRODUCTS, ITS REVENUES COULD STOP GROWING OR COULD DECLINE.

The markets served by the Acacia Technologies group frequently undergo transitions in which products rapidly incorporate new features and performance standards on an industry-wide basis. Products for communications applications, as well as for high-speed computing applications, are based on continually evolving industry standards. A significant portion of the Acacia Technologies group's revenues in recent periods has been, and is expected to continue to be, derived from sales of products based on existing transmission standards. However, the Acacia Technologies group's ability to compete in the future will depend on its ability to identify and ensure compliance with evolving industry standards.

THE ACACIA TECHNOLOGIES GROUP'S SUCCESS IS BASED ON ITS ABILITY TO PROTECT ITS PROPRIETARY TECHNOLOGY AND ITS ABILITY TO DEFEND ITSELF AGAINST INFRINGEMENT CLAIMS.

The success of the Acacia Technologies group relies, to varying degrees, on its proprietary rights and their protection or exclusivity. Although reasonable efforts will be taken to protect the Acacia Technologies group's proprietary rights, the complexity of international trade secret, copyright, trademark and patent law, and common law, coupled with limited resources and the demands of quick delivery of products and services to market, create risk that these efforts will prove inadequate. For example, in our pending litigation against certain television manufacturers alleging their infringement of Soundview Technologies' V-chip patent, a motion for summary judgment filed by the defendants was granted in September 2002. The court ruled that the defendants have not infringed on Soundview Technologies' patent. If we are unsuccessful in our intended appeal of this ruling, legal principles would preclude us from claiming infringement of our patents by other parties. Accordingly, if we are unsuccessful in this or other litigation to protect our intellectual property rights, the future revenues of the Acacia Technologies group could be adversely affected.

From time to time, the Acacia Technologies group may be subject to third-party claims in the ordinary course of business, including claims of alleged infringement of proprietary rights. Any such claims may harm the Acacia Technologies group by subjecting it to significant liability for damage and invalidating its proprietary rights. These types of claims, with or without merit, could subject the Acacia Technologies group to costly litigation and diversion of its technical and management personnel. The Acacia Technologies group depends largely on the protection of enforceable patent rights. The Acacia Technologies group has applications on file with the U.S. Patent and Trademark Office seeking patents on its core technologies and has patents or rights to patents that have been issued. We cannot assure you that the pending patent applications of the Acacia Technologies group will be issued, that third parties will not violate, or attempt to invalidate these intellectual property rights, or that certain aspects of those intellectual property will not be reverse-engineered by third parties without violating the patent rights of the Acacia Technologies group.

-58-

For Acacia Media Technologies and Soundview Technologies, proprietary rights constitute their only significant assets. The Acacia Technologies group

also owns licenses from third parties and it is possible that it could become subject to infringement actions based upon such licenses. The Acacia Technologies group generally obtains representations as to the origin and ownership of such licensed content. However, this may not adequately protect the Acacia Technologies group. The Acacia Technologies group enters into confidentiality agreements with third parties and generally limits access to information relating to its proprietary rights. Despite these precautions, third parties may be able to gain access to and use the Acacia Technologies group's proprietary rights to develop competing technologies and products with similar or better features and prices. Any substantial unauthorized use of the Acacia Technologies group's proprietary rights could materially and adversely affect its business and operational results.

-59-

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This proxy statement contains forward-looking statements within the meaning of the federal securities laws. Forward-looking statements are statements that predict or describe future events or trends and that do not relate solely to historical matters. You can generally identify forward-looking statements as statements containing the words "may," "will," "expect," "believe," "estimate," "anticipate," "intend," "continue," and other similar expressions or the negative of these terms. You should be aware that the matters described in our forward-looking statements are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Statements regarding the following subjects are forward-looking by their nature:

- o our business strategies;
- o market trends and risks;
- o assumptions regarding economic conditions;
- o circumstances affecting anticipated revenues and costs; and
- o legislative, regulatory and competitive developments.

These forward-looking statements are subject to various risks and uncertainties, including those related to:

- o the recent slowdown affecting technology companies;
- o our ability to successfully develop products;
- o rapid technological change in our markets;
- o anticipated sources of future revenues;
- o changes in demand for our future products;
- o our ability to raise capital in the future; and
- o the adequacy of our capital resources to fund our operations.

Other risks, uncertainties and factors, including those discussed under "Risk Factors" in this proxy statement or described in reports that we file from time to time with the Securities and Exchange Commission, such as our Form 10-K

and 10-Q, could cause our actual results and those of our industries' to differ materially from those projected in any forward-looking statements we make. We are not obligated to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

-60-

STOCKHOLDERS MEETING

DATE, TIME AND PLACE OF MEETING

We are providing this proxy statement to you in connection with the solicitation of proxies by our board of directors for use at the special meeting. The special meeting will be held on December 11, 2002, at 1:30 p.m., Pacific time, at 610 Newport Center Drive, Suite 130, Newport Beach, California 92660. This proxy statement is first being mailed to our stockholders on or about November 12, 2002.

RECORD DATE

We have established November 1, 2002 as the record date for the special meeting. Only holders of record of shares of our existing common stock at the close of business on this date will be eligible to vote at the special meeting.

PROPOSALS TO BE CONSIDERED AT THE MEETING

You will be asked to consider and vote on the four proposals described in this proxy statement.

If any of the proposals is not approved, we will not implement any of the other proposals.

We do not expect that any other matter will be brought before the special meeting. If, however, other matters are properly presented, the individuals named on your proxy card will vote in accordance with their judgment with respect to those matters.

VOTE REQUIRED TO APPROVE THE PROPOSALS

The recapitalization proposal and the merger proposal will require the favorable vote of a majority of the outstanding shares of our existing common stock. As a result, abstentions and broker non-votes on the recapitalization proposal and the merger proposal will have the same effect as "no" votes. Broker non-votes occur when a broker returns a proxy but does not have authority to vote on a particular proposal.

Each of the related stock incentive plan proposals will be decided by the favorable vote of a majority of the shares present or represented and entitled to vote at the special meeting. Abstentions will have the same effect as "no" votes on these two proposals. Broker non-votes will not affect the outcome of these two proposals.

Each outstanding share of existing common stock is entitled to one vote on each proposal. As of November 1, 2002, the most recent practicable date prior to the date of this proxy statement, we had issued and outstanding 19,640,808 shares of existing common stock. The shares of existing common stock held in our treasury will not be entitled to vote or counted in determining the number of outstanding shares. Approval of the merger and the recapitalization will require a majority vote our outstanding common stock. As of November 1, 2002, 2.2% of

our outstanding common stock was owned by our executive officers, directors and their affiliates.

The merger is also conditional on obtaining a majority vote of the outstanding common stock of CombiMatrix Corporation. As of November 1, 2002, 10.0% of CombiMatrix Corporation's outstanding common stock was owned by its executive officers, directors and their affiliates, and 17.5% is owned by Nanogen, Inc., an unrelated third party.

QUORUM

In order to carry on the business of the special meeting, we must have a quorum. This means a majority of the outstanding shares of our existing common stock must be represented in person or by proxy at the special meeting. Abstentions and broker non-votes will count for quorum purposes.

-61-

PROCEDURE FOR VOTING BY PROXY

If you properly fill in your proxy card and send it to us in time to vote, your shares will be voted as you have directed. If you sign the proxy card but do not make specific choices, the individuals named on your proxy card will vote your shares in favor of approval and adoption of each proposal. If you mark "abstain" on your proxy card, your shares will be counted as present for purposes of determining the presence of a quorum. If necessary, unless you have indicated on your proxy card that you wish to vote against one or more of the proposals, the individuals named on your proxy card may vote in favor of a proposal to adjourn the special meeting to a later date in order to solicit and obtain sufficient votes for any of the proposals.

A proxy card is enclosed for your use. To vote without attending the special meeting in person, you should complete, sign, date and return the proxy card in the accompanying envelope, which is postage-paid if mailed in the United States.

If you have completed and returned a proxy card, you can still vote in person at the special meeting. You may revoke your proxy before it is voted by submitting a new proxy card with a later date, by voting in person at the special meeting or by filing with the Secretary of Acacia Research a written revocation of proxy. Attendance at the special meeting will not of itself constitute revocation of a proxy.

PRO FORMA TABLE REGARDING SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth pro forma information regarding the beneficial ownership of the AR-CombiMatrix stock and the AR-Acacia Technologies stock, based on share ownership information known to us as of November 1, 2002 and assuming that the recapitalization and merger were effective as of such date and assuming that each share of Acacia Research common stock would convert into 0.5582 of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. The table sets forth information regarding (i) all persons known to us to beneficially own five percent (5%) or more of Acacia Research common stock, (ii) each director, (iii) each executive officer of Acacia Research, (iv) all current directors and executive officers as a group, and (v) each person who will own five percent (5%) or more of the AR-CombiMatrix stock or the AR-Acacia Technologies stock following the recapitalization and merger.

| | AR-COMBIMATRIX | AR-ACACIA TECHNOLOG | |
|---|---|---------------------|---|
| BENEFICIAL OWNER(1) | AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP | PERCENT (2) | AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP |
| Paul R. Ryan | 512,019(3) | 2.2% | 852,346(4) |
| Thomas B. Akin | 102,185(5) | * | 136,039(6) |
| Fred A. de Boom | 31,370(7) | * | 56,200(8) |
| Edward W. Frykman | 36,165(9) | * | 64,790(10) |
| Robert L. Harris, II | 276,461(11) | 1.2% | 448,256(12) |
| G. Louis Graziadio, III | 12,280(13) | * | 22,000(14) |
| Amit Kumar, Ph.D. | 242,046(15) | * | 245,766(16) |
| Clayton Haynes | 18,420(17) | * | 33,000(18) |
| All Directors and Executive Officers as a | | | |
| Group (eight persons) | 1,179,121(19) | 4.9% | 1,858,397(20) |
| Nanogen, Inc. | 4,016,346 | 17.5% | 0 |
| Donald D. Montgomery, Ph.D. | 2,281,484(21) | 9.9% | 28,786 |

* Less than one percent

(1) The address for Dr. Kumar and Dr. Montgomery is the principal offices of CombiMatrix Corporation, located at 6500 Harbour Heights Parkway, Mukilteo, Washington 98275; the address for Nanogen, Inc. is 10398 Pacific Center Court, San Diego, California, 92121; and the address for each other person is the principal offices of Acacia Research Corporation, located at 500 Newport Center Drive, Newport Beach, California 92660..

-62-

- (2) The percentage of shares beneficially owned is based on 22,968,551 shares of AR-CombiMatrix stock and 19,640,808 shares of AR-Acacia Technologies stock outstanding as of November 1, 2002. Beneficial ownership is determined under rules and regulations of the Securities and Exchange Commission. Shares of AR-Acacia Technologies stock and AR-CombiMatrix stock subject to options that are currently exercisable or exercisable within 60 days after November 1, 2002 are deemed to be outstanding and beneficially owned by the person holding such options for the purpose of computing the number of shares beneficially owned and the percentage ownership of such person, but are not deemed to be outstanding for the purpose of computing the footnotes to this table, and subject to applicable community property laws, we believe that such persons have sole voting and investment power with respect to all shares of the AR-CombiMatrix stock and AR-Acacia Technologies stock shown as beneficially owned by them.
- (3) Includes 327,138 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (4) Includes 521,129 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.

- (5) Includes 68,003 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002, and 34,183 shares held by Talkot Crossover Fund, L.E, of which Mr. Akin serves as managing general partner.
- (6) Includes 74,800 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002, and 61,239 shares held by Talkot Crossover Fund, L.E, of which Mr. Akin serves as managing general partner.
- (7) Includes 18,420 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (8) Includes 33,000 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (9) Includes 28,244 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (10) Includes 50,600 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (11) Includes 276,461 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (12) Includes 448,256 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (13) Includes 12,280 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (14) Includes 22,000 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (15) Includes 241,432 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (16) Includes 244,666 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (17) Includes 18,420 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (18) Includes 33,000 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (19) Includes 990,399 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.

-63-

- (20) Includes 1,427,451 shares of AR-Acacia Technologies stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (21) Includes 19,254 shares of AR-CombiMatrix stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.

-64-

THE RECAPITALIZATION PROPOSAL

DESCRIPTION OF THE RECAPITALIZATION

You are being asked to consider and approve the recapitalization under which each outstanding share of our existing common stock will be converted into a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. The fraction of a share of AR-CombiMatrix stock into which each outstanding share of Acacia Research common stock will be converted will be equal to the quotient obtained by dividing (a) the number of shares of CombiMatrix Corporation common stock owned by Acacia Research immediately prior to the effective time of the merger by (b) the total number of shares of Acacia Research common stock issued and outstanding immediately prior to the effective time. As of October 3, 2002, this fraction was 0.5582, but this fraction is subject to change prior to the effective time of the merger based on any change in the number of shares owned by Acacia Research and any change in the number of outstanding shares of CombiMatrix Corporation.

If the recapitalization is implemented, your rights as stockholders will be governed by the proposed restated certificate of incorporation which is attached as ANNEX B. The restated certificate of incorporation contains the terms of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. Accordingly, you should carefully read the restated certificate of incorporation.

If the recapitalization proposal is approved, we plan to implement the recapitalization by filing the restated certificate of incorporation with the Delaware Secretary of State. We presently anticipate that this filing will be made as soon as possible after the special meeting. No state or federal regulatory approvals are required for the consummation of the recapitalization.

Our board of directors may determine not to implement the recapitalization proposal for any reason at any time prior to the effective time of the recapitalization, either before or after stockholder approval. In addition, the restated certificate of incorporation may be amended prior to the effective time of the recapitalization; however, we have no current plans to make such an amendment.

BACKGROUND OF AND REASONS FOR THE RECAPITALIZATION PROPOSAL

Our board of directors approved the recapitalization proposal and the merger proposal following its review of various alternatives for maximizing stockholder value, advancing our financial and strategic objectives and creating flexibility for our future growth. The recapitalization proposal is designed to

separate the performance of the two groups and to charge the managers of each group with the responsibility of maximizing the returns from their businesses. The merger proposal is designed to consolidate our ownership and capture the value of our principal subsidiary, and permit us to effectuate the recapitalization by creating the CombiMatrix group in a manner that reflects fully the value of CombiMatrix Corporation.

At a meeting held on February 25, 2002, our board of directors considered a variety of proposals to increase the overall value of the existing common stock. Our board of directors had extensive discussions with our senior financial and legal officers, as well as representatives of Allen Matkins Leck Gamble & Mallory LLP, our legal adviser ("Allen Matkins"). Among the alternatives which our directors considered were:

- o the preservation of the current equity and operating structure;
- the creation of two classes of common stock to reflect separately the results of our subsidiary CombiMatrix Corporation and our media technology business; and
- o an initial public offering of common stock of CombiMatrix Corporation and the spin-off of the balance of that company to holders of our existing common stock.

-65-

Our board of directors used several criteria to contrast the benefits and drawbacks of these transaction alternatives to you including:

- o tax efficiency;
- o capital markets acceptance;
- o likelihood of success;
- o flexibility to provide equity incentives for employees;
- ability of CombiMatrix Corporation to raise equity capital in the future; and
- o long-term maximization of our investment in CombiMatrix Corporation.

Our board of directors concluded that an initial public offering or spin-off of shares of CombiMatrix Corporation would not be feasible at this time because an initial public offering would not achieve the separation and maximization of the value of our two business groups, and market conditions have prevented CombiMatrix Corporation and similar companies from having the access to capital necessary for an initial public offering at this time. Our board of directors concluded that a spin-off of shares was not feasible due to tax constraints and because such a spin-off would not provide a vehicle for raising equity capital.

Our board of directors further concluded that to effectuate the recapitalization proposal, it would be beneficial to acquire the minority interests in CombiMatrix Corporation. Minority interests were created primarily in connection with the sale of CombiMatrix Corporation common stock to third parties in connection with its initial formation in April 1996 several private equity financings (for the purposes of raising capital for ongoing operations) occurring during the period from May 1997 to August 2000 and settlement of

litigation. In March 2000, in the most recent of the private equity financings, Acacia Research purchased 2,000,000 shares of CombiMatrix Corporation common stock at \$5.00 per share. At October 3, 2002, CombiMatrix Corporation had approximately 240 stockholders other than Acacia Research, none of which were our affiliates. From time to time, Acacia Research has purchased shares directly from other stockholders. Shares purchased from such stockholders occurred on separate occasions in 1998, 2000 and 2001 and involved a total of 1,578,850 shares. None of the shares purchased were purchased from affiliates of Acacia Research or CombiMatrix Corporation.

Our board of directors reached the conclusion that it would be beneficial to acquire the CombiMatrix minority interests due to the fact that owning 100% of CombiMatrix Corporation would provide several benefits to Acacia Research and its stockholders including:

- the AR-CombiMatrix stock would reflect fully the value of CombiMatrix Corporation, increasing the group's overall value and potential access to capital following the merger and recapitalization;
- Acacia Research would retain full control over CombiMatrix
 Corporation, freeing Acacia Research to act in the best interests of
 Acacia Research and its stockholders without concern of harming the
 CombiMatrix Corporation minority stockholders; and
- Acacia Research could potentially avoid claims of unfair treatment to CombiMatrix Corporation's minority stockholders by permitting them to participate in the recapitalization and achieve liquidity for their ownership interests in CombiMatrix Corporation.

Our board of directors discussed at length the valuation methodology that would be used in valuing CombiMatrix Corporation common stock in the merger. Our board determined that because the merger would be contingent on approval of the recapitalization proposal and CombiMatrix Corporation stockholders would receive only AR-CombiMatrix stock in the merger, the CombiMatrix Corporation stockholders would be issued a percentage of AR-CombiMatrix stock representing their existing percentage ownership interests in CombiMatrix Corporation. At the meeting on February 25, 2002, our board of directors approved the recapitalization and merger

-66-

transaction in principle, recognizing that the proposals would be subject to a number of conditions, including negotiation of a definitive merger agreement and a determination by our accountants that the recapitalization and merger would be tax-free to you and us.

On February 26, 2002, the CombiMatrix Corporation board of directors met to consider the proposed merger. At this meeting, CombiMatrix Corporation management and its financial, accounting and legal advisors reviewed with these directors the status of negotiations and potential transaction terms under discussion. The disinterested director reviewed an overview of various aspects of the proposed transaction structure, including the proposed exchange ratio of the merger and a review of businesses and assets that were proposed to be attributed to the new classes of Acacia Research common stock. At that meeting the CombiMatrix Corporation board of directors approved the formation of a special committee consisting of its disinterested director, Rigdon Currie, to consider and evaluate the benefits of the merger, negotiate the terms of the transaction, consider whether such terms and conditions are fair, from a financial point of view, to CombiMatrix Corporation and its stockholders, and

report such findings and make a recommendation to the CombiMatrix Corporation board. The special committee was also authorized to hire financial and legal advisers and other experts it deemed necessary. At that meeting, the CombiMatrix Corporation board of directors approved in principle the merger, subject to a number of conditions, including the negotiation of a definitive merger agreement, receipt of a fairness opinion, the favorable recommendation of the special committee and other customary conditions. Accordingly, although the proposed exchange ratio for the merger had been approved by the boards of both Acacia Research and CombiMatrix Corporation by February 28, 2002, final agreement on the exchange ratio remained subject to approval or re-negotiation by the special committee and receipt of a fairness opinion, among other conditions.

At the February 26, 2002 meeting, the CombiMatrix Corporation board also referred the merger proposal to the CombiMatrix Corporation joint business development committee, which is a committee established under CombiMatrix Corporation's charter documents for the purpose of resolving conflicts of interest. The joint business development committee is comprised of an equal number of designees of Acacia Research and CombiMatrix Corporation. It was intended that this equal representation would help resolve potential conflicts of interest between the two companies in a manner that would be fair to both companies. The joint business development committee considered and approved the merger proposal on March 19, 2002.

The members of the joint business development committee designated by Acacia Research are Paul Ryan, Robert Harris and Robert Berman, and the designees appointed by CombiMatrix Corporation are Amit Kumar, Scott Burell and Donald Montgomery. Messrs. Ryan, Harris and Berman are the Chairman and Chief Executive Officer, President, and Senior Vice President of Business Development, General Counsel and Secretary respectively of Acacia Research. Messrs. Kumar, Burrell, and Montgomery are the President and Chief Executive Officer, Senior Vice President of Finance and Treasurer, and Senior Vice President and Chief Technology Officer, respectively, of CombiMatrix Corporation. In addition Messrs. Ryan and Harris are directors of Acacia Research and Messrs. Ryan, Kumar and Montgomery are directors of CombiMatrix Corporation.

On February 26, 2002, after the board meeting, the special committee appointed by the board elected to engage the law firm of McKenna & Cuneo LLP ("McKenna") as legal counsel to the special committee. Thereafter on March 19, 2002, the special committee engaged A.G. Edwards & Sons, Inc. to act as financial adviser to the special committee and to analyze a number of valuation metrics applicable to the potential transaction based upon materials previously distributed to the board. Commencing on March 21, 2002, A.G. Edwards conducted a financial investigation of CombiMatrix Corporation's business and operations and performed certain analyses. Among other things, representatives of A.G. Edwards met with CombiMatrix Corporation officers and key employees and reviewed various documents, financial statements and projections and other reports and material provided by us and CombiMatrix Corporation.

On March 8, 2002, Allen Matkins circulated an initial draft of the merger agreement. There ensued over the next several weeks a series of conference calls and negotiations followed by numerous revisions and recirculations of the merger agreement. During this period of time, representatives of Acacia Research and Allen Matkins conducted due diligence and spoke on numerous occasions regarding the documents to be prepared in connection with the recapitalization.

-67-

Between March 8, 2002 and March 19, 2002, there were several discussions

between representatives of the CombiMatrix Corporation special committee and us in which the terms of the merger agreement were discussed and negotiated. However, as a result of these negotiations, it was agreed that certain of the representations and warranties made under the merger agreement would survive for a 180 days following the merger instead of terminating upon consummation of the merger as originally proposed, and that stock options of CombiMatrix Corporation employees would be assumed by Acacia Research. During these negotiations, the special committee consulted with McKenna, A.G. Edwards and CombiMatrix Corporation management.

On March 19, 2002, our board of directors met and confirmed its prior conclusions concerning alternatives available to us and identified the following as the advantages of the recapitalization proposal and the merger proposal:

- o The creation of two classes of common stock intended to reflect separately the performance of the CombiMatrix group and the Acacia Technologies group is expected to increase stockholder value and accommodate investor interests by more specifically tracking the earnings, cash flows and investment results of each group. The AR-CombiMatrix stock is expected to be valued in the market based on the success of its research and development efforts and progress in meeting its business plan. The AR-Acacia Technologies stock's valuation is expected to be based on growth in earnings and cash flows. As a result, we expect that holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be distinct investor groups;
- o The merger should permit the AR-CombiMatrix stock to reflect fully the value of CombiMatrix Corporation, should provide greater marketability of the AR-CombiMatrix stock by increasing its attractiveness to potential investors as a result of the ability to fully control CombiMatrix Corporation, and should eliminate potential claims by the CombiMatrix Corporation minority stockholders regarding their ability to participate in the recapitalization;
- The creation of two classes of common stock should facilitate research coverage by industry specific research analysts, and thus should provide increased market awareness of Acacia Research and each of the two groups;
- o The creation of two classes of common stock should enhance the autonomy of each of the groups by allowing each group and its management to focus on that group's own identity, business strategy, financial model and culture and to structure employee incentives which are tied directly to the share performance of that group;
- o The financial and strategic flexibility, after the recapitalization, for us to raise capital for the CombiMatrix group and the Acacia Technologies group and to engage in mergers, acquisitions, strategic investments, capital restructurings and other transactions affecting either the CombiMatrix group or the Acacia Technologies group should be enhanced as a result of the availability of two different equity securities. In the ordinary course of business, our board of directors may consider such transactions from time to time, but it has no current plans or intentions with respect to any specific transaction;
- The recapitalization benefits the stockholders of CombiMatrix Corporation by providing them liquid, publicly-traded NASDAQ listed shares; and
- o The implementation of the recapitalization proposal and the merger proposal is not expected to be taxable to us or you, except for cash received instead of fractional shares of AR-CombiMatrix stock.

Our board of directors also considered the following potential disadvantages of the recapitalization proposal and the merger proposal:

 The recapitalization proposal requires a complex capital structure that may not be well-understood by investors and thus could inhibit the efficient valuation of either or both classes of common stock;

-68-

- The potential diverging or conflicting interests of the two groups and the issues that could arise in resolving any conflicts;
- Investors in the AR-CombiMatrix stock and the AR-Acacia Technologies stock will be exposed to the risks of our consolidated businesses and liabilities because both groups remain legally a part of Acacia Research;
- o The market values of the AR-CombiMatrix stock and the AR-Acacia Technologies stock could be affected by market reaction to decisions by our board of directors and management that investors perceive to affect differently one class of common stock compared to the other, such as decisions regarding the allocation of assets, expenses, liabilities and corporate opportunities and financing resources between the groups;
- o The possible inability or increased difficulty of receiving a ruling from the Internal Revenue Service in connection with a proposed acquisition to be effected using either the AR-CombiMatrix stock or the AR-Acacia Technologies stock; and
- The risks related to the recapitalization and merger as set forth in the risk factors beginning on page 41.

Our board of directors determined that on balance the potential advantages of the recapitalization proposal outweigh the potential disadvantages and concluded that the recapitalization proposal is in the best interests of Acacia Research and our stockholders. In addition, after an extensive discussion and considering such factors as the fairness of the consideration to be paid to the stockholders of CombiMatrix Corporation from a financial point of view and the terms of the merger agreement, our board determined that the merger proposal is in our best interests and the best interests of our stockholders.

On March 19, 2002, our board of directors unanimously approved the agreement and plan of merger, implementing the recapitalization and the calling of the special meeting.

On March 19, 2002, the board of directors of CombiMatrix Corporation met to discuss and evaluate the merger. The board of CombiMatrix Corporation noted that the CombiMatrix Corporation special committee had met with representatives of McKenna and A.G. Edwards on several occasions and that the special committee and McKenna had negotiated the terms of the merger agreement. After an extensive discussion and considering numerous factors, including the liquidity that could be attained by the CombiMatrix Corporation stockholders as a result of the merger and recapitalization, the consideration being paid in the merger and other factors it deemed relevant, the CombiMatrix Corporation board of directors unanimously approved the agreement and plan of merger and the calling of a special meeting; subject, however, to receipt of an opinion of A.G. Edwards that the consideration to be paid to the stockholders of CombiMatrix Corporation is

fair from a financial point of view.

RECOMMENDATION OF OUR BOARD OF DIRECTORS

OUR BOARD OF DIRECTORS HAS CAREFULLY CONSIDERED THE RECAPITALIZATION PROPOSAL AND BELIEVES THAT THE RECAPITALIZATION PROPOSAL IS IN THE BEST INTERESTS OF ACACIA RESEARCH AND OUR STOCKHOLDERS. OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU APPROVE THE RECAPITALIZATION PROPOSAL.

OPINION OF A.G. EDWARDS

On behalf of CombiMatrix Corporation and its board of directors, the CombiMatrix Corporation special committee retained A.G. Edwards to render an opinion as to whether the consideration to be received by the minority stockholders of CombiMatrix Corporation in the proposed merger was fair, from a financial point of view, to the minority stockholders. A.G. Edwards issued an opinion, as of April 17, 2002, that the consideration to be received by the minority stockholders of CombiMatrix Corporation in the proposed merger was fair, from a financial point of view, to the minority stockholders.

-69-

A.G. Edwards, as part of its investment banking business, is regularly engaged in the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements and valuations for estate, corporate and other purposes. A.G. Edwards is not aware of any present or contemplated relationship between A.G. Edwards and CombiMatrix Corporation or its directors and officers or its stockholders, or between A.G. Edwards and Acacia Research or its directors and officers or its stockholders, which in A.G. Edwards' opinion would affect its ability to render a fair and independent opinion in this matter.

In arriving at its written opinion, A.G. Edwards considered, among other things: (i) the signed merger agreement and discussions with counsel representing Acacia Research, CombiMatrix Corporation and the special committee concerning the merger agreement and other related documents; (ii) the historical and future business and operations of Acacia Research, CombiMatrix Corporation and Acacia Media Technologies Corporation; (iii) the historical financial performance of Acacia Research through a review of their audited financial results; (iv) the historical and forecasted financial statements for CombiMatrix Corporation as prepared by its management; (v) an investigation of the future operational and financial performance and anticipated cash needs of CombiMatrix and Acacia Media Technologies Corporation, respectively; (vi) an investigation regarding the current operations and future prospects of CombiMatrix Corporation and Acacia Media Technologies Corporation, primarily through discussions with the managements of CombiMatrix Corporation and Acacia Media Technologies Corporation, respectively; (vii) the biological array processor market and the primary market segments CombiMatrix Corporation will pursue; (viii) the market data for stocks of public companies in the same or similar markets as CombiMatrix Corporation; (ix) an investigation of the existing patent portfolio of Acacia Media Technologies Corporation through discussions with internal and external counsel representing Acacia Media Technologies Corporation; (x) an investigation of the role and responsibilities of Acacia Research concerning the post-merger management and operations of CombiMatrix Corporation and Acacia Media Technologies Corporation; (xi) the history and performance of "tracking" stocks and similar transaction structures; (xii) an investigation of studies related to marketability discounts applied to minority interests in private companies; (xiii) Acacia Research's annual report on Form 10-K for its fiscal

year ended December 31, 2001, Acacia Research's quarterly reports on Form 10-Q for its fiscal quarters ended March 31, 2001, June 30, 2001 and September 30, 2001, and certain other publicly available information for CombiMatrix Corporation and Acacia Research; and (xiv) such other studies and analyses that A.G. Edwards considered appropriate.

In preparing its opinion, A.G. Edwards has assumed and relied upon the accuracy and completeness of all financial and other information that was publicly available, or supplied or otherwise made available to A.G. Edwards by CombiMatrix Corporation, Acacia Research and Acacia Media Technologies Corporation. A.G. Edwards has not been engaged to, and therefore has not, verified the accuracy or completeness of any such information. A.G. Edwards has relied upon the assurances of the managements of CombiMatrix Corporation, Acacia Research and Acacia Media Technologies Corporation that they are not aware of any facts that would make any financial or other information inaccurate or misleading. For purposes of the opinion, management of CombiMatrix Corporation provided A.G. Edwards with projections regarding the future financial performance of CombiMatrix Corporation. These projections vary from historical trends primarily because CombiMatrix Corporation has been a development stage company and management anticipates that future revenues and results of operations will reflect the results of the company's research and development efforts and the sale of products and services that were previously in development. A.G. Edwards has been informed and assumed that financial projections supplied to, discussed with or otherwise made available to it reflect the best currently available estimates and judgments of the management of CombiMatrix Corporation as to the expected future financial performance of CombiMatrix Corporation. A.G. Edwards has not independently verified such information or assumptions nor does it express any opinion with respect thereto.

A.G. Edwards has not made any independent valuation or appraisal of the assets or liabilities of CombiMatrix Corporation, Acacia Research or Acacia Media Technologies Corporation, nor has it been furnished with any such valuations or appraisals. A.G. Edwards also did not independently attempt to assess or value any of the intangible assets (including goodwill) nor did it make any independent assumptions with respect to their application in the merger.

A.G. Edwards was not engaged to and did not review, nor is it expressing any opinion with respect to, any alternative transaction or strategic alternatives that may be available to CombiMatrix Corporation or its minority

-70-

stockholders. A.G. Edwards has not expressed any opinion as to what the value of CombiMatrix Corporation's common stock has been or will be, nor have we considered the tax implications of the merger. A.G. Edwards' opinion also does not address the merits of the underlying decision by CombiMatrix Corporation to engage in the merger. A.G. Edwards' opinion is necessarily based on the economic, market and other conditions as in effect on, and the information made available to A.G. Edwards as of April 17, 2002. A.G. Edwards has not undertaken any process to update its opinion since its issuance on April 17, 2002, therefore the opinion and the process and procedures described herein do not reflect any change in market conditions or the financial condition or prospects of CombiMatrix Corporation, Acacia Research or Acacia Media Technologies Corporation since that date.

The full text of the written opinion of A.G. Edwards dated April 17, 2002 setting forth the assumptions made, matters considered and limitations on reviews undertaken, is attached hereto as Annex G to this proxy statement and

prospectus and is incorporated herein by reference. Minority stockholders of CombiMatrix Corporation are urged to read the opinion, together with the assumptions and considerations set forth therein, in its entirety. A.G. EDWARDS' OPINION WAS PREPARED FOR THE INFORMATION OF THE SPECIAL COMMITTEE OF THE BOARD OF DIRECTORS OF COMBIMATRIX CORPORATION AND DOES NOT CONSTITUTE A RECOMMENDATION AS TO HOW ANY HOLDER OF THE OUTSTANDING SHARES OF COMBIMATRIX CORPORATION'S COMMON STOCK SHOULD VOTE WITH RESPECT TO THE MERGER.

Several factors influenced A.G. Edwards' opinion regarding the exchange of a minority interest in a privately held company for an economic interest in a publicly-traded entity. A.G. Edwards analyzed these factors and compared the benefits, the risks and concerns of owning the proposed class of publicly traded stock versus owning a minority position in an illiquid, privately held company.

The following is a summary of the analyses used by A.G. Edwards in rendering its opinion.

ANALYSIS OF TRACKING STOCKS. A.G. Edwards researched and analyzed a number of factors typically associated with stocks structured to reflect the performance of a particular business segment or unit within a corporation (i.e. tracking stocks) and their application in this transaction. As part of its analysis, A.G. Edwards reviewed a number of independent third-party studies concerning the benefits, risks and historical performance of publicly-traded tracking stocks. A.G. Edwards' analysis evaluated certain risks associated with tracking stocks and the mitigating factors proposed in the transaction. These risks were mitigated in a variety of ways. For example, (a) the risk related to AR-CombiMatrix stockholders having limited and variable voting rights was mitigated by the fact that voting rights with respect to the two classes of stock will be based on relative market capitalization and management believes that the aggregate market value, and hence voting right, of AR-CombiMatrix stock will be greater than the aggregate market value, and hence voting right, of the AR-Acacia Technologies stock; (b) the risk that there will be limited remedies available if a business decision disadvantages AR-CombiMatrix stockholders is mitigated by the fact that our board of directors has a fiduciary duty to all the stockholders and the fact that minority stockholders will have voting rights with respect to certain issues including potential mergers; and (c) the risk related to the potential for divergent or conflicting stockholder interests has been mitigated by the establishment of policies and guidelines for our board of directors for the resolution of potential divergent or conflicting interests. These mitigating factors are not necessarily unique to this transaction and are similar to mitigating factors commonly associated with other tracking stocks. A.G. Edwards also compared marketability discounts typically associated with tracking stocks against the marketability discounts typically associated with minority positions in private companies.

ANALYSIS OF IMPACTS ON MINORITY STOCKHOLDERS' INTERESTS. A.G. Edwards reviewed the potential impact of the proposed transactions on a number of factors affecting the value of the minority stockholders' interests, including changes in economic interests, liquidity, marketability discounts, access to capital, research coverage, legal ownership, voting rights, voting control, board representation, management and reporting and disclosure. The impact of the proposed transactions on these factors is summarized in the following table:

-71-

| FACTOR | PRE-TRANSACTION | POST-TRANSACTION |
|------------------------------|---|---|
| Economic Interests | Approximately 42%(1) economic interest in CombiMatrix Corporation via its common stock. | Approximately 42%(1) e stock. |
| Liquidity | Illiquid, private company stock. | Publicly-traded stock dictated by trading vo |
| Marketability Discount | Typical discounts are 30-45% for minority positions in private companies. | Discounts for tracking discounts for illiquid |
| Access to Capital | Limited. | May be improved due to |
| Research Coverage | None. | Significantly increase due to independence an |
| Legal Ownership | Approximately 42%(1) minority ownership. | 42%(1) minority owners priority claim on Comb a liquidity event. No Technologies shares. |
| Voting Rights | In proportion to shares owned of CombiMatrix Corporation, but no rights pertaining to Acacia Research. | One share equals one v dependent on relative AR-Acacia Technologies voting rights. |
| Voting Control | Acacia Research controls voting with 58%(2) ownership stake and 12%(3) additional voting control through stockholder agreement. | Part of a diffuse stoc controlling party. |
| Board Representation | CombiMatrix Corporation-specific board significantly controlled by Acacia Research. | Acacia Research board governance. |
| | No rights regarding election of Acacia Research board. | Acacia Research board. |
| | Current CombiMatrix Corporation management. | |
| Reporting and Disclosure | business; therefore segment information and material events disclosed as if group was an SEC-reporting company. | Same. |
| <pre>(1) Percentage as</pre> | of April 17, 2002, the date of A.G. Edwards' opinion. | |

 Percentage as of April 17, 2002, the date of A.G. Edwards' opinion. As of November 1, the percentage was 52%.

(2) Percentage as of April 17, 2002. As of November 1, the percentage was 48%.

-72-

A.G. Edwards believes that its analyses of the above items must be considered as a whole and that selecting individual items or portions of such analyses, without considering all factors and analyses, would create an incomplete view of the processes underlying the analyses set forth in the A.G. Edwards report and its fairness opinion. A.G. Edwards concluded that the impact on these items, taken as a whole, supported its conclusion as to the fairness of the consideration.

VOTING RIGHTS AND VALUATION ANALYSIS. Due to the fact that the relative voting rights of the AR-CombiMatrix stock and the AR-Acacia Technologies stock will be determined by the public market values of the stocks, A.G. Edwards utilized several methodologies to establish an initial valuation range for each group solely for the purposes of comparing voting rights following the transactions. A.G. Edwards concluded that the stockholders of AR-CombiMatrix stock would likely have majority voting control following the recapitalization and merger based upon the fact that the results of the valuation analyses indicated that the AR-CombiMatrix stock would have a higher relative initial valuation than the AR-Acacia Technologies stock. These valuation methodologies included (i) an analysis of companies that could be considered comparable to CombiMatrix Corporation, (ii) a discounted cash flow analysis utilizing CombiMatrix management's projections of anticipated future cash flows, (iii) an analysis of the cost of acquiring Acacia Technologies' patent portfolio, and (iv) a comparison of the implied value of CombiMatrix Corporation and the Acacia Technologies group to the overall value of Acacia Research.

A.G. Edwards concluded that the voting rights of existing CombiMatrix minority stockholders were not likely to be adversely affected by the merger and recapitalization. This finding was based principally upon the fact that both prior to and following the proposed transactions the minority stockholders will have a minority stockholder interest and that such stockholders constitute and will constitute a group of mostly unrelated individuals and entities unable to exert effective control over CombiMatrix Corporation and Acacia Research, as applicable.

OTHER MATTERS. The preparation of a fairness opinion is not necessarily susceptible to partial analyses or summary. In rendering its fairness opinion, A.G. Edwards applied its judgment to a variety of complex analyses and assumptions. A.G. Edwards may have given various analyses more or less weight than other analyses, and may have deemed various assumptions more or less probable than other assumptions. The assumptions made, and the judgments applied, by A.G. Edwards in rendering its opinion are not readily susceptible to description beyond that set forth in the written text of the fairness opinion itself.

We have not requested, nor has A.G. Edwards provided, an updated fairness opinion as a result of events subsequent to April 17, 2002, because we do not believe that such subsequent events materially change the basic analyses and conclusions underlying A.G. Edwards' opinion. Events subsequent to April 17, 2002, including the settlement with Nanogen, Inc., resulted in a change in the ownership percentages of the stockholders of CombiMatrix Corporation. The impact of the changed ownership percentages on the pre- and post-transaction economic interest, legal ownership, and voting control components of A.G. Edwards' analysis is reflected in the footnotes to the table above. Notwithstanding such changes in the percentage interests held by each CombiMatrix stockholder, including Acacia Research, it is our view that the effect of the

recapitalization and merger on the CombiMatrix minority stockholders remains the same, in that each share of CombiMatrix Corporation common stock will still be exchanged for one share of AR-CombiMatrix stock, CombiMatrix Corporation stockholders will still be entitled to receive the same percentage of the AR-CombiMatrix stock as their percentage interest in CombiMatrix Corporation common stock immediately prior to the recapitalization and merger, CombiMatrix stockholders will still obtain greater liquidity for their shares, and there will be no material impact on the other factors discussed in the table above.

Notwithstanding the fact that following the recapitalization and merger, Nanogen, Inc. will hold approximately 17.5% of the outstanding AR-CombiMatrix stock, we do not believe that it is likely that Nanogen, Inc. will be able to exercise control or materially influence the business of Acacia Research following the recapitalization and merger. The reasons for this belief include (i) the fact that Nanogen, Inc. will be a minority stockholder of both the AR-CombiMatrix stock and Acacia Research as a whole, with a voting interest of less than 17.5% on all matters on which the AR-CombiMatrix stock and the AR-Acacia Technologies stock vote together, (ii) we do not believe that Nanogen, Inc. has organized or is likely to organize a voting group that will be able to exercise significant influence, and (iii) the lack of any special voting rights or other contractual rights that would allow Nanogen, Inc. to exert influence or control over Acacia Research beyond, the voting power represented by its shares of AR-CombiMatrix stock.

-73-

A.G. Edwards' opinion does not cover the fairness of the transaction to Nanogen, Inc., because Nanogen, Inc. became a stockholder of CombiMatrix Corporation after the date of A.G. Edwards' opinion, which is limited to its date.

In performing its analyses, A.G. Edwards made numerous assumptions with respect to industry performance and general business and economic conditions, which are beyond the control of CombiMatrix Corporation. Such analyses were prepared solely as part of A.G. Edwards' analysis of the fairness of the consideration to be received by CombiMatrix Corporation in the merger, pursuant to the merger agreement, and were provided to CombiMatrix Corporation's special committee in connection with the delivery of A.G. Edwards' fairness opinion. In addition, as described above, A.G. Edwards' opinion and presentation to CombiMatrix Corporation's special committee of the board of directors was one of many factors taken into consideration by the special committee in making its determination to approve the merger agreement.

The terms of the engagement of A.G. Edwards by CombiMatrix Corporation are set forth in a letter agreement dated March 13, 2002 between A.G. Edwards and CombiMatrix Corporation. Pursuant to the terms of that agreement and an amendment dated August 2, 2002, as compensation for rendering its opinion to the special committee, CombiMatrix Corporation agreed to pay A.G. Edwards total fees of \$375,000. In addition, CombiMatrix Corporation agreed to reimburse A.G. Edwards for the reasonable travel and out-of-pocket expenses incurred in connection with its engagement. CombiMatrix Corporation and Acacia Research have agreed to indemnify A.G. Edwards against certain liabilities in connection with the engagement of A.G. Edwards.

MANAGEMENT AND ALLOCATION POLICIES

One of the fundamental objectives of the recapitalization proposal is to separate the business and operations of the two groups and to operate each group on a stand-alone basis. In order to accomplish this objective in a fair and

equitable manner, our board of directors has established management and allocation policies to help us allocate costs and charges between the two groups on an objective basis. These policies pertain to issues such as the allocation of debt, corporate overhead, interest, dividends, finances, taxes and other charges between the two groups, the financing of each group, corporate opportunities and competition between groups. We will allocate our corporate overhead to each group based upon the use of services by that group, where practicable. Corporate overhead includes costs of our personnel and employee benefits, legal, accounting and auditing, tax, insurance, investor relations and stockholder services and services related to our board of directors. We will allocate in a similar manner a portion of our costs of administrative shared services, such as information technology services. Where determinations based on use alone are not practical, we will use other methods and criteria that we believe are equitable and provide a reasonable estimate of the cost attributable to the groups.

Our board of directors will establish a standing committee with the authority to (i) interpret, make determinations under, and oversee the implementation of the Common Stock Policies other than as they relate to dividends; (ii) adopt additional general policies; and (iii) engage third party service providers to assist in discharging its duties.

POLICIES SUBJECT TO CHANGE WITHOUT STOCKHOLDER APPROVAL

We have summarized the management and allocation policies as we expect them to be effective upon the recapitalization. We are not requesting stockholder approval of these policies.

Our board of directors may modify or rescind these policies, or may adopt additional policies, in its sole discretion without stockholder approval. This could have different effects upon holders of AR-CombiMatrix stock and holders of AR-Acacia Technologies stock or could result in a benefit or detriment to one class of stockholders compared to the other class. Our board of directors would make any such decision in accordance with its good faith business judgment that such decision is in the best interests of Acacia Research and all of our stockholders as a whole.

-74-

ALLOCATION OF ASSETS

These policies set forth our board of directors' intention regarding the attribution of assets. Assets are to be attributed between the two groups principally according to the assets attributable to the separate businesses that comprise each group. The CombiMatrix group is comprised of the businesses relating to CombiMatrix Corporation and Advanced Material Sciences, a majority-owned subsidiary of CombiMatrix Corporation, and the assets of Acacia Research directly attributable to the CombiMatrix group. The Acacia Technologies group is principally comprised of the businesses relating to Soundview Technologies Incorporated and Acacia Media Technologies Corporation, and the assets of Acacia Research directly attributable to the Acacia Technologies group. We currently intend to attribute all of our present and future interests worldwide in our life sciences business to the CombiMatrix group.

FIDUCIARY AND MANAGEMENT RESPONSIBILITIES

Because the CombiMatrix group and the Acacia Technologies group will

continue to be a part of a single company, our directors and officers will have the same fiduciary duties to holders of the AR-CombiMatrix stock and the AR-Acacia Technologies stock that they currently have to the holders of our existing common stock. Under Delaware law, absent an abuse of discretion, a director or officer will be deemed to have satisfied his or her fiduciary duties to Acacia Research and our stockholders if that person is disinterested and acts in accordance with his or her good faith business judgment in the interests of Acacia Research and all of our stockholders as a whole. Our board of directors and chief executive officer, in establishing policies with regard to intra-company matters such as business transactions between groups and allocations of assets, liabilities, debt, corporate overhead, taxes, interest, corporate opportunities and other matters, will consider various factors and information which could benefit or cause detriment to the stockholders of the respective groups and will make determinations in the best interests of Acacia Research and all of our stockholders as a whole.

It is unlikely that the interests of the CombiMatrix group and the Acacia Technologies group will conflict because they operate in very different types of businesses. If and when there are conflicting interests between the two groups, the directors of Acacia Research will use good faith business judgment to resolve such conflicts. The board will also seek to form two committees of independent directors, one related to each group, to evaluate the fairness of a contemplated transaction from the perspective of each group if the board determines that the nature of the conflicting interests warrant doing so.

Because the recapitalization will result in no change in our corporate structure, Paul R. Ryan, our Chairman and Chief Executive Officer, will have the same duties and responsibilities for the management of our assets and businesses which comprise the CombiMatrix group and the Acacia Technologies group following the recapitalization as he has now. The individuals named below will hold the positions in Acacia Research listed next to their names and will continue to have the same general responsibilities that they had prior to the recapitalization. The costs attributable to their responsibilities will be allocated as discussed below under "--Financial Statements; Allocation Matters-Corporate Overhead and Administrative Shared Services."

| NAME | POSITIONS WITH THE COMPANY |
|--|--|
| | |
| Paul R. Ryan Robert L. Harris II Clayton J. Haynes Robert A. Berman Roy Mankovitz Robert B. Stewart Andrew H. Duncan John H. Roop Alejandro Magana | Chairman and Chief Executive Officer President Senior Vice President, Chief Financial Officer and Treasurer Senior Vice President of Business Development, General Counsel and Secretar Senior Vice President, Intellectual Property Senior Vice President, Corporate Development Vice President, Business Development Vice President, Engineering Vice President, International Licensing |

-75-

Our board of directors has designated separate management teams for each of the CombiMatrix group and the Acacia Technologies group, consisting of officers of the subsidiaries that make up those groups, to ensure that the efforts of each team of managers are focused on the business and operations for which they have responsibility. These individuals are named in "CombiMatrix

Group-Business-Management" and "Acacia Technologies Group-Business-Management."

DIVIDEND POLICY

We have not paid cash dividends on our existing common stock and do not anticipate paying cash dividends on the AR-CombiMatrix stock or the AR-Acacia Technologies stock for the foreseeable future.

In making its dividend decisions regarding the AR-CombiMatrix stock and the AR-Acacia Technologies stock, our board of directors will rely on the respective financial statements of the CombiMatrix group and the Acacia Technologies group. See the historical financial statements of the CombiMatrix group and the Acacia Technologies group included in this proxy statement. The method of calculating net income (loss) per share for the AR-CombiMatrix stock and the AR-Acacia Technologies stock is set forth in the restated certificate of incorporation in ANNEX B under the definitions of Acacia Research Corporation Earnings (Loss) Attributable to the CombiMatrix Group and Acacia Research Corporation Earnings (Loss) Attributable to the Acacia Technologies Group. We encourage you to carefully read these definitions.

Our board of directors does not currently intend to change the above-described dividend policy but reserves the right to do so at any time based primarily on the financial condition, results of operations and capital requirements of the respective groups and of Acacia Research as a whole. Future dividends on the AR-CombiMatrix stock and the AR-Acacia Technologies stock will be payable when, as and if declared by our board of directors out of the lesser of (1) all funds of Acacia Research legally available therefor and (2) the amount calculated under the definition of that group's Available Dividend Amount contained in the restated certificate of incorporation in ANNEX B. We encourage you to carefully read these definitions. Each group's Available Dividend Amount is intended to be similar to the amount that would be legally available for the payment of dividends on the stock for that group under Delaware law if that group were a separate company.

FINANCING ACTIVITIES

GENERAL. We will continue to manage most financial activities on a centralized basis. These activities include the investment of surplus cash, the issuance and repayment of short-term and long-term debt and the issuance and repurchase of any preferred stock. If Acacia Research transfers cash or other property allocated to one group to the other group, we will account for such transfer as a short term loan unless the board of directors determines that a given transfer (or type of transfer) should be accounted for as a long-term loan, a capital contribution, or as a return of capital.

Other than cash advances exceeding \$25 million, our board of directors has not adopted specific criteria to determine which of the foregoing will be applied to a particular transfer of cash or property from one group to the other. Our board of directors will make these determinations, either in specific instances or by setting applicable policies generally, in the exercise of its business judgment based on all relevant circumstances, including the financing needs and objectives of the receiving group, the investment objectives of the transferring group, the availability, cost and time associated with alternative financing sources, prevailing interest rates and general economic conditions. We will make all transfers of material assets from one group to the other on a fair value basis for the foregoing purposes, as determined by our board of directors.

Although we may allocate our debt and preferred stock between groups, the debt and preferred stock will remain our obligations and all of our stockholders will be subject to the risks associated with those obligations.

INTER-GROUP LOANS. Cash or other property that we allocate to one group

that is transferred to the other group, if accounted for as a short-term loan, will bear interest at a rate equal to that at which we can borrow such funds.

-76-

EQUITY ISSUANCES AND REPURCHASES AND DIVIDENDS. We will reflect all financial effects of issuances and repurchases of shares of AR-CombiMatrix stock or shares of AR-Acacia Technologies stock entirely in the financial statements of that group. We will reflect financial effects of dividends or other distributions on, and purchases of, shares of AR-CombiMatrix stock or AR-Acacia Technologies stock entirely in the respective financial statements of the CombiMatrix group and the Acacia Technologies group.

INTER-GROUP CONTRACTS AND ACCESS TO TECHNOLOGY AND KNOW-HOW

The terms of all current and future material transactions, relationships and other matters between the groups, including those as to which the groups may have potentially divergent interests, will be determined on a basis that the board of directors, or management following guidelines or principles established by the board of directors, considers to be in the best interests of Acacia Research and its stockholders as a whole.

Each group will have free access to all of our technology and know-how (excluding products and services of the other group) that may be useful in that group's business, subject to obligations and limitations applicable to Acacia Research and to such exceptions that its board of directors may determine. The groups will consult with each other on a regular basis concerning technology issues that affect both groups.

REVIEW OF CORPORATE OPPORTUNITIES

Our board of directors will review any matter which involves the allocation of a corporate opportunity to either the CombiMatrix group or the Acacia Technologies group or in part to the CombiMatrix group and in part to the Acacia Technologies group. In accordance with Delaware law, our board of directors will make its determination with regard to the allocation of any such opportunity and the benefit of such opportunity in accordance with their good faith business judgment of the best interests of Acacia Research and all of our stockholders as a whole. Among the factors that our board of directors may consider in making this allocation is whether a particular corporate opportunity is principally related to the business of the CombiMatrix group or the Acacia Technologies group; whether one group, because of its managerial or operational expertise, will be better positioned to undertake the corporate opportunity; and existing contractual agreements and restrictions.

FINANCIAL STATEMENTS; ALLOCATION MATTERS

We will prepare financial statements in accordance with generally accepted accounting principles, consistently applied, for the CombiMatrix group and the Acacia Technologies group, and these financial statements, taken together, will comprise all of the accounts included in our corresponding consolidated financial statements. The financial statements of each of the CombiMatrix group and the Acacia Technologies group will reflect the financial condition, results of operations and cash flows of the businesses included therein.

Group financial statements will also include allocated portions of our debt, interest, corporate overhead and costs of administrative shared services and taxes. We will make these allocations for the purpose of preparing each group's financial statements; however, holders of AR-CombiMatrix stock and

AR-Acacia Technologies stock will continue to be subject to all of the risks associated with an investment in Acacia Research and all of our businesses, assets and liabilities. See the historical financial statements for the CombiMatrix group and the Acacia Technologies group included in this proxy statement.

In addition to allocating debt and interest as described above, our board of directors has adopted certain allocation policies, each of which is reflected in the financial statements of the respective groups included in this proxy statement. In general, we will allocate our corporate overhead to each group based upon the use of services by that group where practicable. Corporate overhead includes costs of our personnel and employee benefits, legal, accounting and auditing, tax, insurance, investor relations and stockholder services and services related to our board of directors. We will allocate in a similar manner a portion of our costs of administrative shared services, such as information technology services. Where determinations based on use alone are not practical, we will use other methods and criteria that we believe are equitable and that provide a reasonable estimate of the cost attributable to the groups.

-77-

TAXES

We will determine our federal income taxes and those of our subsidiaries which own assets allocated between the groups on a consolidated basis. We will allocate consolidated federal income tax provisions and related tax payments or refunds between the groups based principally on the financial statements income, taxable income and tax credits directly attributable to each group under generally accepted accounting principles. Such allocations will reflect each group's contribution, whether positive or negative, to our consolidated federal taxable income and the consolidated federal tax liability and tax credit position. We will credit tax benefits that can not be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits. Inter-group transactions will be treated as taxed as if each group were a stand-alone company.

COMMON STOCK OWNERSHIP OF DIRECTORS AND SENIOR OFFICERS

As a policy, our board of directors will periodically monitor the ownership of shares of AR-CombiMatrix stock and shares of AR-Acacia Technologies stock by our directors and senior officers and our option grants to them so that their interests are generally aligned with the two classes of common stock and with their duty to act in the best interests of Acacia Research and our stockholders as a whole. However, because of the anticipated differences in trading values between the AR-CombiMatrix stock and the AR-Acacia Technologies stock, the actual value of their interests in the AR-CombiMatrix stock and AR-Acacia Technologies stock will vary significantly. Our board of directors will monitor our affiliates' ownership and option grants in the two classes of stock to try to avoid making additional option grants to affiliates that might incentivize them to favor one group over the other.

DESCRIPTION OF AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK

Following is a summary of the material terms of the AR-CombiMatrix stock and the AR-Acacia Technologies stock. The summary is not complete. We encourage you to read the proposed restated certificate of incorporation which is attached as ANNEX B.

AUTHORIZED AND OUTSTANDING SHARES

Our existing certificate of incorporation authorizes us to issue 80,000,000 shares of stock, consisting of 60,000,000 shares of common stock, par value \$0.001 per share, and 20,000,000 shares of preferred stock, par value \$0.001 per share. Our board of directors may issue shares of preferred stock in series, without stockholder approval. As of November 1, 2002, a total of 19,640,808 shares of our existing common stock and no shares of preferred stock were issued and outstanding.

The new certificate of incorporation will authorize Acacia Research to issue 110,000,000 shares of stock as follows: 50,000,000 shares of a class of common stock, designated as Acacia Research Corporation-CombiMatrix Common Stock (the "AR-CombiMatrix stock"), 50,000,000 shares of a class of common stock, designated as Acacia Research Corporation-Acacia Technologies Common Stock (the "AR-Acacia Technologies stock"), and 10,000,000 shares of preferred stock. Shares of each class of stock will have a par value of \$0.001 per share. We will be able to issue shares of preferred stock in series, without stockholder approval.

Immediately after the recapitalization and merger, assuming the number of shares of existing Acacia Research common stock and CombiMatrix Corporation common stock then outstanding is the same as the number outstanding on November 1, 2002, a total of 22,968,551 shares of AR-CombiMatrix stock and 19,640,808 shares of the AR-Acacia Technologies stock will be issued and outstanding.

REASONS FOR INCREASE IN AUTHORIZED COMMON STOCK

The increase in authorized shares is necessary in order to implement the various aspects of the recapitalization proposal and the issuance of shares in connection with the merger. The authorization of approximately 33,000,000 shares of AR-CombiMatrix stock and approximately 27,000,000 shares of AR-Acacia Technologies stock is needed for the recapitalization and merger to occur. These estimates include approximately 10,000,000 shares of AR-CombiMatrix stock and approximately 8,000,000 shares of AR-Acacia Technologies stock

-78-

that will need to be reserved for issuance pursuant to option plans and outstanding options and warrants. Further, as described under "--Conversion and Redemption," our board of directors has the right to convert one class of common stock into the other. The number of shares issuable in a conversion will vary based on the relative market values of the two classes of common stock and the number of outstanding shares of common stock being converted and whether or not the conversion will be at a 10% premium. Our board of directors may also authorize the issuance of stock dividends.

If our board of directors determines that a conversion or a stock dividend is in the best interests of Acacia Research, but at that time sufficient authorized shares of common stock are not available, its stockholders would be required to approve an amendment to the restated certificate of incorporation.

Our board of directors believes that an increase in the number of authorized shares of common stock at this time is in the best interests of Acacia Research so that we have available the number of shares needed for possible future conversion, dividends, acquisitions or capital raising, and for our new stockholder rights plan and employee benefit plans.

Other than the issuance of shares under our employee benefit plans or our outstanding warrants and the issuance of options for AR-CombiMatrix stock and

AR-Acacia Technologies stock as discussed under "--Options to be Issued upon the Recapitalization and Merger," or the issuance of shares to Nanogen, Inc. as discussed below under the heading "Antidilution Provisions," we have no present understanding or agreement for the issuance of any additional shares of AR-CombiMatrix stock or AR-Acacia Technologies stock. Although our board of directors has no present intention of doing so, the additional shares that would be authorized for issuance if the recapitalization and merger is implemented could be issued in one or more transactions that would make a takeover of Acacia Research more difficult and, therefore, less likely, even though a takeover might be financially beneficial to Acacia Research and our stockholders. We have no knowledge of any person or entity that intends to seek a controlling interest in Acacia Research or to make a takeover proposal.

We may issue the authorized but unissued shares of AR-CombiMatrix stock and AR-Acacia Technologies stock for any proper corporate purpose, which could include any of the purposes set forth above. We will not solicit the approval of our stockholders for the issuance of additional authorized shares of AR-CombiMatrix stock or AR-Acacia Technologies stock unless our board of directors believes that approval is advisable or is required by stock exchange regulations or Delaware law.

DIVIDENDS

Dividends on the AR-CombiMatrix stock and dividends on the AR-Acacia Technologies stock will be limited to an amount not greater than the Available Dividend Amount (as defined in the restated certificate of incorporation) for the relevant group. The Available Dividend Amount under our restated certificate of incorporation is essentially the same as legally available funds under Delaware law, both of which consist of either the surplus (market value of assets less liabilities and par value) or, if there is no surplus, the net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.

In addition, Delaware law limits the amount of distributions on capital stock to legally available funds as defined under Delaware law, which are determined on the basis of our entire company, and not only the respective groups. As a result, the amount of legally available funds will reflect the amount of any net losses of each group, any distributions on AR-CombiMatrix stock, AR-Acacia Technologies stock or any preferred stock and any repurchases of AR-CombiMatrix stock, AR-Acacia Technologies stock or certain preferred stock. Dividend payments on the AR-CombiMatrix stock and on the AR-Acacia Technologies stock could be precluded because legally available funds are not available under Delaware law, even though the Available Dividend Amount test for the particular relevant group was met. We cannot assure you that there will be an Available Dividend Amount for either group.

Subject to the prior payment of dividends on any outstanding shares of preferred stock and the limitations described above, our board of directors will be able, in its sole discretion, to declare and pay dividends exclusively on the AR-CombiMatrix stock, exclusively on the AR-Acacia Technologies stock or on both, in equal or unequal amounts. In making its dividend decisions, our board of directors will not be required to take into account the

-79-

relative Available Dividend Amounts for the two groups, the amount of prior dividends declared on either class, the respective voting or liquidation rights of either class or any other factor.

VOTING RIGHTS

Currently, holders of our existing common stock have one vote per share on all matters submitted to stockholders.

Under our proposed restated certificate of incorporation the entire voting power of the stockholders of Acacia Research will be vested in the holders of common stock, who will be entitled to vote on any matter on which the holders of our stock are, by law or by the provisions of the restated certificate of incorporation, entitled to vote, except as otherwise provided by law, by the terms of any outstanding preferred stock or by any provision of the new certificate of incorporation restricting the power to vote on a specified matter to other stockholders.

Holders of common stock will vote as a single class on each matter on which holders of common stock are generally entitled to vote.

On all matters as to which both classes of common stock will vote together as a single class:

- o each share of AR-CombiMatrix stock will have one vote; and
- o each share of AR-Acacia Technologies stock will have a number of votes equal to the quotient of the average market value of a share of AR-Acacia Technologies stock over the 20-trading day period ending on the 10th trading day prior to the record date for determining the holders of common stock entitled to vote, divided by the average market value of a share of AR-CombiMatrix stock over the same period.

Accordingly, the relative per share voting rights of the AR-CombiMatrix stock and the AR-Acacia Technologies stock will fluctuate depending on changes in the relative market values of shares of such classes of common stock. The purpose of the floating voting power is to link voting power to relative economic interests in Acacia Research.

EXAMPLES OF THE CALCULATION OF THE NUMBER OF VOTES EACH SHARE OF AR-ACACIA TECHNOLOGIES STOCK WOULD BE ENTITLED ON ALL MATTERS ON WHICH HOLDERS OF AR-COMBIMATRIX STOCK AND AR-ACACIA TECHNOLOGIES STOCK VOTE AS A SINGLE CLASS

EXAMPLE #1: If the average market values for the 20-trading day valuation period were \$4 for the AR-Acacia Technologies stock and \$6 for the AR-CombiMatrix stock, each share of AR-CombiMatrix stock would have one vote and each share of AR-Acacia Technologies stock would have 0.67 votes based on the following calculation:

> \$4 -- = 0.67 votes \$6

Based on the assumptions in this example, and assuming 20 million shares of AR-CombiMatrix stock and 20 million shares of AR-Acacia Technologies stock were outstanding, the shares of AR-CombiMatrix stock would represent approximately 60% of our total voting power and the shares of AR-Acacia Technologies stock would represent approximately 40% of our total voting power.

-80-

EXAMPLE #2: If the average market values for the 20-trading day valuation period were 5 for the AR-Acacia Technologies stock and 5 for the

AR-CombiMatrix stock, each share of AR-CombiMatrix stock would have one vote and each share of AR-Acacia Technologies stock would have one (1) vote based on the following calculation:

```
$5
-- = 1.0 vote
$5
```

Based on the assumptions in this example, and assuming 20 million shares of AR-CombiMatrix stock and 20 million shares of AR-Acacia Technologies stock were outstanding, the shares of AR-CombiMatrix stock would represent approximately 50% of our total voting power and the shares of AR-Acacia Technologies stock would represent approximately 50% of our total voting power.

EXAMPLE #3: If the average market values for the 20-trading day valuation period were \$6 for the AR-Acacia Technologies stock and \$4 for the AR-CombiMatrix stock, each share of AR-CombiMatrix stock would have one vote and each share of AR-Acacia Technologies stock would have 1.50 votes based on the following calculation:

```
$6
-- = 1.50 votes
$4
```

Based on the assumptions in this example, and assuming 20 million shares of AR-CombiMatrix stock and 20 million shares of AR-Acacia Technologies stock were outstanding, the shares of AR-CombiMatrix stock would represent approximately 40% of our total voting power and the shares of AR-Acacia Technologies stock would represent approximately 60% of our total voting power.

These examples, each of which is based on the assumption that the total number of issued and outstanding shares of each class is 20,000,000, are summarized in the table below:

| | ASSUMED SHARE PRICE | VOTING RIGHTS | TOTAL VOTES | RELATIVE VOTING POWER |
|------------------------|------------------------|------------------|-------------|--------------------------|
| | | | | |
| EXAMPLE #1: | | | | |
| AR-CombiMatrix | \$6 | 1.0 vote/share | 20,000,000 | 60% |
| AR-Acacia Technologies | \$4 | 0.67 votes/share | 13,333,333 | 40% |
| EXAMPLE #2: | | | | |
| AR-CombiMatrix | \$5 | 1.0 vote/share | 20,000,000 | 50% |
| AR-Acacia Technologies | \$5 | 1.0 vote/share | 20,000,000 | 50% |
| EXAMPLE #3: | | | | |
| AR-CombiMatrix | \$4 | 1.0 vote/share | 20,000,000 | 40% |
| AR-Acacia Technologies | \$6 | 1.50 votes/share | 30,000,000 | 60% |

IN THESE EXAMPLES WE HAVE PROVIDED A BETTER UNDERSTANDING OF THE MECHANICS SURROUNDING THE CALCULATION OF VOTING POWER. IT SHOULD NOT BE ASSUMED THAT THE EXAMPLES USED ARE IN ANY WAY INDICATIVE OF THE RESPECTIVE COMMON STOCK TRADING PRICES FOLLOWING THE MERGER AND RECAPITALIZATION.

We will set forth the number of outstanding shares of AR-CombiMatrix stock and AR-Acacia Technologies stock in our Annual Reports on Form 10-K and our Quarterly Reports on Form 10-Q filed under the Securities Exchange Act of 1934. We will disclose in any proxy statement for a stockholders' meeting the number

of outstanding shares and per share voting rights of the AR-CombiMatrix stock and the AR-Acacia Technologies stock.

-81-

If shares of only one class of common stock are outstanding, each share of that class will have one vote. If either class of common stock is entitled to vote as a separate class with respect to any matter, each share of that class will, for purpose of such vote, have one vote on such matter.

Fluctuations in the relative voting rights of the AR-CombiMatrix stock and the AR-Acacia Technologies stock could influence an investor interested in acquiring and maintaining a fixed percentage of the voting power of Acacia Research to acquire such percentage of both classes of common stock and would limit the ability of investors in one class to acquire for the same consideration relatively more or less votes per share than investors in the other class.

The holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will not have any rights to vote separately as a class on any matter coming before stockholders of Acacia Research, except for certain limited class voting rights provided under Delaware law. In addition to the approval of the holders of a majority of the voting power of all shares of common stock voting together as a single class, the approval of a majority of the outstanding shares of the AR-CombiMatrix stock or the AR-Acacia Technologies stock, voting as a separate class, would be required under Delaware law to approve any amendment to the restated certificate of incorporation that would change the par value of the shares of the class or alter or change the powers, preferences or special rights of the shares of such class so as to affect them adversely. As permitted by Delaware law, the restated certificate of incorporation will provide that an amendment to the restated certificate of incorporation that increases or decreases the number of authorized shares of AR-CombiMatrix stock or AR-Acacia Technologies stock will only require the approval of the holders of a majority of the voting power of all shares of common stock, voting together as a single class, and will not require the approval of the holders of the class of common stock affected by such amendment, voting as a separate class.

CONVERSION AND REDEMPTION

Our existing certificate of incorporation currently does not provide for either mandatory or optional conversion or redemption of our existing common stock. The recapitalization proposal will permit the conversion or redemption of the AR-CombiMatrix stock and the AR-Acacia Technologies stock as described below.

MANDATORY DIVIDEND, REDEMPTION OR CONVERSION OF COMMON STOCK IF DISPOSITION OF GROUP ASSETS OCCURS

If Acacia Research sells, transfers, assigns or otherwise disposes of, in one transaction or a series of related transactions, all or substantially all of the properties and assets attributed to either group (a "disposition"), we are required, except as described below, to:

- o pay a dividend in cash and/or securities or other property to the holders of shares of the class of common stock relating to the group subject to the disposition having a fair value equal to the net proceeds of the disposition; or
- o (A) if the disposition involves all, but not merely substantially all,

of such properties and assets, redeem all outstanding shares of common stock relating to that group in exchange for cash and/or securities or other property having a fair value equal to the net proceeds of the disposition; or (B) if the disposition involves substantially all, but not all, of such properties and assets, redeem that number of whole shares of the class of common stock relating to that group as have in the aggregate an average market value, during the period of ten consecutive trading days beginning on the 26th trading day immediately succeeding the consummation date, closest to the net proceeds of the disposition; and the redemption price will be cash and/or securities or other property having a fair value equal to such net proceeds; or

o convert each outstanding share of such class of common stock into a number of shares of common stock relating to the other group equal to 110% of the ratio of the average market value of one share of common stock relating to the group subject to the disposition to the average market value of one share of common stock relating to the other group during the 10-trading day period beginning on the 26th trading day following the disposition date.

-82-

The purpose of this provision is to provide holders of each class of stock with an economic interest in the proceeds of the disposition of the assets of the respective group.

Stockholder approval is typically required for the sale of all or substantially all of a company's assets. However, we may dispose of all or substantially all of the assets attributed to either group without stockholder approval provided those assets do not constitute all or substantially all of the assets of Acacia Research as a whole.

We may only pay a dividend or redeem shares of common stock as set forth above if we have legally available funds under Delaware law and the amount to be paid to holders is less than or equal to the Available Dividend Amount for the group. We are required to pay such dividend or complete such redemption or conversion on or prior to the 95th trading day following the disposition.

For purposes of determining whether a disposition has occurred, "substantially all of the properties and assets" attributed to either group means a portion of such properties and assets:

- o that represents at least 80% of the then fair value of the properties and assets attributed to that group; or
- o from which were derived at least 80% of the aggregate revenues of that group for the immediately preceding twelve fiscal quarterly periods.

The "net proceeds" of a disposition means an amount equal to what remains of the gross proceeds of the disposition after any payment of, or reasonable provision is made as determined by our board of directors for:

- any taxes payable by us, or which would have been payable but for the utilization of tax benefits attributable to the group not subject to the disposition, in respect of the disposition or in respect of any resulting dividend or redemption;
- any transaction costs, including, without limitation, any legal, investment banking and accounting fees and expenses; and

o any liabilities of or attributed to the group subject to the disposition, including, without limitation, any liabilities for deferred taxes, any indemnity or guarantee obligations incurred in connection with the disposition or otherwise, any liabilities for future purchase price adjustments and any preferential amounts plus any accumulated and unpaid dividends in respect of the preferred stock attributed to that group.

We may elect to pay the dividend or redemption price in connection with a disposition either in the same form as the proceeds of the disposition were received or in any other combination of cash, securities or other property that our board of directors or, in the case of securities that have not been publicly traded for a period of at least 15 months, an independent investment banking firm, determines will have an aggregate market value of not less than the fair value of the net proceeds.

-83-

EXAMPLE OF THE PROVISIONS REQUIRING A MANDATORY DIVIDEND, REDEMPTION OR CONVERSION IF A DISPOSITION OCCURS

If (1) 20 million shares of AR-CombiMatrix stock and 20 million shares of AR-Acacia Technologies stock were outstanding, (2) the net proceeds of the disposition of substantially all, but not all, of the assets of the Acacia Technologies group equals \$80 million, (3) the average market value of the AR-Acacia Technologies stock during the 10-trading day valuation period was \$4 per share and (4) the average market value of the AR-CombiMatrix stock during the same valuation period was \$8 per share, then we could do any of the following:

 pay a dividend to the holders of shares of AR-Acacia Technologies stock equal to:

| | Net Proceeds | = | Amount per share |
|-----|---|-----------|-------------------|
| | Number of Outstanding Shares of AR-Acacia Technologies stock | | |
| | \$80 million | = | \$4 per share |
| | 20 million shares | _ | |
| (2) | redeem for \$4 per share a number of shares stock equal to: | of AR-Aca | cia Technologies |
| | Net Proceeds | _ | |
| | Average Market Value of AR-Acacia Technologies stock | = | Number of shares |
| | \$80 million | _ | |
| | \$4 per share | = | 20,000,000 shares |
| | | | |

(3) convert each outstanding share of AR-Acacia Technologies stock into a number of shares of AR-CombiMatrix stock equal to:

Average Market Value of AR-Acacia

| | | Technologies stock | = | Number of Shares |
|-----|---|--|---|------------------|
| 1.1 | Х | Average Market Value of AR- CombiMatrix stock | | |
| | | \$4 per share | = | 0.55 shares |
| 1.1 | Х | \$8 per share | | |

IN THESE EXAMPLES WE HAVE PROVIDED A BETTER UNDERSTANDING OF THE MECHANICS SURROUNDING THE CALCULATION OF VOTING POWER. IT SHOULD NOT BE ASSUMED THAT THE EXAMPLES USED ARE IN ANY WAY INDICATIVE OF THE RESPECTIVE COMMON STOCK TRADING PRICES FOLLOWING THE MERGER AND RECAPITALIZATION.

-84-

EXCEPTIONS TO THE DIVIDEND, REDEMPTION OR CONVERSION REQUIREMENT IF A DISPOSITION OCCURS

We are not required to take any of the above actions for any disposition of all or substantially all of the properties and assets attributed to either group in a transaction or series of related transactions that results in our receiving for such properties and assets primarily equity securities of any entity that:

- acquires such properties or assets, succeeds to the business conducted with such properties or assets, or controls such acquirer or successor; and
- (2) engages primarily or proposes to engage primarily in one or more businesses similar or complementary to the businesses conducted by that group prior to the disposition, as determined by our board of directors.

The purpose of the exception is to enable us technically to "dispose" of properties or assets of a group to other entities engaging or proposing to engage in businesses similar or complementary to those of that group without requiring a dividend on, or a conversion or redemption of, the class of common stock of that group, so long as we hold an equity interest in that entity. A joint venture in which we own a direct or indirect equity interest is an example of such an acquirer. We are not required to control that entity, whether by ownership or contract provisions.

We are also not required to effect a dividend, redemption or conversion if the disposition is:

- o of all or substantially all of our properties and assets in one transaction or a series of related transactions in connection with our dissolution, liquidation or winding up and the distribution of our assets to stockholders;
- o on a pro rata basis, such as in a spin-off, to the holders of all outstanding shares of the class of common stock relating to the group subject to the disposition; or
- o made to any person or entity controlled by us, as determined by our board of directors.

NOTICES IF DISPOSITION OF GROUP ASSETS OCCURS

Not later than the 20th trading day after the consummation of a disposition, we will announce publicly by press release:

- o the estimated net proceeds of the disposition;
- o the number of shares outstanding of the class of common stock relating to the group subject to the disposition; and
- o the number of shares of such class of common stock into or for which convertible securities are then convertible, exchangeable or exercisable and the conversion, exchange or exercise price thereof.

Not earlier than the 36th trading day and not later than the 40th trading day after the consummation of the disposition, we will announce publicly by press release whether we will pay a dividend or redeem shares of common stock with the net proceeds of the disposition or convert the shares of common stock of the group subject to the disposition into the other class of common stock.

We are required to cause to be mailed to each holder of shares of the class of common stock relating to the group subject to the disposition the additional notices and other information required by the restated certificate of incorporation.

-85-

CONVERSION OF COMMON STOCK AT OPTION OF ACACIA RESEARCH AT ANY TIME

Our board of directors may at any time convert each share of AR-CombiMatrix stock into a number of shares of AR-Acacia Technologies stock equal to 110% of the ratio of the average market values of the AR-CombiMatrix stock to the AR-Acacia Technologies stock over a 20-trading day period. Conversely, our board of directors may also at any time convert each share of AR-Acacia Technologies stock into a number of shares of AR-CombiMatrix stock equal to 110% of the ratio of the average market values of the AR-Acacia Technologies stock to the AR-CombiMatrix stock over a 20-trading day period. We will calculate the ratio as of the fifth trading day prior to the date Acacia Research mails the conversion notice to holders.

These provisions allow us the flexibility to recapitalize the two classes of common stock into one class of common stock that would, after such recapitalization, represent an equity interest in all of our businesses. The optional conversion or redemption could be exercised at any future time if our board of directors determines that, under the facts and circumstances then existing, an equity structure consisting of two classes of common stock was no longer in the best interests of all of its stockholders. Such exchange could be exercised, however, at a time that is disadvantageous to the holders of one of the classes of common stock.

Many factors could affect the market values of the AR-CombiMatrix stock or the AR-Acacia Technologies stock, including our results of operations and those of each of the groups, trading volume and general economic and market conditions. Market values could also be affected by decisions by our board of directors or our management that investors perceive to affect differently one class of common stock compared to the other. These decisions could include changes to our management and allocation policies, transfers of assets between groups, allocations of corporate opportunities and financing resources between the groups and changes in dividend policies.

REDEMPTION IN EXCHANGE FOR STOCK OF SUBSIDIARY

Our board of directors may redeem on a pro rata basis all of the outstanding shares of AR-CombiMatrix stock or AR-Acacia Technologies stock for shares of the common stock of one or more of our wholly-owned subsidiaries which own all of the assets and liabilities attributed to the relevant group. We may redeem shares of common stock for subsidiary stock only if we have legally available funds under Delaware law.

These provisions are intended to give us increased flexibility with respect to spinning-off the assets of one of the groups by transferring the assets of that group to one or more wholly-owned subsidiaries and redeeming the shares of common stock related to that group in exchange for stock of such subsidiary or subsidiaries. As a result of any such redemption, holders of each class of common stock would hold securities of separate legal entities operating in distinct lines of business. Such a redemption could be authorized by our board of directors at any time in the future if it determines that, under the facts and circumstances then existing, an equity structure comprised of the AR-CombiMatrix stock and the AR-Acacia Technologies stock is no longer in the best interests of all of our stockholders as a whole.

SELECTION OF SHARES FOR REDEMPTION

If less than all of the outstanding shares of a class of common stock are to be redeemed, we will redeem such shares proportionately from among the holders of outstanding shares of such common stock or by such method as may be determined by our board of directors to be equitable.

FRACTIONAL INTERESTS; TRANSFER TAXES

We will not be required to issue fractional shares of any capital stock or any fractional securities to any holder of either class of common stock upon any conversion, redemption, dividend or other distribution described above. If a fraction is not issued to a holder, we will pay cash instead of such fraction.

We will pay all documentary, stamp or similar issue or transfer taxes that may be payable in respect of the issue or delivery of any shares of capital stock and/or other securities on conversion or redemption of shares.

-86-

LIQUIDATION

Currently, in the event of our liquidation, dissolution or termination, after payment, or provision for payment, of its debts and other liabilities and the payment of full preferential amounts to which the holders of any preferred stock are entitled, holders of existing common stock are entitled to share equally in the remaining net assets of Acacia Research.

Under the restated certificate of incorporation, in the event of our dissolution, liquidation or winding up, after payment or provision for payment of the debts and other liabilities and full preferential amounts to which holders of any preferred stock are entitled, regardless of the group to which such shares of preferred stock were attributed, the holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be entitled to receive our assets remaining for distribution to holders of common stock on a per share basis in proportion to the liquidation units per share of such class. The purpose of this provision is to provide for the distribution of assets upon a liquidation that reflects the initial relative economic interests of the respective classes of stock.

Each share of AR-CombiMatrix stock will have one liquidation unit. Each share of AR-Acacia Technologies stock will have a number of liquidation units equal to the quotient of the average market value of a share of AR-Acacia Technologies stock over the 20-trading day period ending on the 40th trading day after the effective date of the recapitalization, divided by the average market value of a share of AR-CombiMatrix stock over the same period.

After the number of liquidation units to which each share of AR-Acacia Technologies stock is entitled has been calculated in accordance with this formula, that number will not be changed without the approval of holders of the class of common stock adversely affected except as described below. As a result, after the date of the calculation of the number of liquidation units to which the AR-Acacia Technologies stock is entitled the liquidation rights of the holders of the respective classes of common stock may not bear any relationship to the relative market values or the relative voting rights of the two classes. We consider that liquidation is a remote contingency and believe that, in general, these liquidation provisions are immaterial to trading in the AR-CombiMatrix stock and the AR-Acacia Technologies stock.

No holder of AR-CombiMatrix stock will have any special right to receive specific assets of the CombiMatrix group and no holder of AR-Acacia Technologies stock will have any special right to receive specific assets of the Acacia Technologies group in the case of a dissolution, liquidation or winding up of Acacia Research.

If we subdivide or combine the outstanding shares of either class of common stock or declare a dividend or other distribution of shares of either class of common stock to holders of such class of common stock, the number of liquidation units of either class of common stock will be appropriately adjusted, as determined by our board of directors, to avoid any dilution in the aggregate, relative liquidation rights of any class of common stock.

Neither a merger nor consolidation of Acacia Research into or with any other corporation, nor any sale, transfer or lease of all or any part of the assets of Acacia Research, will, alone, be deemed a liquidation or winding up of Acacia Research, or cause the dissolution of Acacia Research, for purposes of these liquidation provisions.

DETERMINATIONS BY OUR BOARD OF DIRECTORS

Any determinations made in good faith by our board of directors under any provision described under "Description of AR-CombiMatrix Stock and AR-Acacia Technologies Stock," and any determinations with respect to any group or the rights of holders of shares of either class of common stock, will be final and binding on all of our stockholders, subject to the rights of stockholders under applicable Delaware law and under the federal securities laws.

PREEMPTIVE RIGHTS

Neither the holders of AR-CombiMatrix stock nor the holders of AR-Acacia Technologies stock will have any preemptive rights or any rights to convert their shares into any other securities of Acacia Research.

-87-

ANTIDILUTION PROVISIONS

Pursuant to a September 30, 2002 settlement agreement with Nanogen, Inc.,

CombiMatrix Corporation agreed to issue to Nanogen 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, and agreed to issue additional shares of CombiMatrix Corporation common stock or, following the merger and recapitalization, AR-CombiMatrix stock, to Nanogen under specified circumstances, for the purpose of maintaining Nanogen's 17.5% ownership interest in the CombiMatrix Corporation common stock. Specifically, Nanogen shall receive additional shares of CombiMatrix Corporation common stock or AR-CombiMatrix stock is the stock of the purpose of maintaining Nanogen's 17.5% ownership interest in the CombiMatrix Corporation common stock. Specifically, Nanogen shall receive additional shares of CombiMatrix Corporation common stock or AR-CombiMatrix stock:

- o for a period of three years from the date of the settlement agreement, in an amount equal to 17.5% of the number of shares of stock issued upon exercise of currently outstanding options and warrants to purchase CombiMatrix Corporation common stock or AR-CombiMatrix stock, as applicable, as well as any additional options and/or warrants granted prior to the date on which the stock is first publicly traded;
- o for the period beginning on the date of the settlement agreement and ending on the earlier of (i) the date on which the CombiMatrix Corporation common stock or AR-CombiMatrix stock is first publicly traded or (ii) the date which is 100 days after the date of the settlement agreement, in an amount equal to 17.5% of the number of additional shares issued of CombiMatrix Corporation common stock or AR-CombiMatrix stock;
- o for the period beginning on the date which is 100 days following the date of the settlement agreement and ending on the earlier of (i) the date on which the CombiMatrix Corporation common stock or AR-CombiMatrix stock is first publicly traded or (ii) the date which is 270 days after the date of the settlement agreement, in amount equal to the 17.5% of the number of shares of CombiMatrix Corporation common stock or AR-CombiMatrix common stock issued to any of CombiMatrix Corporation's existing stockholders, directors, officers or employees as of the date of the settlement agreement, or to specified strategic partners of CombiMatrix Corporation.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE RECAPITALIZATION

The following discussion is a summary of the material United States federal income tax consequences of the proposed recapitalization. The discussion insofar as it relates to you addresses only those of you who hold your Acacia Research common stock, and will, after the recapitalization, hold your AR-Acacia Technologies stock and AR-CombiMatrix stock, as capital assets. This summary does not discuss all aspects of United States federal income taxation that may be relevant to Acacia Research or our stockholders in light of their respective particular tax circumstances, nor does it discuss any state, local, foreign or non-income tax consequences. This discussion does not address the federal income tax consequences that may be applicable to taxpayers subject to special treatment under the Internal Revenue Code of 1986, as amended, which will be referred to as the "Code" in the following discussion. For example, taxpayers that may be subject to special treatment under the Code include:

- o tax-exempt entities;
- o partnerships, S corporations and other pass-through entities;
- o mutual funds;
- o small business investment companies;
- o regulated investment companies;
- o insurance companies and other financial institutions;

o dealers in securities;

-88-

- o traders that mark to market;
- stockholders who hold their shares as part of a hedge, appreciated financial position, straddle or conversion transaction;
- stockholders who acquired their shares through the exercise of options or otherwise as compensation or through a tax-qualified retirement plan; and
- o individuals who are not citizens or residents of the United States, foreign corporations and other foreign entities.

This discussion is based on the Code, Treasury Department regulations, published positions of the Internal Revenue Service, which is referred to in the following discussion as the "IRS," and court decisions now in effect, all of which are subject to change. In particular, the United States Congress could enact legislation or the Treasury Department could issue regulations or other guidance, including, without limitation, regulations issued pursuant to its broad authority under Section 337(d) of the Code, affecting the treatment of stock with characteristics similar to the AR-Acacia Technologies stock and the AR-CombiMatrix stock. Any such change, which may or may not be retroactive, could alter the tax consequences discussed in this document.

PricewaterhouseCoopers LLP has provided an opinion to us, based on the law in effect as of the date of the filing of this proxy statement and prospectus, regarding the material federal income tax consequences of the proposed recapitalization. The opinion has been filed with the Securities and Exchange Commission as an exhibit to the registration statement of which this proxy statement and prospectus forms a part. The opinion relies on certain factual background information which, in all material respects, is set forth in this proxy statement and prospectus and on representations as to certain factual matters and covenants, including those contained in the certificates furnished by officers of Acacia Research to PricewaterhouseCoopers LLP, for purposes of rendering its opinion. The opinion also relies on the following assumptions:

- The completion of the recapitalization in accordance with this proxy statement and prospectus.
- At all times relevant to the recapitalization, including periods following the recapitalization to the extent relevant, Acacia Research (i) is duly formed and in good standing under all applicable laws and regulations and (ii) will be treated as a corporation for United States federal income tax purposes under relevant IRS regulations.
- All items described as debt or stock in connection with the recapitalization have been, or will be, properly classified as debt or stock, respectively, for United States federal income tax purposes.
- o Except as otherwise discussed in this proxy statement and prospectus, the stock of any entity described as "voting" stock will have the right to vote for all corporate directors, on a per share basis which is proportionate with all other shares of the entity's voting stock.
- o Under applicable Delaware corporate law, the AR-CombiMatrix stock and

the AR-Acacia Technologies stock will both qualify as voting stock of Acacia Research.

- o The recapitalization (i) will be duly documented, (ii) will be effected in a manner that complies with all applicable legal and regulatory requirements, and (iii) will satisfy the arm's-length standard of section 482 of the Code and the IRS regulations issued thereunder because the terms of the recapitalization are assumed to be comparable to the terms of similar transactions between arm's-length parties. In addition, in the case of any transfer of stock in exchange for cash or other stock , the value of the consideration received will be approximately equal to the value of the shares surrendered.
- o With respect to the shares of AR-Acacia Technologies stock and AR-CombiMatrix stock received by the Acacia Research stockholders in exchange for their Acacia Research common stock pursuant to the recapitalization, the Acacia Research stockholders will become the legal and beneficial owner of such

-89-

shares for purposes of all applicable laws and regulations at such time as title to such shares vests with them pursuant to the recapitalization.

If any of the background information, or any of these assumptions, factual representations or covenants are inaccurate, the conclusions contained in the opinion could be affected.

It is a condition to our obligation to consummate the recapitalization that we receive an opinion of PricewaterhouseCoopers LLP, based upon reasonably requested representation letters and dated as of the closing date of the recapitalization, to the effect that the recapitalization will be treated as a reorganization described in Section 368(a) (1) (E) of the Code under the law in effect as of the closing date of the recapitalization, and we will not recognize gain or loss by reason of the issuance of the AR-CombiMatrix stock and the AR-Acacia Technologies stock, under the law in effect as of the closing date of the recapitalization.

The material United States federal income tax consequences of the recapitalization proposal, as set forth in the opinion filed as an exhibit to this proxy statement and prospectus are as follows:

- o The AR-CombiMatrix stock and the AR-Acacia Technologies stock will be treated as stock of Acacia Research for federal income tax purposes.
- The exchange by you of your Acacia Research common stock for AR-CombiMatrix stock and AR-Acacia Technologies stock will constitute a recapitalization within the meaning of section 368(a)(1)(E) of the Code. We will be "a party to a reorganization" within the meaning of section 368(b) of the Code.
- No gain or loss will be recognized by you on the exchange of your Acacia Research common stock solely for AR-CombiMatrix stock and AR-Acacia Technologies stock.
- The payment of cash in lieu of fractional share interests of AR-CombiMatrix stock will be treated as if the fractional shares were distributed as part of the exchange to the exchange agent and then

were purchased by the exchange agent. These cash payments will be treated as full payment for the stock as provided in section 1001 of the Code. Accordingly, you will recognize taxable gain on the receipt of such cash payment in an amount equal to the lesser of: (i) the amount of the cash payment you receive, or (ii) the excess of (A) the sum of the aggregate fair market values of the shares of AR-CombiMatrix stock and AR-Acacia Technologies stock you receive in the recapitalization, plus the amount of the cash payment received, over (B) your basis in all of your shares of Acacia Research common stock surrendered in the recapitalization.

- o Your basis in the AR-CombiMatrix stock will equal a portion of your basis in the Acacia Research common stock surrendered in the exchange based on the relative fair market of the AR-CombiMatrix stock as compared to the total consideration received by you pursuant to the recapitalization. The holding period of the AR-CombiMatrix stock to be received by you will include the holding period of the Acacia Research common stock surrendered in exchange therefor, provided that you held the Acacia Research common stock as a capital asset as of the date of the exchange.
- o Your basis in the AR-Acacia Technologies stock will equal a portion of your basis in the Acacia Research common stock surrendered in the exchange based on the relative fair market of the AR-Acacia Technologies stock as compared to the total consideration received by you pursuant to the recapitalization. The holding period of the AR-Acacia Technologies stock to be received by you will include the holding period of the Acacia Research common stock surrendered in exchange therefor, provided that you held the Acacia Research common stock as a capital asset as of the date of the exchange.
- No gain or loss will be recognized by us on the issuance of AR-CombiMatrix stock and AR-Acacia Technologies stock in exchange for the Acacia Research common stock.

-90-

NO IRS RULING

We have not sought any ruling from the IRS in connection with the proposed recapitalization. The IRS has announced that it will not issue advance rulings on the classification of instruments similar to the AR-Acacia Technologies stock and the AR-CombiMatrix stock that have certain voting and liquidation rights in an issuing corporation but whose dividend rights are determined by reference to the earnings of a segregated portion of the issuing corporation. In addition, there are no court decisions or other authorities that bear directly on the tax effects of the issuance and classification of stock with the features of the AR-Acacia Technologies stock and the AR-CombiMatrix stock. Further, the tax opinion described above is not binding on the IRS or the courts. Thus, it is possible that the IRS could successfully take the position that:

- the AR-Acacia Technologies stock and the AR-CombiMatrix stock is stock of a separate corporation, not stock of Acacia Research;
- o the receipt of AR-Acacia Technologies stock and AR-CombiMatrix stock in exchange for your Acacia Research common stock pursuant to the recapitalization is a taxable event to you, in which case you may be required to recognize taxable dividend income up to an amount equal to

the lesser of: (i) the combined fair market value of the AR-CombiMatrix stock and AR-Acacia Technologies stock received, or (ii) Acacia Research's current and accumulated earnings and profits, if any, and you would be required to recognize a taxable gain in an amount equal to the excess of the combined fair market value of the AR-CombiMatrix stock and AR-Acacia Technologies stock received (less any dividend income you recognize) over your tax basis in your Acacia Research shares; and/or

 we recognized a significant taxable gain by reason of the recapitalization.

The preceding summary of the tax opinion and related matters does not purport to be a complete analysis or discussion of all potential tax effects relevant to the recapitalization. Thus, you are urged to consult your own tax advisors as to the specific tax consequences to you of the recapitalization, including tax return reporting requirements, the applicability and effect of federal, state, local, foreign and other tax laws and the effect of any proposed changes in the tax laws.

STOCK EXCHANGE LISTINGS

We have applied to list the AR-CombiMatrix stock and the AR-Acacia Technologies stock on the NASDAQ National Market under the symbols "CBMX" and "ACTG", respectively.

EXCHANGE PROCEDURES

Upon consummation of the recapitalization, your stock certificates for our existing common stock will represent shares of AR-CombiMatrix stock and AR-Acacia Technologies stock. Shortly after the recapitalization, holders of Acacia Research common stock will receive instructions on how they may exchange their existing stock certificates for new certificates representing their AR-CombiMatrix stock and their AR-Acacia Technologies stock. Prior to the receipt of the new certificates, stockholders will be able to trade their shares of AR-CombiMatrix stock and AR-Acacia Technologies stock through book entry with our transfer agent, U.S. Stock Transfer Corporation.

STOCK TRANSFER AGENT AND REGISTRAR

Our existing transfer agent, U.S. Stock Transfer Corporation, will act as the registrar and transfer agent for both the AR-CombiMatrix stock and the AR-Acacia Technologies stock.

FINANCIAL ADVISORS

William Blair & Company, L.L.C. is acting as our sole advisor with respect to the structuring of the recapitalization proposal. William Blair & Company's role as our advisor has consisted of analyzing the current

-91-

capitalization and organizational structure of our company and our subsidiaries, meeting with us and helping us to develop a strategy on how best to improve the capitalization and organizational structure, and responding to questions and comments regarding the strategy raised by our management. We have agreed to pay William Blair & Company a fee of \$350,000.

We have also agreed to reimburse William Blair & Company for their

reasonable out-of-pocket expenses, including the fees and expenses of their lawyers, and to indemnify them against liabilities under the Securities Act of 1933, as amended (the "Securities Act"), and certain other liabilities.

EFFECT ON EXISTING OPTIONS AND WARRANTS

If the recapitalization is implemented, each outstanding option and warrant to acquire a share of Acacia Research common stock under our existing stock option plans or warrants will be converted into separately exercisable options or warrants, as the case may be, to acquire a fraction of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. The exact conversion ratio for shares of AR-CombiMatrix stock will be equal to the quotient obtained by dividing (a) the number of shares of CombiMatrix Corporation common stock owned by Acacia Research immediately prior to the effective time of the merger by (b) the total number of shares of Acacia Research common stock issued and outstanding immediately prior to the effective time. As of November 1, 2002, this fraction was 0.5582. The exercise price for the resulting AR-Acacia Technologies stock options and warrants and AR-CombiMatrix stock options and warrants will be calculated by multiplying the exercise price under such existing stock option or warrant by a fraction, the numerator of which is the result obtained by multiplying the opening price of the applicable class of common stock underlying such option on the first date such stocks are traded after the recapitalization times the applicable conversion ratio and the denominator of which is the sum of such amounts for the AR-CombiMatrix stock and the AR-Acacia Technologies stock.

We intend to file a registration statement on Form S-8 to register shares of AR-Acacia Technologies stock subject to AR-Acacia Technologies stock options. We expect the registration statement will be effective shortly after the effective time of the recapitalization.

NO DISSENTERS' RIGHTS WITH RESPECT TO RECAPITALIZATION PROPOSAL

Under Delaware law, stockholders who dissent from the recapitalization proposal will not have appraisal rights with respect to the recapitalization.

NO REGULATORY APPROVALS

No state or federal regulatory approvals are required for the recapitalization.

-92-

THE MERGER PROPOSAL

DESCRIPTION OF THE MERGER

In the proposed merger, CombiMatrix Corporation will merge with and into a specially-formed, wholly-owned subsidiary of Acacia Research. The merger subsidiary will be the surviving corporation and will be renamed "CombiMatrix Corporation." As a result of the merger, each outstanding share of CombiMatrix Corporation common stock, other than those shares held by Acacia Research, will be automatically converted into the right to receive one share of AR-CombiMatrix stock. Shares of CombiMatrix Corporation common stock held by Acacia Research or held by CombiMatrix Corporation as treasury stock will be canceled and will not be converted into AR-CombiMatrix stock.

ISSUANCE OF SHARES; OWNERSHIP INTERESTS

In the merger, holders of CombiMatrix Corporation common stock other than Acacia Research will receive one share of AR-CombiMatrix stock for each share of CombiMatrix Corporation common stock owned by such stockholders immediately prior to the merger. In the recapitalization, the holders of Acacia Research common stock will receive the same number of shares of AR-CombiMatrix stock as the number of shares of CombiMatrix Corporation common stock held by Acacia Research immediately prior to the effective time of the merger.

As a result of these transactions, (a) holders of CombiMatrix Corporation common stock other than Acacia Research will receive the same percentage of the issued and outstanding shares of AR-CombiMatrix stock as such stockholders' percentage ownership interest in the issued and outstanding shares of CombiMatrix Corporation common stock immediately prior to the effective time of the merger and (b) holders of Acacia Research common stock will receive, in the aggregate, the same percentage of the issued and outstanding shares of AR-CombiMatrix stock as Acacia Research's percentage ownership interest in the issued and outstanding shares of CombiMatrix Corporation common stock immediately prior to the effective time of the merger.

The specific percentage of the issued and outstanding shares of AR-CombiMatrix stock that will be received in the merger by holders of Acacia Research common stock and CombiMatrix Corporation common stock will depend on the specific percentage of the issued and outstanding shares of CombiMatrix Corporation common stock owned by Acacia Research and the holders of CombiMatrix Corporation common stock immediately prior to the effective time of the merger. As of November 1, 2002, Acacia Research owned 47.7% of the issued and outstanding shares of CombiMatrix Corporation common stock and the stockholders of CombiMatrix Corporation other than Acacia Research owned the remaining 52.3%. Accordingly, if the merger were to have occurred on November 1, 2002, holders of Acacia Research common stock would have received 47.7% of the issued and outstanding shares of AR-CombiMatrix stock and holders of CombiMatrix Corporation common stock other than Acacia Research would have received 52.3% of the issued and outstanding shares of AR-CombiMatrix stock.

The relative percentage interests calculated on a fully diluted basis will depend upon the number of options and warrants outstanding immediately prior to the effective time of the merger. Based on the number of options and warrants outstanding as of November 1, 2002, and not including shares to be issued to Nanogen, Inc. pursuant to anti-dilution provisions of the settlement agreement discussed in "Recent Developments" above, the holders of Acacia Research common stock and options and warrants to purchase Acacia Research common stock would receive 41.0% of the shares of AR-CombiMatrix stock calculated on a fully diluted basis and the holders of CombiMatrix Corporation common stock, options and warrants (other than Acacia Research) would receive 59.0% of the issued and outstanding shares of AR-CombiMatrix stock calculated on a fully diluted basis. The number of outstanding options and warrants of Acacia Research, and the number of outstanding shares, options and warrants of CombiMatrix Corporation, as of November 1, 2002, are set forth in the table below:

-93-

ACACIA RESEARCH AND COMBIMATRIX CORPORATION OUTSTANDING SHARES, OPTIONS AND WARRANTS AS OF NOVEMBER 1, 2002

ACACIA RESEARCH Issued and outstanding shares

19,640,808

| Edgar Filing: ACACIA | RESEARCH CORP - Form S-4/A |
|----------------------|----------------------------|
| | |

| Vested options and warrants Unvested options and warrants | 4,288,319 1,399,089 |
|--|------------------------|
| Outstanding options and warrants | 5,687,408 |
| Total | 25,328,216 |

| | HELD BY ACACIA RESEARCH | HELD BY STOCKHOLDERS OTHER THAN ACACIA RESEARCH |
|--|----------------------------|---|
| COMBIMATRIX CORPORATION Issued and outstanding shares | 10,963,277 | 12,005,274 |
| | | |
| Vested options and warrants | 0 | 2,264,658* |
| Unvested options and warrants | 0 | 1,491,052* |
| | | |
| Outstanding options and warrants | 0 | 3,755,710 |
| | | |
| Total | 10,963,277 | 15,760,984* |

* Does not include additional shares to be issued to Nanogen, Inc. pursuant to anti-dilution provisions of the settlement agreement discussed in "Recent Developments" above.

BACKGROUND OF AND REASONS FOR THE MERGER

Please see "The Recapitalization Proposal - Background of and Reasons for the Recapitalization Proposal" for detailed information regarding the background of and reasons for the merger.

RECOMMENDATION OF OUR BOARD OF DIRECTORS

OUR BOARD OF DIRECTORS HAS CAREFULLY CONSIDERED THE MERGER PROPOSAL AND BELIEVES THAT THE MERGER IS IN THE BEST INTERESTS OF ACACIA RESEARCH AND OUR STOCKHOLDERS. ACCORDINGLY, OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU APPROVE THE MERGER PROPOSAL.

-94-

TABLE REGARDING SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information regarding the beneficial ownership of the CombiMatrix Corporation stock as of November 1, 2002. The table sets forth information regarding (i) all persons known to us to beneficially own five percent (5%) or more of the CombiMatrix Corporation's common stock, (ii) each director of CombiMatrix Corporation, (iii) each executive officer of CombiMatrix Corporation, and (iv) all current directors and executive officers as a group.

| | COMBIMATRIX CORPORATION COMMON STOCK | |
|---------------------------------|--|-------------|
| BENEFICIAL OWNER(1) | AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP | PERCENT (2) |
| Acacia Research Corporation (3) | 10,963,277 | 47.7% |

| Nanogen, Inc. | 4,016,346 | 17.5% |
|---|-----------|-------|
| Amit Kumar, Ph.D. (4) | 104,862 | * |
| Donald D. Montgomery, Ph.D. (3)(5) | 2,265,416 | 9.9% |
| Warren G. Hargis (6) | 85,833 | * |
| Scott Burell, CPA (7) | 20,000 | * |
| Jeffrey B. Oster, Ph.D. (8) | 86,666 | * |
| Edward M. Eadeh (9) | 113,020 | * |
| Brooke P. Anderson, Ph.D. (10) | 67,861 | * |
| Brett L. Undem (11) | 63,194 | * |
| Peter G. Edelman, Ph.D. (12) | 10,313 | * |
| Paul R. Ryan (13) | 36,250 | * |
| Robert L. Harris, II (14) | 26,250 | * |
| Rigdon Currie (15) | 48,750 | * |
| R. Bruce Stewart (16) | 36,250 | * |
| Thomas B. Akin (17) | 26,250 | * |
| All Directors and Executive Officers as a Group | | |
| (fourteen persons)(18) | 2,990,915 | 12.6% |

^{*} Less than one percent

- (2) The percentage of shares beneficially owned is based on 22,968,551 shares of CombiMatrix Corporation common stock outstanding as of November 1, 2002. Beneficial ownership is determined under rules and regulations of the Securities and Exchange Commission. Shares of CombiMatrix Corporation common stock subject to options that are currently exercisable or exercisable within 60 days after November 1, 2002 are deemed to be outstanding and beneficially owned by the person holding such options for the purpose of computing the number of shares beneficially owned and the percentage ownership of such person, but are not deemed to be outstanding for the purpose of computing the percentage ownership of any other person. Except as indicated in the footnotes to this table, and subject to applicable community property laws, we believe that such persons have sole voting and investment power with respect to all shares of CombiMatrix Corporation common stock shown as beneficially owned by them.
- (3) On April 19, 1996, an Agreement of Shareholders was executed by and between Acacia Research and Dr. Montgomery in connection with the issuance of CombiMatrix Corporation's common stock. Acacia Research and Dr. Montgomery may be deemed to be a "group" for purposes of 13(d)(3) of the Securities Exchange Act of 1934, as amended. Acacia Research and Dr. Montgomery may therefore be deemed to beneficially own those shares listed as beneficially owned by the other. The Agreement of Shareholders provides for certain rights and obligations regarding the nomination and election of directors. The listed holders disclaim beneficial ownership of the shares except to the extent that they have a pecuniary interest therein.

-95-

(4) Includes 104,862 shares of CombiMatrix Corporation common stock issuable

⁽¹⁾ The address for Acacia Research Corporation, Mr. Ryan, Mr. Harris, Mr. Stewart and Mr. Akin is the principal offices of Acacia Research, located at 500 Newport Center Drive, Newport Beach, California 92660; the address for Nanogen, Inc. is 10398 Pacific Center Court, San Diego, California, 92121; and the address for each other person is the principal offices of CombiMatrix Corporation, located at 6500 Harbour Heights Parkway, Mukilteo, Washington 98275.

upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.

- (5) Includes 15,416 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (6) Includes 78,333 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (7) Includes 20,000 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (8) Includes 86,666 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (9) Includes 113,020 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (10) Includes 33,061 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (11) Includes 52,083 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (12) Includes 10,313 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (13) Includes 36,250 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (14) Includes 26,250 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (15) Includes 48,750 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (16) Includes 36,250 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (17) Includes 26,250 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.
- (18) Includes 687,504 shares of CombiMatrix Corporation common stock issuable upon exercise of options that are currently exercisable or will become exercisable within 60 days of November 1, 2002.

ACCOUNTING TREATMENT

We will account for the acquisition of the equity interest of CombiMatrix

Corporation not held by us in the merger as a purchase of a business. Under this method of accounting, the assets acquired and liabilities assumed of CombiMatrix Corporation, including intangible assets, will be recorded at their fair market values as of the date of their acquisition. The results of operations and cash flows of CombiMatrix Corporation will be included in the financial statements of the CombiMatrix group following the completion of the recapitalization and merger.

Consistent with generally accepted accounting principles ("GAAP"), amounts assigned to purchased in-process research and development -- i.e., CombiMatrix Corporation research and development projects that are still in process at the closing of the merger, but which, if unsuccessful, have no alternative future use -- must be charged as expenses on the date that the merger closes. As a result of the merger, based on estimates used in the unaudited proforma financial information provided elsewhere herein, we expect to incur a write-off related to in-process research and development totaling approximately \$10.3 million. The charge related to in-process research and development will be reflected in Acacia Research Corporation's consolidated financial statement when the merger is consummated and will be allocated to the CombiMatrix group.

-96-

Results of operations of CombiMatrix Corporation, including the related amortization of intangible assets and write-off of in-process research and development associated with the merger, will be included in the results of operations of the CombiMatrix group subsequent to the date on which the merger is completed.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES OF THE MERGER

The following discussion is a summary of the material United States federal income tax consequences of the proposed merger. This summary does not discuss all aspects of United States federal income taxation that may be relevant to Acacia Research or our stockholders in light of their respective particular tax circumstances, nor does it discuss any state, local, foreign or non-income tax consequences. This discussion does not address the federal income tax consequences that may be applicable to taxpayers subject to special treatment under the Internal Revenue Code of 1986, as amended, which will be referred to as the "Code" in the following discussion. For example, taxpayers that may be subject to special treatment under the Code include:

- o tax-exempt entities;
- o partnerships, S corporations and other pass-through entities;
- o mutual funds;
- o small business investment companies;
- o regulated investment companies;
- o insurance companies and other financial institutions;
- o dealers in securities;
- o traders that mark to market;
- stockholders who hold their shares as part of a hedge, appreciated financial position, straddle or conversion transaction;

- stockholders who acquired their shares through the exercise of options or otherwise as compensation or through a tax-qualified retirement plan; and
- o individuals who are not citizens or residents of the United States, foreign corporations and other foreign entities.

This discussion is based on the Code, Treasury Department regulations, published positions of the Internal Revenue Service, which is referred to in the following discussion as the "IRS," and court decisions now in effect, all of which are subject to change. In particular, the United States Congress could enact legislation or the Treasury Department could issue regulations or other guidance, including, without limitation, regulations issued pursuant to its broad authority under Section 337(d) of the Code, affecting the treatment of stock with characteristics similar to the AR-CombiMatrix stock. Any such change, which may or may not be retroactive, could alter the tax consequences discussed in this document.

PricewaterhouseCoopers LLP has provided an opinion to us, based on the law in effect as of the date of the filing of this proxy statement and prospectus, regarding the material federal income tax consequences of the proposed merger. The opinion has been filed with the Securities and Exchange Commission as an exhibit to the registration statement of which this proxy statement and prospectus forms a part. The opinion relies on certain factual background information, which in all material respects, is set forth in this proxy statement and prospectus and on representations as to certain factual matters and covenants, including those contained in the certificates furnished by officers of Acacia Research and CombiMatrix Corporation to PricewaterhouseCoopers LLP, for purposes of rendering its opinion. The opinion also relies on the following assumptions:

-97-

- The completion of the merger in accordance with this proxy statement and prospectus.
- o At all times relevant to the merger, including periods following the merger to the extent relevant, each of Acacia Research, CombiMatrix Corporation and Combi Acquisition Corp. (i) is duly formed and in good standing under all applicable laws and regulations and (ii) will be treated as a corporation for United States federal income tax purposes under relevant IRS regulations.
- All items described as debt or stock in connection with the merger have been, or will be, properly classified as debt or stock, respectively, for United States federal income tax purposes.
- o Except as otherwise discussed in this proxy statement and prospectus, the stock of any entity described as "voting" stock will have the right to vote for all corporate directors, on a per share basis which is proportionate with all other shares of the entity's voting stock.
- Under applicable Delaware corporate law, the AR-CombiMatrix stock will qualify as voting stock of Acacia Research.
- o Under applicable Delaware corporate law, Acacia Research will be the sole stockholder of Combi Acquisition Corp., successor to CombiMatrix Corporation, upon completion of the merger. As of that same time,

Acacia Research will be the sole stockholder (directly or indirectly) of the following corporations: (i) CombiMatrix Corporation, which along with Advanced Material Sciences, Inc., a majority-owned subsidiary of CombiMatrix, will be the sole entities comprising the CombiMatrix group, and (ii) Soundview Technologies, Inc. and Acacia Media Technologies Corporation, which will collectively principally comprise the Acacia Technologies group.

- The merger will qualify as a statutory merger under applicable Delaware corporate law.
- o The merger (i) will be duly documented, (ii) will be effected in a manner that complies with all applicable legal and regulatory requirements, and (iii) will satisfy the arm's-length standard of section 482 of the Code and the IRS regulations issued thereunder because the terms of the merger are assumed to be comparable to the terms of similar transactions between arm's-length parties. In addition, in the case of any transfer of stock in exchange for cash or stock of the transferee entity, the value of the consideration received will be approximately equal to the value of the shares surrendered.
- o With respect to each transfer of a transferred asset, the respective transferee will become the legal and beneficial owner of the asset for purposes of all applicable laws and regulations at such time as title to the transferred asset vests with the transferee pursuant to the merger.

If any of the background information or any of these assumptions, factual representations or covenants are inaccurate, the conclusions contained in the opinion could be affected.

The Acacia Research stockholders will not exchange any stock of Acacia Research in the merger. Therefore, no gain or loss will be recognized by the Acacia Research stockholders in the merger with respect to their shares of Acacia Research common stock. However, pursuant to the terms of the recapitalization, the Acacia Research stockholders will exchange their Acacia Research common stock for shares of AR-CombiMatrix stock and AR-Acacia Technologies stock. The material United States federal income tax consequences of the recapitalization are described above under the caption "Material United States Federal Income Tax Consequences of the Recapitalization."

The material federal income tax consequences of the merger, as set forth in the opinion filed as an exhibit to this proxy statement and prospectus are as follows:

 The AR-CombiMatrix stock will be treated as stock of Acacia Research for federal income tax purposes.

-98-

o The transfer by operation of law pursuant to the merger of substantially all of the assets of CombiMatrix Corporation to Combi Acquisition Corp. in exchange for AR-CombiMatrix stock and the assumption by Combi Acquisition Corp. of the liabilities of CombiMatrix Corporation by operation of law pursuant to the merger plus the liabilities to which the CombiMatrix Corporation assets may be subject, will qualify as a reorganization within the meaning of Sections 368(a)(1)(A) an 368(a)(2)(D) of the Code (which set forth

certain requirements for certain types of tax-free reorganizations). For purposes of this paragraph, "substantially all" means at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets of CombiMatrix Corporation. Acacia Research, Combi Acquisition Corp., and CombiMatrix Corporation will each be "a party to a reorganization" within the meaning of section 368(b) of the Code.

- o No gain or loss will be recognized to CombiMatrix Corporation on the transfer of substantially all of its assets to Combi Acquisition Corp. by operation of law pursuant to the merger in exchange for AR-CombiMatrix stock, cash to pay dissenters, if any, and the assumption by Combi Acquisition Corp. of the liabilities of CombiMatrix Corporation by operation of law pursuant to the merger, since the cash will be distributed to the dissenting stockholders of CombiMatrix Corporation pursuant to the plan of reorganization.
- o No gain or loss will be recognized by us or Combi Acquisition Corp. on the transfer by operation of law pursuant to the merger of substantially all of CombiMatrix Corporation's assets to Combi Acquisition Corp. in exchange for AR-CombiMatrix stock, cash, if any, and the assumption of the liabilities of CombiMatrix Corporation by operation of law pursuant to the merger.
- o Combi Acquisition Corp. will not recognize gain or loss when it exchanges AR-CombiMatrix stock for substantially all the assets of CombiMatrix Corporation by operation of law pursuant to the merger.
- o The CombiMatrix Corporation stockholders will not recognize gain or loss when they exchange their CombiMatrix Corporation common stock solely for AR-CombiMatrix stock by operation of law pursuant to the merger (including any fractional share interests to which they may be entitled).
- o The payment of cash to CombiMatrix Corporation stockholders in lieu of fractional share interests of AR-CombiMatrix stock will be treated as if the fractional shares were distributed as part of the exchange to the exchange agent and then were purchased by the exchange agent. These cash payments will be treated as full payment for the stock as provided in Section 1001(a) of the Code. Accordingly, each CombiMatrix Corporation stockholder will recognize taxable gain on the receipt of these cash payments in an amount equal to the lesser of: (i) the amount of the cash payment received by the stockholder, or (ii) the excess of (A) the sum of the aggregate fair market value of the shares of AR-CombiMatrix stock received by the stockholder in the merger, plus the amount of the cash payment received, over (B) the stockholder's basis in all of the stockholder's shares of CombiMatrix Corporation common stock surrendered in the merger.
- o The CombiMatrix Corporation stockholders' (other than Acacia) basis in the AR-CombiMatrix stock (including any fractional share interests to which they may be entitled) received pursuant to the merger will be equal to the basis they had in their CombiMatrix Corporation common stock.
- o The holding period of the AR-CombiMatrix stock to be received by the CombiMatrix Corporation stockholders pursuant to the merger (including any fractional share interests to which they may be entitled) will include the holding period of the CombiMatrix Corporation common stock to be surrendered pursuant to the merger in exchange therefor, provided the CombiMatrix Corporation common stock is held as a capital asset in the hands of the CombiMatrix Corporation stockholders on the

date of the exchange.

o Combi Acquisition Corp.'s tax basis in the assets transferred to it by operation of law pursuant to the merger will equal CombiMatrix Corporation's basis in those assets. Combi Acquisition Corp.'s holding period in the assets it receives pursuant to the merger will include CombiMatrix Corporation's holding period in such assets.

-99-

- o Our basis in the Combi Acquisition Corp. stock will be adjusted as if:
 - o we received the assets of CombiMatrix Corporation which were transferred by operation of law to Combi Acquisition Corp. in the merger (and we assumed any liabilities which Combi Acquisition Corp. assumed or to which the CombiMatrix Corporation assets received were subject) directly from CombiMatrix Corporation in a transaction in which our basis in the assets of CombiMatrix Corporation was determined under Section 362(b) of the Code (which governs the determination of a corporation's tax basis in property received in certain types of tax-free transactions); and
 - o we then transferred the CombiMatrix Corporation assets (and liabilities which Combi Acquisition Corp. assumed by operation of law in the merger or to which the CombiMatrix Corporation assets acquired by Combi Acquisition Corp. were subject) to Combi Acquisition Corp. in a transaction in which our basis in Combi Acquisition Corp. stock was determined under Section 358 of the Code (which governs the determination of a stockholder's tax basis in stock received in certain types of tax-free transactions). The purpose of this basis adjustment, which is required under IRS regulations, is to reflect the basis of CombiMatrix Corporation's assets in the basis of Acacia Research's stock in Combi Acquisition Corp. immediately upon the completion of the merger.

O NO IRS RULING

We have not sought any ruling from the IRS in connection with the proposed merger. The IRS has announced that it will not issue advance rulings on the classification of an instrument similar to the AR-CombiMatrix stock that has certain voting and liquidation rights in an issuing corporation but whose dividend rights are determined by reference to the earnings of a segregated portion of the issuing corporation's assets, including assets held by a subsidiary of the issuing corporation. In addition, there are no court decisions or other authorities that bear directly on the tax effects of the issuance and classification of stock with the features of the AR-CombiMatrix stock. Further, the tax opinion described above is not binding on the IRS or the courts. Thus, it is possible that the IRS could successfully take the position that:

- the AR-CombiMatrix stock is stock of a separate corporation, not stock of Acacia Research;
- we recognized a significant taxable gain by reason of the merger or the issuance of AR-CombiMatrix stock; and/or
- CombiMatrix Corporation is not includable in our consolidated United States federal income tax return, and, among other things, any dividends paid or deemed paid to us by CombiMatrix Corporation could

be taxable to us, subject to any applicable dividends received deduction.

The preceding summary of the tax opinion and related matters does not purport to be a complete analysis or discussion of all potential tax effects relevant to the merger. Thus, you are urged to consult your own tax advisors as to the specific tax consequences to you of the merger, including tax return reporting requirements, the applicability and effect of federal, state, local, foreign and other tax laws and the effect of any proposed changes in the tax laws.

OTHER TAX MATTERS

It is a condition to our obligation to consummate the merger that we receive an opinion of PricewaterhouseCoopers LLP, based upon reasonably requested representation letters and dated as of the closing date, to the effect that the merger will be treated as a reorganization described in Section 368(a) of the Code under the law in effect as of the closing date of the merger, and we will not recognize gain or loss by reason of the issuance of AR-CombiMatrix stock, under the law in effect as of the closing date of the merger. In addition, it is a condition to the obligation of CombiMatrix Corporation to consummate the merger that CombiMatrix Corporation receive an opinion of PricewaterhouseCoopers LLP, based upon reasonably requested representation letters and dated as of the closing date, to the effect that the merger will be treated as a reorganization described in Section 368(a) of the Code under the law in effect as of the closing date of the merger will be treated as a fiber closing date of the merger. Neither we nor CombiMatrix Corporation currently intend to waive the condition that we and CombiMatrix Corporation receive the respective tax opinions described

-100-

above. In the unlikely event that the parties do decide to waive the condition, however, we will recirculate this document to disclose the waiver of the condition and all related material disclosures, including the risks to our stockholders, if any, resulting from the waiver, and will resolicit proxies from our stockholders.

APPRAISAL RIGHTS

Our stockholders will not have any dissenters' or appraisal rights under Delaware law in connection with the merger. CombiMatrix Corporation stockholders, however, who object to the merger will have dissenters' appraisal rights.

RESTRICTIONS ON RESALE OF AR-COMBIMATRIX COMMON STOCK BY AFFILIATES OF ACACIA RESEARCH AND COMBIMATRIX CORPORATION

The shares of AR-CombiMatrix stock to be received by the stockholders of CombiMatrix Corporation in connection with the merger have been registered under the Securities Act and, except as set forth in this paragraph, may be traded without restriction. The shares of AR-CombiMatrix stock to be issued in connection with the merger and received by persons who may be deemed to be "affiliates" (as that term is defined in Rule 144 under the Securities Act) of Acacia Research or CombiMatrix Corporation prior to the merger may be resold by them only in transactions permitted by the resale provisions of Rule 145 under the Securities Act or as otherwise permitted under the Securities Act.

FEDERAL SECURITIES LAWS CONSEQUENCES; STOCK TRANSFER RESTRICTION AGREEMENTS

This document does not cover any resales of the shares of AR-CombiMatrix stock to be received by CombiMatrix Corporation's stockholders in the merger, and no person is authorized to make any use of this document in connection with any such resale.

All shares of AR-CombiMatrix stock that CombiMatrix Corporation stockholders receive in the merger will be freely transferable, with the exception of (a) the shares of AR-CombiMatrix stock received by persons who are deemed to be "affiliates" of CombiMatrix under the Securities Act and the rules and regulations promulgated under that Act, at the time of the CombiMatrix Corporation special meeting, and (b) shares subject to any "market standoff agreement" as described below. Persons who are deemed "affiliates" may re-sell their shares of AR-CombiMatrix stock only in transactions permitted by Rule 145 under the Securities Act or as otherwise permitted under that Act. Persons who may be deemed to be affiliates of CombiMatrix Corporation for such purposes generally include individuals or entities that control, are controlled by or are under common control with CombiMatrix Corporation and may include some officers, directors and principal stockholders of CombiMatrix Corporation. The merger agreement provides that, subject to applicable law, CombiMatrix Corporation share certificates surrendered for exchange pursuant to the merger agreement by any person constituting an "affiliate" of CombiMatrix Corporation will not be exchanged until Acacia Research receives an executed letter agreement to the effect that those persons will not offer or sell or otherwise dispose of any shares of AR-CombiMatrix stock issued to them in the merger in violation of the Securities Act.

One of the conditions to our obligation to consummate the merger is that each director, officer and employee of CombiMatrix Corporation who is also a stockholder of CombiMatrix Corporation shall have executed a "market standoff agreement" pursuant to which each such person shall have agreed not to sell any shares of AR-CombiMatrix stock received in the merger for a period of six (6) months after the effective time of the merger. Accordingly, all such directors, officers and employees who enter into such market standoff agreements will not be permitted to sell any of the shares of AR-CombiMatrix stock that they receive in the merger during the six (6) month period following the merger.

-101-

PRINCIPAL PROVISIONS OF THE MERGER AGREEMENT

The following is a summary of significant provisions of the merger agreement. For a more complete understanding of the merger agreement, you should read the agreement. The merger agreement is attached as ANNEX A and is incorporated into this proxy statement/prospectus by reference.

GENERAL DESCRIPTION OF THE MERGER

In the proposed merger, CombiMatrix Corporation will merge into a specially-formed, wholly-owned subsidiary of Acacia Research. The merger subsidiary will be the surviving corporation and will be renamed "CombiMatrix Corporation."

Immediately prior to the consummation of the merger, we will file our restated certificate of incorporation with the Delaware Secretary of State. Among other things, our restated certificate of incorporation will authorize the AR-CombiMatrix stock and the AR-Acacia Technologies stock and will split our outstanding common stock into shares of these two classes of common stock.

As a result of the merger, each outstanding share of CombiMatrix

Corporation common stock, other than those shares held by Acacia Research, will be automatically converted into the right to receive one share of AR-CombiMatrix stock. Shares of CombiMatrix Corporation common stock held by Acacia Research or held by CombiMatrix Corporation as treasury stock will be canceled and will not be converted into AR-CombiMatrix stock.

EFFECTIVE TIME

We expect to close the merger shortly after the special meeting of stockholders. The merger will be effective upon the filing of appropriate documents with the Delaware Secretary of State, or at such later time as we may specify in those documents. We plan to file those documents soon after the special stockholders meeting.

CONVERSION OF SHARES AND CONSIDERATION TO BE RECEIVED IN THE MERGER

At the effective time of the merger:

- each issued and outstanding share of CombiMatrix Corporation common stock, other than shares owned by Acacia Research and our affiliates, will be converted into the right to receive one share of AR-CombiMatrix stock; and
- each share of CombiMatrix Corporation common stock owned by us and our affiliates will be canceled.

EXCHANGE OF COMBIMATRIX CORPORATION STOCK CERTIFICATES

Promptly after the effective time of the merger, we or the exchange agent will mail the following materials to each person who holds shares of CombiMatrix Corporation common stock as of the effective time:

- o a letter of transmittal to be used by the holder to surrender its shares and send them to the exchange agent to be exchanged for the merger consideration; and
- o instructions explaining to the holder what to do to effect the exchange of its shares of CombiMatrix Corporation common stock for the merger consideration.

We will honor a request from a person surrendering a CombiMatrix Corporation common stock certificate that the AR-CombiMatrix stock being given in exchange be issued to a person other than the registered holder named on the exchange agent's books so long as the requesting person (which is approximately the same percentage interest as Acacia Research's current stock ownership interest in CombiMatrix Corporation):

-102-

- submits all documents necessary to evidence and effect the transfer to the new holder; and
- o pays any transfer or other taxes resulting from issuing shares of AR-CombiMatrix stock to a person other than the registered holder of the certificate, unless the requesting person satisfactorily establishes to Acacia Research that any tax has been paid or is inapplicable.

Holders of CombiMatrix Corporation common stock exchanged for

AR-CombiMatrix stock in the merger will be entitled to receive dividends and other distributions on AR-CombiMatrix stock (without interest) that are declared or made with a record date after the effective time. However, dividends or other distributions will not be paid to any former holder of CombiMatrix Corporation common stock until that holder surrenders its shares of CombiMatrix Corporation common stock to the exchange agent.

TREATMENT OF COMBIMATRIX CORPORATION STOCK OPTIONS

At the effective time of the merger, each outstanding option to purchase shares of CombiMatrix Corporation common stock under CombiMatrix Corporation's 1995 Stock Option Plan, 1998 Stock Option Plan and 2000 Stock Awards Plan, whether or not exercisable, will be assumed by us. Each assumed option will continue to be governed by the same terms and conditions that governed it under the applicable CombiMatrix Corporation plan immediately before the effective time of the merger except that the option will be exercisable for shares of AR-CombiMatrix stock rather than CombiMatrix Corporation common stock. The number of shares of AR-CombiMatrix stock issuable upon exercise of the assumed option, as well as the exercise price, will be the same as the number of shares of CombiMatrix Corporation common stock issuable and exercise price prior to the merger.

We have agreed to file a registration statement on Form S-8 to register the shares of AR-CombiMatrix stock subject to AR-CombiMatrix stock options. We expect that the registration statement will be effective shortly after the effective time of the merger.

On November 1, 2002, options to purchase 3,717,660 shares of CombiMatrix Corporation common stock were outstanding and the weighted average exercise price of those options was \$9.45 per share.

TREATMENT OF COMBIMATRIX CORPORATION WARRANTS

At the effective time of the merger, each outstanding warrant to purchase shares of CombiMatrix Corporation common stock will be assumed by us. Each assumed warrant will continue to be governed by the same terms and conditions that governed it immediately before the effective time of the merger except that the warrant will be exercisable for shares of AR-CombiMatrix stock rather than CombiMatrix Corporation common stock. The number of shares of AR-CombiMatrix stock issuable upon exercise of the assumed warrant, as well as the exercise price, will be the same as the number of shares of CombiMatrix Corporation common stock issuable and exercise price prior to the merger.

TREATMENT OF COMBIMATRIX CORPORATION BENEFITS AND OTHER EMPLOYEE MATTERS

Except as described above with respect to the existing stock option plans and the proposed new stock incentive plans, there will not be any change in employee benefit programs or employee benefits as a result of the merger. Immediately after the merger employees will have the same credit, under employee benefit programs for time served in terms of eligibility, vesting, benefit accrual and determination of the level of benefits.

REPRESENTATIONS AND WARRANTIES

The merger agreement contains representations and warranties by us, Combi Acquisition Corp., our wholly-owned subsidiary which CombiMatrix Corporation will be merged with and into in the merger, and CombiMatrix Corporation which we believe are usual and customary in transactions such as the merger.

PRINCIPAL COVENANTS

COMBIMATRIX CORPORATION'S CONDUCT OF BUSINESS PENDING THE MERGER

Pursuant to the merger agreement, CombiMatrix Corporation has agreed that, until the effective time of the merger, CombiMatrix Corporation will carry on its business in substantially the same manner as conducted prior to the date of the merger agreement.

COVENANTS OF ACACIA RESEARCH

Pursuant to the merger agreement, we have agreed that, after the effective time of the merger, we will:

- assume the CombiMatrix Corporation common stock options, and file a registration statement on Form S-8 with the Securities and Exchange Commission to register the shares issuable under those assumed options; and
- o indemnify each officer and director of CombiMatrix Corporation as of the effective date and obtain a policy of directors' and officers' liability insurance for a three year period after the effective date.

There are exceptions to these obligations in the merger agreement. CombiMatrix Corporation may also agree to further exceptions in writing.

OTHER COVENANTS

The merger agreement contains additional covenants which we believe are usual and customary in transactions such as the merger, including a general covenant requiring each party to use its reasonable best efforts to effect the consummation of the merger.

CONDITIONS TO THE CONSUMMATION OF THE MERGER

CONDITIONS TO EACH PARTY'S OBLIGATIONS

Each party's obligation to consummate the merger is subject to the satisfaction of the following conditions:

- No court or other governmental entity of competent jurisdiction shall have entered, enacted, issued or enforced any judgment, order, statute, law or regulation that would prevent the completion of the merger, nor shall any suit, action or proceeding be pending that would prevent completion of the merger;
- Each party's stockholders shall have approved and adopted the merger agreement, and our stockholders shall have approved the recapitalization proposal;
- The registration statement on Form S-4 filed with the Securities and Exchange Commission has been declared effective, and no stop order has been issued;
- o The shares of AR-CombiMatrix stock to be issued in the merger to the stockholders of CombiMatrix Corporation shall have been approved for listing on the NASDAQ National Market; and
- Each party shall have received the opinion of PricewaterhouseCoopers
 LLP, to the effect that the merger will be treated for federal income

tax purposes as a reorganization described in Section 368(a) of the federal income tax code, and neither we nor Combi Acquisition Corp. will recognize gain or loss by reason of the issuance of the AR-CombiMatrix stock.

-104-

ADDITIONAL CONDITIONS TO OUR OBLIGATIONS

Our obligation to consummate the merger is subject to the satisfaction of the following additional conditions, which may be waived in writing exclusively by Acacia Research:

- o The representations and warranties of CombiMatrix Corporation in the merger agreement shall be true and correct in all respects on and as of the effective time of the merger, and CombiMatrix Corporation shall have performed and complied in all material respects with all of its covenants and obligations under the merger agreement;
- No material adverse effect with respect to CombiMatrix Corporation shall have occurred since the date of the merger agreement, and no events or circumstances shall have occurred since then that would have a material adverse effect on CombiMatrix Corporation;
- Any and all consents, waivers, assignments and approvals of CombiMatrix Corporation shall have been obtained;
- o We shall have been provided with a certificate executed on behalf of CombiMatrix Corporation by its president and chief executive officer, its chief operating officer or its chief financial officer to the effect that, as of the effective time of the merger, certain conditions have been met;
- There shall be no more than one percent of the outstanding shares of CombiMatrix Corporation common stock dissenting to the merger agreement and seeking appraisal rights;
- o There shall not have been a "change of law" that, in our good faith judgment after consultation with its external advisors, could, if adopted, be reasonably likely to have a material adverse tax consequence to CombiMatrix Corporation, its stockholders, us or our stockholders arising from the transactions contemplated by the merger agreement;
- Each director, officer and employee of CombiMatrix Corporation who is also a stockholder of CombiMatrix Corporation common stock shall have executed a "market standoff agreement" pursuant to which such person shall agree not to sell any AR-CombiMatrix stock which they receive in the merger for a period of six (6) months after the effective time; and
- We shall be satisfied, in our reasonable discretion, that the merger will not be deemed a "change of control" under the CombiMatrix Corporation Executive Severance Plan.

ADDITIONAL CONDITIONS TO OBLIGATIONS OF COMBIMATRIX CORPORATION

The obligation of CombiMatrix Corporation to effect the merger is subject to the satisfaction of each of the following additional conditions, any of which

may be waived in writing exclusively by CombiMatrix Corporation:

- Our representations and warranties in the merger agreement shall be true and correct in all respects on and as of the effective time of the merger, and we shall have performed and complied in all material respects with all of our covenants and obligations under the merger agreement;
- No material adverse effect with respect to our existing business shall have occurred since the date of the merger agreement and no events or circumstances shall have occurred since such date that would have a material adverse effect on our existing business;
- o There shall not have been a "change of law" that, in the good faith judgment of CombiMatrix Corporation after consultation with its external advisors, could, if adopted, be reasonably likely to have a material adverse tax consequence to CombiMatrix Corporation, its stockholders, us or our stockholders, arising from the transactions contemplated by the merger agreement;

-105-

- Any and all consents, waivers, assignments and approvals shall have been obtained;
- o CombiMatrix Corporation shall have been provided with a certificate executed on behalf of Acacia Research by officers with titles of senior vice president or above to the effect that, as of the effective time of the merger, certain conditions have been met;
- CombiMatrix Corporation shall have received the opinion of Allen Matkins Leck Gamble & Mallory LLP, legal counsel to Acacia Research, as to the due and valid authorization and issuance of the AR-CombiMatrix stock;
- CombiMatrix Corporation shall have received the opinion of an investment banker of national reputation as to the fairness of the merger from a financial point of view; and
- A special committee of disinterested directors of the CombiMatrix Corporation board of directors shall have recommended approval of the merger.

TERMINATION

The merger agreement may be terminated and the merger may be abandoned at any time prior to the effective time of the merger as follows:

- o by mutual consent; and
- o by either us or CombiMatrix Corporation, if:

(1) the merger has not been consummated by December 31, 2002; provided, however, that this right to terminate will not be available to any party whose action or failure to act has been a principal cause of or resulted in the failure of the merger to occur on or before that date;

(2) there is a final nonappealable order of a federal or state court in effect preventing consummation of the merger;

(3) consummation of the merger is illegal due to applicable statute, rule, regulation, injunction, order or decree;

(4) at the CombiMatrix Corporation special meeting the requisite vote of the CombiMatrix Corporation stockholders in favor of the merger and the merger agreement is not obtained, unless the failure to obtain the requisite vote was caused by the action or failure to act of the party seeking to terminate the merger agreement;

(5) at our special meeting the requisite vote of our stockholders is not obtained in favor of the merger agreement and the recapitalization proposal unless the failure to obtain the requisite vote was caused by the party seeking to terminate the merger agreement;

(6) any governmental action is taken, or any statute, rule, regulation or order enacted, promulgated or issued or deemed applicable to the merger by any governmental body, which would (a) prohibit our ownership or operation of the business of CombiMatrix Corporation or our existing business or (b) compel us or CombiMatrix Corporation to dispose of or hold separate all or a material portion of the business assets of CombiMatrix Corporation or our existing business as a result of the merger;

(7) by CombiMatrix Corporation if it is not in material breach of its obligations under the merger agreement and we have breached any representation, warranty or covenant in the merger agreement, or if any representation or warranty of ours has become untrue, provided that we shall have thirty (30) days to cure such breach or untruthfulness (unless by its nature the breach or untruthfulness cannot be cured); or

-106-

(8) by us if we are not in material breach of our obligations under the merger agreement and CombiMatrix Corporation has breached any representation, warranty or covenant in the merger agreement, or if any representation or warranty of CombiMatrix Corporation has become untrue, provided that CombiMatrix Corporation shall have thirty (30) days to cure such breach or untruthfulness (unless by its nature the breach or untruthfulness cannot be cured).

EFFECT OF TERMINATION

In the event of termination of the merger agreement, the merger agreement shall become void and there shall be no liability or obligation on our part or on the part of Combi Acquisition Corp. or CombiMatrix Corporation, or their respective officers, directors or stockholders, except that each party will remain liable for any willful breaches of such party's covenants or intentional or willful breaches of such party's representations and warranties prior to termination.

AMENDMENTS AND WAIVERS

Generally, we and CombiMatrix Corporation may amend or waive any provision of the merger agreement before the effective time of the merger. However, if a material condition is waived, we must amend the registration statement of which this prospectus and proxy statement forms a part, and CombiMatrix Corporation must resolicit proxies for the adoption of the merger agreement. Moreover, after CombiMatrix Corporation stockholders have approved the merger, their further approval would be required to modify the amount or type of consideration that

they will receive in the merger or to otherwise alter the merger agreement in a manner materially adverse to them.

NO RELIEF FROM LIABILITY FOR WILLFUL BREACH

No termination of the merger agreement will relieve either party of its liability for willful breach of the agreement.

-107-

ACACIA RESEARCH CORPORATION

BUSINESS

Acacia Research Corporation develops, acquires and licenses enabling technologies for the life sciences and media technology sectors, which comprise the two business groups of Acacia Research.

Our life sciences business, referred to as the "CombiMatrix group," is comprised principally of CombiMatrix Corporation. Our core technology opportunity in the life sciences sector has been developed through our subsidiary, CombiMatrix Corporation. CombiMatrix Corporation is a life science technology company with a proprietary system for rapid, cost competitive creation of DNA and other compounds on a programmable semiconductor chip. This proprietary technology has significant applications relating to genomic and proteomic research.

Our media technologies business, collectively referred to as "Acacia Technologies group," owns technology commonly known as the V-chip. The V-chip was adopted by the manufacturers of televisions sold in the U.S. to provide blocking of certain programming based upon its content rating code, in compliance with the Telecommunications Act of 1996. The V-chip technology is protected by U.S. Patent No. 4,544,584. In addition, Acacia Technologies owns a digital media transmission ("DMT") technology enabling the digitization, encryption, storage, transmission, receipt and playback of digital content. The DMT technology is protected by five U.S. and seventeen international patents. The DMT technology is utilized by a variety of companies, including cable companies, satellite companies, telephone companies, digital radio stations, content delivery networks, Internet service providers, hardware manufacturers and software manufactures, and covers many types of digitized content including movies, music, games, live events, instructional classes and photographs.

-108-

Following is a summary of the principal companies that constitute our two business groups:

GROUP NAME

COMBIMATRIX GROUP:

CombiMatrix Corporation

A life science technology company with a proprietary system for rapid, cost competitive creation of DNA and other compounds on a programmable semiconductor chip. This proprietary

DESCRIPTION OF BUSINESS

technology has significant applications relating to genomic and proteomic research.

CombiMatrix Corporation recently purchased Acacia Research's interest in Advanced Material Sciences, Inc., a development stage company that holds the exclusive license for CombiMatrix Corporation's biological array processor technology in certain fields of material science. CombiMatrix Corporation issued 180,982 shares of its common stock in exchange for Acacia Research's 58% interest in Advanced Material Sciences, Inc. CombiMatrix Corporation currently owns 87% of Advanced Material Sciences and the remaining interests are owned by unaffiliated entities.

ACACIA TECHNOLOGIES GROUP:

| Soundview Technologies Incorporated | A media technology company that owns |
|-------------------------------------|--|
| | intellectual property related to the |
| | telecommunications field, including a |
| | television blanking system, also known |
| | as "V-chip," which licenses to |
| | television manufacturers. |
| | |
| | |

Acacia Media Technologies Corporation A media technology company that owns a digital media transmission technology used to digitize, encrypt, store, transmit, receive and playback digitized content sent via pathways such as cable, satellite and the Internet, and covering a variety of services such as those commonly known as video-on-demand, audio-on-demand and streaming media.

Following the recapitalization and merger, if approved, our stock will be divided into two classes reflecting the two business groups described above.

For information regarding market and technology background, products and services, solutions, strategies, marketing and distribution, joint ventures, regulatory matters related to the specific business units, competition in the two sectors, research, development and engineering, management, employees, patents, licenses and franchises and other business matters, please see the relevant sections in "CombiMatrix Group - Business" and "Acacia Technologies Group - Business".

-109-

MANAGEMENT

BOARD OF DIRECTORS

Our board of directors is fixed at six members and is divided into three classes, with each class being as nearly equal in number of directors as possible. The term of a class expires, and their successors are elected for a

term of three years, at each annual meeting of our stockholders.

Following the recapitalization and merger, if approved, our board of directors will continue to be divided into three classes and will consist of the same persons that currently serve as members of the board. For information regarding the proposed management of the respective groups, please see the relevant sections in "CombiMatrix Group - Business" and "Acacia Technologies Group - Business."

The following table sets forth information as to the persons who serve as our directors.

| NAME | AGE | DIRECTOR SINCE | POSITIONS WITH THE COMPANY |
|-------------------------|-----|----------------|---|
| Paul R. Ryan | 57 | 1995 | Chairman and Chief Executive Officer |
| Robert L. Harris, II | 44 | 2000 | President and Director |
| Thomas B. Akin* | 50 | 1998 | Director |
| Fred A. de Boom* | 66 | 1995 | Director |
| Edward W. Frykman* | 66 | 1996 | Director |
| G. Louis Graziadio, III | 53 | 2002 | Director |

* MEMBER OF THE AUDIT COMMITTEE AND THE COMPENSATION COMMITTEE

Biographical information regarding and each of our directors is set forth below.

CLASS I DIRECTORS (TERMS EXPIRING 2004)

ROBERT L. HARRIS, II has served as a director since April 2000 and as President since July 2000. Mr. Harris was previously the President and Director of Entertainment Properties Trust from 1997 to July 2000. Mr. Harris founded Entertainment Properties Trust, which is a publicly-traded company that purchases real estate from major entertainment companies. Mr. Harris led the International Division and served as Senior Vice President of AMC Entertainment from 1993 to 1997, and served as President of Carlton Browne and Company, Inc., a holding company and trust with assets in real estate, insurance and financial services, from 1984 to 1992. He also serves on the Board of Directors of the George L. Graziadio School of Business and Management at Pepperdine University.

FRED A. DE BOOM has served as a director since February 1995. Mr. de Boom has been a principal in Sonfad Associates since June 1993. Sonfad Associates is a Los Angeles-based investment banking firm that is involved in mergers and acquisitions, private debt and equity placements, strategic and financial business planning, leveraged buy-outs and ESOP funding, bank debt refinance, asset based and lease financing, and equity for debt restructuring. Previously, he was employed as a Vice President of Tokai Bank for five years and as a Vice President of Union Bank for eight years. Mr. de Boom received his B.A. degree from Michigan State University and his M.B.A. degree from the University of Southern California.

CLASS II DIRECTORS (TERMS EXPIRING 2005)

THOMAS B. AKIN has served as a director since May 1998. Mr. Akin has been the Managing General Partner of four private investment funds (Talkot Partners I, Talkot Partners II, LLC, Talkot Crossover Fund, L.P., and Talkot Capital)

since 1996. Mr. Akin previously served in a variety of capacities for Merrill Lynch and Co., including Managing Director of Western Regional Sales from 1986 to 1994. Mr. Akin holds a B.A. from the

-110-

University of California at Santa Cruz and attended the University of California at Los Angeles Graduate School of Business.

EDWARD W. FRYKMAN has served as a director since April 1996. Mr. Frykman has been an Account Executive with Crowell, Weedon & Co. since 1992. Previously, Mr. Frykman served as Senior Vice President of L.H. Friend & Co. Both Crowell, Weedon & Co. and L.H. Friend & Co. are investment brokerage firms located in Southern California. In addition, Mr. Frykman was a Senior Account Executive with Shearson Lehman Hutton where he served as the Manager of the Los Angeles Regional Retail Office.

CLASS III DIRECTOR (TERMS EXPIRING 2003)

PAUL R. RYAN has served as a director since August 1995, as Chief Executive Officer since January 1997 and as Chairman since April 2000. He also served as President of the Company from January 1997 until July 2000. Prior to being named Chief Executive Officer, he was Executive Vice President and Chief Investment Officer of Acacia Research from 1996 through 1997 and Vice President, Capital Management, of Acacia Research from 1995 through 1996. He was formerly co-founder and general partner of the American Health Care Fund, L.P., held positions with Young & Rubicam, Ogilvy & Mather, and Merrill Lynch and was a private venture capital investor. Mr. Ryan holds a B.S. from Cornell University and attended the New York University Graduate School of Business.

G. LOUIS GRAZIADIO, III has been a director since February 2002. Since 1990, Mr. Graziadio has held the positions of Chairman and Chief Executive Officer of Second Southern Corp., the managing partner of Ginarra Partners, L.L.C., a California company engaged in a wide range of investment activities and business ventures. He also serves as a director of Graziadio Development Company, California Rice Bran Co., Inc., Beachcliff Real Estate, Inc., Boss Holdings, Inc. and Boss Manufacturing, Co.

EXECUTIVE OFFICERS

Following the recapitalization and merger, if approved, we anticipate that our executive officers will remain the same. Certain of our executive officers also serve as officers of the subsidiaries that constitute our respective business groups. For information regarding the proposed management of the respective groups, please see the relevant sections in "CombiMatrix Group -Business" and "Acacia Technologies Group - Business."

Set forth below is certain information concerning our executive officers as of the date hereof.

| NAME | AGE | POSITIONS WITH THE COMPANY |
|----------------------|-----|--------------------------------------|
| | | |
| Paul R. Ryan | 57 | Chairman and Chief Executive Officer |
| Robert L. Harris, II | 44 | President |

Clayton J. Haynes 33 Chief Financial Officer, Treasurer and Senior Vice President, Financial Amit Kumar, Ph.D 38 Chief Executive Officer and President of CombiMatrix Corporation

The following is biographical information and a brief description of the capacities in which each of the executive officers has served during the past five years. Biographical information on Messrs. Ryan and Harris is set forth above under "Board of Directors."

CLAYTON J. HAYNES joined us in April 2001 as Treasurer and Senior Vice President, Finance. In November 2001, Mr. Haynes was appointed Chief Financial Officer of Acacia Research. From 1992 to March 2001, Mr. Haynes was employed by PricewaterhouseCoopers LLP, ultimately serving as a Manager in the Business Advisory Services practice. Mr. Haynes received a B.A. from the University of California at Los Angeles, is a Certified Public Accountant and is a member of the American Institute of Certified Public Accountants.

AMIT KUMAR, PH.D. joined us in July 2000 as Senior Vice President of Life Sciences. Dr. Kumar was elected to the position board of directors of CombiMatrix Corporation in September 2000. Dr. Kumar was appointed to the position of Chief Executive Officer and President of CombiMatrix Corporation in September 2001.

-111-

From 1999 to 2000, Dr. Kumar was CEO and President of Signature Bioscience, a genomic and proteomic tool company. From 1998 to 1999, he was an Entrepreneur in Residence at Oak Investment Partners, specializing in emerging life science and biotechnology companies. Dr. Kumar held the position of Senior Manager at IDEXX Laboratories, and was Head of Research and Development at Idetek Corporation from 1995 to 1998. Dr. Kumar attended Stanford University, received his Ph.D. from the California Institute of Technology and was a Post Doctorate Fellow at Harvard University.

EMPLOYEES

As of November 1, 2002, Acacia Research and its CombiMatrix subsidiary had 117 full-time employees. We are not a party to any collective bargaining agreement. We consider our employee relations to be good.

For more information regarding employees, please see the relevant sections in "CombiMatrix Group - Business" and "Acacia Technologies Group - Business."

PROPERTIES

We lease approximately 7,143 square feet of office space in Newport Beach, California, under a lease agreement that expires in February 2007. We also lease approximately 7,019 square feet of office space in Pasadena, California, under a lease agreement that expires in November 2003, which is subleased through the remaining term of the lease agreement. Our consolidated subsidiary, CombiMatrix Corporation, leases office and laboratory space totaling approximately 90,111 square feet located north of Seattle, Washington, under a lease agreement that expires in December 2008.

We are a guarantor under a lease agreement for office space in Hollywood, California that expires in August 2005. That lease agreement was entered into by Soundbreak.com, which ceased operations in February 2001. A portion of those leased premises is subleased through the remaining term of that lease agreement.

Acacia Research continues to pursue opportunities to sublease the remaining space.

For more information regarding properties, please see the relevant sections in "CombiMatrix Group - Business" and "Acacia Technologies Group - Business."

LEGAL PROCEEDINGS

In the ordinary course of our business, we are regularly the subject of, or party to, various pending or threatened legal actions. We believe that any liability arising from these actions will not have a material adverse effect on our financial position, results of operations or cash flows.

For information regarding legal proceedings, please see the relevant sections in "CombiMatrix Group - Business" and "Acacia Technologies Group - Business."

THE INVESTMENT COMPANY ACT OF 1940

The regulatory scope of the Investment Company Act of 1940 ("Investment Company Act"), which was enacted principally for the purpose of regulating vehicles for pooled investments in securities, extends generally to companies engaged primarily in the business of investing, reinvesting, owning, holding or trading in securities. We believe that our anticipated principal activities will not subject us to regulation under the Investment Company Act. However, the Investment Company Act may also apply to a company which does not intend to be characterized as an investment company but which, nevertheless, engages in activities which may be deemed to be within the scope of certain provisions of the Investment Company Act. In such an event, we may become subject to certain restrictions relating to our activities, including restrictions on the nature of our investments and the issuance of securities. In addition, the Investment Company Act imposes certain requirements on companies deemed to be within its regulatory scope, including registration as an investment company, adoption of a specific form of corporate structure and compliance with certain burdensome reporting, record-keeping, voting, proxy, disclosure and other rules and regulations, all of which could cause significant registration and compliance costs. Accordingly,

-112-

we will continue to review our activities from time to time with a view toward reducing the likelihood that we could be classified as an "investment company" within scope of the Investment Company Act.

-113-

COMBIMATRIX GROUP (A DEVELOPMENT STAGE DIVISION OF ACACIA RESEARCH CORPORATION)

BUSINESS

The CombiMatrix group is comprised of CombiMatrix Corporation, a subsidiary of Acacia Research, and Advanced Material Sciences, a subsidiary of CombiMatrix Corporation, and includes corporate assets, liabilities and transactions of Acacia Research that relate to its life sciences business. CombiMatrix Corporation is a development stage company engaged in the development of a

proprietary universal biochip with applications in the genomics, proteomics and combinatorial chemistry markets.

The CombiMatrix group is developing a technology to allow it, its customers and any entities with which the CombiMatrix group has joint development efforts, to rapidly produce customizable biological array processors, which are semiconductor-based tools for use in identifying and determining the roles of genes, gene mutations and proteins. The CombiMatrix group is designing its products principally to be responsive to the needs of pharmaceutical and biotechnology researchers to analyze raw genomic data in the discovery and development of pharmaceutical products. Its biological array processor is a semiconductor coated with a three-dimensional layer of porous material in which DNA, RNA, proteins, peptides or small molecules can be synthesized or immobilized within discrete test sites. The CombiMatrix group integrates a micro-fabricated semiconductor chip, proprietary software, chemistry, and hardware into a system that it believes will enable it, its customers and any entities with which the CombiMatrix group has joint development efforts, to design, customize and fabricate biological array processors made to user's specifications, typically in less than a day. The CombiMatrix group's system should enable researchers to conduct rapid, iterative experiments to analyze the large amounts of genomic information generated by the Human Genome Project and other genomic research efforts. The CombiMatrix group believes that its customizable biological array processors will enable users to reduce the time and costs associated with the discovery and development of pharmaceutical products.

MARKET OVERVIEW AND TECHNOLOGY BACKGROUND

GENERAL OVERVIEW

The pharmaceutical and biotechnology industries are faced with increasing costs and substantial risks of failure in the drug discovery, development and commercialization process. The time required to successfully commercialize a new proprietary drug now averages 15 years, and the direct and indirect costs of the process average almost \$800 million per drug. Less than 1% of all new chemical compounds that are developed by pharmaceutical companies result in pharmaceutical products that are approved for patient use. The pharmaceutical and biotechnology industries are attempting to reduce their costs and risks of failure by turning to new technologies to help identify deficiencies in drug candidates as early as possible in the process so that drug discovery and development become more efficient and cost-effective. Additionally, with vast amounts of genomic data becoming available for use in the development of therapeutics and diagnostic tests, they are searching for ways to expedite their analysis of available genomic data so that they can be the first to bring new therapeutics and diagnostic tests to market.

DRUG DISCOVERY AND DEVELOPMENT

The discovery and development of new drugs for a particular disease typically involve several steps. First, researchers identify a target for therapeutic intervention, such as a protein, that is either directly involved in the disease or lies in a biochemical pathway leading to the disease. The next step is to identify chemical compounds that interact with the target and modulate the target's activity in a manner that might help reverse, inhibit or prevent the disease. The most promising compounds to emerge from this process advance to the next stage, where synthetic derivatives of the compounds are generated and tested to determine a lead compound. The interactions of these lead compounds with the target and their activity in animal or cellular models of the disease are then tested to determine which compounds might be developed successfully into new drugs. The best new drug candidates then begin clinical trials in humans. -114 -

Recent advances have led to the use of genomics in choosing targets for drug development. This process begins with the discovery and identification of genes within the genome and the functions of these genes in regulating biological processes and disease. This information is used to assess the value of a particular gene or its protein product as a target for drug discovery. Once a target is chosen, high throughput chemistry and other drug discovery methods are used to identify chemical compounds that interact with the target and might help reverse, inhibit or prevent the disease. These compounds are then tested in pre-clinical and clinical development programs.

According to industry statistics, pharmaceutical and biotechnology companies world-wide spent approximately \$55 billion on drug research and development during 1999. Of this amount, approximately \$14.7 billion was spent on drug discovery, \$7.6 billion on toxicology, \$17.8 billion on pre-clinical testing and clinical trials and \$14.9 billion on post-marketing evaluations and other matters.

The CombiMatrix group believes that biological array processors, whether they contain DNA, peptides, or proteins have potential applications in all major phases of drug discovery and development. In the discovery phase, the CombiMatrix group believes biological array processors can facilitate the process of identifying and validating targets and lead compounds. In the development phase, the CombiMatrix group believes biological array processors can enhance the speed and accuracy of the toxicology, pre-clinical and clinical development process. The CombiMatrix group believes that biological array processors can also play a role in monitoring the therapeutic effectiveness of drugs that have been approved for use.

GENES AND PROTEINS

The human body is composed of billions of cells each containing DNA that encodes the basic instructions for cellular function. The complete set of an individual's DNA is called the genome, and is organized into 23 pairs of chromosomes, which are further divided into smaller regions called genes. Each gene is composed of a strand of four types of nucleotide bases, referred to as A, C, G and T. The bases of one DNA strand bind to the bases of the other strand in a specific fashion to form base pairs: the base A always binds with the base T and the base G always binds with the base C.

The human genome has approximately 3 billion nucleotides and their precise order is known as the DNA sequence. When a gene is turned on, or expressed, the genetic information encoded in the DNA is copied to a specific type of RNA, called messenger RNA, or mRNA. The mRNA provides instructions for the synthesis of proteins. Proteins direct cellular function, the development of individual traits and are involved in many diseases. Variations in any part of the sequence of DNA, called polymorphisms, can interfere with the normal function of proteins and may result in a change in cell function leading to disease, a predisposition to disease, an adverse response to drugs or other unwanted effects.

GENE EXPRESSION PROFILING

Gene expression profiling is the process of determining which genes are active in a specific cell or group of cells and is accomplished by measuring mRNA, the intermediary between genes and proteins. By comparing gene expression patterns between cells from normal tissue and cells from diseased tissue, researchers may identify specific genes or groups of genes that play a role in the presence of disease. Studies of this type, used in drug discovery, require

monitoring thousands, and preferably tens of thousands, of mRNAs in large numbers of samples. As the correlation between gene expression patterns and specific diseases is determined, the CombiMatrix group believes that gene expression profiling will have an increasingly important role as a diagnostic tool. Diagnostic use of expression profiling tools is anticipated to grow rapidly with the combination of the sequencing of various genomes and the availability of more cost-effective technologies.

GENETIC VARIATION AND FUNCTION

Genetic variation is mostly due to polymorphisms in genomes, although functional variations may also arise from differences in the way genes are expressed in a given cell, as well as the timing and levels of their expression. Although most cells contain an individual's full set of genes, each cell expresses only a small fraction of this set in different quantities and at different times.

-115-

The most common form of genetic variation occurs as a result of a difference in a single nucleotide in the DNA sequence, commonly referred to as a single nucleotide polymorphism, or SNP. The human genome is estimated to contain between three and six million SNPs. By screening for polymorphisms, researchers seek to correlate variability in the sequence of genes with a specific disease. SNPs are believed to be associated with a large number of human diseases, although most SNPs are believed to be benign and not to be associated with disease. Determining which SNPs may be related to a disease is a complex process requiring investigation of a vast number of SNPs. An SNP association study might require testing for 300,000 possible SNPs in 1,000 patients. Although only a few hundred of these SNPs might be clinically relevant, 300 million genotyping tests, or assays, might be required to complete a study. Using available technologies, this scale of SNP genotyping is both impractical and prohibitively expensive.

While in some cases one SNP will be responsible for medically important effects, it is now believed that the genetic component of most major diseases is associated with a combination of SNPs. As a result, the scientific community has recognized the importance of investigating combinations of many SNPs in an attempt to discover medically valuable information. In order to understand how genetic variation causes disease, researchers must compare gene sequence polymorphisms, or conduct SNP genotyping, from healthy and diseased individuals. Researchers may also compare gene expression patterns, or perform gene expression profiling, from healthy and diseased tissues.

SNP GENOTYPING

SNP genotyping is the process of comparing individuals' gene sequences to identify variations in these sequences and determine the significance of these variances. The CombiMatrix group believes that large-scale SNP genotyping, when commercially feasible, has the potential to be used for a variety of applications including:

- o genomics-based drug development;
- o clinical trial design and analysis;
- o testing for predisposition to, and diagnosis of, disease;
- o predicting the effectiveness of therapeutics; and

o applications outside healthcare.

PROTEOMICS

Proteomics is the process of determining which proteins are present in cells, how they interact with one another, and how they are correlated with genomic variation. This process is useful in drug discovery and diagnostics because most drugs target proteins that play a role in the existence or development of a disease. Although the potential market for proteomic products is uncertain, the CombiMatrix group believes that proteomics may have application in:

- o discovery of new drug targets and new biochemical pathways;
- o measurement of protein expression and modification; and
- correlation of protein variation and function with genomic variation and function.

CURRENT TECHNOLOGIES

There are currently a variety of traditional technologies available for analyzing genetic variation and function. Traditional technologies generally perform assays individually, or serially, and often require relatively large sample volumes, adding significantly to the costs of assays. Traditional technologies can be improved by using microfluidics, a process that miniaturizes the scale of experimentation for traditional methods. In addition,

-116-

most traditional technologies have limited flexibility to perform different applications. Arrays were developed to overcome the limitations of traditional technologies.

An array is a collection of miniaturized test sites arranged on a surface that permits many tests to be performed simultaneously, or in parallel, in order to achieve higher throughput. The average size of test sites in an array and the spacing between them defines the array's density. Higher density increases parallel processing throughput. In addition to increasing the throughput, higher density reduces the required volume for the sample being tested, and thereby lowers costs. Currently, the principal commercially available ways to produce arrays include mechanical deposition, bead immobilization, inkjet printing and photolithography.

While current array technologies have advantages over traditional technologies, the CombiMatrix group believes the full market potential for testing devices to study genetic variation and function has not been realized. This is true for a number of reasons, including the following:

- HIGH COST. Many currently available array technologies require relatively expensive capital equipment for manufacturing and customizing arrays and reading test results.
- o LOW THROUGHPUT. Some array technologies produce a relatively low density of test sites, which results in low throughput.
- o LIMITED APPLICATION. Many array technologies have limited application outside of SNP genotyping and gene expression profiling, for example

in proteomics.

- INCONVENIENCE. Many array manufacturers do not offer researchers all elements required to design arrays and to complete and analyze their tests, such as test devices, software, instrumentation and reagents.
- INABILITY TO FABRICATE IN HOUSE. Most array manufacturers will ship pre-fabricated arrays to customers, even though large customers have a tremendous desire to fabricate their own arrays in house.

THE COMBIMATRIX SOLUTION

The CombiMatrix group believes that its integrated system has advantages over other existing technologies because it will be a cost-effective, fast, flexible, customizable alternative to existing analytical tools designed for similar purposes. Researchers using the CombiMatrix group's system should be able to design and order custom biological array processors or fabricate them in-house, conduct their tests, analyze the results in the relatively inexpensive hybridizer-reader supplied by the CombiMatrix group or any entities with which the CombiMatrix group has joint development efforts, and reorder additional custom biological array processors incorporating modified test parameters, all within a few days. In addition, customers who wish to fabricate arrays themselves will be able to utilize the CombiMatrix group's synthesizers and blank chips to produce their own arrays.

The CombiMatrix group believes that its biological array processor system will offer several advantages over competing products that are commercially available. The principal scientific advantages of its system are derived from the following three features:

- o the CombiMatrix group's proprietary software, which directs the individually controlled electrodes at the test sites on the surface of its semiconductors and allows the CombiMatrix group to synthesize or immobilize different sequences of DNA or RNA, peptides or small molecules;
- its virtual flask technology, which uses the chemistry of carefully engineered liquid solutions instead of physical walls around each electrode and avoids the problem of chemical contamination between test sites; and

-117-

 its porous reaction layer, which coats one surface of the semiconductor and functions as a three-dimensional environment for the synthesis or immobilization of relatively large quantities of DNA, RNA, peptides or small molecules so that a stronger test signal is generated at each test site.

As a result of these scientific features, the CombiMatrix group believes that the system it is designing will have the following characteristics:

o RAPIDLY CUSTOMIZABLE. The CombiMatrix group believes its proprietary software, chemistry and semiconductor system will allow it or its partners to design, customize and ship biological array processors for SNP genotyping and gene expression profiling that are tailored to meet a customer's specifications in a relatively short time, typically as little as a day. The CombiMatrix group's customization time should be short because it intends to rely on proprietary software and chemical

processes, rather than costly and often imprecise mechanical methods, to produce its biological array processors. The CombiMatrix group believes researchers will be able to compress the time required to complete an iterative series of genomic tests because of the short turnaround time that should be required for the delivery of its customized biological array processors.

- VERSATILE. The CombiMatrix group system can design and create sequences of DNA, RNA, peptides or small molecules in the test sites on its biological array processors, although its first product will be limited to DNA sequences.
- HIGH THROUGHPUT. The CombiMatrix group's synthesizers will enable its customers to fabricate from six to forty custom designed biological array processors per day with a total of up to several thousand test sites per processor.
- o ACCURATE AND COST-EFFECTIVE. Relatively large amounts of DNA, RNA, peptides or small molecules that can be synthesized or immobilized in the porous reaction layer at each test site generate strong assay signals that facilitate accurate interpretation of test data. These strong assay signals will enable the CombiMatrix group's customers to analyze the results of their tests without investing in the relatively expensive capital equipment needed to detect weak signals.
- O CONVENIENT AND INTEGRATED. The CombiMatrix group plans to offer its customers a complete system including the software, biological array processors, instrumentation and reagents necessary to design and perform their assays and obtain an analysis of the results using the Internet if they so choose. Typically, tests using the CombiMatrix group's biological array processors should be able to be completed and analyzed within hours by using the equipment, reagents and software supplied by the CombiMatrix group.
- o MANUFACTURING SCALABILITY. The CombiMatrix group believes it will be able to increase production to respond to increased demand because its semiconductors are manufactured by others using conventional semiconductor fabrication methods and its customization equipment can be rapidly assembled by the CombiMatrix group or any entities with which the CombiMatrix group has joint development efforts.

PRODUCTS AND SERVICES

The CombiMatrix group's technology potentially represents a significant advance over existing biochip technologies and other platforms for combinatorial chemistry. The first application of the technology that the CombiMatrix group is pursuing is in the field of genomics, where it is developing a biochip for the analysis of DNA. The CombiMatrix group believes that this technology may be applied to the fields of genetic analysis and disease management. The CombiMatrix group is also developing the chip in the emerging field of proteomics, where analysis of DNA is correlated to the levels of proteins in patient samples. Many researchers believe that the analysis of proteomic information will lead to the development of new drugs and better disease management. Once the CombiMatrix group demonstrates the feasibility of its approach in each market, it intends to enter into strategic alliances with major participants to speed commercialization in multiple applications.

THE COMBIMATRIX GROUP'S STRATEGY

The CombiMatrix group's goal is to provide biotechnology, pharmaceutical companies and academic researchers with the industry standard solution for rapid evaluation of genetic function/variation, proteomic research, and bioinformatic tools.

FOCUSING ON HIGH-GROWTH MARKETS

The CombiMatrix group is initially focusing on the gene expression profiling, SNP genotyping, proteomic, and bioinformatics markets. Initial product sales will be derived from of its DNA synthesizers, DNA microarrays, hybridization-reader system, and bioinformatic tools. The CombiMatrix group believes the market for its rapid customization microarrays and in-house synthesizers has the potential for high growth due to increasing demand for therapeutics and diagnostics based on newly available genomic information. To date, the lack of high-throughput, cost- effective, and the slow turnaround of current technologies has limited the growth of this market.

PARTNERING WITH MULTIPLE COMPANIES TO EXPAND MARKET OPPORTUNITY

The CombiMatrix group plans to pursue multiple relationships to facilitate the expansion of its semiconductor based microarray technologies and to exploit large and diverse markets. The CombiMatrix group expects to enter into relationships and collaborations to gain access to complementary technologies, distribution channels, manufacturing infrastructure, and information content. The CombiMatrix group intends to structure relationships that maximize its research and development efforts with the strong distribution and manufacturing capabilities of its customers and any entities with which the CombiMatrix group has joint development efforts, enabling industry standard solutions for pharmaceutical and biotechnology researchers. Such a strategy will enable the CombiMatrix group to focus on its strength which is research and development, and leverage the strengths of any entities with which it has entered into agreements to commercialize its products.

COMMERCIALIZING AND MANUFACTURING DESKTOP SYNTHESIZERS AND MICROARRAY TECHNOLOGY FOR GENE EXPRESSION PROFILING AND MOLECULAR DIAGNOSTICS

The CombiMatrix group intends to rapidly commercialize its microarray technology for gene expression profiling through agreements to jointly develop technology. The CombiMatrix group has an agreement with Roche to jointly develop technology. Roche contributes extensive expertise in instrument and reagent development, as well as offers a large and experienced worldwide sales and marketing team. The CombiMatrix group believes that the combination of its microarray technology with Roche's leadership position in the genetic analysis and diagnostic markets will enable it to capture a significant portion of the gene expression profiling and molecular diagnostic markets.

In addition to Roche, the CombiMatrix group plans on establishing other relationships for its DNA microarray technology. The CombiMatrix group also intends on establishing alliances for its proteomic and bioinformatic products.

EXPANDING TECHNOLOGIES INTO MULTIPLE PRODUCT LINES

The CombiMatrix group intends to utilize the flexibility of its semiconductor based microarray technologies to develop multiple product lines. In addition to providing new sources of revenue, it believes these product lines will further its goal of establishing its microarray technology as the industry standard for array-based analysis.

STRENGTHENING TECHNOLOGICAL LEADERSHIP

The CombiMatrix group plans to continue advancing its proprietary technologies through its internal research efforts, collaborations with industry leaders and strategic licensing. The CombiMatrix group may also pursue acquisitions of complementary technologies and leverage its technologies into other value-added businesses. Its efforts to strengthen their technology include the following:

-119-

- RAPIDLY COMMERCIALIZING ITS SNP GENOTYPING AND GENE EXPRESSION PROFILING PRODUCTS. The CombiMatrix group is initially focusing on the SNP genotyping and gene expression profiling markets because it believes that there is substantial demand for tools that help analyze newly available genomic information and thereby assist pharmaceutical and biotechnology companies in developing new drugs and diagnostic tools. Typically, sales of products in these markets do not require advance clearance by the Food and Drug Administration and, as a result, can be achieved more quickly and with less cost than sales of regulated devices.
- DEVELOPING PRODUCT APPLICATIONS IN PROTEOMICS. Proteomic research has 0 not developed as rapidly as SNP genotyping and gene expression profiling because of the absence of effective technology and tools for conducting research. The CombiMatrix group believes that its biological array processor system can be developed to facilitate proteomic research. The CombiMatrix group has developed chemical processes for the rapid immobilization of proteins and small molecules within the test sites on its biological array processors. The CombiMatrix group believes its system may be particularly effective in proteomic research because the proprietary materials that can be used to form the three-dimensional porous reaction layer on its biological array processors are a hospitable environment for the immobilization and study of proteins. The CombiMatrix group has produced customized test devices with peptides and small molecules for possible use in proteomic research. The CombiMatrix group is currently developing its technology for proteomic applications.
- O EXPANDING OUR PROPOSED PRODUCT OFFERINGS. The CombiMatrix group is engaged in several research and development initiatives to expand its product offerings by increasing the density of its biological array processors and by developing additional applications of its technology for drug discovery and development. The CombiMatrix group believes that the flexible, parallel processing capabilities of its biological array processor system may have potential applications related to:
 - o gene discovery and function characterization;
 - o specific targeting of drug discovery efforts;
 - o the development of customized drugs;
 - o high-throughput screening for pharmaceutical candidates;
 - the development of diagnostic methods for identifying, classifying and staging diseases;
 - o the prediction of successful drug therapy for a particular patient population;

- the identification of an individual patient's tolerance for a particular drug so that previously abandoned drugs can be selectively prescribed;
- early recognition of potential adverse response to drug therapy; and
- o identification of predisposition to disease in order to prescribe preventative therapies.

However, the CombiMatrix group has not yet produced products to address or access the potential of its technology in these areas.

 PROTECTING AND STRENGTHENING ITS INTELLECTUAL PROPERTY POSITION. Through the CombiMatrix group's two issued patents in the United States and one in Europe, its more than 42 patent applications pending in the United States, Europe and elsewhere and its trade secrets, the CombiMatrix group believes it has suitable intellectual property protection for its proprietary technologies. The CombiMatrix group plans to build its intellectual property portfolio through internal research efforts, collaborations with industry leaders, strategic licensing and possible acquisitions of complementary technologies. The CombiMatrix group also plans to pursue patent protection for downstream products created using its proprietary products.

-120-

THE COMBIMATRIX GROUP SYSTEM AND TECHNOLOGY

The CombiMatrix group anticipates that a customer wishing to use its bioarray product will use its proprietary software to provide the CombiMatrix group, or an entity with which the CombiMatrix group has joint development efforts, with information relating to the sequences that the customer wishes to evaluate. Array design software will design an initial array of DNA segments and then instruct a synthesizer unit to customize one or more biological array processors containing these selected DNA segments. This process will be entirely automated. The completed biological array processor will be shipped to the customer along with kits including specific instructions and reagents needed to conduct these evaluations. The CombiMatrix group expects that the time interval between receipt of the customer's order and shipment of the biological array processors and reagent kits will typically be less than a day. Alternatively for a customer with an in-house synthesizer, the process will be competed typically overnight. To use the processor, the customer will prepare a sample and introduce to the processor. The processor will then be inserted into a hybridizer-reader unit that the CombiMatrix group, or an entity with which the CombiMatrix group has joint development efforts, will have supplied to the customer. Proprietary software will enable the customer to image the processor, format the data and perform analysis.

In practical operation, the CombiMatrix group expects that a customer will typically analyze the results of an initial experiment and choose to change the composition of its biological array processors to further optimize its performance. For example, a customer may choose to change the sequences of some array elements, eliminate some sequences altogether, or incorporate additional sequences. The CombiMatrix group's biological array processor system will allow a researcher to order or fabricate successive arrays with the desired changes.

THE COMBIMATRIX GROUP PROCESS

Each of the CombiMatrix group's biological array processors is made up of a semiconductor chip on which the CombiMatrix group has installed electrical conduits and applied a layer of porous material. It will have up to approximately 10,000 test sites, one for each electrode site on the semiconductor. The CombiMatrix group can synthesize or immobilize DNA, RNA, peptides or small molecules within the porous reaction layer at each test site on the surface of its semiconductor, although it has not synthesized or immobilized any combination of DNA, RNA, peptides and small molecules on a single biological array processor. The CombiMatrix group confines the chemical synthesis within each test site using chemistry of carefully engineered liquid solutions. This avoids the problem of chemical contamination between different test sites. Because confinement is accomplished without physical walls, the CombiMatrix group refers to this enabling technology as a virtual flask. This virtual flask technology enables the CombiMatrix group to use semiconductor devices that are fabricated by contractors using conventional semiconductor processes.

In the case of the CombiMatrix group's DNA arrays, each test site, or virtual flask, will contain a particular DNA segment, or capture probe, that is made by putting nucleotide bases, A, G, C, or T, together one at a time. These DNA probes typically contain between 16 and 60 nucleotide bases. The CombiMatrix group's software selectively activates each electrode where a new nucleotide base is to be added. Once activated, the electrode causes an electrochemical reaction to occur that produces chemicals that react with the existing chains of DNA at that site to activate them for bonding with the next nucleotide base. These electrochemically-generated chemicals are confined by the CombiMatrix group's virtual flask technology to the region of the porous reaction layer that surrounds the electrode where they are produced. A fluidics delivery unit then floods the semiconductor with a solution containing a nucleotide base, which binds only to the capture probe at activated sites. This cycle is repeated over and over to produce different DNA segments at each test site. Quality assurance tests are performed following completion of the synthesis process. The CombiMatrix group's laboratory tests have confirmed that other substances, such as peptides, immobilized proteins and antibodies, small organic molecules and enzymes, among others, can also be chemically isolated in the virtual flasks.

SEMICONDUCTOR COMPONENT

The CombiMatrix group's semiconductors are manufactured by others using conventional semiconductor fabrication processes. The CombiMatrix group believes that the total number of test sites on a semiconductor is limited only by the degree of miniaturization of the semiconductor fabrication process. The CombiMatrix group believes that its semiconductor architecture is scalable and, as a result, that it can benefit directly from the

-121-

substantial investments that have been made by the semiconductor industry in miniaturizing chip fabrication processes. At the present time, the CombiMatrix group is using devices made with a 3.0 micron process size that yield 1,024 potential test sites within less than a square centimeter. Each of the individual sites is 100 microns in diameter, about the diameter of a human hair. The CombiMatrix group believes that by using a standard 0.25 micron semiconductor fabrication process, it can produce a biological array processor with over 1,000,000 sites per square centimeter, although it has not yet made or tested a biological array processor with more than 18,000 potential test sites.

POROUS REACTION LAYER

The CombiMatrix group's proprietary porous reaction layer is a three-dimensional medium within which sequences of DNA, RNA, peptides or small molecules can be synthesized and immobilized. The CombiMatrix group's porous reaction layer materials can be attached to the active side of its semiconductor. The three-dimensional and porous nature of the reaction layer enables the CombiMatrix group to produce significantly more biomolecules within each virtual flask site than is possible when the molecules are produced on a flat two-dimensional surface, as is typical for other array technologies. As a consequence, the CombiMatrix group can achieve a significant improvement in the test signals and is able to use less costly devices to determine test results than devices required for some competing technologies. These features improve the overall performance of its biological array processor system and reduce the cost to prospective customers.

HYBRIDIZER-READER

Hybridization is the binding of DNA sequences in a test sample with the DNA material that has been created at specific test sites on its biological array processors. In the case of DNA, segments bind together when the DNA segments in a sample and the DNA segments on its test sites are complementary. The CombiMatrix group is developing a combination hybridization chamber and biological array processor reader that it calls the hybridizer-reader. The hybridization chamber is being designed to help researchers standardize their experimental conditions, such as temperature, so that consistent results may be obtained from experiment to experiment. In the hybridization chamber, a solution that the researcher wants to analyze will be washed over one or more of the CombiMatrix group's biological array processors. DNA in the sample that is complementary with the DNA on the capture probes of the CombiMatrix group's biological array processors will bond. The hybridizer-reader will measure and identify the presence or absence and relative strength of bonding in the test sites on the biological array processors using conventional equipment. Because the optical signals resulting from the tests are stronger than those obtained from chips that contain a single molecular layer of test material, at its current chip density the CombiMatrix group will be able to read test results with a standard video camera system that should be substantially less expensive than the typical optical reader system needed to read other chips on the market. If the CombiMatrix group is able to increase substantially the density of its biological array processor, researchers may be required to use more expensive equipment to analyze the smaller volume of material bonded at each test site.

IN-HOUSE SYNTHESIZERS

The process of fabricating bioarray processors is performed using an electrochemical technique, which takes advantage of the virtual flask technology. This capability enables us to build synthesizers (desk top versions as well as high-throughput industrial versions) that can be operated at the site of use. Therefore, customers who choose to fabricate their own arrays can do so by purchasing, leasing, or licensing one of our synthesizers for operation in their own facilities. This capability will enable customers to utilize array processors quickly by eliminating the time necessary for shipping from a central manufacturing facility. In addition, these customers will never be required to disclose to any party, including the CombiMatrix group, the sequences or genes in which they are investigating.

SOFTWARE

The CombiMatrix group has designed and is testing integrated, modular software that will direct the design and customization of its biological array processors for use in DNA applications. The software required to enable proteomic research is in the early stages of development. -122-

The CombiMatrix group's current software is being designed to:

- permit customers to access public databases for gene sequence information;
- permit customers to transmit their research objectives to the CombiMatrix group or partners over the Internet, or to their own in-house synthesis lab behind their IT firewall;
- enable the CombiMatrix group to rapidly screen potential DNA segments against large numbers of DNA targets during its design process;
- enable the CombiMatrix group to direct its manufacturing equipment to synthesize DNA segments designed by it on the surface of its biological array processors; and
- o permit the CombiMatrix group to quality check the finished product.

REGULATORY MATTERS

The CombiMatrix group intends to sell products to the pharmaceutical, biotechnology and academic communities for research applications. Therefore, its initial products will not require approval from, or be regulated by, the United States Food and Drug Administration ("FDA") as a manufacturer nor will they be subject to the FDA's current good manufacturing practice ("cGMP") regulations. Additionally, the CombiMatrix group's initial products will not be subject to certain reagent regulations promulgated by the FDA. However, the manufacture, marketing and sale of certain products and services for any clinical or diagnostic applications will be subject to extensive government regulation as medical devices in the United States by the FDA and in other countries by corresponding foreign regulatory authorities.

The FDA requires that a manufacturer seeking to market a new or modified medical device, or an existing medical device for a new indication, obtain either a pre-market notification clearance under the Federal Food, Drug and Cosmetic Act or a showing of substantial equivalence in function to an existing regulated device. The CombiMatrix group anticipates that its products will become subject to medical device regulations in the United States only when they are marketed for clinical uses for any clinical or diagnostic purpose, excluding pure research or product discovery research purposes. Material changes to existing medical devices are also subject to FDA review and clearance or approval prior to commercialization in the United States.

Should the CombiMatrix group market products for any clinical or diagnostic purpose or act as a manufacturer or supplier of products for a third-party customer to market for any clinical or diagnostic purpose, it will be required to register as a medical device manufacturer with the FDA. As a registered manufacturer, the CombiMatrix group would be subject to routine inspection by the FDA for compliance with cGMP regulations and other applicable regulations. In addition, the CombiMatrix group must currently comply with a variety of other federal, state and local laws and regulations relating to safe work conditions and manufacturing practices. The extent of government regulation that might result from any future legislation or administration cannot be predicted. Moreover, there can be no assurance that the CombiMatrix group or its third-party customers will be able to obtain appropriate FDA regulatory approvals on a timely basis, or at all, or that the CombiMatrix group will be able to comply with cGMP regulations.

Sales of the CombiMatrix group's products outside the United States will be subject to foreign regulatory requirements that vary from country to country. Additional approvals from foreign regulatory authorities may be required, and there can be no assurance that the CombiMatrix group will be able to obtain foreign marketing approvals on a timely basis, or at all, or that it will not be required to incur significant costs in obtaining or maintaining foreign regulatory approvals. For example, if the CombiMatrix group products are marketed for clinical or diagnostic purposes in the European Union, the CombiMatrix group will have to obtain the certificates required for the "CE" mark to be affixed to the CombiMatrix group products for sales in European Union member countries. The "CE" mark is a European Union symbol of adherence to quality assurance standards and compliance with applicable European Union directives and regulations.

-123-

JOINT VENTURES

In October 2001, CombiMatrix Corporation formed a joint venture with Marubeni Japan, one of Japan's leading trading companies. The joint venture, based in Tokyo, will focus on development and licensing opportunities for CombiMatrix Corporation's biochip technology with pharmaceutical and biotechnology companies in the Japanese market. Marubeni made an investment to acquire a ten percent minority interest in the joint venture.

Prior to April 25, 2002, CombiMatrix Corporation owned 28.6% of Advanced Material Sciences ("AMS") which in turn held an exclusive license for CombiMatrix Corporation's microarray synthesis technology for the development and discovery of advanced electronic materials for such purposes as fuel cell catalysts. In consideration for this exclusive license, CombiMatrix Corporation would share in the revenues earned by AMS for commercialization of these discoveries based on CombiMatrix Corporation's microarray technology. The term of this arrangement was 20 years. As the technology was being developed at AMS, management realized that it was inefficient to build redundant infrastructure to perform this research. Rather than build and buy new equipment and facilities to conduct materials discovery, it was decided to utilize the existing infrastructure at CombiMatrix Corporation to more efficiently and quickly perform materials discovery research. On April 25, 2002, CombiMatrix Corporation acquired Acacia's majority interest in AMS in consideration of 180,982 shares of CombiMatrix Corporation's common stock. AMS is now being operated as a research and development division within CombiMatrix Corporation.

MARKETING AND DISTRIBUTION

In July 2001, CombiMatrix Corporation entered into non-exclusive worldwide license, supply, research and development agreements with Roche Diagnostics GmbH ("Roche"). These agreements were amended and restated in September 2002, primarily to grant Roche manufacturing rights with respect to the products under development in return for additional cash consideration under the agreements. The revised agreements also make minor modifications to terms of the agreements involving matters such as milestones, payments and technical specifications, none of which we consider to be material. Such minor modifications are a standard part of the research and development process and are routinely made in development agreements. During the course of our relationship with Roche, since the date of the original agreements, we have engaged in a continuous process of monitoring and reevaluating the terms of our agreements, and have amended the agreements in several respects to establish more meaningful goals, milestones and timelines. The agreements are non-exclusive with respect to CombiMatrix Corporation's core technology, meaning that CombiMatrix Corporation remains free

to license its core technology to third parties for applications in the genomics, proteomics and other fields. The agreements contain exclusivity or co-exclusivity provisions only with respect to the specific products being co-developed for, and partially funded by, Roche pursuant to the agreements.

Under the terms of the revised agreements, it is contemplated that Roche will co-develop, use, manufacture, market and distribute CombiMatrix Corporation's biochips (microarrays) and related technology for rapid production of customizable biochips. Additionally, CombiMatrix Corporation and Roche will develop a platform technology, providing a range of standardized biochips for use in important research applications. Roche has made and will continue to make payments for the deliverables stipulated and for expanded license and manufacturing rights.

The agreements provide for minimum payments by Roche to CombiMatrix Corporation over the first three years, including milestone achievements, payments for products, royalties and research and development projects. Nevertheless, because our agreements with Roche contain provisions that would allow Roche to terminate the agreements, the future payments by Roche to CombiMatrix Corporation might never be realized. Since July 2001, CombiMatrix Corporation has completed several milestones in its strategic alliance with Roche including demonstration of several key performance metrics of its custom in-situ microarray system.

In August 2001, CombiMatrix Corporation entered into a two-year license and supply agreement with the National Aeronautics and Space Administration ("NASA"). The agreement has a two-year term and provides for the license, purchase and use by the NASA Ames Research Center of CombiMatrix Corporation's active biochips (microarrays) and related technology to conduct biological research in terrestrial laboratories and in space. CombiMatrix Corporation does not expect to derive significant revenue in the future from this agreement.

-124-

MANUFACTURING AND CUSTOMIZATION

The CombiMatrix group is developing automated, computer-directed manufacturing processes for the synthesis of sequences of DNA, RNA, peptides or small molecules in the virtual flasks on its biological array processors.

The CombiMatrix group's biological array processor manufacturing process will involve:

- processing wafers of semiconductors manufactured by others into individual devices and installing electrical contacts on the semiconductor devices; and
- o applying the porous reaction layer to the semiconductor devices.

The CombiMatrix group, or any entities with which the CombiMatrix group has joint development efforts, will then customize its biological array processors in response to customer orders by:

- synthesizing test materials in the virtual flasks on the biological array processors using its synthesis module; and
- o checking the quality of the customized biological array processors.

Initially, the CombiMatrix group plans to rely upon third-party

manufacturers to produce the semiconductors, chemical reagents and accessories for its products. The CombiMatrix group intends to continue the outsourcing of portions of its manufacturing process to subcontractors where the CombiMatrix group determines it is in its best commercial interest.

Substantially all of the components and raw materials used in the manufacture of the CombiMatrix group's products, including semiconductors and reagents, are currently provided from a limited number of sources or in some cases from a single source. Although the CombiMatrix group believes that alternative sources for those components and raw materials are available, any supply interruption in a sole-sourced component or raw material might result in up to a several-month production delay and materially harm the CombiMatrix group's ability to manufacture products until a new source of supply, if any, could be located and qualified. In addition, an uncorrected impurity or supplier's variation in a raw material, either unknown to the CombiMatrix group or incompatible with its manufacturing process, could have a material adverse effect on its ability to manufacture products. The CombiMatrix group may be unable to find a sufficient alternative supply channel in a reasonable time period, or on commercially reasonable terms, if at all. The CombiMatrix group utilizes semiconductors made with a 3.0 micron fabrication process that is no longer in wide use due to increased miniaturization of semiconductors. If the CombiMatrix group is unable to achieve higher densities of test sites, it may become difficult or more expensive for the CombiMatrix group to obtain sufficient quantities of semiconductors as manufacturers phase out 3.0 micron production capacity.

PATENTS, LICENSES AND FRANCHISES

The CombiMatrix group's primary patent strategy is to protect all aspects of its biological array processor system, including the porous reaction layer, the virtual flask technology, processes for designing capture probes, unique properties of a protein-based biological array processor and business methods for automating ordering, creating and manufacturing custom made biological array processors. The CombiMatrix group's patent applications are divided by subject matter into areas of: its core biological array processor technology; other hardware for detection and manufacturing; software for designing, for example, capture probes; and chemical compositions and processes.

CombiMatrix Corporation has 42 patent applications pending in the United States and Europe. The CombiMatrix group's policy is to file patent applications and to protect technology, inventions and improvements to inventions that are commercially important to the development of its business.

-125-

In July 2000, CombiMatrix Corporation was granted U.S. Patent No. 6,093,302, which expires in July 2017, for its biochip microarray processor system. This system enables quick and economical turnaround of custom-designed microarrays for use in biological research. A microarray consists of a chemical "virtual flask" located on the surface of a semiconductor chip containing thousands of microarrays, which are separated from each other using special solutions instead of physical barriers. Each microarray has electronic circuitry that may be directed by a computer to construct a specified compound. The patent covers CombiMatrix Corporation's core technology, which is a method for producing microarrays by synthesizing biological materials on a three-dimensional, active surface.

The CombiMatrix group seeks to protect its corporate identity with trademarks and service marks. In addition its trademark strategy includes

protecting the identity and goodwill associated with its biological array processor products. The CombiMatrix group purchases chemical reagents from suppliers who are licensed under appropriate patent rights. It is its policy to obtain licenses from patent holders if needed to practice its chemical processes.

The CombiMatrix group's success will depend, in part, upon its ability to obtain patents and maintain adequate protection of its intellectual property in the United States and other countries. If it does not protect its intellectual property adequately, competitors may be able to use its technologies and thereby erode any competitive advantage that the CombiMatrix group may have. The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant problems in protecting their proprietary rights abroad. These problems can be caused by the absence of rules and methods for defending intellectual property rights.

The patent positions of companies developing tools for the biotechnology and pharmaceutical industries, including the CombiMatrix group's patent position, generally are uncertain and involve complex legal and factual questions. The CombiMatrix group will be able to protect its proprietary rights from unauthorized use by third parties only to the extent that its proprietary technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. The CombiMatrix group's existing patent and any future patents it obtains may not be sufficiently broad to prevent others from practicing its technologies or from developing competing products. There also is risk that others may independently develop similar or alternative technologies or design around its patented technologies. In addition, others may challenge or invalidate the CombiMatrix group's patents, or its patents may fail to provide it with any competitive advantage. Enforcing its intellectual property rights may be difficult, costly and time consuming, and ultimately may not be successful.

The CombiMatrix group also relies upon trade secret protection for its confidential and proprietary information. It seeks to protect its proprietary information by entering into confidentiality and invention disclosure and transfer agreements with employees, collaborators and consultants. These measures, however, may not provide adequate protection for the CombiMatrix group's trade secrets or other proprietary information. Employees, collaborators or consultants may still disclose its proprietary information, and the CombiMatrix group may not be able to meaningfully protect its trade secrets. In addition, others may independently develop substantially equivalent proprietary information or techniques or otherwise gain access to its trade secrets.

The CombiMatrix group cannot assure you that any of its patent applications will result in the issuance of any additional patents, that its patent applications will have priority of invention or filing date over similar rights of others, or that, if issued, any of its patents will offer protection against its competitors. Additionally, the CombiMatrix group cannot assure you that any patent issued to it will not be challenged, invalidated or circumvented in the future or that the intellectual property rights it has created will provide a competitive advantage. Litigation may be necessary to enforce its intellectual property rights or to determine the enforceability, scope of protection, or validity of the intellectual property rights of others.

COMPETITION

The CombiMatrix group expects to encounter competition in the area of business opportunities from other entities having similar business objectives. Many of these potential competitors possess financial, technical, human and other resources greater than those of the CombiMatrix group. The CombiMatrix group anticipates that it will face increased competition in the future as new

companies enter the market and advanced technologies become

-126-

available. In the life sciences industry, many competitors have more experience in research and development than the CombiMatrix group. Technological advances or entirely different approaches developed by one or more of its competitors could render the CombiMatrix group's processes obsolete or uneconomical. The existing approaches of competitors or new approaches or technology developed by competitors may be more effective than those developed by the CombiMatrix group.

The CombiMatrix group is aware of other companies or companies with divisions that have, or are developing, technologies for the SNP genotyping, gene expression profiling and proteomic markets. The CombiMatrix group believes that its primary competitors will be Abbott Laboratories, Affymetrix, Inc., Agilent Technologies, Inc., Bayer AG, Becton, Dickinson and Company, Ciphergen Biosystems, Inc., Gene Logic Inc., Genometrix Incorporated, Hyseq Inc., Illumina, Inc., Incyte Genomics, Inc., Johnson & Johnson, Motorola, Inc., Nanogen, Inc., Orchid Biosciences, Inc., PE Biosystems, Protogene, Inc., Roche Diagnostics GmbH, and Sequenom, Inc. However, the CombiMatrix group's market is rapidly changing, and the CombiMatrix group expects to face additional competition from new market entrants, new product developments and consolidation of its existing competitors. Many of the CombiMatrix group's competitors have existing strategic relationships with major pharmaceutical and biotechnology companies, greater commercial experience and substantially greater financial and personnel resources than it does. The CombiMatrix group expects new competitors to emerge and the intensity of competition to increase in the future.

The CombiMatrix group believes that the principal competitive factors in selling its products will be:

- o the time required to engineer, produce and ship products;
- o the speed and accuracy with which test results can be read and interpreted;
- o the density of testing devices;
- o the cost and pricing of the installed base of competing products; and
- o access to proprietary genetic databases.

The CombiMatrix group believes that it will be able to compete favorably with regard to these factors even though it has competitors who currently produce testing devices with higher densities than its proposed initial products, and, initially, it will not offer its customers access to proprietary genetic information.

RESEARCH, DEVELOPMENT AND ENGINEERING

The CombiMatrix group's research and development expenses excluding non-cash stock compensation charges, were \$5.0 million and \$7.7 million and \$2.7 million and \$5.8 million for the three and six months ended June 30, 2002 and 2001, respectively, and \$11.7 million, \$8.8 million and \$2.4 million in 2001, 2000 and 1999, respectively. None of these amounts includes the amortization of deferred stock compensation expenses related to research and development. The CombiMatrix group intends to invest aggressively in its proprietary technologies through internal development and, to the extent available, licensing of third-party technologies to increase and improve other characteristics of its

products. The CombiMatrix group also plans to continue to invest in improving the cost-effectiveness of its products through further automation and improved information technologies. The CombiMatrix group's future research and development efforts may involve research conducted by the CombiMatrix group, collaborations with other researchers and the acquisition of chemistries and other technologies developed by universities and other academic institutions.

The CombiMatrix group is developing a variety of life sciences related products and services. These industries are characterized by rapid technological development. The CombiMatrix group believes that its future success will depend in large part on its ability to continue to enhance its existing products and services and to develop other products and services, which complement existing ones. In order to respond to rapidly changing competitive and technological conditions, the CombiMatrix group expects to continue to incur significant research

-127-

and development expenses during the initial development phase of new products and services, as well as on an ongoing basis.

There are four major development hurdles to our core technology platform, three of which have been overcome, as described below:

- O DESIGN AND FABRICATION OF SEMICONDUCTOR ARRAYS. The CombiMatrix group has utilized common tools well known to the semiconductor industry such as EDA software (electronic design automation), lithography fabrication techniques, and other semiconductor processing methods to fabricate a number of array designs that are utilized as the base electronic component of its products. The CombiMatrix group continues to utilize these tools to advance their designs in a manner similar to semiconductor companies. The core functional needs of the devices have been achieved in designing and building semiconductor arrays.
- O DESIGN AND FABRICATION OF INSTRUMENTATION FOR SYNTHESIS OF DNA ON ARRAYS AND THE ACTUAL SYNTHESIS OF DNA ON SUCH ARRAYS. In order to produce bioarrays with in-situ synthesized DNA, the CombiMatrix group designed and built unique instrumentation. Such instrumentation incorporates standard electronic, mechanical and fluidic components, as well as customized firmware and user interface software. These prototype systems operate in a manner that allows the synthesis of DNA on multiple arrays.
- O DESIGN AND FABRICATION OF INSTRUMENTATION TO PERFORM ASSAYS ON ARRAYS AS WELL AS TO MEASURE SUCH PERFORMANCE. Instruments commonly known as Reader-Hybridizers have been designed and prototypes have been built to automate the process of performing an assay on our bioarrays as well as to measure the performance of the assay. These instruments incorporate standard, electronic, mechanical, robotic, and fluidic components as well as firmware and software to function.
- O DEVELOPMENT OF A COST-EFFECTIVE, COMMERCIALLY VIABLE APPROACH TO MANUFACTURE ARRAYS. As the CombiMatrix group moves forward to broad commercialization of its technology platform, advanced manufacturing techniques are being developed to provide the most reliable and cost-effective approach to manufacture bioarrays, as well as to develop products that are commercially viable. These methods will utilize certain protocols (many of which are well known in the manufacturing sector) including robotic automation as well as some

internally developed protocols. These processes are currently in development.

GOVERNMENT GRANTS AND CONTRACTS

Government grants and contracts have allowed the CombiMatrix group to fund certain internal scientific programs and exploratory research. The CombiMatrix group retains ownership of all intellectual property and commercial rights generated during these projects. The United States government, however, retains a non-exclusive, non-transferable, paid-up license to practice the inventions made with federal funds pursuant to applicable statutes and regulations. The CombiMatrix group does not believe that the retained license will have any impact on its ability to market its products. The CombiMatrix group does not need government approval to enter into collaborations or other relationships with third parties.

The CombiMatrix Corporation has been awarded two grants and two contracts from the federal government in connection with its biological array processor technology. In July 1999, the CombiMatrix Corporation was awarded a \$60,000 Phase I Small Business Innovative Research ("SBIR") contract from the Department of Defense to develop nanode array sensor microchips to enable simultaneous detection of numerous chemical and biological warfare agents. Also in July 1999, the CombiMatrix Corporation was awarded a \$100,000 Phase I SBIR Department of Energy grant to use the CombiMatrix Corporation's proprietary biochip technology to develop microarrays of affinity probes for the analysis of gene products. In January 2000, the CombiMatrix Corporation was awarded a \$730,000 Phase II SBIR Department of Defense contract for the use of its biochip technology to further develop nanode array sensor microchips. The term of the Phase II SBIR Department of Defense contract ends in July 2002. CombiMatrix Corporation expects to recognize \$91,000 in contract revenues in the third guarter of 2002. Upon delivery of a prototype electrochemical biological detection system to the DOD in the third quarter of 2002,

-128-

CombiMatrix Corporation will have completed its obligations under the Phase II SBIR Department of Defense contract and as a result, expects to receive the final payment under the contract in the third quarter of 2002. As such, CombiMatrix Corporation will no longer receive grant revenues under the Phase II SBIR Department of Defense contract after the third quarter of 2002. In February 2002, the CombiMatrix Corporation was awarded a six-month \$100,000 Phase I National Institutes of Health grant for the development of its protein biochip technology, entitled "Self-Assembling Protein Microchips."

The CombiMatrix group will continue to pursue grants and contracts that complement its research and development efforts.

MANAGEMENT

The management of the CombiMatrix group will consist of the following individuals, each of whom is an officer of CombiMatrix Corporation:

| NAME | AGE | POSITIONS WITH THE COMBIMATRIX GROUP |
|-------------------|-----|---------------------------------------|
| | | |
| Amit Kumar, Ph.D. | 38 | President and Chief Executive Officer |

| Donald D. Montgomery, Ph.D. | 44 | Senior Vice President and Chief Technology Officer |
|-----------------------------|----|--|
| Warren G. Hargis | 50 | Senior Vice President and Chief Operating Officer |
| Scott R. Burell, CPA | 37 | Vice President of Finance and Treasurer |
| Jeffrey B. Oster, Ph.D. | 49 | Senior Vice President of Intellectual Property and Associate |
| Edward M. Eadeh | 51 | Senior Vice President of Business Development |
| Brooke P. Anderson, Ph.D. | 39 | Vice President of Software Development |
| Brett L. Undem | 33 | Vice President of Investor Relations |
| Peter G. Edelman, Ph.D. | 46 | Vice President of Development |

The following is biographical information and a brief description of the capacities in which each of the above persons has served during the past five years. Biographical information for Dr. Amit Kumar is set forth above under the heading "Acacia Research Corporation - Business."

DONALD D. MONTGOMERY, PH.D. has been a Director since April 1996, the CombiMatrix Corporation's Senior Vice President and Chief Technology Officer since April 2000 and a member of the CombiMatrix Corporation's Scientific Advisory Board since September 2000. From April 1996 to April 2000, Dr. Montgomery was the CombiMatrix Corporation's Vice President of Research and Development. From September 1995 to April 1996, Dr. Montgomery was an entrepreneur engaged in private scientific research. Dr. Montgomery received an A.B. from Grinnell College and a Ph.D. in chemistry from the California Institute of Technology. Dr. Montgomery also performed post-doctoral work at the Joint Institute for Laboratory Astrophysics in Boulder, Colorado.

WARREN G. HARGIS has been CombiMatrix Corporation's Chief Operating Officer since February 2002. Mr. Hargis joined CombiMatrix Corporation in March 2000 as Vice President of Human Resources. From March 1996 to March 2000, Mr. Hargis served as the Director of Human Resources, International Operations and Global Compensation for Sterling Diagnostic Imaging. From November 1979 to March 1996, Mr. Hargis was employed by DuPont EI De Nemours & Co., serving in various positions in the polymer products, petrochemicals, textile fabrics and imaging systems departments, completing his career at DuPont as Manager of Human Resources in the Medical Products Division. Mr. Hargis attended Lamar University.

SCOTT R. BURELL, CPA, was promoted to Vice President of Finance of CombiMatrix Corporation in November 2001. Prior to this, Mr. Burell had served as Controller from the time he joined CombiMatrix Corporation in February 2001. From May 1999 to February 2001, Mr. Burell was the controller for Network Commerce, Inc., a publicly traded technology and information infrastructure company located in Seattle. Prior to

-129-

this, Mr. Burell spent 9 years with Arthur Andersen's Audit and Business Advisory practice in Seattle. Mr. Burell is a certified public accountant and holds bachelor of science degrees in Accounting and Business Finance from Central Washington University.

JEFFREY B. OSTER, PH.D. has been CombiMatrix Corporation's Senior Vice

President of Intellectual Property and Associate General Counsel since November 2000. From January 1998 to November 2000, Dr. Oster was a partner in the Seattle-based law firm of Davis Wright Tremaine LLP, practicing intellectual property law. From September 1996 to January 1998, Dr. Oster was the General Counsel of Cytotine Networks, Inc., a pharmaceutical development company. From October 1992 to September 1996, Dr. Oster was the General Counsel of Cell Therapeutics Inc., a pharmaceutical development company. Dr. Oster received a B.A. from Johns Hopkins University, a Ph.D. from the University of Pennsylvania, and a J.D. from Rutgers Law School.

EDWARD M. EADEH has been CombiMatrix Corporation's Vice President of International Business Development since May 2000. From August 1997 to September 1999, Mr. Eadeh was Vice President of Asia Pacific Sales for Sterling. From February 1995 to August 1997, Mr. Eadeh was the Vice President of Asia Pacific Sales for Polaroid Medical Imaging. Mr. Eadeh attended Wayne State University.

BROOKE P. ANDERSON, PH.D. has been CombiMatrix Corporation's Vice President of Software Development since April 2000 and a member of the CombiMatrix Corporation's Scientific Advisory Board since September 2000. From August 1997 to April 2000, Dr. Anderson served as the CombiMatrix Corporation's Director of Engineering and, from its formation in October 1995 to September 2000, served as a member of the CombiMatrix Corporation's board of directors. From October 1995 to January 1997, Dr. Anderson also served as its President. Prior to that time, Dr. Anderson co-founded Acacia Research, and from January 1993 to August 1997, Dr. Anderson served as Vice President, Research and Development of Acacia Research. Dr. Anderson received a B.S.E. in nuclear engineering from the University of Michigan and an M.S. in applied physics, and a Ph.D. in computation and neural systems from the California Institute of Technology.

BRETT L. UNDEM joined Acacia Research as Vice President of Investor Relations/Corporation Finance in June of 2000. He then transferred to CombiMatrix Corporation in January 2001 and currently holds the title of Vice President of Investor Relations. Mr. Undem was previously Vice President of Canterbury Consulting, an institutional investment advisory firm, from 1998 to 2000. From 1993 to 1998, Mr. Undem was a Senior Consultant at Wurts & Associates, a Los Angeles-based institutional investment-consulting firm. Mr. Undem received a B.S. in finance from the University of Arizona and earned the designation Certified Investment Management Analyst from the Wharton School of Business.

PETER G. EDELMAN, PH.D. joined CombiMatrix Corporation in January 2002 as Director, Process Development, and was promoted to Vice President of Development in March 2002. Dr. Edelman previously served as Principal Scientist for Confluent Surgical, Inc., an implantable medical device start-up company, from 1998 to 2002. From 1988 to 1998, Dr. Edelman worked in research and development for Chiron Diagnostics (now Bayer Diagnostics) in Medfield, Massachusetts. Dr. Edelman received a B.S. in chemistry from Bates College and a Ph.D. in polymer chemistry from the University of Connecticut.

It is intended that the above named individuals will continue serving in their existing CombiMatrix Corporation roles for the CombiMatrix group.

EMPLOYEES

As of November 1, 2002, the CombiMatrix group had 105 full-time employees, 19 of whom hold Ph.D. degrees and 77 of whom are engaged in full-time research and development activities. The CombiMatrix group plans to expand its research and development programs as well as corporate collaborations, and will hire additional staff as these initiatives are implemented. The CombiMatrix group is not a party to any collective bargaining agreement. It considers its employee relations to be good.

The CombiMatrix group also makes selective use of paid consultants to assist in solving specialized problems or providing particular services. Consultants are used when the CombiMatrix group determines that it is

-130-

more economical than hiring an employee or where the best available services are only available on a consulting basis. In addition to consultants, the CombiMatrix group intends to utilize the services of university employees to perform basic research that is useful to it. The CombiMatrix group believes that this offers a cost-effective means of obtaining valuable information not directly related to its core technology.

As the CombiMatrix group's business grows, it anticipates that it will be required to selectively hire a certain number of chemists, biologists, engineers and lab technicians as well as additional managerial, financial and clerical employees. The market for scientists and engineers is competitive and there can be no assurance that the CombiMatrix group will be able to hire all of the skilled employees it needs or that it will be able to reach its desired staffing levels within a reasonable period of time.

PROPERTIES

CombiMatrix Corporation leases office and laboratory space totaling approximately 90,111 square feet located north of Seattle, Washington, under a lease agreement that expires in December 2008. Presently, the CombiMatrix group is not seeking any additional facilities.

The CombiMatrix group believes that its facility meets its office, laboratory and manufacturing requirements for the foreseeable future.

ENVIRONMENTAL MATTERS

The operations of the CombiMatrix group involve the use, transportation, storage and disposal of hazardous substances, and as a result, these subsidiaries are subject to environmental and health and safety laws and regulations. Although the CombiMatrix group currently use fairly small quantities of hazardous substances, as it expands its operations, its use of hazardous substances will likely increase and lead to additional and more stringent requirements. The cost of complying with these and any future environmental regulations could be substantial. In addition, if the CombiMatrix group fails to comply with environmental laws and regulations, or releases any hazardous substance into the environment, the CombiMatrix group could be exposed to substantial liability in the form of fines, penalties, remediation costs and other damages, or could suffer a curtailment or shut down of its operations.

INTERNET

Because the CombiMatrix group or its partners plan to utilize the Internet for product ordering as well as transmission of test data, it will be subject to government regulation concerning Internet usage and electronic commerce. The CombiMatrix group expects that state, federal and foreign agencies will adopt and modify regulations covering issues such as user and data privacy, taxation of products provided over the Internet, the use and export of cryptographic technology and content and quality of products. For example, the European Union has adopted a privacy directive that regulates the collection and use of information. The globalization of Internet commerce may be harmed by these and similar regulations since the European Union privacy directive prohibits transmission of certain information outside the European Union unless the

receiving country has enacted individual privacy protection laws at least as strong as those enacted by the European Union privacy directive. In July 2000 the European Union issued a formal opinion permitting United States entities to transfer data to and from its countries if the United States entity adheres to safe harbor and privacy principles.

The taxation of commerce activities in connection with the Internet has not been established, may change in the future and may vary from jurisdiction to jurisdiction. For example, a number of proposals have been made at the local, state, national and international levels that would impose additional taxes on the sale of products over the Internet. These proposals, if adopted, could substantially impair the growth of electronic commerce and could subject the CombiMatrix group's business activities to taxation unless it persuades customers to use their own intranet computer capabilities. Moreover, if any state or country were to assert successfully that the CombiMatrix group should collect sales or other taxes on the exchange of products over the Internet, its customers may refuse to use its services through the Internet.

-131-

LEGAL PROCEEDINGS

On September 30, 2002, CombiMatrix Corporation and Dr. Montgomery entered into a settlement agreement with Nanogen to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, Nanogen dismissed with prejudice its lawsuit against CombiMatrix Corporation and Dr. Montgomery. In return, CombiMatrix Corporation agreed to pay Nanogen \$500,000 within 30 days of the settlement and an additional \$500,000 within one year of the settlement. CombiMatrix Corporation also agreed to make quarterly payments to Nanogen equal to 12.5% of total sales of products developed by CombiMatrix Corporation and its affiliates and based on the patents that had been in dispute in the litigation, up to an annual maximum of \$1,500,000. The minimum quarterly payments under the settlement agreement will be \$37,500 per quarter for the period from October 1, 2003 through October 1, 2004, and \$25,000 per guarter thereafter until the patents expire. Also pursuant to the settlement agreement, CombiMatrix Corporation agreed to issue to Nanogen 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, subject to antidilution provisions under specified circumstances, including the exercise of outstanding options and warrants and issuances of additional capital stock of CombiMatrix Corporation, for a period of up to three years.

-132-

ACACIA TECHNOLOGIES GROUP (A DIVISION OF ACACIA RESEARCH CORPORATION)

BUSINESS

The Acacia Technologies group is principally comprised of Soundview Technologies Incorporated ("Soundview Technologies"), Acacia Media Technologies Corporation ("Acacia Media Technologies"), formerly Greenwich Information Technologies LLC, and includes all corporate assets and liabilities and related transactions of Acacia Research that relate to its media technology businesses. Both Soundview Technologies and Acacia Media Technologies are wholly-owned subsidiaries of Acacia Research.

Soundview Technologies was incorporated in March 1996 under the laws of the State of Delaware. Soundview Technologies has acquired and is developing intellectual property in the telecommunications field, including audio and video blanking systems, also known as V-chip technology, which it licenses to television manufacturers. In March 1998, the Federal Communications Commission ("FCC") approved the television guidelines rating system, as well as the V-chip technical standards. Soundview Technologies owns the exclusive right and title to U.S. Patent No. 4,554,584, which describes a method for implementing the V-chip system in parallel with the existing closed-captioning circuits already in place in televisions. This patent expires in July 2003.

Acacia Media Technologies was formed as a limited liability company under the laws of the State of Delaware in 1996 and converted to become a Delaware corporation in 2001. Acacia Media Technologies owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems. Audio-on-demand offers similar functionality with music or other audio content. Video-on-demand allows television viewers to order movies or other programs from a remote file server and to view them at home with full VCR functionality, including pause, fast-forward and reverse. Information-on-demand is one of the primary applications of interactive entertainment.

The Acacia Technologies group is responsible for the development, licensing and protection of its intellectual property and proprietary technologies and continues to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry.

MARKET OVERVIEW

SOUNDVIEW TECHNOLOGIES' MARKETS

The 1996 Telecommunications Act requires all television manufacturers to include V-chip technology in all new television sets with screens 13 inches or larger sold in the United States. Approximately 26.0 million new televisions are sold each year in the United States. The Acacia Technologies group's V-chip technology is a cost-effective method for V-chip implementation that is compatible with components currently in use in televisions. The Acacia Technologies group's V-chip technology uses a television's receiver circuitry to decode content rating information sent as part of the broadcast signal. By utilizing the broadcast signal that carries closed-caption data, the Acacia Technologies group's technology is relatively inexpensive to implement. The industry and its trade association adopted this method as the technical standard for new television sets sold in the United States that are required to have V-chip technology. There may be other patents that pertain to the V-chip technology.

ACACIA MEDIA TECHNOLOGIES' MARKETS

The market for audio and video transmission and receiving systems, such as audio-on-demand and video-on-demand, continues to grow inside the United States and abroad. The technology underlying the infrastructure required to deliver digitized signals to consumers continues to rapidly improve, making the expansion of the infrastructure more economical, and increasing the opportunities for the commercialization of the Acacia Technologies group's audio and video-on-demand patent portfolio. It is estimated that there are currently 17 million digital satellite customers in the United States and 9 million outside the United States. There are an estimated 13 million digital cable subscribers in the United States, and this number is anticipated to increase to over 40 million by 2005. It is also estimated that there are currently 11 million broadband Internet customers in the United States, and this number is anticipated to increase significantly by 2005. Interactive services such as video-on-demand are being rolled out to these digital customers, and it is anticipated that revenues for the video-on-demand industry will reach \$3 billion by 2005. The Acacia Technologies group will continue to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry.

MARKETING AND DISTRIBUTION

V-CHIP TECHNOLOGY

The Acacia Technologies group's strategy has been to license television manufacturers that are utilizing the V-chip technology. Its strategy has been to license to major manufacturers with the largest potential licensing fees first, and then to focus on smaller or less well-known manufacturers. By successfully licensing to the largest manufacturers first, Acacia Technologies believes that it has established strong precedent with respect to its intellectual property rights. This precedent has enabled the Acacia Technologies group to deal effectively with additional manufacturers and to avoid, in some circumstances, costly negotiations or litigation.

During the past year, the Acacia Technologies group has licensed 12 major television manufactures including Philips, Hitachi, Pioneer, Samsung, Sanyo, Funai, LG Electronics, Thomson, JVC, Daewoo, Orion, and Matsushita. Litigation for patent infringement and anti-trust violations is pending against Sony, Mitsubishi, Sharp and Toshiba. These 12 licensees and 4 litigants manufacture most of the television sets sold in the United States. These license agreements contain provisions in some cases for lump sum payments, in other cases provisions for ongoing royalty payments or a combination of both.

The Acacia Technologies group has identified several additional companies that also manufacture televisions for sale in the U.S. and it intends to continue to attempt to enter into licenses with these companies. The Acacia Technologies group expects to enter into licenses with these companies, but may initiate additional litigation against these companies if they use Acacia Technologies' V-Chip technology without a license. The Acacia Technologies group's success in entering into licenses or litigation with these companies may, however, be impacted by developments in its existing litigation. In pending litigation against Sony, Mitsubishi, Sharp and Toshiba, the court in September 2002 ruled that the defendants had not infringed the V-chip patent. While the Acacia Technologies group is currently exploring strategies in connection with this ruling and intends to appeal, litigation is inherently uncertain and there can be no assurance that the Acacia Technologies group will be successful in any such appeal. As a result of this ruling, in October 2002 Soundview Technologies voluntarily filed to dismiss, without prejudice, its pending action for infringement of the V-chip patent against seventeen television manufacturers. By voluntarily dismissing this lawsuit at this time, Soundview Technologies will be able to refile the action in the event that a favorable final decision is reached with respect to the issue of infringement in the lawsuit against Sony, Mitsubishi, Sharp and Toshiba. Acacia Technologies' V-chip patent expires in July 2003.

DIGITAL MEDIA TRANSMISSION TECHNOLOGY

Streaming and audio/video on demand refers to technology that permits viewers or listeners to experience on-demand digital audio and video. In order

for streaming and audio/video on demand content to be transmitted, it must be digitized, compressed and encrypted using software. The digitized content is then stored by the originator or a content aggregator on a digital server. Upon request by the end user, the digitized content is sent via cable, satellite, the Internet, or radio transmission to a receiver. The receiver is usually a computer, set top box, radio, or other portable hand held device which plays, pauses, rewinds, and fast forwards the content at the discretion of the user.

Digital Media Transmission ("DMT") technology is a broad technology covering the process of digitizing, encrypting, compressing, storing, transmitting, receiving and playing back audio and/or video content. The technology is supported by five issued U.S. Patents consisting of 137 claims, and seventeen international patents. The DMT technology is developed and can be used in services commonly referred to as video-on-demand, audio-on-demand, and streaming media. As these types of services continue to be introduced to the marketplace, DMT is

-134-

expected to be utilized with increasing frequency. There may be other patents held by third parties that pertain to the DMT technology.

Acacia Technologies group's DMT technology has the potential to be utilized by companies worldwide engaged in the digitization, encryption, storage, transmission, receipt, and playback of digital content. Digital satellite television has been perhaps the fastest growing medium for transmission of digitized content. Cable companies are seeking to convert their existing customers to digital formats to compete with satellite. Broadband Internet service is expanding throughout the United States for the delivery of digital entertainment services to the computer.

Acacia Technologies group has identified entities whose operations it believes may infringe upon its DMT technology and other potential licensees that may use its DMT technology involved in this process including cable companies, satellite companies, DSL providers, fiber network providers, server manufacturers, content delivery networks, consumer electronics companies, corporate webcasters, interactive gaming companies, encoder application vendors, software manufacturers, adult entertainment companies, and computer manufacturers, all on a worldwide basis.

Acacia Technologies group intends to engage in a worldwide licensing program based upon the adoption rates and uses of its DMT technology. Acacia Technologies group believes that current non-licensed users of its DMT technology infringe upon its patented DMT technology. Since Acacia Technologies group's acquisition in 2001 of the remaining ownership interests in Acacia Media Technologies Corporation, the entity that owns the DMT technology, it has worked to identify entities that may infringe on the DMT technology. Acacia Technologies group intends to pursue licensing arrangements with such entities, but may initiate litigation in the event that users of its DMT technology refuse to obtain a license with respect to its patented technology. Acacia Technologies group has not entered into licensing agreements with respect to the DMT technology to date. Acacia Technologies group's digital media transmission patent portfolio expires in 2011 in the U.S. and in 2012 in international markets.

PATENTS, LICENSES AND FRANCHISES

The Acacia Technologies group's patent that describes a method for implementing the V-chip system in parallel with the existing closed-captioning

circuits already in place in televisions, was issued in November 1985 and expires in July 2003. In April 1998, the U.S. Patent and Trademark Office issued a reexamination certificate confirming the approval of all existing and newly added claims of its issued patent. The reexamination was requested by Soundview Technologies in August 1996 to confirm the strength of its patent in light of other existing patents. Over 30 new prior art references were introduced and examined during the process, which took more than eighteen months for the Patent Office to complete. As a result, patentability of all original claims as issued was confirmed and 17 new claims more specific to the V-chip implementation were granted.

The Acacia Technologies group owns five issued U.S. patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods as follows: U.S. Patent No. 5,132,992, U.S. Patent No. 5,253,275, U.S. Patent No. 5,550,863, U.S. Patent No. 6,002,720 and U.S. Patent No. 6,144,702. In addition, the Acacia Technologies group owns seventeen foreign patents also relating to audio and video transmission and receiving systems technology. Foreign rights include a patent granted in Mexico, a patent granted by the European Patent Office covering Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Monaco, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom, and a patent application pending in Japan. Those patents that have already been issued and granted were issued or granted during the past nine years, the earliest of which will expire in 2011. The Acacia Technologies group is pursuing business opportunities with possible providers of information-on-demand systems and others involved in supplying related information-on-demand services.

REGULATORY MATTERS

The Acacia Technologies group markets and licenses technologies relating to audio-on-demand and video-on-demand. These technologies can be used to transmit content by several means including satellite, cable and telecommunications systems. The satellite, cable and telecommunications industries are subject to federal regulation, including Federal Communications Commission ("FCC") licensing and other requirements. These

-135-

industries are also often subject to extensive regulation by local and state authorities. While most satellite, cable and telecommunication industry regulations do not apply directly to the Acacia Technologies group, they affect programming distributors, one of the large potential customers for the technologies covered by the Acacia Technologies group patent portfolio. The Acacia Technologies group monitors pending legislation and administrative proceedings to ascertain relevance, analyze impact and develop strategies regarding regulatory trends and developments within these industries.

Federal law requires cable operators to reserve up to one-third of a system's channel capacity for local commercial television stations that have elected must-carry status. In addition, a cable system is generally required to carry local non-commercial television stations. The FCC has also implemented comparable rules for satellite carriers requiring that if a satellite system carries one local broadcast station in a local market pursuant to a royalty-free license granted under the Satellite Home Viewer Improvement Act of 1999, then it must carry all local broadcast stations in that market. To meet these requirements, some cable and satellite systems must decide which programming services to keep and which to remove in order to make space available for local television stations. These must-carry requirements may impact the Acacia

Technologies group's information-on-demand and streaming media business by causing cable and satellite systems operators to reduce the number of channels on their systems that would have used technologies covered by Acacia Technologies group's patent portfolio.

On January 18, 2001, the FCC issued a Notice of Inquiry ("NOI") concerning interactive television. The NOI raises a series of questions that suggest that cable systems might be regarded as essential, open platforms of spectrum for non-discriminatory third-party use, rather than facilities-based providers competing in a wider market. Interactive television is a service so new that the FCC has difficulty defining it, but the FCC states that it considers interactive television to embrace at least electronic program guides, interactive video content, and supplementary signals that wrap around video and provide additional content or services. The NOI seeks comments on the nature of interactive television (e.g., what is it, who will provide it, how will it be provided, what are the business models for its provision), and whether cable systems will be a "superior platform" for the provision of interactive television. Although the NOI cannot lead directly to rules, it asks very detailed questions all arising from a common regulatory premise: that cable operations who are affiliated with interactive television providers should not be permitted to "discriminate" in favor of their own interactive television services with respect to spectrum usage; and that interactive television providers affiliated with cable operators may need to be subjected to equivalent rules of non-discrimination so that they may not obtain leverage from any exclusive arrangement they would otherwise negotiate with popular programmers. The outcome of the NOI will largely determine whether there will be subsequent FCC regulations for the interactive television industry. As of March 19, 2002, the FCC had not yet proposed any new regulations as a result of the NOI. Any regulation of this industry could impact the Acacia Technologies group's information-on-demand and streaming media business by limiting the growth of the market for these technologies or regulating their licensing, but at this time, it is too speculative to determine what those rules or their impact may be.

COMPETITION

The Acacia Technologies group expects to encounter competition in the area of business opportunities from other entities having similar business objectives. Many of these potential competitors possess financial, technical, human and other resources greater than those of the Acacia Technologies group. The Acacia Technologies group anticipates that it will face increased competition in the future as new companies enter the market and advanced technologies become available.

Other companies may develop competing technologies that offer better or less expensive alternatives to the V-chip technology and/or the Acacia Technologies group's audio-on-demand and video-on-demand technology. Many potential competitors, including television manufacturers and other media technology companies, have significantly greater resources. Technological advances or entirely different approaches developed by one or more of its competitors could render Acacia Technologies group's technologies obsolete or uneconomical.

-136-

MANAGEMENT

The Acacia Technologies group's senior management will consist of the following individuals:

| NAME | AGE | POSITIONS WITH THE ACACIA TECHNOLOGIES GROUP |
|---------------------|-----|--|
| Paul R. Ryan | 57 | Chairman and Chief Executive Officer - Acacia Media Technologies Corp Technologies Incorporated |
| Robert L. Harris II | 44 | President – Acacia Media Technologies Corporation and Chief Executive Technologies Incorporated |
| Robert A. Berman | 39 | Senior Vice President, Business Development - Acacia Media Technologi Soundview Technologies Incorporated |
| Clayton J. Haynes | 33 | Chief Financial Officer - Acacia Media Technologies Corporation and S Incorporated |
| Robert B. Stewart | 36 | Senior Vice President, Corporate Finance - Acacia Media Technologies |
| Roy J. Mankovitz | 61 | Senior Vice President, Intellectual Property - Acacia Media Technolog |
| Andrew H. Duncan | 37 | Vice President, Business Development - Acacia Media Technologies Corp |
| John H. Roop | 52 | Vice President, Engineering - Acacia Media Technologies Corporation |
| Alejandro Magana | 47 | Vice President, International Licensing - Acacia Media Technologies C |

The following is biographical information and a brief description of the capacities in which each of the above persons has served during the past five years. Biographical information on Messrs. Ryan, Harris and Haynes is set forth on pages 110 and 111 under "Acacia Research Corporation--Business."

ROBERT A. BERMAN joined Acacia Research in 2000 and was named Senior Vice President and General Counsel in February 2001. He is also the President of Soundview Technologies. Mr. Berman has extensive licensing and business development experience with media technology companies, and held senior positions at National Media Corporation from 1997 to 1999 and at QVC from 1993 to 1997. He practiced law at the Philadelphia law firm of Blank, Rome, Comisky and McCauley from 1989 to 1993. Mr. Berman received a B.S. from the University of Pennsylvania's Wharton School in 1985, and a J.D. from Northwestern Law School in 1989.

ROBERT B. STEWART joined Acacia Research in 1997 and is responsible for corporate finance and investor relations. He also leads the company's initiative to raise external capital for Acacia's affiliate companies. From 1995 to 1997, Mr. Stewart was President of Macallan, Dunhill & Associates, a registered investment advisor and general partner of a private investment fund. Mr. Stewart has a Bachelors degree in Economics from the University of Colorado/Boulder.

ROY J. MANKOVITZ has been Senior Vice President, Intellectual Property of the Acacia Media Technologies Corporation since December 2001. Mr. Mankovitz is best known for his former position as a Director, and Corporate Counsel, Intellectual Property of Gemstar - TV Guide International ("Gemstar"). Mr. Mankovitz was with Gemstar from 1991 to 1998, where he was responsible for the worldwide patent, trademark and copyright program, including technology licensing, litigation, strategic alliances and the establishment, acquisition and protection of intellectual property rights. He was also a member of the research and development group for new product development and a named inventor of more than two-dozen United States and foreign patents assigned to Gemstar. Prior to Gemstar, Mr. Mankovitz was a member of the law firm Christie, Parker and Hale, LLP where he was responsible for intellectual property prosecution,

litigation support, infringement and validity studies, and client counseling for electronics companies, including Gemstar, Samsung and Fujitsu. Mr. holds a B.S. in Electrical Engineering from Columbia University and a J.D. from the University at La Verne, Los Angeles College of Law.

ANDREW H. DUNCAN has been Vice President, Business Development of the Acacia Media Technologies Corporation since February 2002. Mr. Duncan was formerly Vice President, Consumer Electronics of Gemstar - TV Guide International with direct reporting responsibility to the CEO. Mr. Duncan was with Gemstar from 1994 to

-137-

2001, where he was responsible for licensing and marketing of the highly successful VCR Plus+ and Electronic Program Guide. At Gemstar, he developed and controlled licensing and marketing policy with all major consumer electronic manufacturers worldwide, including Sony, Philips and RCA. Prior to Gemstar, Mr. Duncan was European Marketing and Product Manager for Thomson Multimedia (formerly RCA/GE in the United States) where he was responsible for that company's consumer electronics multi-brand business across Europe. Mr. Duncan holds and honors degree in chemistry from Nottingham University and diplomas in marketing and direct marketing from London University (Kings College).

JOHN ROOP has been Vice President, Engineering of Acacia Media Technologies since March 2002. Since 1995, Mr. Roop has acted as a non-testifying expert witness as a technology consultant in a number of high value, media technology intellectual property litigations. Mr. Roop was with StarSight Telecast, Inc. from 1992 to 1995 where he held the positions of Senior Vice President, Technology and Development, and Vice President, Engineering. He has also previously held the positions of Director of Engineering of InSight Telecast, Inc., Vice President of Engineering of VSAT Systems, Inc., and Director of Data Communications of Telcom General Corp. Mr. Roop holds a B.S. in Electrical Engineering from the University of California, Berkeley.

ALEJANDRO MAGANA has been Vice President, International Licensing since June 2002. Most recently, Mr. Magana was a consultant for international and domestic companies, including Gemstar-TV Guide, where he negotiated and finalized contracts with media companies and cable operators in Mexico and Latin America. Mr. Magana was Vice President of Business Development with Grupo Televisa from 1987 to 1997, where he was responsible for joint ventures and strategic alliances worldwide. Mr. Magana also served as a member of the Board of Directors for several companies owned by Grupo Televisa and initiated the Consumer Products Division of Grupo Televisa.

EMPLOYEES

As of November 1, 2002, the Acacia Technologies group had 12 full-time employees. None of the companies included in the Acacia Technologies group is a party to any collective bargaining agreement. The Acacia Technologies group considers its employee relations to be good.

PROPERTIES

The Acacia Technologies group operates out of facilities leased by Acacia Research, consisting of approximately 7,143 square feet of office space in Newport Beach, California, under a lease agreement that expires in February 2007. Presently, the Acacia Technologies group is not seeking any additional facilities.

LEGAL PROCEEDINGS

In 2000, Soundview Technologies filed a federal patent infringement and antitrust lawsuit against certain television manufacturers, the Consumer Electronics Manufacturers Association and the Electronics Industries Alliance d/b/a/ Consumer Electronics Association. In its lawsuit now pending before the United States District Court for the District of Connecticut, Soundview Technologies alleges that television sets fitted with V-chips and sold in the United States infringe Soundview Technologies' patent. Additionally, Soundview Technologies alleges that the Consumer Electronics Manufacturers Association has induced infringement of Soundview Technologies' patent and that the defendants have violated the federal Clayton and Sherman Antitrust Acts by engaging in collusive attempts to prevent others in the electronics and television broadcasting industries from entering into licensing agreements with Soundview Technologies. Soundview Technologies is seeking monetary damages, an injunction preventing unlicensed use of its patented technology and other remedies. In September 2002, the court granted a motion for summary judgment filed by the defendants, ruling that the defendants have not infringed on Soundview Technologies' patent. While we are currently exploring strategies in response to this ruling and intend to appeal it, litigation is inherently uncertain and we can give no assurance that we will be successful in any such appeal.

In August 2002, Soundview Technologies filed a federal patent infringement lawsuit against seventeen television manufacturers in the United States District Court for the District of Nevada. In this lawsuit, Soundview

-138-

alleges that television sets fitted with V-chips and sold in the United States infringe Soundview Technologies' patent. As a result of the summary judgment ruling in the case before the United States District Court for the District of Connecticut, in October 2002, Soundview Technologies voluntarily filed to dismiss, without prejudice, the Nevada infringement lawsuit. By voluntarily dismissing this lawsuit at this time, Soundview Technologies will be able to refile the action in the event that a favorable final decision is reached with respect to the issue of infringement in the Connecticut lawsuit.

During 2001, Soundview Technologies executed separate settlement and/or license agreements with Samsung Electronics, Hitachi America, Ltd., LG Electronics, Inc., Funai Electric Co., Ltd., Daewoo Electronics Corporation of America, Sanyo Manufacturing Corporation, Thomson Multimedia, Inc., JVC Americas Corporation, MatsushitElectric Industrial Co., Ltd. and Orion Electric Co., Ltd. In addition, Soundview Technologies settled its lawsuits with Pioneer Electronics (USA) Incorporated, an affiliate of Pioneer Corporation, and received payments from Philips Electronics North America Corporation pursuant to a settlement and license agreement signed in December 2000. Certain of these license agreements constitute settlements of patent infringement litigation brought by Soundview Technologies.

As of December 31, 2001, the Acacia Technologies group received license fee payments from television manufacturers totaling \$25.6 million and granted non-exclusive licenses of Soundview Technologies' U.S. Patent No. 4,554,584 to the respective television manufacturers. Certain of the settlement and license agreements provide for future royalty payments to Soundview Technologies. The Acacia Technologies group received and recognized as revenue \$2.4 million of the license fee payments in the first quarter of 2001, \$10.0 million of the license fee payments in the second quarter of 2001, \$10.7 million of the license fee payments in the third quarter of 2001 and \$1.0 million of the license fee payments in the fourth quarter of 2001. License fee payments received during

2001 totaling \$1.5 million are included in deferred revenues at December 31, 2001 pursuant to the terms of the respective agreements.

-139-

ACACIA RESEARCH CORPORATION MANAGEMENT'S DISCUSSION AND ANALYSIS

GENERAL

Acacia Research develops, licenses and provides products for the media technology and life science sectors. Acacia Research's media technologies and life sciences businesses are referred to as the "Acacia Technologies group" and the "CombiMatrix group," respectively. Acacia Research licenses its V-chip technology to television manufacturers and owns pioneering technology for digital streaming and audio and video-on-demand. We will continue to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry. Acacia Research's core technology opportunity in the life science sector has been developed through our majority-owned subsidiary, CombiMatrix Corporation, which is developing a proprietary system for rapid, cost competitive creation of DNA and other compounds on a programmable semiconductor chip.

In the first and second quarters of 2002, our financial condition and results of operations were highlighted by our majority owned subsidiary, CombiMatrix Corporation, receiving \$413,000 in grant and contract revenues, including \$182,000 in grant revenue resulting from continuing performance under its Phase II Small Business Innovative Research Department of Defense contract, \$141,000 in one-time contract research and development revenues and \$90,000 in revenue related to performance under its Phase I National Institutes of Health grant. In addition, during the six months ended June 30, 2002, our media technologies group operating activities were highlighted by the continued building of its executive management team, including the hiring of key media technology and intellectual property industry experts that will be responsible for the development, licensing and protection of the Acacia Technologies group's intellectual property and proprietary technologies, as well as the pursuit of both licensing and strategic business alliances with leading companies in the growing media technologies industry.

In 2001, our financial condition and results of operations were highlighted by the receipt of \$25.6 million in payments from the licensing of our television V-chip technology, and \$6.4 million received by CombiMatrix Corporation pursuant to separate license, supply and research and development agreements with Roche Diagnostics GmbH ("Roche") and the National Aeronautics and Space Administration ("NASA") and continued performance under its Phase II SBIR contract with the U.S. Department of Defense. In addition, CombiMatrix Corporation continued its expansion of research and development activities in 2001. In 2000, our financial condition and results of operations were highlighted primarily by the continued expansion of research and development and the building of the management team at CombiMatrix Corporation. In 1999, our financial condition and results of operations were highlighted primarily by the investment in our subsidiary, Soundbreak.com, and the expansion associated with CombiMatrix Corporation's research and development. In the following discussion and analysis, the period-to-period comparisons must be viewed in light of the impact that the acquisition and disposition of securities of various business interests has had on our financial condition and results of operations.

During 2001, we began to receive significant payments from the licensing of our television V-chip technology to television manufacturers. In addition, CombiMatrix Corporation began to receive significant payments from its strategic

partners and licensees. However, to date, our subsidiary companies have relied primarily upon selling equity securities, including sales to and loans from us, to generate the funds needed to finance the implementation of their plans of operation. Our subsidiary companies may be required to obtain additional financing through bank borrowings, debt or equity financings or otherwise, which would require us to make additional investments or face a dilution of our equity interests.

We cannot assure you that we will not encounter unforeseen difficulties that may deplete our capital resources more rapidly than anticipated. Any efforts to seek additional funds could be made through equity, debt or other external financings; however, we cannot guarantee that additional funding will be available on favorable terms, if at all. If we fail to obtain additional funding when needed for us and our subsidiary companies, we may not be able to execute our business plans and our business may suffer.

-140-

ACQUISITION AND OPERATING ACTIVITIES

During 2001, we continued to significantly increase financing, acquisition and operating activities while receiving significant payments from our media technologies licensing arrangements and from our life science strategic partners and licensees. We intend to continue to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry. Additionally, we intend to continue to invest in growing our life science businesses by identifying and developing opportunities in the life science sector that will be created by commercializing the new biochip technology of CombiMatrix Corporation and other related investments in that sector. Financing activities are listed in the "Liquidity and Capital Resources" section that follows. Highlights of the acquisition and operating activities for the six months ended June 30, 2002 and the year ended December 31, 2001 include:

SECOND QUARTER 2002:

In April 2002, CombiMatrix Corporation's Japanese subsidiary entered into a technology access and purchase agreement in Japan with the Computational Biology Research Center ("CBRC"), a division of the Japanese National Institute of Advanced Industrial Science and Technology. CBRC has purchased and installed a CombiMatrix Corporation gene chip synthesizer and entered into a multi-year agreement to purchase blank chips that will be used to synthesize custom gene chips. The agreement also gives CBRC access to CombiMatrix Corporation's set of informatics tools to help in its efforts to expand biotechnology related businesses in Japan.

On April 25, 2002, CombiMatrix Corporation purchased our interest in Advanced Material Sciences, a development stage company that holds the exclusive license for CombiMatrix Corporation's biological array processor technology in certain fields of material science. CombiMatrix Corporation issued 180,982 shares of its common stock to us in exchange for our 58% interest in Advanced Material Sciences. As a result of the sale of our interest in Advanced Material Sciences, CombiMatrix Corporation currently owns 87% of Advanced Material Sciences and the remaining interests are owned by unaffiliated entities.

In May 2002, CombiMatrix Corporation's Japanese subsidiary entered into a technology access collaboration and purchasing agreement with the Genome Science Laboratory at the Research Center for Advanced Science and Technology ("RCAST") of the University of Tokyo. Under the terms of the agreement, RCAST has installed a CombiMatrix Corporation gene chip synthesizer and entered into a

multi-year agreement to purchase blank chips that will be used in the development of diagnostic microarray applications, drug lead development and target gene identification for the drug discovery industry. The agreement includes a memorandum of understanding that in the event of the discovery or development of novel and valuable content, candidates or products, the parties will establish an agreement for the commercialization of those discoveries. Such an agreement enables both CombiMatrix Corporation and RCAST to benefit from any discoveries made using this platform.

FIRST QUARTER 2002:

In February 2002, CombiMatrix Corporation was awarded a six month \$100,000 Phase I National Institutes of Health grant for the development of its protein biochip technology. The title of the grant is "Self-Assembling Protein Microchips." This grant is in addition to a two-year Phase II SBIR grant from the U.S. Department of Defense for the development of multiplexed chip based assays for chemical and biological warfare agent detection.

On March 20, 2002, we announced that our board of directors approved a plan to divide our common stock into two new classes of common stock: new "CombiMatrix" common stock, that would reflect the performance of our CombiMatrix subsidiary and all corporate assets, liabilities and related transactions of Acacia Research attributed to the CombiMatrix business, and new "Acacia Technologies" common stock, that would reflect the performance of our media technology businesses, including Soundview Technologies, Acacia Media Technologies and all corporate assets, liabilities, and related transactions of Acacia Research attributed to the media technology businesses. The plan is subject to several conditions including stockholder approval. If the recapitalization proposal were approved and the other conditions were satisfied, our stockholders would receive shares of both of the new classes of stock in exchange for existing Acacia Research Corporation shares. The new share classes are intended to be separately listed on the NASDAQ National Market System under the symbols "CBMX" and "ACTG," respectively.

-141-

We also announced that our board of directors and CombiMatrix Corporation's board of directors have approved an agreement for us to acquire the minority stockholder interests in CombiMatrix Corporation. The proposed acquisition would be accomplished through a merger in which the minority stockholders of CombiMatrix Corporation would receive shares of the new Acacia Research Corporation "CombiMatrix" common stock in exchange for their existing shares. The proposed transaction will be submitted to our stockholders and the stockholders of CombiMatrix Corporation for approval.

On May 7, 2002, we filed a registration statement with the Securities and Exchange Commission related to the proposed recapitalization and merger transactions discussed above.

FIRST QUARTER 2001:

In the first quarter of 2001, Soundview Technologies executed separate settlement and/or license agreements with Samsung Electronics, Hitachi America, Ltd., LG Electronics, Inc., Funai Electric Company, Ltd., Daewoo Electronics Corporation of America and Sanyo Manufacturing Corporation. In addition, Soundview Technologies settled its lawsuits with Pioneer Electronics (USA) Incorporated. Certain of these license agreements constitute settlements of patent infringement litigation brought by Soundview Technologies. The settlement and license agreements provide for licensing payments to Soundview Technologies,

and grant non-exclusive licenses of Soundview Technologies' U.S. Patent No. 4,554,584 (the "V-chip patent") to the respective television manufacturers. Certain of these settlement and license agreements provide for future royalty payments to Soundview Technologies. We received, and recognized as revenue, \$2.4 million in one-time license fee payments, in exchange for the grant of V-chip patent licenses, during the first quarter of 2001. In addition, we received a payment of \$1.0 million pursuant to a settlement and license agreement executed in December 2000, which is included in deferred revenues at December 31, 2001.

In February 2001, the board of directors of Soundbreak.com, a majority-owned subsidiary of Acacia Research, resolved to cease operations as of February 15, 2001 and liquidate its remaining assets and liabilities of the company. Accordingly, we reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the consolidated statements of operations and comprehensive loss as of and for the year ended December 31, 2000.

SECOND QUARTER 2001:

In June 2001, our ownership interest in Soundview Technologies increased from 67% to 100%, following Soundview Technologies' completion of a stock repurchase transaction with its former minority stockholders. Soundview Technologies repurchased the stock of its former minority stockholders in exchange for a cash payment and the grant to such stockholders of the right to receive 26% of future net revenues generated by Soundview Technologies' current patent portfolio, which includes its V-chip patent.

During the second quarter of 2001, Soundview Technologies executed separate settlement and license agreements with Thomson Multimedia, Inc. and JVC Americas Corporation. Certain of these settlement and license agreements provide for future royalty payments to Soundview Technologies. We received, and recognized as revenue, one-time license fee payments totaling \$10.0 million in exchange for the grant of V-chip patent licenses during the second quarter of 2001.

THIRD QUARTER 2001:

In the third quarter of 2001, Soundview Technologies executed separate settlement and/or license agreements with Matsushita Electric Industrial Co., Ltd. and Orion Electric Co., Ltd. We received, and recognized as revenue, one-time license fee payments totaling \$10.7 million in exchange for the grant of V-chip patent licenses during the third quarter of 2001. In addition, we received a payment of \$0.5 million pursuant to a license agreement executed in December 2000, which is included in deferred revenues at December 31, 2001.

In July 2001, CombiMatrix Corporation entered into non-exclusive worldwide license, supply, and research and development agreements with Roche. These agreements were amended and restated in September 2002. Under

-142-

the terms of the revised agreements, it is contemplated that Roche will co-develop, use, manufature, market and distribute CombiMatrix Corporation's biochips (microarrays) and related technology for rapid production of customizable biochips. Additionally, CombiMatrix Corporation and Roche will develop a platform technology, providing a range of standardized biochips for use in important research applications. Roche has made will continue to make payments for the deliverables stipulated and for expanded license and manufacturing rights.

The agreements provide for minimum payments by Roche to CombiMatrix Corporation over the first three years, including milestone achievements, payments for products, royalties and research and development projects. In the third quarter of 2001, CombiMatrix Corporation received an up-front payment under the Roche agreement, which is included in deferred revenues at December 31, 2001.

In August 2001, CombiMatrix Corporation entered into a license and supply agreement with NASA. The agreement provides for the license, purchase and use by the NASA Ames Research Center of CombiMatrix Corporation's active biochips (microarrays) and related technology to conduct biological research in terrestrial laboratories and in space.

FOURTH QUARTER 2001:

On October 22, 2001, our board of directors declared a ten percent (10%) stock dividend. The stock dividend, totaling 1,777,710 shares, was distributed on December 5, 2001 for stockholders of record as of November 21, 2001. All share and per share information presented herein is adjusted for the stock dividend.

In October 2001, CombiMatrix Corporation formed a joint venture with Marubeni Japan, one of Japan's leading trading companies. The joint venture, based in Tokyo, will focus on development and licensing opportunities for CombiMatrix Corporation's biochip technology with pharmaceutical and biotechnology companies in the Japanese market. Marubeni made an investment to acquire a ten percent (10%) minority interest in the joint venture.

In November 2001, we increased our ownership interest in Acacia Media Technologies, formerly Greenwich Information Technologies LLC, from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. In December 2001, we converted the company from a limited liability company to a corporation and changed the name of the company to Acacia Media Technologies Corporation. Acacia Media Technologies owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

In December 2001, CombiMatrix Corporation completed a major milestone in its strategic alliance with Roche. CombiMatrix Corporation demonstrated several key performance metrics of its custom in-situ microarray system. In the fourth quarter of 2001, CombiMatrix Corporation received certain milestone payments under the Roche agreement, which are included in deferred revenues at December 31, 2001.

In the fourth quarter of 2001, we received, and recognized as revenue, a one-time license fee payment totaling \$1.0 million in exchange for the grant of a V-chip patent license. In addition, CombiMatrix Corporation received payments under its license and supply agreement with NASA, which are included in deferred revenues at December 31, 2001.

As of September 30, 2001, CombiMatrix Corporation capitalized costs incurred in connection with the filing of a registration statement with the Securities and Exchange Commission in November 2000, totaling \$1.4 million. Approximately \$0.9 million of these costs were included in current assets in our December 31, 2000 consolidated balance sheet. In the fourth quarter of 2001, all of these deferred costs were charged to operations due to uncertainty regarding the future recoverability of such costs stemming from unfavorable market conditions in late 2001 and early 2002.

-143-

EFFECT OF VARIOUS ACCOUNTING METHODS ON OUR RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICIES

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

- o revenue recognition;
- o research and development expenses;
- o litigation, claims and assessments;
- o stock-based compensation;
- o accounting for income taxes; and
- o valuation of long-lived and intangible assets and goodwill.

REVENUE RECOGNITION. We derive our revenues from three primary sources: (i) fees from the licensing of our television V-chip technology to television manufacturers, (ii) revenues under multiple-element arrangements with strategic partners and licensees and (iii) government grant revenues.

As described below, significant management judgments must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if our management made different judgments.

Television V-chip License Fees: Our television V-chip technology settlement and/or license agreements provide for the payment of contractually determined license fees to us in consideration for the grant to certain television manufacturers of a non-exclusive, retroactive and future license to manufacture and/or sell products covered by the V-chip patent. While payments recognized to date have been one-time payments for the grant of V-chip patent licenses, certain of the agreements also provide for future royalties or additional required payments based on future television sales or the outcome of future litigation and settlement activities. The agreements executed with the various television manufacturers include certain release provisions with respect to Soundview Technologies' ongoing patent infringement and anti-trust enforcement efforts. Amounts received under the settlement and license agreements are recorded as license fee income in our consolidated statement of operations and comprehensive loss.

License fee income is recognized as revenue when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable and (iv) collectibility of amounts is reasonably assured. Pursuant to the terms of the agreements, we have no further obligation with respect to the sale of the non-exclusive retroactive and future license, including no express or implied obligation on our part to maintain or upgrade the technology or license, or provide future support or services. Generally, the agreements provide for the grant of the license upon receipt by Soundview Technologies of payment of the contractual license fee. As such, the earnings process is generally complete upon the receipt of payment from the television manufacturer, and revenue is recognized when all of the criteria above are met.

License fee payments received by us that do not meet the revenue recognition criteria above are recorded as deferred revenues until the criteria are met. In the event that license fee amounts due from television manufacturers have been accrued, we assess collection based on a number of factors, including past transaction history and credit-worthiness. If we determine that collection of an accrued license fee is not reasonably assured, we defer the fee and recognize revenue upon receipt of cash.

Revenues Under Multiple-Element Arrangements with Strategic Partners and Licensees: CombiMatrix Corporation entered into a non-exclusive worldwide license, supply, research and development agreement with Roche in July 2001. Under the terms of the agreement, Roche will purchase, use and resell CombiMatrix Corporation's microarray and related technologies for rapid production of customizable biochips. Additionally, CombiMatrix Corporation and Roche will develop a platform technology, providing a range of standardized biochips for use in research applications. The agreement has a 15-year term and provides for minimum payments by

-144-

Roche to CombiMatrix Corporation over the first three years, including milestone achievements, payments for products, royalties and research and development projects.

Revenues from the sale of products and services under multiple-element arrangements are recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fees are fixed and determinable and (iv) collectibility is reasonably assured.

Pursuant to Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"), an arrangement with multiple deliverables should be segmented into individual units of accounting based on the separate deliverables only if there is objective and reliable evidence of fair value to allocate the consideration to the deliverables. Accordingly, revenues from multiple-element arrangements involving license fees, up-front payments and milestone payments, which are received or billable in connection with other rights and services that represent continuing obligations of CombiMatrix Corporation, are deferred until all of the elements have been delivered or until objective and verifiable evidence of the fair value of the undelivered elements has been established.

Upon establishing verifiable evidence of the fair value of the elements in multiple-element arrangements, the fair value is allocated to each element of the arrangement, such as licensing or research and development deliverables, based on the relative fair values of the elements. We determine the fair value of each element in multiple-element arrangements based on objective and verifiable evidence of the price charged when the same element is sold separately. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue.

For the year ended December 31, 2001, CombiMatrix Corporation received payments totaling \$5.3 million from Roche, including up-front payments and milestone payments, which are classified as deferred revenues in the accompanying December 31, 2001 consolidated balance sheet because objective and reliable evidence of fair value of the various elements of the Roche Agreement

does not currently exist and all elements of the contract have not been delivered. Pursuant to SAB No. 101, the elements associated with the amounts received to date and additional payments will be treated as one accounting unit. The up-front fees and cash payments received upon the accomplishment of the contractual milestones will be deferred. Revenue will be recognized when all of the related elements, for which objective and reliable evidence does not exist, have been delivered and there is objective and reliable evidence to support the fair value for all of the undelivered elements. Under our existing agreement and timelines, CombiMatrix expects to have completed and delivered all of the remaining milestones under the license and supply agreement by the fourth quarter of 2002. When verifiable, objective evidence of fair value for the remaining undelivered elements has been obtained, deferred revenues associated with payments received to date for the completed elements will become recognizable as revenue. We intend to obtain verifiable, objective evidence of fair value for the remaining undelivered elements by reviewing the public record for similar arms-length, multiple-element agreements between unrelated third-party companies in comparable industries. The review and establishment of verifiable, objective evidence of fair value for the remaining undelivered elements is expected to be completed in the fourth quarter of 2002. Future deliverables include refinement to Roche's specifications of certain hardware elements of the microarray technology platform.

Government Grants: Revenues from government grants and contracts are recognized when the related services are performed and approved by the grantor and when collectibility is reasonably assured. Amounts recognized are limited to amounts due from customers based upon the contract or grant terms.

RESEARCH AND DEVELOPMENT EXPENSES. Our research and development expenses to date have been incurred primarily by our subsidiary, CombiMatrix Corporation. CombiMatrix Corporation is engaged in several research and development initiatives to expand its product offerings by increasing the number of test sites on their active biochips from 1,024 sites per square centimeter currently to over 10,000 sites per square centimeter and by developing additional applications of its technology for drug discovery and development.

Research and development expenses have been CombiMatrix Corporation's largest expense to date. Research and development expenses primarily relate to costs of developing its semiconductor-based, active biochip

-145-

system, including salaries and benefits, recruiting and relocation expenses related to the expansion of its research and development staff, costs associated with increased usage of laboratory materials and supplies and increased facilities costs. CombiMatrix Corporation expects to continue to incur significant expenses for research and development, for developing and expanding its manufacturing capabilities and for other efforts to commercialize its products. As a result, we expect that our research and development expenses will continue to increase in the foreseeable future.

In July 2001, CombiMatrix Corporation signed a non-exclusive license and supply agreement and a research and development agreement with Roche in the genomics and related diagnostic fields, which provide for payments to CombiMatrix Corporation upon development of proposed products incorporating its technology. In 2001, research and development expenses incurred were primarily driven by CombiMatrix Corporation's obligations under the research and development agreement with Roche. These projects include continued development of production microarray synthesis techniques, as well as higher density microarrays. These projects are expected to continue into 2002 and 2003 as

determined by the timelines outlined in ${\tt CombiMatrix}$ Corporation's agreements with Roche.

We account for research and development expenses pursuant to Statement of Financial Accounting Standards ("SFAS") No. 2, "Accounting for Research and Development Costs" ("SFAS No. 2"). SFAS No. 2 requires that all research and development costs, as defined therein, be charged to expense as incurred. Research and development expenses incurred to date consist of costs incurred for direct and overhead-related research expenses and are expensed as incurred. Costs to acquire technologies which are utilized in research and development and which have no alternative future use are expensed when incurred. Costs related to filing and pursuing patent applications are expensed as incurred, as recoverability of such expenditures is uncertain. Under SFAS No. 2, research and development refers to a plan or design for a new product or process or for a significant improvement to an existing product or process whether intended for sale or use. Significant management estimates are required with respect to the determination of which costs relate to plans or designs for a new product or process or for a significant improvement to an existing product. Had management determined that certain costs incurred were not related to research and development activities, different accounting treatment for such costs may have been required.

The costs of software developed for use in CombiMatrix Corporation's products are expensed as incurred until technological feasibility for the software has been established. Software development costs incurred to date have been classified as research and development expenses. Significant management estimates are required with respect to the determination of when technological feasibility for the software has been established. Technological feasibility is established upon completion of a detail program design or, in its absence, completion of a working model. Thereafter, all software production costs are required to be capitalized and subsequently reported at the lower of unamortized cost or net realizable value. Had management made differing judgments regarding technological feasibility, different accounting treatment of costs of software developed for use in CombiMatrix Corporation's products may have been required.

LITIGATION, CLAIMS AND ASSESSMENTS. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, our management must make estimates of whether (i) it is probable that an asset has been impaired or a liability has been incurred at the date of the consolidated financial statements and (ii) whether the amount of loss can be reasonably estimated. In the event that in management's estimation it is probable that an asset has been impaired or a liability has been incurred at the date of the consolidated financial statements and amounts of loss can be reasonably estimated, the estimated contingent loss from the loss contingency is accrued by a charge to income.

Because of the uncertainties related to both probabilities of outcome and amounts and ranges of potential loss associated with outstanding claims and pending litigation at December 31, 2001, management is unable to make a reasonable estimate of the likelihood of outcome or the liability that could result from an unfavorable outcome. As such, we have not accrued for any loss contingencies as of December 31, 2001. As additional information becomes available, we will assess the potential liability related to our pending litigation and revise our estimates. Such revisions in our estimates of the potential liability could materially impact our results of operation and financial position.

STOCK-BASED COMPENSATION. Acacia Research's stock option policies provide for the granting of stock options to employees, generally, at exercise prices equal to the fair value of the underlying stock on the date of grant. The fair values of Acacia Research stock option grants are determined by reference to the quoted market prices of our stock as listed on the NASDAQ National Market on the grant date. The fair values of stock options granted by our non-public subsidiaries are determined by the board of directors of the respective companies.

Non-cash stock compensation cost related to stock options issued to employees is accounted for in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"), and related interpretations. Compensation cost attributable to such options is recognized based on the difference, if any, between the closing market price of the stock on the date of grant and the exercise price of the option. Compensation cost is deferred and amortized on an accelerated basis over the vesting period of the individual option awards using the amortization method prescribed in Financial Accounting Standards Board ("FASB") Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN No. 28"). Non-cash compensation cost of stock options and warrants issued to non-employee service providers, which has not been significant, is accounted for under the fair value method required by SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

During the year ended December 31, 2000, CombiMatrix Corporation recorded deferred non-cash stock compensation charges aggregating approximately \$53.8 million in connection with the granting of stock options. Pursuant to Acacia Research's policy, the stock options were originally granted by CombiMatrix Corporation at exercise prices equal to the fair value of the underlying CombiMatrix Corporation common stock on the date of grant as determined by its board of directors. However, such exercise prices were subsequently determined to have been granted at exercise prices below fair value due to a substantial step-up in the fair value of CombiMatrix Corporation common stock pursuant to a valuation provided by an investment banker in contemplation of a potential CombiMatrix Corporation initial public offering in 2000. In connection with the proposed CombiMatrix Corporation initial public offering and pursuant to Securities and Exchange Commission rules and guidelines, we were required to reassess the value of stock options issued during the one-year period preceding the potential initial public offering and utilize the stepped-up fair value provided by the investment banker for purposes of determining whether such stock option issuances were compensatory, resulting in the calculation of the \$53.8 million in deferred non-cash stock compensation charges in 2000. Deferred non-cash stock compensation charges are being amortized over the respective option grant vesting periods, which range from one to four years. Non-cash stock compensation charged to income during 2001 totaled \$20.8 million and related primarily to the continued amortization of CombiMatrix Corporation's deferred stock compensation amounts during 2001. Pursuant to the vesting terms of CombiMatrix Corporation's stock options outstanding at December 31, 2001, we will incur non-cash stock compensation amortization expenses of \$8.1 million in 2002, \$3.6 million in 2003 and \$1.1 million in 2004.

During the third and fourth quarters of 2001, certain CombiMatrix Corporation unvested stock options were forfeited. Pursuant to the provisions of APB No. 25 and related interpretations, the reversal of previously recognized non-cash stock compensation expense on forfeited unvested stock options, in the

amount of \$4.7 million, has been reflected in the 2001 consolidated statement of operations and comprehensive loss as a reduction in 2001 non-cash stock compensation expense. In addition, the forfeiture of certain unvested options during 2001 resulted in a reduction of the remaining deferred non-cash stock compensation expense scheduled to be amortized in future periods.

Amounts to be amortized in future periods reflected above may be impacted by certain subsequent stock option transactions including modification of terms, cancellations, forfeitures and other activity.

ACCOUNTING FOR INCOME TAXES. As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves the estimating of our actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, amortization of intangibles and asset depreciation for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our

-147-

consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance or increase this allowance in a period, we must include an expense within the tax provision in the consolidated statement of operations and comprehensive loss.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and our valuation allowance. We have recorded a full valuation allowance against our net deferred tax assets of \$49.9 million as of December 31, 2001, due to uncertainties related to our ability to utilize our deferred tax assets, primarily consisting of certain net operating losses carried forward, before they expire. In assessing the need for a valuation allowance, we have considered our estimates of future taxable income, the period over which our deferred tax assets may be recoverable, our history of losses and our assessment of the probability of continuing losses in the foreseeable future. In management's estimate, any positive indicators, including forecasts of potential future profitability of our businesses, are outweighed by the uncertainties surrounding our estimates and judgments of potential future taxable income. In the event that actual results differ from these estimates or we adjust these estimates should we believe we would be a to realize these deferred tax assets in the future, an adjustment to the valuation allowance would increase income in the period such determination was made. Any changes in the valuation allowance could materially impact our financial position and results of operations.

VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. We assess the impairment of identifiable intangibles, long-lived assets and related goodwill and enterprise level goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors we consider important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;

- o significant negative industry or economic trends; and
- o significant decline in our stock price for a sustained period.

When we determine that the carrying value of intangibles, long-lived assets and related goodwill and enterprise level goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model. Net intangible assets, long-lived assets and goodwill amounted to \$21.4 million as of December 31, 2001.

In 2002, SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), became effective and as a result, we will cease to amortize approximately \$4.7 million of goodwill effective January 1, 2002. We recorded approximately \$1.1 million of amortization on these amounts during 2001. In lieu of amortization, we are required to perform an initial impairment review of our goodwill in 2002 and an annual impairment review thereafter. We expect to complete our initial review during the first quarter of 2002. We currently do not expect to record an impairment charge upon completion of the initial impairment review. However there can be no assurance that at the time the review is completed, a material impairment charge will not be recorded.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. SFAS No. 144 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In conjunction with such tests, it may be necessary to review depreciation estimates and methods as required by APB Opinion No. 20, "Accounting Changes," or the amortization period as required by SFAS No. 142.

-148-

ACCOUNTING FOR INVESTMENTS

The various interests that we acquire in our investees are accounted for under two broad accounting methods: (i) the consolidation method and (ii) the equity method. The applicable accounting method is generally determined based on our voting interest in an investee.

Consolidation. Investees in which we directly or indirectly own more than 50% of the outstanding voting securities are generally accounted for under the consolidation method of accounting. Under this method, the investee's accounts are reflected within our consolidated statements of operations and comprehensive loss. Participation of other stockholders in the earnings or losses of a consolidated investee is reflected in the caption "minority interests" in our consolidated net results of operations to reflect only our share of the earnings or losses of consolidated, non-wholly-owned investees. In the case in which losses applicable to the minority interests in an investee exceed the minority interests in the equity capital of the investee, such excess and any further losses applicable to the minority interests are charged against the majority interest. However, if future earnings materialize, the majority interest will be credited to the extent of such losses previously absorbed.

Equity Method. Investees, over whom we exercise significant influence, whose results we do not consolidate, are generally accounted for under the

equity method of accounting. Whether or not we exercise significant influence with respect to an investee depends on an evaluation of several factors including, among others, representation on the investee's board of directors and ownership level, which is generally 20% to 50% interest in the voting securities of the investee, including voting rights associated with our holdings in common, preferred and other convertible instruments in the investee. Under the equity method of accounting, an investee's accounts are not reflected within our consolidated statements of operations and comprehensive loss; however, our share of the earnings or losses of the investee is reflected in the caption "equity income (losses) of affiliates" in the consolidated statements of operations and comprehensive loss.

At December 31, 2001, we have consolidated all of our investees over whom we exercise significant control. On November 1, 2001, we increased our ownership interest in Acacia Media Technologies from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. The results of operations have been included in the consolidated statements of operations and comprehensive loss from November 1, 2001.

In most cases, we have representation on the boards of directors of our investees. In addition to our investments in voting equity securities, we also periodically make advances to our subsidiaries in the form of promissory notes.

-149-

RESULTS OF OPERATIONS (IN THOUSANDS)

| | FOR THE YEARS ENDED DECEMBER 31, | | | |
|---|----------------------------------|------------|-----------|--|
| | 2001 | 2000 | 1999 | |
| Revenues | \$ 24,636 | \$ 57 | \$ 266 | |
| Research and development expenses | (18,839) | (11,864) | (1,806) | |
| Marketing, general and administrative expenses | (46,300) | (22,089) | (4,418) | |
| Amortization of patents and goodwill | (2,695) | (2,251) | (1,622) | |
| Loss on disposal of consolidated subsidiaries | | (1,016) | | |
| Other income (expense), net | 4,166 | (1,235) | (1,042) | |
| Minority interests | 17,540 | 9,166 | 1,221 | |
| Loss from discontinued operations of Soundbreak.com | | (7,443) | (776) | |
| Loss from disposal of Soundbreak.com | | (2,111) | | |
| (Provision) benefit for income taxes | (780) | 73 | (20) | |
| Cumulative effect of change in accounting principle | | (246) | | |
| | | | | |
| Net loss | \$(22,272) | \$(38,959) | \$(8,197) | |
| | | | | |

| THREE MON | ITHS ENDED | SIX MONI | THS ENDED | |
|------------------|------------------|------------------|------------------|--|
| | | | | |
| JUNE 30, 2002 | JUNE 30, 2001 | JUNE 30, 2002 | JUNE 30, 2001 | |
| | | | | |
| (UNAUDITED) | | (UNAUDITED) | | |

| Net revenues | \$ 438 | \$10 , 091 | \$ 687 | \$ 12,714 |
|--|--------------------|-------------------|---------------------|------------|
| Cost of sales | (253) | | (253) | |
| Research and development expenses | (5,026) | (2,651) | (7,694) | (5,802) |
| Non-cash stock compensation expense - research and | | | | |
| development | (692) | (2,013) | (1,113) | (4,411) |
| Marketing, general and administrative expenses | (5,516) | (9,550) | (9,587) | (15,771) |
| Non-cash stock compensation expense - marketing, | | | | |
| general and administrative | (1,451) | (5,176) | (2,453) | (11,197) |
| Amortization of patents and goodwill | (564) | (638) | (1,128) | (1,271) |
| Other (expense) income, net | (816) | 1,031 | (1,269) | 2,175 |
| Benefit (provision) for income taxes | 75 | (228) | 144 | (241) |
| Minority interests | 4,104 | 4,362 | 6,539 | 9,553 |
| | | | | |
| Net loss | \$(9 , 701) | \$(4,772) | \$(16 , 127) | \$(14,251) |
| | | | | |

COMPARISON OF THE THREE AND SIX MONTHS ENDED JUNE 30, 2002 TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2001

LICENSE FEE INCOME. During the three months ended June 30, 2002, license fee income was \$0 as compared to \$10.0 million in license fee income during the three months ended June 30, 2001. During the six months ended June 30, 2002, license fee income was \$0 as compared to \$12.4 million in license fee income during the six months ended June 30, 2001. The license fee income for the three and six months ended June 30, 2001 includes license fees received from television manufacturers with whom we executed separate settlement and/or license agreements during the first and second quarter of 2001 and December 2000. Pursuant to the terms of the respective settlement and/or license agreements with each of the television manufacturers, Soundview Technologies granted to such manufacturers, non-exclusive licenses for its patented V-chip technology. Soundview Technologies did not record any license fee income during the first and second quarters of 2002. The Acacia Media Technologies Group continues to pursue both licensing and strategic business alliances with other television manufacturers and leading companies in the media technologies industry.

Acacia Media Technologies Group's patent on the V-chip technology expires in July 2003. The Acacia Media Technologies Group may continue to collect license fees on televisions sold in the United States during the patent term, subsequent to the July 2003 patent expiration date. The Acacia Media Technologies Group is beginning to market its digital media transmission technology and is looking to acquire other technologies. The eventual licensing and sale of these technologies is intended to replace the revenue generated by licensing the V-chip

-150-

technology. If we do not succeed in acquiring such technologies or are unable to commercially license our existing and future technologies, our financial condition may be adversely impacted.

PRODUCT REVENUE AND COST OF SALES. During the three and six months ended June 30, 2002, product revenue was \$274,000 as compared to \$0 in product revenue during the three and six months ended June 30, 2001. During the three and six months ended June 30, 2002, cost of sales was \$253,000 as compared to \$0 in cost of sales during the three and six months ended June 30, 2001. Product revenue and cost of sales relates to the sale of a gene chip synthesizer and a gene-chip

reader to a Japanese government institution by CombiMatrix's Japanese subsidiary.

GRANT REVENUE. During the three months ended June 30, 2002, grant revenue was \$164,000 as compared to \$91,000 in grant revenue during the three months ended June 30, 2001. During the six months ended June 30, 2002, grant revenue was \$413,000 as compared to \$274,000 in grant revenue during the six months ended June 30, 2001. Grant revenue during the six months ended June 30, 2002 includes \$182,000 (\$91,000 in the first and second quarters of 2002) in grant revenue from CombiMatrix Corporation's continuing performance under its Phase II Small Business Innovative Research Department of Defense ("SBIR") contract, \$141,000 (recognized in the first quarter of 2002) in one-time contract research and development revenues and \$90,000 (\$17,000 and \$73,000 in the first and second quarter of 2002, respectively) in revenue related to performance under its Phase I National Institutes of Health grant. Grant revenue for the three and six months ended June 30, 2001 related to CombiMatrix's continued performance under its Phase II SBIR contract.

CombiMatrix Corporation was awarded the two-year \$0.7 million Phase II SBIR contract in January 2000, which expires in July 2002. We expect to recognize a final grant revenue amount of \$91,000 in the third quarter of 2002 related to the Phase II SBIR contract. In February 2002, CombiMatrix Corporation was awarded a six -month \$100,000 Phase I National Institutes of Health grant for the development of its protein biochip technology, of which \$90,000 has been recognized as revenue in the first two quarters of 2002, and we expect to recognize the remaining portion of the grant in the third quarter of 2002.

RESEARCH AND DEVELOPMENT EXPENSES. During the three months ended June 30, 2002, research and development expense was 5.0 million, as compared to 2.7 million in the three months ended June 30, 2001. During the six months ended June 30, 2002, research and development expense was \$7.7 million, as compared to \$5.8 million in the six months ended June 30, 2001. Research and development expenses for both periods relate to CombiMatrix. The increase in research and development expense for 2002 as compared to the same period in 2001 was primarily due to an increase in activities related to CombiMatrix's continuing performance under the product commercialization phase of its license, supply, research and development agreements with Roche Diagnostics GmbH ("Roche"), including increases in labor, supplies and materials, development of prototype microarrays and instruments, and the use of outside consultants for certain engineering and manufacturing efforts.

CombiMatrix Corporation's research and development activities during the third and fourth quarters of 2001 and the first two quarters of 2002 were focused on efforts to further develop and enhance its microarray technologies as well as to commercialize these technologies. The majority of these efforts were driven by CombiMatrix Corporation's obligations under its license, supply, research and development agreements with Roche, which were executed in July 2001. These projects include development of production microarray synthesis techniques, higher density microarrays and the overall commercialization efforts of the technologies that Roche is licensing from CombiMatrix Corporation.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. We incurred marketing, general and administrative expenses of \$5.5 million (\$2.5 million related to CombiMatrix) during the three months ended June 30, 2002, as compared to \$9.6 million (\$3.3 million related to CombiMatrix) in the three months ended June 30, 2001. Marketing, general and administrative expenses were \$9.6 million (\$4.5 million related to CombiMatrix) during the six months ended June 30, 2002, as compared to \$15.8 million (\$6.4 million related to CombiMatrix) in the six months ended June 30, 2001.

The decrease in marketing, general and administrative expenses for 2002 as compared to the same period in 2001 was due to: a decrease in salaries and

benefits costs related to a decrease in headcount at Acacia corporate resulting from the closure and/or write-off of several of our early stage investments at the end of 2000; a decrease in CombiMatrix Corporation's sales and marketing head count and related expenses, recruitment and relocation

-151-

expenses, administrative head count and legal costs; and a decrease in legal fees incurred related to Soundview Technologies' patent licensing and related infringement settlements. Legal fees related to the license fee agreements executed with television manufacturers are generally incurred on a contingency basis, based on license fee payments received. Marketing, general and administrative expenses for the six months ended June 30, 2002 include \$692,000 in professional fees incurred in connection with the preparation and filing of our registration statement on Form S-4 related to the proposed recapitalization transaction discussed elsewhere herein.

NON-CASH STOCK COMPENSATION EXPENSE.

Research and Development. During the three and six months ended June 30, 2002, research and development related non-cash stock compensation charges, all of which relate to CombiMatrix Corporation, were \$0.7 million and \$1.1 million, respectively, as compared to \$2.0 million and \$4.4 million, respectively, during the comparable periods in 2001.

Marketing, General and Administrative Expenses. During the three and six months ended June 30, 2002, marketing, general and administrative non-cash stock compensation charges were \$1.5 million (\$1.4 million related to CombiMatrix Corporation) and \$2.5 million (\$2.4 million related to CombiMatrix Corporation), respectively, as compared to \$5.2 million (approximately \$5.2 million related to CombiMatrix Corporation) and \$11.2 million (\$10.4 million related to CombiMatrix Corporation), respectively, in the comparable period in 2001.

The decrease in non-cash stock compensation charges related to research and development and marketing, general and administrative expenses is primarily due to the forfeiture and cancellation of certain options in the third and fourth quarters of 2001 and a reduction in scheduled stock compensation amortization related to the accelerated method of amortization utilized by us pursuant to FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN No. 28"), which results in higher amounts of amortization in the early vesting periods, and lower amounts of amortization in subsequent vesting periods. CombiMatrix non-cash stock compensation amortization expense for the six months ended June 30, 2002 are net of \$748,000 in stock compensation expense reversal related to the forfeiture of certain unvested stock options in the first and second quarters of 2002.

AMORTIZATION OF PATENTS AND GOODWILL. During the three months ended June 30, 2002 and 2001, amortization expense relating to patents and goodwill was \$0.6 million. During the six months ended June 30, 2002, amortization expense was \$1.1 million as compared to \$1.3 million in amortization expense during the six months ended June 30, 2001. Amortization expense relating to patents and goodwill for the three and six months ended June 30, 2002 excludes \$0.2 million and \$0.5 million, respectively, of amortization expense pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), which requires goodwill to be tested for impairment under certain circumstances and written off when determined to be impaired, rather than being amortized as previous standards required. The reduction in goodwill amortization in the three and six months ended June 30, 2002 was offset by an increase in patent amortization

related to the increase in our ownership interest in Acacia Media Technologies Corporation (formerly Greenwich Information Technologies, a limited liability company) from 33% to 100% through the purchase of the ownership interest of Acacia Media Technologies Corporation's other member in November 2001.

As a result of the purchase, we will be recording additional patent amortization of \$0.2 million on a quarterly basis over the related patents' economic useful lives (approximately 10 years) related to the intangibles identified in connection with the application of the purchase method of accounting.

OTHER (EXPENSE) INCOME, NET. During the three months ended June 30, 2002, other expense, net (primarily comprised of interest income, realized and unrealized gains and losses on trading securities, equity in losses of affiliate and other) was \$0.8 million as compared to \$1.0 million in net other income in 2001. During the six months ended June 30, 2002, other expense, net (primarily comprised of interest income, realized and unrealized gains and losses on trading securities, equity in losses of affiliate and other) was \$1.3 million as compared to \$2.2 million in net other income in 2001.

-152-

INTEREST INCOME. During the three months ended June 30, 2002, interest income was \$0.3 million as compared to \$1.0 million in the three months ended June 30, 2001. During the six months ended June 30, 2002, interest income was \$0.7 million as compared to \$2.2 million in the six months ended June 30, 2001. The decrease in interest income during 2002 was primarily due to the impact of a decrease in interest rates on our short-term investments related to sharp interest rate cuts by the Federal Open Market Committee and other external economic factors negatively impacting rates of return on short-term investments occurring during the third and fourth quarters of 2001.

REALIZED LOSSES ON SHORT-TERM INVESTMENTS. During the three months ended June 30, 2002, net realized losses on short-term investments was \$0.9 million as compared to no realized losses on short-term investments in the three months ended June 30, 2001. During the six months ended June 30, 2002, net realized losses on short-term investments was \$1.5 million as compared to no realized losses on short-term investments in the six months ended June 30, 2001. The increase in realized losses on short-term investments during 2002 was due to realized losses recorded on certain trading securities during the three and six months ended June 30, 2002. We did not hold any trading securities during the three or six months ended June 30, 2001.

UNREALIZED LOSSES ON SHORT-TERM INVESTMENTS. During the three months ended June 30, 2002, net unrealized losses were \$0.2 million as compared to no unrealized losses in the same period in 2001. During the six months ended June 30, 2002, net unrealized loses were \$0.5 million as compared to no unrealized losses in the same period in 2001. The increase is due to the results of certain trading securities held during the respective periods. We did not hold any trading securities during the three or six months ended June 30, 2001.

EQUITY IN LOSSES OF AFFILIATE. During the three months ended June 30, 2002, equity in losses of affiliate was \$0 as compared to \$55,000 in the three months ended June 30, 2001. During the six months ended June 30, 2002, equity in losses of affiliate was \$0 as compared to \$110,000 in the six months ended June 30, 2001. Equity in losses of affiliate during the three and six months ended June 30, 2001 was comprised of losses recorded for our equity investment in Acacia Media Technologies Corporation. As of December 31, 2001, we no longer account for any of our investments under the equity method as we directly own

more that 50% of the outstanding voting securities of our subsidiaries and, as a result, account for our investments under the consolidation method of accounting.

MINORITY INTERESTS. Minority interests in the losses of consolidated subsidiaries was \$4.1 million during the three months ended June 30, 2002 as compared to \$4.4 million in the same period in 2001. Minority interests in the losses of consolidated subsidiaries was \$6.5 million during the six months ended June 30, 2002 as compared to \$9.6 million in the same period in 2001. Minority interests in the losses of consolidated subsidiaries for the three and six months ended June 30, 2002 were primarily comprised of minority interests in the net losses of CombiMatrix totaling \$4.0 million and \$6.3 million, respectively. Minority interests in the losses of consolidated subsidiaries for the three and six months ended June 30, 2001 were comprised primarily of minority interests in the net losses of CombiMatrix totaling \$5.3 million and \$10.8 million, respectively. Minority interests in the losses of consolidated subsidiaries for the three and six months ended June 30, 2001 were partially offset by minority interests in the net income of Soundview Technologies totaling \$1.0 million and \$1.3 million, respectively. The decrease in minority interests in the losses of consolidated subsidiaries is primarily due to a reduction in CombiMatrix's net losses for the three and six months ended June 30, 2002 as compared to the same periods in 2001.

2001 COMPARED TO 2000

LICENSE FEE INCOME. In 2001, license fee income was \$24.2 million as compared to no license fee income during 2000. The increase in license fee income for 2001 resulted primarily from the settlement of patent infringement litigation brought by Soundview Technologies and includes license fee amounts received from eleven of the twelve television manufacturers with whom we have executed separate settlement and/or license agreements during 2001 and 2000. Pursuant to the terms of the respective settlement and license agreements with each of the television manufacturers, Soundview Technologies granted to such manufacturers, non-exclusive licenses for its U.S. Patent No. 4,554,584.

-153-

GRANT REVENUE. In 2001, grant revenue was \$0.5 million as compared to \$0.02 million in grant revenue in 2000. The increase in grant revenue during 2001 resulted from CombiMatrix Corporation's continuing performance under its Phase II Small Business Innovative Research Department of Defense contract.

RESEARCH AND DEVELOPMENT EXPENSES. In 2001, research and development expense was \$18.8 million, all of which related to CombiMatrix Corporation, as compared to \$11.9 million in 2000, of which \$9.3 million related to CombiMatrix Corporation. The increase in research and development expense for 2001 as compared to the same period in 2000 was primarily due to a general expansion of CombiMatrix Corporation's research and development activities, including an increase in personnel and amounts of supplies and materials used, an increase in CombiMatrix Corporation's non-cash stock compensation charges included in research and development expense, increased costs related to efforts to further develop and enhance its microarray technology and increased costs related to significant engineering efforts undertaken to commercialize its technology. Most of these efforts were driven by CombiMatrix Corporation's obligations under the license and supply agreement with Roche, executed in July 2001. These projects include development of production microarray synthesis techniques, as well as higher density microarrays. Given the contractual requirements under our existing R&D agreements coupled with our efforts to enhance current technologies as well as to develop new technologies, we expect that future R&D cash spending

will increase from current spending levels.

In 2001, research and development expense included non-cash stock compensation charges, all of which related to CombiMatrix Corporation, totaling \$7.2 million. Non-cash stock compensation charges for 2001 are net of \$0.8 million of non-cash stock compensation expense reversal related to the forfeiture of certain unvested stock options during the third and fourth quarters of 2001. In 2000, research and development expense for non-cash stock compensation.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. We incurred marketing, general and administrative expenses of \$46.3 million (\$27.7 million related to CombiMatrix Corporation) in 2001, compared to \$22.1 million (\$11.2 million related to CombiMatrix Corporation) in 2000. The increase in marketing, general and administrative expenses for 2001 as compared to the same period in 2000 was primarily due to an increase in non-cash stock compensation charges, the continued expansion of CombiMatrix Corporation's operations including an increase in salaries and benefits due to an increase in the number of CombiMatrix Corporation personnel, an increase in personnel recruitment and relocation expenses, an increase in rent and utilities expenses relating to CombiMatrix Corporation's move to larger office facilities during the first quarter of 2001, the write-off of \$1.4 million of deferred initial public offering costs in the fourth quarter of 2001 by CombiMatrix Corporation and an increase in legal fees related to Soundview Technologies' patent licensing and related infringement settlements.

Marketing, general and administrative expenses included \$13.6 million (\$12.8 million related to CombiMatrix Corporation) and \$7.3 million (\$6.5 million related to CombiMatrix Corporation) of non-cash stock compensation charges for 2001 and 2000, respectively. Marketing, general and administrative non-cash stock compensation charges for 2001 are net of \$3.9 million of non-cash stock compensation expense reversal related to the forfeiture of certain unvested stock options during the third and fourth quarters of 2001.

AMORTIZATION OF PATENTS AND GOODWILL. In 2001, amortization expense relating to patents and goodwill was \$2.7 million as compared to \$2.3 million in 2000. As a result of the increase in our ownership interest in Acacia Media Technologies from 33% to 100% through the purchase of the ownership interest of Acacia Media Technologies' other member in November 2001, and the purchase of additional equity interests in CombiMatrix Corporation in July 2000, we incurred additional amortization expense in 2001 as compared to 2000 relating to the intangible assets acquired. See "Recent Accounting Pronouncements" for summary of pronouncements affecting amortization of goodwill in future periods.

LOSS ON DISPOSAL OF CONSOLIDATED SUBSIDIARIES. In 2001, loss on disposal of consolidated subsidiaries was zero as compared to 1.0 million in 2000. In the fourth quarter of 2000, we recorded 1.0 million in write-offs of early stage investments.

OTHER INCOME (EXPENSE), NET. In 2001, other income, net (primarily comprised of interest income, realized and unrealized gains and losses on trading securities, equity in losses of affiliates and other) was \$4.2 million as compared to \$1.2 million in net other expense in 2000.

-154-

INTEREST INCOME. In 2001, interest income was \$3.8 million as compared to \$3.1 million in 2000. The increase in interest income during 2001 was due to higher cash balances during 2001 as compared to 2000, resulting from various

private equity financings and the receipt of significant license fee payments by Soundview Technologies during the year. The increase in interest income for 2001 was partially offset by the impact of a decrease in interest rates on our short-term investments related to sharp interest rate cuts by the Federal Open Market Committee and other external economic factors negatively impacting rates of return on short-term investments occurring during the third and fourth quarters of 2001.

REALIZED GAINS ON SHORT-TERM INVESTMENTS. In 2001, net realized gains on short-term investments was \$0.4 million as compared to no realized gains on short-term investments in 2000. The increase in realized gains on short-term investments during 2001 was due to realized gains recorded on our short-term investments classified as trading securities during 2001.

UNREALIZED GAINS ON SHORT-TERM INVESTMENTS. In 2001, net unrealized gains were \$0.2 million as compared to no unrealized gains in 2000. The increase is due to our investment in equity securities during 2001 classified as trading securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Pursuant to SFAS No. 115, unrealized gains and losses on trading securities are recorded in the consolidated statement of operations. In 2000, all of our short-term investments were classified as available-for-sale, and pursuant to SFAS No. 115, unrealized gains and losses were recorded as a separate component of comprehensive income (loss) in stockholders' equity until realized.

EQUITY IN LOSSES OF AFFILIATES. In 2001, equity in losses of affiliates was \$0.2 million as compared to \$1.7 million in 2000. Losses during 2001 were comprised of a loss of \$0.2 million for our investment in Acacia Media Technologies, as determined by the equity method of accounting through November 1, 2001. We increased our ownership percentage in Acacia Media Technologies to 100% on November 1, 2001. Losses during 2000 were comprised of a loss of \$0.3 million for our investment in Signature-mail.com, a loss of \$0.2 million for our investment in Acacia Media Technologies, a loss of \$0.1 million for our investment in Whitewing Labs and a loss of \$1.1 for our investment in Mediaconnex, as determined by the equity method of accounting. We wrote-off our equity investments in Signature-mail.com, Whitewing Labs and Mediaconnex, as of December 31, 2000.

MINORITY INTERESTS. Minority interests in the losses of consolidated subsidiaries increased to \$17.5 million in 2001 as compared to \$9.2 million in 2000. The increase in minority interests in 2001 was primarily due to the increase in losses incurred by CombiMatrix Corporation as a result of increased non-cash stock compensation amortization charges, its continued expansion of research and development efforts and increased marketing, general and administrative expenses. The increase in 2001 minority interests resulting from CombiMatrix Corporation's increased losses was partially offset by minority interests in the income of Soundview Technologies from January through June 2001. We increased our ownership percentage in Soundview Technologies to 100% in June 2001.

(PROVISION) BENEFIT FOR INCOME TAXES. In 2001, the provision for income taxes was \$0.8 million as compared to a benefit of \$0.07 million in 2000. The increase in the provision for income taxes in 2001 was primarily due to a significant increase in taxable income generated by Soundview Technologies related to its patent infringement settlement and patent licensing activities as compared to the 2000 period.

DISCONTINUED OPERATIONS. On February 13, 2001, the board of directors of Soundbreak.com resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the company. Accordingly, we reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in our 2000 consolidated

statements of operations and comprehensive loss. Discontinued operations of Soundbreak.com included \$7.4 million of loss from discontinued operations in 2000 and \$2.1 million of accrued expenses in connection with its cessation of operations.

2000 COMPARED TO 1999

NET REVENUE. In 2000, net revenue was \$0.06 million as compared to \$0.3 million in 1999. The decrease in net revenues was primarily due to an increase of \$0.04 million in advertising revenues, offset by a decrease of \$0.1 million in CombiMatrix Corporation revenue from federal grants, and a decrease of \$0.1 million in capital management fees due to the closure in 1999 of Acacia Research Capital Management division, which was the

-155-

general partner in two domestic private investment partnerships and an investment advisor to two offshore private investment corporations. During 2000, grant revenue was \$0.02 million as compared to \$0.1 million in grant revenue during 1999. The grant revenue resulted from CombiMatrix Corporation's award of two grants in July 1999 for Phase I SBIR from the Department of Energy and the Department of Defense and a Phase II SBIR Department of Defense contract for the use of its biochip technology to develop nanode array sensor microchips in January 2000. No capital management fee income, which includes performance fee income, was earned during 2000 compared to \$0.1 million during 1999 due to the closure of the Acacia Research Capital Management division on December 31, 1999. Costs associated with exiting this business were not material.

RESEARCH AND DEVELOPMENT EXPENSES. We incurred research and development expenses of \$11.9 million in 2000 as compared to \$1.8 million in 1999. Research and development expenses for 2000 are comprised of costs primarily incurred by CombiMatrix Corporation, which increased to \$9.3 million from \$2.4 million in 1999. This increase was due to an increase in the number of CombiMatrix Corporation personnel and larger laboratory facilities to accommodate the expansion of its research and development efforts focused on developing and improving microarray synthesis techniques. In addition, \$2.5 million of acquired in-process research and development expense was charged to income related to our acquisition of an additional ownership position from existing CombiMatrix Corporation stockholders in July 2000.

In 2000, research and development expenses for non-cash stock compensation (including warrants), all of which related to CombiMatrix Corporation, totaled \$3.4 million. In 1999, research and development expenses for non-cash stock compensation were not material.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. We incurred marketing, general and administrative expenses of \$22.1 million in 2000, compared to expenses of \$4.4 million in 1999. The increase in marketing, general and administrative expenses in 2000 was primarily due to general expansion of our operations, including an increase in business development expenses as we explored new business opportunities, the extensive use of consultants to assist in solving specialized issues or providing specific services, an increase in facilities costs due to the expansion of our office facilities and increased personnel and payroll expenses. In 2000, CombiMatrix Corporation relocated from Burlingame, California to Mukilteo, Washington. This relocation was completed during the third quarter, and related costs of \$0.8 million were incurred in 2000 in connection with the relocation.

Marketing, general and administration expenses included \$7.3 million (\$6.5

million related to CombiMatrix Corporation) and \$0.2 million of non-cash stock compensation charges for 2000 and 1999, respectively.

AMORTIZATION OF PATENTS AND GOODWILL. In 2000, amortization expenses relating to patents and goodwill were \$2.3 million as compared to \$1.6 million in 1999. As a result of our purchase of additional equity interests in Soundview Technologies in July 1997 and January 1998, in MerkWerks in January 1998 and June 1999 and in CombiMatrix Corporation in July 2000, we are incurring increased amortization expenses each quarter for periods ranging from three to five years relating to the intangible assets acquired.

LOSS ON DISPOSAL OF CONSOLIDATED SUBSIDIARIES. In 2000, loss on disposal of consolidated subsidiaries was \$1.0 million as compared to zero in 1999. In the fourth quarter of 2000, we recorded \$1.0 million in write-offs of early stage investments.

OTHER EXPENSE, NET. In 2000, other expense, net (primarily comprised of interest income, write-off of equity investments, equity in losses of affiliates and other) totaled \$1.2 million as compared to other expense, net of \$1.0 million in 1999. The increase in other expense, net in 2000 was primarily due to \$2.6 million of write-offs of equity investments in Signature-mail.com, Whitewing Labs and Mediaconnex, and an increase in equity in losses of affiliates, partially offset by an increase in interest income in 2000.

INTEREST INCOME. In 2000, interest income was \$3.1 million as compared \$0.3 million in 1999. The increase was due to higher cash balances in 2000 as compared to 1999. We received \$64.5 million in cash from outside investors in connection with our warrant call and private equity financings for Acacia Research and CombiMatrix Corporation in 2000.

-156-

INTEREST EXPENSE. In 2000, we reported no interest expense as compared to \$0.3 million in 1999. The expense incurred in 1999 was primarily attributable to CombiMatrix Corporation and relates to three-year 6% unsecured subordinated promissory notes issued by CombiMatrix Corporation in a private offering completed in March 1998. Warrants to purchase CombiMatrix Corporation common stock were also issued in this private placement. During the fourth quarter of 1999, CombiMatrix Corporation offered holders of the unsecured subordinated notes the opportunity to convert their outstanding principal balance into CombiMatrix Corporation common stock and all noteholders had converted as of December 1999.

EQUITY IN LOSSES OF AFFILIATES. In 2000, equity in losses of affiliates was \$1.7 million as compared to \$1.1 million in 1999. In 2000, losses were primarily attributable to a loss of \$1.1 million for our investment in Mediaconnex. This amount was offset by a decrease in the recognized losses for Whitewing Labs, Acacia Media Technologies and Signature-mail.com totaling \$0.6 million in 2000 as compared to \$1.1 million in 1999.

MINORITY INTERESTS. In 2000, minority interests in the losses of consolidated subsidiaries was \$9.2 million as compared to \$1.2 million in 1999. The increase in minority interests in 2000 was primarily due to the increase in losses incurred by CombiMatrix Corporation as a result of its continued expansion of research and development efforts, an increase in non-cash stock compensation charges and increased marketing, general and administrative expenses.

DISCONTINUED OPERATIONS. On February 13, 2001, the board of directors of

Soundbreak.com resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the company. Accordingly, we reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the consolidated statements of operations and comprehensive loss in 2000. Discontinued operations of Soundbreak.com included \$7.4 million of loss from discontinued operations in 2000 and \$2.1 million of accrued expenses to be incurred in connection with its cessation of operations. Operating results in 1999 were restated to present Soundbreak.com as discontinued operations resulting in a loss from discontinued operations of \$0.8 million in 1999.

INFLATION

Inflation has not had a significant impact on Acacia Research.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2002, we had cash and short-term investments of \$66.4 million on a consolidated basis, including discontinued operations, of which Acacia Research, on a stand-alone basis excluding its subsidiaries, had \$37.2 million. At December 31, 2001, we had cash and short-term investments of \$84.6 million on a consolidated basis, including discontinued operations, of which Acacia Research, on a stand-alone basis excluding its subsidiaries, had \$44.2 million. Consolidated working capital was \$53.6 million and \$72.4 million at June 30, 2002 and December 31, 2001, respectively. Highlights of the financing and commitment activities for the six months ended June 30, 2002 and the year ended December 31, 2001 include the following:

FIRST AND SECOND QUARTER 2002

o In February 2002, in conjunction with the relocation of our corporate headquarters, we entered into a non-cancelable lease agreement to lease approximately 7,143 square feet of office space in Newport Beach, California through February 2007. Minimum annual rental commitments under this operating lease are \$255,000 in 2002; \$286,000 in 2003; \$295,000 in 2004; \$303,000 in 2005; \$312,000 in 2006; and \$39,000 in 2007.

YEAR ENDED DECEMBER 31, 2001

 In January 2001, we completed an institutional private equity financing raising gross proceeds of \$19.0 million through the issuance of 1,107,274 units. Each unit consists of one share of our common stock and one three-year callable common stock purchase warrant. Each common stock purchase warrant

-157-

entitles the holder to purchase 1.10 shares of our common stock at a price of \$19.09 per share and is callable by us once the closing bid price of our common stock averages \$23.86 or above for 20 or more consecutive trading days on the NASDAQ National Market. We issued an additional 20,000 units in lieu of cash payments for finders' fees in conjunction with the private placement.

 In May 2001, Advanced Material Sciences completed a private equity financing raising gross proceeds of \$2.0 million through the issuance of 2,000,000 shares of common stock. Advanced Material Sciences issued an additional 29,750 shares of common stock, in lieu of cash payments,

and warrants to purchase approximately 54,000 shares of common stock, for finders' fees in connection with the private placement. Each common stock purchase warrant entitles the holder to purchase shares of Advanced Material Sciences common stock at a price of \$1.10 per share.

- o In September 2001, CombiMatrix Corporation entered into a sale and leaseback arrangement with a bank, providing up to \$7.0 million in financing for equipment and other capital purchases. Pursuant to the terms of the agreement, certain equipment and leasehold improvements, totaling \$2.6 million in net book value, were sold to the bank at a purchase price of \$3.0 million resulting in a deferred gain on the sale of assets of \$0.4 million. In addition, CombiMatrix Corporation entered into a capital lease arrangement to lease the fixed assets from the bank. The capital lease agreement provides CombiMatrix Corporation with the option to purchase the equipment for a nominal amount at the end of the lease term, which expires in September 2004.
- o In October 2001, CombiMatrix Corporation formed a joint venture with Marubeni Japan, one of Japan's leading trading companies. The joint venture, based in Tokyo, will focus on development and licensing opportunities for CombiMatrix Corporation's biochip technology with pharmaceutical and biotechnology companies in the Japanese market. Marubeni made an investment of \$1.0 million to acquire a ten percent minority interest in the joint venture.

Net cash used in continuing operating activities was \$13.2 million for the six months ended June 30, 2002. Net cash used in continuing operations was primarily due to a loss from continuing operations of \$15.1 million, net sales of trading securities totaling \$3.1 million and net cash outflows related to working capital totaling \$1.2 million. At June 30, 2002, we had an additional \$0.4 million of net cash used in operating activities of discontinued operations.

Net cash used in continuing operating activities was \$10.4 million in 2001. Cash used for continuing operations is primarily due to a loss from continuing operations of \$22.3 million, increased by minority interests of \$17.5 million and the purchase of trading securities of \$4.1 million, partially offset by non-cash expenses including depreciation, amortization and compensation expense relating to stock options and warrants in the amount of \$24.7 million, and license fee, up-front and milestone payments received and recorded as deferred revenues at December 31, 2001 totaling \$7.5 million. In 2001, we had an additional \$2.2 million of net cash used in operating activities of discontinued operations.

Net cash provided by investing activities was \$4.2 million during the six months ended June 30, 2002 primarily related to the sale of certain short-term securities to fund CombiMatrix Corporation's continuing operations. Net cash provided by investing activities of continuing operations was \$13.0 million in 2001. Significant investing activities include a net sale of short-term investments classified as available-for-sale of \$19.6 million, net of purchases of common stock from minority stockholders of subsidiaries totaling \$2.6 million and purchases of additional equity in consolidated subsidiaries totaling \$3.3 million. We had an additional \$0.2 million used in investing activities of discontinued operations.

We did not conduct any significant financing activities during the six months ended June 30, 2002. Our net cash provided by financing activities was \$23.2 million in 2001. Cash provided by financing activities in 2001 was primarily due to \$18.3 million of net proceeds from an institutional private equity financing in January 2001, capital contributions from minority stockholders of subsidiaries totaling \$3.3 million and proceeds from the

exercise of stock options and warrants totaling \$1.8 million.

-158-

Warrants issued by us in connection with our private placement completed in January 2001 contain call and redemption provisions should the closing bid price of our common stock exceed \$23.86 per share for 20 or more consecutive trading days. The exercise price per share for the common stock underlying the warrants is \$19.09. In the event the requirements to call the warrants are satisfied, we may call such warrants and we expect most, if not all, of the holders to exercise such warrants in response. There can be no assurance that the closing bid price of our common stock will exceed all such thresholds or that, if it does, we will decide to call the warrants.

We have sustained losses since our inception contributing to an accumulated deficit of \$116.1 million at June 30, 2002 on a consolidated basis, which includes operating losses of \$21.5 million, \$43.2 million and \$37.2 million for the six months ended June 30, 2002 and the years ended December 31, 2001 and 2000, respectively. The consolidated accumulated deficit of \$116.1 million also includes an increase related to a reclassification of accumulated deficit in the amount of \$21.7 million to permanent capital representing the fair value of the ten percent stock dividend distributed to stockholders in 2001. There can be no assurance that we will become profitable. If we do, we may never be able to sustain profitability. We expect to incur significant losses for the foreseeable future. We are making efforts to reduce expenses and may take steps to raise additional capital.

Generally, our subsidiary companies have relied primarily upon selling equity securities, including sales to and loans from us, to generate the funds needed to finance implementation of their plans of operations. In 2001, we began to receive significant payments from our media technology licensing arrangements and from our life sciences strategic partners and licensees. However, we may be required to obtain additional financing through bank borrowings, debt or equity financings or otherwise, which would require us to make additional investments or face a dilution of our equity interests.

We have no significant commitments for capital expenditures in 2001. Our minimum rental commitments on operating leases related to continuing operations total \$13.4 million through February 2007. We have no committed lines of credit or other significant committed funding. However, we anticipate that existing working capital reserves will provide sufficient funds for our operating expenses for at least the next twelve months in the absence of making any major new investments. We intend to seek additional financing to fund new or existing businesses.

There can be no assurances that we will not encounter unforeseen difficulties that may deplete our capital resources more rapidly than anticipated. Any efforts to seek additional funding could be made through equity, debt or other external financing and there can be no assurance that additional funding will be available on favorable terms, if at all. Such financing transactions may be dilutive to existing investors. If we fail to obtain additional funding when needed, we may not be able to execute our business plans and our business may suffer.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 16 to the Acacia Research Corporation financial statements included elsewhere herein.

CHANGE IN ACCOUNTING POLICY

Effective January 1, 2001, we changed our accounting policy for balance sheet classification of employee stock-based compensation resulting from awards in consolidated subsidiaries. Historically, the consolidated financial statements have accounted for cumulative earned employee stock-based compensation related to subsidiaries as a liability, under the caption "accrued stock compensation." Management believes a change to reflect these cumulative charges as minority interests is preferable as it better reflects the underlying economics of the stock-based compensation transaction. As a result of the change, effective January 1, 2001, minority interests has been increased by \$10.4 million, and accrued stock compensation of \$10.4 million has been decreased. The change in accounting policy does not affect previously reported consolidated net income.

-159-

COMBIMATRIX GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS (A DEVELOPMENT STAGE DIVISION OF ACACIA RESEARCH CORPORATION)

You should read this discussion in conjunction with the CombiMatrix group, a development stage division of Acacia Research, financial statements and related notes and the Acacia Research consolidated financial statements and related notes, both included elsewhere herein. Historical results and percentage relationships are not necessarily indicative of operating results for any future periods.

GENERAL

The CombiMatrix group is intended to reflect the performance of CombiMatrix Corporation and Advanced Material Sciences, entities that are in the development stage, and include all corporate assets, liabilities and transactions related to Acacia Research's life sciences businesses. The CombiMatrix group core technology opportunity in the life sciences sector has been primarily developed through CombiMatrix Corporation, which was formed in October 1995. CombiMatrix Corporation is a life science technology company with a proprietary system for rapid, cost competitive creation of DNA and other compounds on a programmable semiconductor chip. This proprietary technology has significant applications relating to genomic and proteomic research. Advanced Material Sciences, which was formed in November 2000, holds the exclusive license for CombiMatrix Corporation's biological array processor technology in certain fields of material sciences. Advanced Material Sciences has no operating history, and is a majority owned subsidiary of Acacia Research.

CombiMatrix stock is intended to reflect the separate performance of the respective division of Acacia Research, rather than the performance of Acacia Research as a whole. The CombiMatrix group is not a separate legal entity. Holders of AR-CombiMatrix stock will be stockholders of Acacia Research. As a result, they will continue to be subject to all of the risks of an investment in Acacia Research and all of its businesses, assets and liabilities. The assets Acacia Research attribute to the CombiMatrix group could be subject to the liabilities of the Acacia Technologies group.

The CombiMatrix group is developing technology that integrates a semiconductor, proprietary materials, proprietary software, chemistry, and the Internet into a system for use by pharmaceutical and biotechnology companies and academic researchers in identifying and determining the roles of genes, gene mutations and proteins. CombiMatrix Corporation's active biochip is a semiconductor coated with a three-dimensional layer of porous material in which

DNA, RNA, peptides or small molecules can be synthesized or immobilized in discrete test sites. Since inception, CombiMatrix Corporation's operating activities have been devoted primarily to research and development of technologies for its active biochip system, including the development of its system, acquiring assets, recruiting personnel, business development and raising capital.

During the first six months of 2002, the CombiMatrix group's financial condition and results of operations were highlighted by the receipt of a \$100,000 Phase I National Institutes of Health grant for the development of its protein biochip technology. In addition, the CombiMatrix group received and recorded as revenue \$413,000 in grant and project revenues, including \$182,000 in grant revenue resulting from continuing performance under its Phase II Small Business Innovative Research Department of Defense contract, \$141,000 in one-time contract research and development revenues and \$90,000 in revenues related to performance under its Phase I National Institutes of Health grant. The CombiMatrix group also recognized \$274,000 from the sale of a genomics microarray synthesizer system to a government institution in Japan.

In 2001, the CombiMatrix group's financial condition and cash flows were highlighted by the receipt of \$6.4 million pursuant to separate license, supply and research and development agreements with Roche Diagnostics GmbH ("Roche") and the National Aeronautics and Space Administration ("NASA") and continued performance under CombiMatrix Corporation's Phase II SBIR grant with the U.S. Department of Defense. Both the Roche and NASA agreements were executed during the third quarter of 2001. During the second quarter of 2001, CombiMatrix Corporation created a wholly-owned subsidiary, CombiMatrix K.K. ("CombiMatrix KK"), which became a majority-owned subsidiary during the fourth quarter of 2001 after selling 10% of its common stock for \$1.0 million as part of a joint venture agreement with Marubeni Japan, one of Japan's leading trading companies. In addition, in the third quarter of 2001 CombiMatrix Corporation raised \$3.0 million through the execution of a sale and leaseback transaction with a major financial institution. CombiMatrix Corporation also continued the expansion

-160-

of its research and development activities throughout 2001, including the relocation to its new research facilities and corporate headquarters in January 2001 located in Mukilteo, Washington. In addition, in May 2001, Advanced Material Services completed a private equity financing raising gross proceeds of \$2.0 million through the issuance of 2,000,000 shares of common stock.

In 2000, the CombiMatrix group's financial condition and cash flows were highlighted primarily by the continued expansion of research and development activities, financing activities and the building of its core management and scientific teams, as well as its relocation from California to a temporary research facilities and corporate headquarters in Snoqualmie, Washington. In July 2000, CombiMatrix Corporation was granted U.S. Patent No. 6,093,302, which expires in July 2017, for its biochip microarray processor system. In November 2000, Advanced Material Science was formed, raising initial equity financing of \$3.0 million. In 1999, the CombiMatrix group's financial condition and cash flows were highlighted primarily by research and development and financing activities. In the following discussion and analyses, the period-to-period comparisons must be viewed in light of the impact that the operating and financing activities have had on the CombiMatrix group's financial condition and results of operations.

Since inception, the CombiMatrix group has recognized revenues primarily from activities anciallary to its core technologies, and has incurred

significant net losses. During the six months ended June 30, 2002 and the years ended December 31, 2001, 2000 and 1999, the CombiMatrix group incurred net losses of approximately \$9.5 million, \$28.0 million, \$14.8 million and \$1.6 million, respectively. At June 30, 2002 and December 31, 2001, the CombiMatrix group's accumulated deficit was approximately \$57.2 million and \$47.8 million, respectively. The losses have resulted principally from costs incurred in research and development and from marketing, general and administrative costs associated with the CombiMatrix group's operations. Operating expenses including non-cash stock-based compensation expense increased to \$49.5 million for the year ended December 31, 2001, from \$24.6 million for 2000 and \$2.8 million for 1999. The CombiMatrix group expects to continue to incur net losses and negative cash flow from operations for the foreseeable future due to significant increases in research and development and marketing, general and administrative expenses that will be necessary to further develop CombiMatrix group's technologies towards commercialization. To date, the CombiMatrix group has relied primarily upon selling equity securities to generate the funds needed to finance the implementation of the CombiMatrix group's business strategies. The CombiMatrix group cannot assure that it will not encounter unforeseen difficulties that may deplete capital resources more rapidly than anticipated. Any efforts to seek additional funds could be made through equity, debt or other external financings; however, the CombiMatrix group cannot assure that additional funding will be available on favorable terms, if at all. If the CombiMatrix group fails to obtain additional funding when needed, the CombiMatrix group may not be able to execute its business strategies and its business may suffer.

On September 30, 2002, CombiMatrix Corporation and Dr. Donald Montgomery, an officer and stockholder of CombiMatrix Corporation, entered into a settlement agreement with Nanogen, Inc. to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, CombiMatrix Corporation agreed to pay Nanogen \$500,000 within 30 days of the settlement and an additional \$500,000 within one year of the settlement. CombiMatrix Corporation also agreed to make quarterly payments to Nanogen equal to 12.5% of total sales of products developed by CombiMatrix Corporation and its affiliates and based on the patents that had been in dispute in the litigation, up to an annual maximum of \$1,500,000. The minimum quarterly payments under the settlement agreement will be \$37,500 per quarter for the period from October 1, 2003 through October 1, 2004, and \$25,000 per quarter thereafter until the patents expire. Also pursuant to the settlement agreement, CombiMatrix Corporation agreed to issue 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, to Nanogen, subject to antidilution provisions under specified circumstances, including the exercise of outstanding options and warrants and issuances of additional capital stock of CombiMatrix Corporation, for a period of up to three years.

STRATEGIC PARTNERSHIPS AND FINANCIAL HIGHLIGHTS

During 2001, CombiMatrix Corporation received significant payments from its strategic partners and licensees. By continuing the CombiMatrix Corporation's efforts with these partners and by identifying new strategic relationships, the CombiMatrix group intends to maximize the opportunities in the life sciences sector that will be created by commercializing its biochip system. Financing and investing activities are listed in the "Liquidity and Capital Resources" section that follows. Highlights of activities with the CombiMatrix group's strategic partners

-161-

and other operating activities for the six months ended June 30, 2002 and the

year ended December 31, 2001 include:

o ROCHE

In July 2001, CombiMatrix Corporation entered into non-exclusive worldwide license, supply, research and development agreements with Roche, pursuant to which CombiMatrix Corporation and Roche will develop a platform technology, providing a range of standardized biochips for use in important research applications. These agreements were amended and restated September 2002. Under the agreements, Roche has made and will continue to make payments for the deliverables stipulated and for expanded license and manufacturing rights. Under the terms of the revised agreements, it is contemplated that Roche will co-develop, use, manufacture, market and distribute CombiMatrix Corporation's active biochip system for rapid production of both catalog and customizable biochips. CombiMatrix Corporation's goal is to develop a platform technology, providing a range of standardized biochips for use in important research applications. Roche has made and will continue to make payments for the deliverables contemplated and for expanded license rights. The agreements provide for minimum payments by Roche to CombiMatrix Corporation over the first three years, including milestone achievement payments, payments for products, royalties and payments for research and development projects. All payments received under this agreement to date have been recorded as deferred revenue at December 31, 2001. In December 2001, CombiMatrix Corporation completed a major milestone in its strategic alliance with Roche, by demonstrating several key performance metrics of its custom in-situ microarray system. In February and May 2002, CombiMatrix Corporation completed two additional milestones by delivering certain prototype components of its microarray platform and by demonstrating certain performance characteristics of the platform to Roche.

o NASA

In August 2001, CombiMatrix Corporation entered into a two-year license and supply agreement with NASA. The agreement provides for the license, purchase and use by the NASA Ames Research Center of CombiMatrix Corporation's active biochip system to conduct biological research in both terrestrial and extraterrestrial laboratories. All payments received under this agreement have been recorded as deferred revenue at December 31, 2001. As of December 31, 2001, CombiMatrix Corporation has received non-refundable cash payments from NASA for their purchase of a microarray synthesizer system as well as a license to use the technology for a 2-year period. The existing agreement also provides for the sale of microarrays to NASA in future periods. The NASA agreement contains customary contract provisions regarding termination, including termination by either party in the event of a breach of contract terms.

O CONTRACT RESEARCH AND DEVELOPMENT WITH THE U.S. GOVERNMENT

In February 2002, CombiMatrix Corporation was awarded a Phase I National Institutes of Health grant for the development of its protein biochip technology. The title of the grant is "Self-Assembling Protein Microchips." This grant is in addition to a two-year Phase II SBIR grant from the U.S. Department of Defense for the development of multiplexed chip based assays for chemical and biological warfare agent detection.

During the first six months of 2002 and all of 2001, CombiMatrix Corporation has recognized \$638,000 of grant revenues from its SBIR Phase II grant with the U.S. Department of Defense ("DOD"). CombiMatrix Corporation's business relationship with the DOD began in July 1999 when CombiMatrix Corporation was awarded an SBIR Phase I grant to use its active biochip technology in connection with the development of detection devices

for chemical and biological warfare agents. This grant was completed and \$60,000 of revenues were recognized during 1999. CombiMatrix Corporation was also awarded a \$100,000 Department of Energy ("DOE") grant in July 1999, which was completed in March 2000. CombiMatrix Corporation recognized \$84,000 in the fourth quarter of 1999 and \$17,000 in the first quarter of 2000 under this grant. In July 2000, CombiMatrix Corporation was awarded a two-year \$730,000 SBIR

-162-

Phase II grant to continue its research for the DOD. The CombiMatrix group expects to recognize the final \$91,000 in government grant revenue related to the SBIR Phase II grant during the third quarter of 2002.

O JOINT VENTURE

In May 2001, CombiMatrix Corporation formed CombiMatrix KK, a Japanese corporation located in Tokyo. In October 2001, the KK entered into a joint venture agreement with Marubeni Japan, the purpose of which is to focus on development and licensing opportunities for CombiMatrix Corporation's active biochip system with pharmaceutical and biotechnology companies in the Asian market. Marubeni Japan made a \$1.0 million investment to acquire a 10% minority interest in the joint venture. During the second quarter of 2002, the KK executed technology access and purchase agreements with two government institutions in Japan, which included the sale of its first genomic microarray synthesizer system for \$274,000 to one of these institutions.

EFFECT OF VARIOUS ACCOUNTING METHODS ON RESULTS OF OPERATIONS

The CombiMatrix group believes the following critical accounting policies affect the group's more significant judgments and estimates used in the preparation of the CombiMatrix group financial statements:

- o basis of presentation;
- policies relating to AR-Acacia Technologies stock and AR-CombiMatrix stock;
- o revenue recognition;
- o research and development expenses;
- o litigation, claims and assessments;
- o stock-based compensation;
- o accounting for income taxes; and
- o valuation of long-lived and intangible assets and goodwill.

BASIS OF PRESENTATION. The CombiMatrix group financial statements have been prepared in accordance with generally accepted accounting principles and, taken together with the Acacia Technologies' group financial statements, comprise all the accounts included in the corresponding consolidated financial statements of Acacia Research. The financial statements of each group reflect the financial condition, results of operations and cash flows of the businesses included therein. The financial statements of the CombiMatrix group include the accounts or assets of Acacia Research specifically attributed to the CombiMatrix group

and give effect to the accounting policies that will be applicable upon implementation of the recapitalization proposal. The CombiMatrix group financial statements have been prepared on a basis that management believes to be reasonable and appropriate and reflect the financial position, results of operations and cash flows of businesses that comprise the CombiMatrix group and all other corporate assets, liabilities and related transactions of Acacia Research attributed to the CombiMatrix group, including allocated portions of Acacia Research's general and administrative costs. Intergroup transactions between the CombiMatrix group and the Acacia Technologies group have not been eliminated in the separate group's financial statements.

The preparation of the divisional financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. If the recapitalization proposal is implemented, significant management estimates and judgments will be required related to the implementation of the management and allocation policies applicable to the preparation of the divisional financial statements of the CombiMatrix group. Individual group results may be significantly impacted based on management's estimates and judgments.

POLICIES RELATING TO AR-ACACIA TECHNOLOGIES STOCK AND AR-COMBIMATRIX STOCK. The management and allocation policies applicable to the preparation of the divisional financial statements of the CombiMatrix group and the Acacia Technologies group (collectively, "the groups") may be modified or rescinded, or additional policies may be adopted, at the sole discretion of the Board at any time without approval of the stockholders. The CombiMatrix

-163-

group's divisional financial statements reflect the application of the management and allocation policies adopted by the Board to various corporate activities, as described below. The CombiMatrix group's divisional financial statements should be read in conjunction with Acacia Research's consolidated financial statements and related notes.

TREASURY AND CASH MANAGEMENT POLICIES

Acacia Research will manage most treasury and cash management activities on a de-centralized basis, with each separate group separately managing its own treasury activities. Pursuant to treasury and cash management policies adopted by the Board, after the date on which AR-CombiMatrix stock and AR-Acacia Technologies stock is first issued, the following will apply:

- Acacia Research will attribute each future issuance of AR-Acacia Technologies stock (and the proceeds thereof) to the Acacia Technologies group and will attribute each future issuance of AR-CombiMatrix stock (and the proceeds thereof) to the CombiMatrix group;
- o Acacia Research will attribute each future incurrence or issuance of external debt or preferred stock (and the proceeds thereof) between the Acacia Technologies group and the CombiMatrix group or entirely to one group as determined by the Board, based on the extent to which Acacia Research incurs or issues the debt or preferred stock for the benefit of the CombiMatrix group and the Acacia Technologies group;

- Dividends on AR-Acacia Technologies stock will be charged against the Acacia Technologies group, and dividends on AR-CombiMatrix stock will be charged against the CombiMatrix group;
- Repurchases of AR-Acacia Technologies stock will be charged against the Acacia Technologies group and repurchases of AR-CombiMatrix stock will be charged against the CombiMatrix group;
- As of immediately prior to the first issuance of AR-CombiMatrix stock and AR-Acacia Technologies stock, the CombiMatrix group and the Acacia Technologies group shall be deemed to be allocated the cash and cash equivalents held by the respective groups as of that date;
- Acacia Research will account for any cash transfers from Acacia 0 Research to or for the account of a group, from a group to or for the account of Acacia Research, or from one group to or for the account of the other group (other than transfers in return for assets or services rendered) as short-term loans unless (A) the Board determines that a given transfer (or type of transfer) should be accounted for as a long-term loan, (B) the Board determines that a given transfer (or type of transfer) should be accounted for as a capital contribution, or (C) the Board determines that a given transfer (or type of transfer) should be accounted for as a return of capital. There are no specific criteria to determine when Acacia Research will account for a cash transfer as a long-term loan, a capital contribution or a return of capital rather than an inter-group revolving credit advance; provided, however, that cash advances from Acacia Research to the Acacia Technologies group or to the CombiMatrix group up to \$25 million on a cumulative basis shall be accounted for as short-term or long-term loans at interest rates at which Acacia Research could borrow such funds and shall not be accounted for as a capital contribution. The Board will make such a determination in the exercise of its business judgment at the time of such transfer based upon all relevant circumstances. Factors the Board may consider include, without limitation: the current and projected capital structure of each group; the financing needs and objectives of the recipient group; the availability, cost and time associated with alternative financing sources; and prevailing interest rates and general economic conditions; and
- Any cash transfers accounted for as short-term loans will bear interest at the rate at which Acacia Research could borrow such funds. In addition, any cash transfers accounted for as a long-term loan will have interest rates, amortization, maturity, redemption and other terms that reflect the then-prevailing terms on which Acacia Research could borrow such funds.

-164-

CORPORATE GENERAL AND ADMINISTRATIVE SERVICES AND FACILITIES

Acacia Research will allocate the cost of corporate general and administrative services and facilities between the groups generally based upon utilization. Where determinations based on utilization alone are impracticable, Acacia Research will use other methods and criteria that management believes to be equitable and to provide a reasonable estimate of the cost attributable to each group. Except as otherwise determined by management, the allocated costs of providing such services and facilities will include, without limitation, all costs and expenses of personnel employed in connection with such services and

facilities, including, without limitation, all direct costs of such personnel, such as payroll, payroll taxes and fringe benefit costs (calculated at the appropriate annual composite rate therefor) and all overhead costs and expenses directly related to such personnel and the services or facilities provided by them. In addition, allocated costs will include all materials used in connection with such services or facilities, billed at their net cost to the provider of the services or facilities plus all overhead costs and expenses related to such materials.

Except as may otherwise be specifically provided pursuant to the terms of any agreements among Acacia Research and the groups or any resolutions of the Board, the corporate general and administrative services and facilities to be allocated between the groups will include, without limitation, legal services, accounting services (tax and financial), insurance and deductibles payable in connection therewith, employee benefit plans and administration thereof, investor relations, stockholder services, and services relating to the board of directors.

ALLOCATION OF FEDERAL AND STATE INCOME TAXES

Acacia Research will determine its federal income taxes and the federal income taxes of its subsidiaries that own assets allocated between the groups on a consolidated basis. Acacia Research will allocate consolidated federal income tax provisions and related tax payments or refunds between the groups based principally on the taxable income and tax credits directly attributable to each group. Such allocations will reflect each groups' contribution, whether positive or negative, to Acacia Research, consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits. Inter-group transactions will be treated as taxed on a separate return basis.

Depending on the tax laws of the respective jurisdictions, state and local income taxes are calculated on either a consolidated or combined basis between the groups based on their respective contribution to such consolidated or combined state taxable incomes. State and local income tax provisions and related tax payments or refunds which are determined on a separate corporation basis will be allocated between the groups in a manner designed to reflect the respective contributions of the groups to Acacia Research, separate or local taxable income.

REVENUE RECOGNITION. The CombiMatrix group derives revenues and deferred revenues primarily from two sources: (i) government grant revenues and (ii) multiple-element arrangements with strategic partners and licensees. As described below, significant management judgments must be made and used in connection with the revenue recognized or deferred in any accounting period. Material differences may result in the amount and timing of revenues recognized for any period if the CombiMatrix group makes different judgments.

Government Grants: Revenues from government grants and contracts are recognized as the related services are performed, when the services have been accepted by the grantor and collectibility is reasonably assured. Amounts recognized are limited to amounts due from the grantor based upon the contract or grant terms.

Revenues Under Multiple-Element Arrangements with Strategic Partners and Licensees: Pursuant to Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"), an arrangement with multiple elements or deliverables should be segmented into individual units of accounting based on the separate deliverables only if there is objective and reliable evidence of fair value to allocate the consideration received to the deliverables.

Accordingly, revenues from multiple-element arrangements involving license fees, up-front payments and milestone payments, which are received or billable in connection with other rights and services that represent continuing obligations of the CombiMatrix group, are deferred until all of the multiple elements have been delivered or until objective and verifiable evidence of the fair value of the undelivered elements has been established. Upon establishing verifiable evidence of the fair value of the elements in multiple-element arrangements, the fair value is

-165-

allocated to each element of the arrangement, such as license fees or research and development projects, based on the relative fair values of the elements. The CombiMatrix group determines the fair value of each element in multiple-element arrangements based on objective and reliable evidence of fair value, which is determined for each element based on the price charged when the same element is sold separately to a third party. If evidence of fair value of all undelivered elements exists but evidence does not exist for one or more delivered elements, then revenue is recognized using the residual method. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized as revenue.

For the period ended June 30, 2002 and for the year ended December 31, 2001, the CombiMatrix group received cash consideration from Roche for achieving certain milestones, which have been classified as deferred revenue in the CombiMatrix group's June 30, 2002 and December 31, 2001 consolidated balance sheets due to the determination that the payments received related to elements for which objective and reliable evidence of fair value does not currently exist. Pursuant to SAB No. 101, the elements associated with the amounts received to date and additional milestone payments will be treated as one accounting unit. The up-front fees and cash payments received upon the accomplishment of the contractual milestones will be deferred. Revenue will be recognized when all of the related elements, for which objective and reliable evidence does not exist, have been delivered and there is objective and reliable evidence to support the fair value for all of the undelivered elements.

In general, revenues from the sale of products and/or services either are recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fees are fixed and determinable and (iv) collectibility is reasonably assured.

RESEARCH AND DEVELOPMENT EXPENSES. The CombiMatrix group has been and continues to be engaged in a number of research and development initiatives to improve and expand the active biochip system, including increasing the number of test sites on active biochips from currently 1,024 sites per square centimeter to over 10,000 sites per square centimeter and by developing additional applications of CombiMatrix group's technology for drug discovery.

Except for the amortization of non-cash deferred stock compensation discussed below, research and development expenses have been the CombiMatrix group's largest expense category to date and consist of costs to develop a semiconductor-based, active biochip system. These costs include salaries, benefits, recruiting and relocation expenses attributed to CombiMatrix group's research and development personnel, costs incurred in the development of prototype products, contract engineering and development with third parties, the consumption of laboratory materials and supplies and facilities costs. The CombiMatrix group expects to continue to incur significant expenses for research and development in order to commercialize an active biochip system. As a result, the CombiMatrix group expects that the group's research and development expenses

will continue to increase in the near term.

In addition to the amended license agreement with Roche, CombiMatrix Corporation also entered into a 5-year research and development agreement with Roche, which is subdivided into separate projects. As a result, a portion of the research and development expenses incurred during 2001 were driven by obligations under these projects, which include continued development of production microarray synthesis techniques, as well as higher density microarrays. Research and development expenses required to complete these projects are expected to continue into 2002 and 2003, pursuant to the timelines outlined in the related agreements.

The CombiMatrix group accounts for research and development expenses pursuant to SFAS No. 2, "Accounting for Research and Development Costs" ("SFAS No. 2"). SFAS No. 2 requires that all research and development costs be charged to expense as incurred. These would include the costs described above as well as costs incurred to acquire technologies, which are utilized in research and development and which have no alternative future use. Also, costs related to filing and pursuing patent applications are expensed as incurred, as recoverability of such expenditures is uncertain. Under SFAS No. 2, research and development refers to a plan or design for a new product or process or for a significant improvement to an existing product or process whether intended for sale or use. Significant management estimates are required with respect to the determination of which costs relate to plans or designs for a new product or process or for a significant improvement to an existing product. Had the CombiMatrix group determined that certain costs incurred were not related to research and development activities, different accounting treatment for such costs may have been required.

-166-

The costs of software developed or obtained for internal use is expensed as incurred until certain capitalization criteria have been met, at which time such costs are capitalized and reported as a component of property and equipment. To date, these costs have been classified as research and development expenses. Significant management estimates are required with respect to the determination of when certain capitalization criteria have been met. Typically this occurs upon completion of a prototype and design phase and a functioning model exists. Thereafter, all software program costs are required to be capitalized and amortized over the remaining estimated useful life of the software. Had management made differing judgments regarding the capitalization criteria, different accounting treatment of costs of software developed for internal use may have been required.

In connection with the proposed purchase of the remaining minority interests in CombiMatrix Corporation, Acacia Research expects approximately \$10.3 million of the purchase price to be allocated to in-process research and development ("IPR&D"). Acacia Research management assumes responsibility for determining the IPR&D valuation. The valuation is currently in process and is expected to be completed prior to the mailing of proxy materials to Acacia Research stockholders. The income approach to value is the method currently being used by management to determine the fair market value of CombiMatrix Corporation. Amounts included herein are based on preliminary determinations of fair value.

The fair value assigned to purchased IPR&D was estimated by discounting to present value the cash flows expected to result from each project once it has reached technological feasibility. A discount rate consistent with the risks of each project was used to estimate the present value of future cash flows. In

estimating future cash flows, management considered the contribution of its core technology (for which a United States patent was obtained in July 2000) that would be required for successful exploitation of purchased in-process technology, in order to value the core and in-process technologies discretely. As a result, future cash flows relating to each purchased IPR&D project were reduced in order to reflect the contribution of core technology to each IPR&D project. The cash flows from these projects attributable to core technology were then separately valued to determine the intangible asset value of purchased core technology. In determining the contribution of core technology to in-process projects, management of CombiMatrix Corporation analyzed their historical research and development efforts applicable to obtaining their patent from the United States government vs. their efforts to commercially develop the technology in various IPR&D projects. The ratio of core technology research and development spending to IPR&D spending at the time of the merger was applied to each IPR&D project cash flows to determine cash flows relating to core technology.

The nature of the efforts to develop the purchased IPR&D into commercially viable products principally relates to the completion and/or acceleration of existing development programs. These efforts include testing current and alternative materials used in microarray design, testing of existing and alternative methods for microarray synthesis, developing prototype machinery (including operating software) to synthesize, hybridize and read individual microarrays, and to perform numerous experiments, or assays, with actual target samples in order to determine customer protocols and procedures for using the CombiMatrix group's microarray system. The costs of these efforts have been included in the CombiMatrix group's projections to successfully launch the purchased IPR&D projects. The resulting net cash flows from such projects are based on Acacia Research management's estimates of revenues, cost of sales, research and development expenses, sales and marketing expenses, general and administrative expenses, the anticipated effect of income taxes, and required returns on working capital, fixed assets and other assets necessary to support the generation of these cash flows.

The discounting of net cash flows relating to core technology back to their present value is based on CombiMatrix Corporation's weighted average cost of capital ("WACC"). The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on various required rates of return from investments in various areas of that enterprise. The WACC for CombiMatrix Corporation was approximately 20% at the time of the merger and is the rate used in discounting the net cash flows attributable to purchased core technology. Higher discount rates were used to value the purchased IPR&D projects, however, due to the additional inherent risks associated with these projects, including if and when the technologies will ultimately become commercially viable, market acceptance, and threats from competing technologies. The discount rates used for each project are described below.

The forecast data employed in the valuation analyses was based upon product level forecast information obtained by Acacia Research from numerous internal and external resources. These resources included publicly

-167-

available databases, external market research consultants, company-sponsored focus CombiMatrix Corporation data and internal market experts. Acacia Research senior management reviewed and challenged the forecast data and related assumptions and utilized the information in analyzing IPR&D. The forecast data and assumptions are inherently uncertain and unpredictable. However, based upon the information available at this time, Acacia Research management believes the

forecast data and assumptions to be reasonable. These assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstances will not occur. Accordingly, actual results may vary from the forecasted results. Any such variance may result in a material adverse effect on Acacia Research's financial condition and results of operations.

In the allocation of purchase price to the IPR&D, the concept of alternative future use was specifically considered for each of the programs under development. The acquired IPR&D consists of CombiMatrix Corporation's work to complete each of the identified programs. The programs are very specific to research market for which they are intended. There are no alternative uses for the in-process programs in the event that the programs fail in their continued development or are otherwise not feasible. The development effort for the acquired IPR&D does not possess an alternative future use for Acacia Research as defined by generally accepted accounting principles.

Below is a brief description of each IPR&D project including an estimation of when management believes Acacia Research may realize revenues from the sale of these products.

Genomics Biological Array System: As described elsewhere in this document, CombiMatrix Corporation's genomics biological array processor system is being developed to discretely immobilize sequences of DNA or RNA within individual test sites on a modified semiconductor chip coated with a three-dimensional layer of porous material. The system also includes proprietary hardware units and related software applications to be able to synthesize materials onto the chips, apply target samples of genetic materials and interpret the results. The purpose of this system will be in gene expression profiling and SNP genotyping, which could lead to the better understanding of gene function and ultimately therapeutic discovery to fight disease. CombiMatrix Corporation's projected cash flow models from commercializing this system include servicing CombiMatrix Corporation's existing relationship with Roche as well as other strategic partners, pharmaceutical, biotech and academic institutions. Although current research and development efforts in commercializing this system have been positive, there can be no assurance that the system will be successfully launched and broadly accepted by the pharmaceutical, biotech and academic research fields.

Proteomics Biological Array System: CombiMatrix Corporation's proteomics biological array processor system is being developed to discretely immobilize proteins and other small molecules within individual test sites on a modified semiconductor chip in a similar fashion as described above for the genomics biological array system. However, the chemistry used in synthesizing proteins, the porous reaction layer coating used in synthesis and the software used to design probes for protein synthesis are significantly different from what is currently being developed for the genomics application, largely due to the inherent biological differences between DNA molecules and protein molecules and how they react with CombiMatrix Corporation's proprietary synthesis processes. The proteomics biological array system will be used in determining protein expression, variation and function within living cells, which could lead to the better understanding of protein function and ultimately therapeutic discovery to fight disease. Although current research and development efforts in commercializing this system have been positive, there can be no assurance that the system will be successfully launched and broadly accepted by the pharmaceutical, biotech and academic research fields.

LITIGATION, CLAIMS AND ASSESSMENTS. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, management

must make estimates of whether (i) it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and (ii) whether the amount of loss can be reasonably estimated. In the event that, in management's estimation it is probable that an asset has been impaired or a liability has been incurred at the date of the combined financial statements and amounts of loss can be reasonably estimated, the estimated contingent loss is accrued by a charge to income.

-168-

Because of the uncertainties related to both probabilities of outcome and amounts and ranges of potential loss associated with outstanding claims and pending litigation at December 31, 2001, management is unable to make a reasonable estimate of the likelihood of outcome or the liability that could result from an unfavorable outcome. As such, the CombiMatrix group has not accrued for any loss contingencies as of December 31, 2001. As additional information becomes available, the CombiMatrix group will assess the potential liability related to CombiMatrix group's pending litigation and revise management's estimates. Such revisions in estimates of the potential liability could materially impact our results of operation and financial position.

STOCK-BASED COMPENSATION. Stock option policies provide for the granting of stock options to employees at exercise prices equal to the fair value of the underlying stock on the date of grant, the fair values of which are determined by the board of directors.

Non-cash stock compensation cost related to stock options issued to employees is accounted for in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB No. 25") and related interpretations. Compensation cost attributable to such options is recognized based on the difference, if any, between the closing market price of the stock on the date of grant and the exercise price of the option. Compensation cost is deferred and amortized on an accelerated basis over the vesting period of the individual option awards using the amortization method prescribed in FASB Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN No. 28"). Non-cash compensation cost of stock options and warrants issued to non-employee service providers, which has not been significant, is accounted for under the fair value method required by SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

During the year ended December 31, 2000, the CombiMatrix group recorded deferred non-cash stock compensation charges aggregating approximately \$53.8 million in connection with the granting of stock options during 2000. Pursuant to policy, these stock options were originally granted at exercise prices equal to the fair value of CombiMatrix Corporation's underlying stock on the date of grant as determined by the board of directors. However, such exercise prices were subsequently determined to be granted at exercise prices below fair value due to a substantial step-up in the fair value of stock pursuant to a valuation provided by an investment banker in contemplation of CombiMatrix Corporation's potential initial public offering in 2000. In connection with the proposed initial public offering and pursuant to SEC rules and guidelines, the CombiMatrix group was required to reassess the value of stock options issued during the one-year period preceding the potential initial public offering and utilize the stepped-up fair value provided by the investment banker for purposes of determining whether such stock option issuances were compensatory, which resulted in the CombiMatrix group recognizing \$53.8 million in deferred non-cash stock compensation charges in 2000 and \$729,000 in 2001. These non-cash deferred

stock compensation charges are being amortized using the amortization method prescribed in FIN No. 28 over their respective option vesting periods, which range from one to four years. Non-cash stock compensation charges during the first six months of 2002 and for the year ended December 31, 2001 totaled \$3.5 million and \$20.0 million, respectively. These charges related primarily to the continued amortization of our deferred stock compensation. Pursuant to the vesting terms of the outstanding options, the CombiMatrix group will incur non-cash stock compensation amortization expenses of approximately \$3.2 million for the remaining six months of 2002, \$3.3 million in 2003 and \$1.1 million in 2004.

During the third and fourth quarters of 2001, certain unvested stock options were forfeited. Pursuant to the provisions of APB Opinion No. 25 and related interpretations, the reversal of previously recognized non-cash stock compensation expense on forfeited unvested stock options had the effect of reducing overall stock compensation expense by approximately \$4.7 million during 2001. In addition, the forfeiture of certain unvested options during 2001 resulted in a \$13.2 million reduction of remaining deferred non-cash stock compensation expense scheduled to be amortized in future periods.

In connection with the proposed acquisition of the remaining minority interest of CombiMatrix Corporation, the exchange of CombiMatrix Corporation Common Stock options for AR-CombiMatrix options will result in a new measurement date for those awards. Accordingly, deferred stock-based compensation expense of approximately \$3.1 million will arise and will be amortized in conformity with FIN 28.

-169-

Amounts to be amortized in future periods reflected above may be impacted by certain subsequent stock option transactions including modification of terms, cancellations, forfeitures and other activity.

ACCOUNTING FOR INCOME TAXES. In conjunction with the preparation of the CombiMatrix group's financial statements, Acacia Research is required to estimate income taxes in each of the jurisdictions in which Acacia Research operates. This process involves Acacia Research estimating actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue and asset depreciation for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our balance sheet. Acacia Research must then assess the likelihood that its deferred tax assets will be recovered from future taxable income and to the extent Acacia Research believes that recovery is not likely, Acacia Research must establish a valuation allowance. To the extent Acacia Research establishes a valuation allowance or increases this allowance in a period, Acacia Research must include an expense within the tax provision in the group statements of operations.

Significant management judgment is required in determining the provision for income taxes, deferred tax assets and liabilities and valuation allowance. Acacia Research has recorded a full valuation allowance against net deferred tax assets of \$20.5 million as of December 31, 2001, due to uncertainties related to the ability to utilize deferred tax assets, primarily consisting of certain net operating losses carried forward, before they expire. In assessing the need for a valuation allowance, Acacia Research has considered estimates of future taxable income, the period over which deferred tax assets may be recoverable, history of losses and assessment of the probability of continuing losses in the foreseeable future. In management's estimate, any positive indicators, including forecasts of potential future profitability of businesses, are outweighed by the

uncertainties surrounding estimates and judgments of potential future taxable income. In the event that actual results differ from these estimates or Acacia Research adjusts these estimates should Acacia Research believe it would be able to realize all or a portion of these deferred tax assets in the future, an adjustment to the valuation allowance would increase income in the period such determination was made. Any changes in the valuation allowance could materially impact the financial position and results of operations.

If the recapitalization proposal is approved, Acacia Research will determine its federal income taxes and the federal income taxes of its subsidiaries that own assets allocated between the groups on a consolidated basis. Consolidated federal income tax provisions and related tax payments or refunds will be allocated between the groups based principally on the taxable income and tax credits directly attributable to each group. Such allocations will reflect each group's contribution, whether positive or negative, to Acacia Research's consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits.

VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. The CombiMatrix group assesses the impairment of identifiable intangibles, long-lived assets and related goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors the CombiMatrix group considers important, which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for our overall business;
- o significant negative industry or economic trends; and
- o significant decline in the AR-CombiMatrix stock price for a sustained
 period.

When the CombiMatrix group determines that the carrying value of intangibles, long-lived assets and related goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, the CombiMatrix group measures any impairment based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in our current business model. Net intangible assets, long-lived assets and goodwill amounted to \$13.7 million as of December 31, 2001.

In 2002, SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), became effective and as a result, the CombiMatrix group will cease to amortize approximately \$2.9 million of goodwill effective January 1, 2002. The CombiMatrix group recorded approximately \$0.9 million of amortization of goodwill during 2001. In

-170-

lieu of amortization an initial impairment review of goodwill will be performed in 2002 and an annual impairment review thereafter. In connection with the adoption of SFAS No. 142, the CombiMatrix group performed a transitional goodwill impairment assessment and determined that there was no impairment of goodwill. However, there can be no assurance that a material impairment charge

will not be recorded in future periods.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. SFAS No. 144 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In conjunction with such tests, it may be necessary to review depreciation estimates and methods as required by APB Opinion No. 20, "Accounting Changes," or the amortization period as required by SFAS No. 142. The adoption of SFAS No. 144 did not have a material impact on the CombiMatrix group's financial position or operating results.

COMBIMATRIX GROUP

| RESULTS OF OPERATIONS (IN THOUSANDS) | FOR THE YEARS ENDED DECEMBER 31, | | | FOR THE THREE ENDED JUNE | |
|---|----------------------------------|--------------|-----------|-----------------------------|------|
| | 2001 | 2000 | | 2002 | |
| | | | | (UNAU | JDIT |
| Grant and contract revenues | \$ 456 | \$ 17 | \$ 144 | \$ 164 | \$ |
| Product revenue | | | | 274 | |
| Cost of sales | | | | (253) | |
| Research and development expenses | (11,656) | (8,415) | (1,806) | (5,026) | (|
| Non-cash stock compensation expenses - R&D | (7,183) | (3,397) | | (692) | (|
| Marketing, general and administrative | | | | | |
| expenses | (16,690) | (5,524) | (897) | (2,927) | (|
| Non-cash stock compensation expenses - MG&A | (12,780) | (6,598) | (36) | (1,443) | (|
| Amortization of patents and goodwill | (1,203) | (640) | (30) | (99) | |
| Other income (expense), net | 2,055 | 1,662 | (224) | 89 | |
| Benefit (provision) for income taxes | 155 | 79 | (2) | 39 | |
| Minority interests | 18,817 | 8,300 | 1,248 | 3,979 | |
| Cumulative effect of change in accounting | | | | | |
| principle | | (246) | | | |
| Division net loss | \$(28,029) |) \$(14,762) | \$(1,603) | \$(5,895) | \$(|
| | | | | | == |

THREE AND SIX MONTHS ENDED JUNE 30, 2002 COMPARED TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2001

GRANTS AND CONTRACTS REVENUES. Grant and contract revenues were \$164,000 and \$91,000 during the three months ended June 30, 2002 and 2001, respectively. In addition to \$91,000 of DOD grant revenues recognized in both periods, the CombiMatrix group recognized \$73,000 of NIH grant revenues during the second quarter of 2002. During the six months ended June 30, 2002 and 2001, grant and contract revenues were \$413,000 and \$274,000, respectively. The increase in revenues was due primarily to recognition of a one-time contract research and development fee of \$141,000 in addition to the DOD and NIH revenues recognized during this period, whereas the grant revenues recognized during the six months ended June 30, 2001 was solely from grant revenues recognized from the DOD grant. The CombiMatrix group expects to recognize \$91,000 and \$10,000 under its DOD and NIH grants in the third quarter of 2002, respectively, which represents final payments under both of these grants.

PRODUCT REVENUES AND COST OF SALES. During the three and six months ended June 30, 2002, product revenues were \$274,000 as compared to \$0 during the same periods ended June 30, 2001. During the three and six months ended June 30, 2002, cost of sales was \$253,000 as compared to \$0 during the same periods ended June 30, 2001. Product revenues and cost of sales were recognized as a result of the second quarter 2002 sale of a genomics microarray synthesizer and related hardware to a Japanese government institution by the CombiMatrix group's Japanese subsidiary.

RESEARCH AND DEVELOPMENT. During the three months ended June 30, 2002, research and development expenses were \$5.0 million, as compared to \$2.7 million during the same period ended June 30, 2001. During the six

-171-

months ended June 30, 2002, research and development expenses were \$7.7 million, as compared to \$5.8 million during the same period ended June 30, 2001. The increase in research and development expenses for the periods in 2002 as compared to the same periods in 2001 was primarily due to an increase in activities related to the CombiMatrix group's continuing performance obligations under the product commercialization phase of its license, supply, research and development agreements with Roche. These activities include increases in labor, supplies and materials, development of prototype microarrays and instruments, and the use of outside consultants for certain engineering and manufacturing efforts. Since July 2001, most of the CombiMatrix group's research and development efforts have been driven by obligations under its agreements with Roche. These projects include development of production microarray synthesis techniques, development of higher density microarrays and related instrumentation and software. These projects are expected to continue into 2005 as determined by the timelines specified in the agreements.

MARKETING, GENERAL AND ADMINISTRATIVE. During the three months ended June 30, 2002, marketing, general and administrative expenses were \$2.9 million, as compared to \$3.8 million during the same period ended June 30, 2001. During the six months ended June 30, 2002, marketing, general and administrative expenses were \$5.2 million, as compared to \$7.4 million during the same period ended June 30, 2001. The decrease in marketing general and administrative expenses for the periods in 2002 as compared to the same periods in 2001 was due primarily to reductions in the CombiMatrix group's sales and marketing staff and related expenses, decreased recruitment and relocation expenses, and reduced legal fees incurred during the first and second quarters of 2002 compared to the same periods in 2001. Included in marketing, general and administrative expenses are allocated corporate charges of \$0.3 million and \$0.6 million for the three and six months ended June 30, 2002, respectively, compared to \$0.4 million and \$0.6 million for the same periods ended June 30, 2001, respectively.

NON-CASH STOCK COMPENSATION EXPENSE.

RESEARCH AND DEVELOPMENT. During the three and six months ended June 30, 2002, research and development related non-cash stock compensation charges, were \$0.7 million and \$1.1 million, respectively, as compared to \$2.0 million and \$4.4 million, respectively, during the comparable periods in 2001.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. During the three and six months ended June 30, 2002, marketing, general and administrative non-cash stock compensation charges were \$1.4 million and \$2.4 million, respectively, as compared to \$5.2 million and \$10.4 million, respectively, in the comparable periods in 2001.

The decrease in non-cash stock compensation charges related to research and development and marketing, general and administrative expenses is primarily due to the forfeiture and cancellation of certain options in the third and fourth quarters of 2001 and a reduction in scheduled stock compensation amortization related to the accelerated method of amortization utilized by us pursuant to FIN No. 28, which results in higher amounts of amortization in the early vesting periods, and lower amounts of amortization in subsequent vesting periods. The CombiMatrix group's non-cash stock compensation amortization expense for the six months ended June 30, 2002 are net of \$748,000 in stock compensation expense reversal related to the forfeiture of certain unvested stock options in the first and second quarters of 2002.

INTEREST INCOME. During the three months ended June 30, 2002 and 2001, interest income was \$143,000 and \$0.6 million, respectively. During the six months ended June 30, 2002 and 2001, interest income was \$0.4 million and \$1.3 million, respectively. The decreases for both comparable periods were due primarily to lower average cash and cash equivalents balances and short-term investments in periods ended 2002 as compared to 2001, as well as lower market interest rates earned on the CombiMatrix group's cash and investments.

INTEREST EXPENSE. During the three months ended June 30, 2002 and 2001, interest expense was \$54,000 and \$0, respectively. During the six months ended June 30, 2002 and 2001, interest expense was \$115,000 and \$0, respectively. Interest expense relates to CombiMatrix Corporation's capital lease obligation with a commercial bank, which was executed in September 2001.

MINORITY INTERESTS. During the three months ended June 30, 2002 and 2001, minority interests in the net losses of the CombiMatrix group were \$4.0 million and \$5.3 million, respectively. During the six months ended June 30, 2002 and 2001, minority interests were \$6.4 million and \$10.8 million, respectively. The decrease in

-172-

minority interests was primarily due to the decrease in losses incurred by the CombiMatrix group as a result of a decrease in non-cash stock compensation amortization charges, and the decreases in research and development and marketing, general and administrative expenses described above.

2001 COMPARED TO 2000

REVENUES. Revenues were \$0.5 million in 2001 as compared to \$0.02 million in 2000. Revenues recognized in 2001 relate to the SBIR Phase II Department of Defense grant, which is ongoing. The revenues recognized in 2000 relate to the completion of CombiMatrix Corporation's Department of Energy grant.

RESEARCH AND DEVELOPMENT. Research and development expenses were \$18.8 million in 2001 as compared to \$11.8 million in 2000. The increase in research and development expense was due primarily to an increase in non-cash stock compensation charges, and a general expansion of research and development efforts, which resulted in the growth of research and development personnel as well as the amount of supplies and materials consumed. The CombiMatrix group's research and development activities were focused primarily on efforts to further develop and enhance the active biochip system towards commercialization. Most of these efforts were driven by CombiMatrix Corporation's obligations under our agreements with Roche, which were executed in July 2001. These projects include development of production microarray synthesis techniques, as well as higher density microarrays.

In 2001, research and development expense included non-cash stock compensation charges, totaling \$7.2 million. Non-cash stock compensation charges for 2001 are net of \$0.8 million of non-cash stock compensation expense reversal related to the forfeiture of certain unvested stock options during the third and fourth quarters of 2001. In 2000, research and development expense for non-cash stock compensation was \$3.4 million.

MARKETING, GENERAL AND ADMINISTRATIVE. Marketing, general and administrative expenses were \$29.5 million in 2001 as compared to \$12.1 million in 2000. These costs consist primarily of salaries and related expenses for executive, financial and other administrative personnel, including non-cash stock compensation charges, recruitment and relocation, professional services, litigation costs, and marketing activities, facilities costs and other corporate expenses. The increase was primarily due to an increase in non-cash stock compensation charges, an increase in marketing, general and administrative expenses, an increase in executive and administrative personnel, an increase in personnel recruitment and relocation expenses, and an increase in rent and utilities expenses as a result of CombiMatrix Corporation's January 2001 relocation to and occupancy of approximately 64,000 square feet of office space in their new corporate and research facilities located in Mukilteo, Washington. The CombiMatrix group's legal fees increased significantly in 2001 compared to 2000 as a result of litigation with Nanogen. In addition, marketing, general and administrative expenses include the write-off of approximately \$1.4 million of deferred initial public offering costs, which were charged to income in the fourth quarter of 2001 due to uncertainty related to the future recoverability of these deferred costs, stemming from unfavorable market conditions in late 2001 and early 2002. The CombiMatrix group expects marketing, general and administrative expenses to increase in the future to support the execution of our business strategies.

Amortization of deferred stock compensation included in marketing, general and administrative expenses was \$12.8 million in 2001 as compared to \$6.6 million in 2000. Stock compensation cost is deferred and amortized on an accelerated basis over the vesting period of the individual option awards using the amortization method prescribed in FIN No. 28. The increase in deferred stock compensation amortization in 2001 was due to higher amounts of deferred stock compensation charges scheduled to be amortized in 2001 as compared to 2000 related to \$53.8 million of deferred stock compensation originally recorded in the third and fourth quarters of 2000. Amortization of deferred stock compensation in 2001 was partially offset by \$3.9 million due to forfeitures of unvested stock options occurring in 2001. The CombiMatrix group is scheduled to incur deferred stock compensation amortization charges of approximately \$8.1 million, \$3.6 million and \$1.1 million in 2002, 2003 and 2004, respectively. Included in marketing, general and administrative expenses of the CombiMatrix group are allocated corporate charges of \$1.4 million and \$0.9 million in 2001 and 2000, respectively.

INTEREST INCOME. Interest income was \$2.1 million in 2001 as compared to \$1.7 million in 2000. The increase in interest income was due primarily to higher average balances of cash and cash equivalents and short-term investments in 2001 as compared to 2000. The overall increase in the average level of cash and investment balances

-173-

in 2001 was primarily the result of a private equity financing executed in August 2000 raising gross proceeds of \$36.0 million through the sale of 4 million shares of CombiMatrix Corporation common stock at \$9 per share.

INTEREST EXPENSE. Interest expense was \$0.07 million in 2001 as compared to no interest expense in 2000. Interest expense recorded in 2001 related to CombiMatrix Corporation's capital lease obligation with a commercial bank, which was entered into in September 2001. The CombiMatrix group had no similar obligations in 2000.

MINORITY INTERESTS. Minority interests in the net losses of the CombiMatrix group were \$18.8 million in 2001 as compared to \$8.3 million in 2000. The increase in minority interests in 2001 was primarily due to the increase in losses incurred by the CombiMatrix group as a result of increased non-cash stock compensation amortization charges, its continued expansion of research and development efforts and increased marketing, general and administrative expenses.

CUMULATIVE EFFECT OF ACCOUNTING CHANGE. Cumulative effect of accounting change was zero in 2001 as compared to \$0.2 million in 2000. During the fourth quarter of 2000, Acacia Research Corporation adopted Emerging Issues Task Force No. 98-15, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios." As a result, the beneficial conversion feature of \$1.5 million 6% unsecured promissory notes that was valued at \$0.2 million was charged to the December 31, 2000 statement of operations with a corresponding increase to equity in accordance with Accounting Principles Bulletin Opinion No. 20, "Accounting Changes."

2000 COMPARED TO 1999

REVENUES. Revenues were \$0.02 million in 2000 as compared to \$0.1 million in 1999. The decrease in revenues was due to the overall decrease in activity under our Department of Defense and Department of Energy grants in 2000 as compared to 1999.

RESEARCH AND DEVELOPMENT. Research and development expenses were \$11.8 million in 2000 as compared to \$1.8 million in 1999. The increase in research and development expenses was due primarily to an increase in non-cash stock compensation and a general expansion of the CombiMatrix group research and development efforts, which resulted in the growth of research and development personnel, as well as the amount of supplies and materials consumed. In 2000, research and development expenses for non-cash stock compensation (including warrants), totaled \$3.4 million. In 1999, research and development expenses for non-cash stock compensation were not material.

MARKETING, GENERAL AND ADMINISTRATIVE. Marketing, general and administrative expenses were \$12.1 million in 2000 as compared to \$0.9 million in 1999. The recruiting, hiring and in some cases relocating CombiMatrix Corporation's executive and administrative staff significantly contributed to the overall increase in our marketing, general and administrative expenses in 2000 compared to 1999. Marketing, general and administrative expenses included \$7.3 million and \$0.2 million of non-cash stock compensation charges for 2000 and 1999, respectively. Included in marketing, general and administrative expenses of the CombiMatrix group are allocated corporate charges of \$0.9 million and \$0.4 million, respectively.

AMORTIZATION OF DEFERRED STOCK COMPENSATION. Amortization of deferred stock compensation was \$10.2 million in 2000 as compared to \$0.02 million in 1999. The increase in deferred stock compensation amortization was due to greater amount of deferred stock compensation amortized in 2000 compared to 1999 resulting from the recognition of \$53.8 million of deferred stock compensation in the third and fourth quarters of 2000.

INTEREST INCOME. Interest income was \$1.7 million in 2000 as compared to \$0.04 million in 1999. The increase in interest income was due to higher average balances of cash and cash equivalents and short-term investments in 2000 as

compared to 1999 resulting from increased financing activities in 2000 compared to 1999.

INTEREST EXPENSE. Interest expense was 0 in 2000 as compared to 0.3 million in 1999. The decrease in interest expense was due to a decrease in cash interest expense from 117,000 in 1999 to 0 for the same period in 2000, a decrease in amortization of discount on notes from 0,000 in 1999 to 0 in 2000 and a decrease in

-174-

amortization of debt issuance costs on CombiMatrix Corporations notes from \$36,000 in 1999 to \$0 in 2000. All of these decreases were the result of the exchange of the entire \$1.5 million principal amount of notes for 725,000 shares of common stock in December 1999.

MINORITY INTERESTS. Minority interests in the net losses of the CombiMatrix group were \$8.3 million in 2000 as compared to \$1.2 million in 1999. The increase in minority interests in 2001 was primarily due to the increase in losses incurred by the CombiMatrix group as a result of increased non-cash stock compensation amortization charges, its continued expansion of research and development efforts and increased marketing, general and administrative expenses.

CUMULATIVE EFFECT OF ACCOUNTING CHANGE. Cumulative effect of accounting change was \$0.2 million in 2000 as compared to zero in 1999. During the fourth quarter of 2000, Acacia Research Corporation adopted Emerging Issues Task Force No. 98-15, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios." As a result, the beneficial conversion feature of \$1.5 million 6% unsecured promissory notes that was valued at \$0.2 million was charged to the December 31, 2000 statement of operations with a corresponding increase to equity in accordance with Accounting Principles Bulletin Opinion No. 20, "Accounting Changes."

INFLATION

Inflation has not had a significant impact on the CombiMatrix group in the current or prior periods.

LIQUIDITY AND CAPITAL RESOURCES

From inception through June 30, 2002, the CombiMatrix group has been funded primarily with private equity financing totaling \$64.2 million. At June 30, 2002, cash and cash equivalents and short-term investments totaled \$22.8 million. At December 31, 2001, cash and cash equivalents and short-term investments totaled \$33.3 million, compared to \$47.2 million at December 31, 2000. The CombiMatrix group's cash reserves and short-term investments are held in a variety of investment-grade securities, including government and corporate bonds, commercial paper and money market accounts.

Net cash used in operating activities was \$10.4 million for the six months ended June 30, 2002. Net cash used in operations was primarily due to a net loss from operations of \$9.9 million, and net cash out flows related to working capital totaling \$0.5 million.

Net cash used in operations during the years ended December 31, 2001, 2000 and 1999 was \$17.1 million, \$8.7 million and \$2.7 million, respectively. The CombiMatrix group division net losses for the years ended 2001, 2000 and 1999, excluding minority interests were \$46.8 million, \$22.8 million and \$2.9 million,

respectively. In 2001, the CombiMatrix group's negative cash flow from operations stemmed primarily from the continued expansion of the group's research and development activities including its efforts under the Roche and NASA agreements executed in 2001. Cash outflows from operations were partially offset by the receipt of milestone and advance payments under the Roche and NASA agreements totaling \$6.0 million, which have been recorded as deferred revenues at December 31, 2001. Included in division net loss for 2001, 2000 and 1999 are non-cash charges of \$22.1 million, \$10.9 million and \$0.1 million, respectively, related to amortization of deferred stock compensation, depreciation and amortization expenses.

Net cash provided by investing activities was \$4.4 million during the six months ended June 30, 2002 primarily related to the sale of certain short-term securities to fund operations.

Net cash provided by (used in) investing activities during the years ended December 31, 2001, 2000 and 1999 was \$18.8 million, \$(42.6 million) and \$(88,000), respectively. Net cash inflows from investing activities includes the net impact of the sale and leaseback transaction executed in September 2001 with a commercial bank, resulting in gross proceeds of \$3.0 million from the financing of the majority of the CombiMatrix group's property and equipment. The sale and leaseback transaction is reflected as a cash inflow and outflow from investing activities in the 2001 CombiMatrix group cash flow statement. The sale of short-term investments to fund the

-175-

CombiMatrix group research and development operations totaling \$50.4 million resulted in an overall net cash provided by investing activities in 2001 as compared to net cash used in investing activities in 2000. The increase in cash used in investing activities in 2000 as compared to 1999 was due primarily to purchases of short-term investments and capital equipment.

Net cash attributed to the CombiMatrix group during the years ended December 31, 2001, 2000 and 1999 was \$4.5 million, \$56.4 million and \$1.1 million, respectively. 2001 cash in flows from financing activities attributed to the CombiMatrix group include gross proceeds of \$1.0 million from the issuance of 120 shares of common stock by CombiMatrix KK to Marubeni Japan in October 2001 representing a 10% ownership interest in CombiMatrix KK. In addition, Advance Material Sciences also completed a private equity financing raising \$2.0 million in May 2001. During 2000, CombiMatrix group completed two private equity financings raising gross proceeds of \$53.6 million through the sale of 7.5 million shares of CombiMatrix Corporation common stock. In addition, Advanced Material Science was formed, raising initial equity financing of \$3.0 million. Financing activities included the receipt of \$3.8 million in net proceeds from the sale of common stock to investors in 1999.

CombiMatrix Corporation's rental expenses, including its share of the common area maintenance and operating expenses are approximately \$175,000 per month (excluding any allocated rent expense) at the new headquarters facility. That amount increases over time, subject to acceleration based on actual usage of the premises, to approximately \$195,000 per month by mid 2002 through 2008. CombiMatrix Corporation will pay \$91,000 per month through September 2004 to retire the capital lease obligation. Our future litigation costs with respect to the Nanogen case are uncertain at this time, though they are expected to be significant. CombiMatrix Corporation also has entered into a one-year commitment to purchase \$1.1 million worth of semiconductor wafers contingent upon successfully developing a next-generation microarray.

The CombiMatrix group's long-term capital requirements and the adequacy of our available funds will depend upon many factors, including:

- o the CombiMatrix group's continued progress in research and development programs;
- the costs involved in filing, prosecuting, enforcing and defending any patents claims, should they arise;
- o the CombiMatrix group's ability to license technology;
- o competing technological developments;
- o the creation and formation of strategic partnerships;
- the costs associated with leasing and improving our headquarters in Mukilteo, Washington;
- o the costs of commercialization activities; and
- o other factors that may not be within the CombiMatrix group's control.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 13 to the CombiMatrix group financial statements included elsewhere herein.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The CombiMatrix group's exposure to market risk is limited to interest income sensitivity, which is affected by changes in the general level of United States interest rates, particularly because the majority of the group's investments are in short-term debt securities issued by the U.S. treasury and by U.S corporations. The primary objective of the group's investment activities is to preserve principal while at the same time maximizing the income the CombiMatrix group receives without significantly increasing risk. To minimize risk, the CombiMatrix group maintains its portfolio of cash, cash equivalents and short-term investments in a variety of investment-grade securities and with a variety of issuers, including corporate notes, commercial paper, government securities and money market funds. Due to the nature of its short-term investments, the CombiMatrix group believes that it is not subject to any material market risk exposure.

At June 30, 2002 and December 31, 2001, the CombiMatrix group had certain assets and liabilities denominated in Japanese Yen as a result of forming CombiMatrix KK during 2001. However, due to the relative insignificance of those amounts, the CombiMatrix group does not believe that it has significant exposure to foreign

-176-

currency exchange rate risks. The CombiMatrix group currently does not use derivative financial instruments to mitigate this exposure. The CombiMatrix group continues to review this and may begin hedging certain foreign exchange risks through the use of currency forwards or options in 2002.

ACACIA TECHNOLOGIES GROUP MANAGEMENT'S DISCUSSION AND ANALYSIS (A DIVISION OF ACACIA RESEARCH CORPORATION)

You should read this discussion in conjunction with the Acacia Technologies group, a division of Acacia Research, financial statements and related notes and the Acacia Research consolidated financial statements and related notes, both included elsewhere herein. Historical results and percentage relationships are not necessarily indicative of operating results for any future periods.

GENERAL

The Acacia Technologies group, a division of Acacia Research, is comprised primarily of Acacia Research's wholly-owned media technology subsidiaries Soundview Technologies Incorporated ("Soundview Technologies") and Acacia Media Technologies Corporation, and also includes all other related corporate assets and liabilities and related transactions of Acacia Research that are attributed to its media technology businesses.

The AR-Acacia Technologies stock is intended to reflect the separate performance of the respective division of Acacia Research, rather than the performance of Acacia Research as a whole. The Acacia Technologies group is not a separate legal entity. Holders of the AR-Acacia Technologies stock will be stockholders of Acacia Research. As a result, they will continue to be subject to all of the risks of an investment in Acacia Research and all of Acacia Research's businesses, assets and liabilities. The assets Acacia Research attributes to the Acacia Technologies group could be subject to the liabilities of the CombiMatrix group.

The Acacia Technologies group businesses own intellectual property related principally to the telecommunications industry, including a television blanking system, also known as the "V-chip," which it licenses to television manufacturers and a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems. The Acacia Technologies group is responsible for the development, licensing and protection of its intellectual property and proprietary technologies. The Acacia Technologies group continues to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technology industry.

During the six months ended June 30, 2002, the Acacia Technologies group's operating activities were highlighted by the continuation of the building of its executive management team including the hiring of key media technology and intellectual property industry experts that will be responsible for the development, licensing and protection of the Acacia Technologies group's intellectual property and proprietary technologies, as well as the pursuit of both licensing and strategic business alliances with leading companies in the growing media technologies industry.

In 2001, Acacia Technologies group's financial condition and cash flows were highlighted by the receipt of \$25.6 million in payments from the licensing of the Acacia Technologies group's television V-chip technology, the completion of a private equity financing raising gross proceeds of \$19.0 million and the acquisition of the minority interests in Soundview Technologies in June 2001 and Acacia Media Technologies Corporation in November 2001. In 2000, Acacia Technologies group's financial condition and cash flows were highlighted primarily by the completion of a private equity financing raising gross proceeds of \$23.7 million, the receipt of \$14.8 million from the redemption of warrants issued in connection with a December 1999 private equity financing and the

general expansion of operations, including an increase in business development expenses as the Acacia Technologies group explored new business opportunities. In 1999, Acacia Technologies group's financial condition and cash flows were highlighted primarily by the completion of a private equity financing raising gross proceeds of \$21.0 million and the investment in Acacia Research's subsidiary, Soundbreak.com. In the following discussion and analysis, the period-to-period comparisons must be viewed in light of the impact that the acquisition and disposition of securities of various business interests has had on the Acacia Technologies group's financial condition and results of operations.

During 2001, Acacia Technologies group began to receive significant payments from the licensing of the Acacia Technologies group's television V-chip technology to television manufacturers. However, to date, Acacia Research businesses included in the Acacia Technologies group have relied primarily upon selling equity securities, including sales to and loans from Acacia Research, to generate the funds needed to finance the implementation of

-178-

their plans of operation. The Acacia Technologies group may be required to obtain additional financing through bank borrowings, debt or equity financings or otherwise, which would require Acacia Research to make additional investments or face a dilution of its equity interests.

ACQUISITION AND OPERATING ACTIVITIES

During the six months ended June 30, 2002, the Acacia Technologies group's operating activities primarily consisted of the hiring of key executive personnel and the continuation of its efforts to market and commercialize its intellectual property and related patents.

During 2001, the Acacia Technologies group continued to significantly increase financing, acquisition and operating activities while receiving significant payments from its media technologies licensing arrangements. The Acacia Technologies group will continue to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry. Financing activities are listed in the Liquidity and Capital Resources section that follows. Highlights of the acquisition and operating activities for the year ended December 31, 2001 include:

In the first quarter of 2001, Soundview Technologies executed separate settlement and/or license agreements with Samsung Electronics, Hitachi America, Ltd., LG Electronics, Inc., Funai Electric Company, Ltd., Daewoo Electronics Corporation of America and Sanyo Manufacturing Corporation. In addition, Soundview Technologies settled its lawsuits with Pioneer Electronics (USA) Incorporated. Certain of these license agreements constitute settlements of patent infringement litigation brought by Soundview Technologies. The settlement and license agreements provide for licensing payments to Soundview Technologies, and grant non-exclusive licenses of Soundview Technologies' U.S. Patent No. 4,554,584 to the respective television manufacturers. Certain of these settlement and license agreements provide for future royalty payments to Soundview Technologies. The Acacia Technologies group received, and recognized as revenue, \$2.4 million in one-time license fee payments in exchange for the grant of V-chip patent licenses during the first quarter of 2001. In addition, the Acacia Technologies group received a payment of \$1.0 million pursuant to a settlement and license agreement executed in December 2000, which is included in deferred revenues at December 31, 2001.

In February 2001, the board of directors of Soundbreak.com, a majority-owned subsidiary of Acacia Research, resolved to cease operations as of February 15, 2001 and liquidate its remaining assets and liabilities of the company. Accordingly, the Acacia Technologies group reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the statements of operations as of and for the year ended December 31, 2000.

In June 2001, Acacia Research's ownership interest in Soundview Technologies increased from 67% to 100%, following Soundview Technologies' completion of a stock repurchase transaction with its former minority stockholders. Soundview Technologies repurchased the stock of its former minority stockholders in exchange for a cash payment and the grant to such stockholders of the right to receive 26% of future net revenues generated by Soundview Technologies' current patent portfolio, which includes its V-chip patent.

During the second quarter of 2001, Soundview Technologies executed separate settlement and license agreements with Thomson Multimedia, Inc. and JVC Americas Corporation. Certain of these settlement and license agreements provide for future royalty payments to Soundview Technologies. The Acacia Technologies group received, and recognized as revenue, one-time license fee payments totaling \$10.0 million in exchange for the grant of V-chip patent licenses during the second quarter of 2001.

In the third quarter of 2001, Soundview Technologies executed separate settlement and/or license agreements with Matsushita Electric Industrial Co., Ltd. and Orion Electric Co., Ltd. The Acacia Technologies group received, and recognized as revenue, one-time license fee payments totaling \$10.7 million in exchange for the grant of V-chip patent licenses during the third quarter of 2001. In addition, the Acacia Technologies group received a payment of \$0.5 million pursuant to a license agreement executed in December 2000, which is included in deferred revenues at December 31, 2001.

-179-

In November 2001, Acacia Research increased its ownership interest in Acacia Media Technologies Corporation, formerly Greenwich Information Technologies LLC, from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. In December 2001, Acacia Research converted the Greenwich Information Technologies LLC from a limited liability company to a corporation and changed the name to Acacia Media Technologies Corporation. Acacia Media Technologies owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

In the fourth quarter of 2001, the Acacia Technologies group received, and recognized as revenue, one-time license fee payments totaling \$1.0 million in exchange for the grant of V-chip patent licenses.

EFFECT OF VARIOUS ACCOUNTING METHODS ON RESULTS OF OPERATIONS

CRITICAL ACCOUNTING POLICIES

The following critical accounting policies affect the Acacia Technologies group's more significant judgments and estimates used in the preparation of its financial statements:

- o basis of presentation and principles of combination;
- policies relating to AR-Acacia Technologies stock and AR-CombiMatrix stock;
- o revenue recognition;
- o litigation, claims and assessments;
- o accounting for income taxes; and
- o valuation of long-lived and intangible assets and goodwill.

BASIS OF PRESENTATION AND PRINCIPLES OF COMBINATION. The Acacia Technologies group financial statements have been prepared in accordance with generally accepted accounting principles and, taken together with the CombiMatrix group financial statements, comprise all the accounts included in the corresponding consolidated financial statements of Acacia Research. The financial statements of each group reflect the financial condition, results of operations and cash flows of the businesses included therein. The financial statements of the Acacia Technologies group include the accounts or assets of Acacia Research specifically attributed to the Acacia Technologies group and give effect to the accounting policies that will be applicable upon implementation of the recapitalization proposal. The Acacia Technologies group financial statements have been prepared on a basis that management believes to be reasonable and appropriate and reflect the financial position, results of operations, and cash flows of businesses that comprise the Acacia Technologies group and all other corporate assets, liabilities and related transactions of Acacia Research attributed to the Acacia Technologies group, including allocated portions of Acacia Research's general and administrative costs. Intergroup transactions between the CombiMatrix group and the Acacia Technologies group have not been eliminated in the separate group's financial statements.

The preparation of the divisional financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. If the Recapitalization Proposal is implemented, significant management estimates and judgments will be required related to the implementation of the management and allocation policies applicable to the preparation of the divisional financial statements of the Acacia Technologies group. Individual group results may be significantly impacted based on management's estimates and judgments.

POLICIES RELATING TO AR-ACACIA TECHNOLOGIES STOCK AND AR-COMBIMATRIX STOCK. The management and allocation policies applicable to the preparation of the divisional financial statements of the CombiMatrix group and the Acacia Technologies group (collectively, "the groups") may be modified or rescinded, or additional policies may be adopted, at the sole discretion of the Board at any time without approval of the stockholders. The Acacia Technologies group's divisional financial statements reflect the application of the management and allocation policies adopted by the Board to various corporate activities, as described below. The Acacia Technologies group's

-180-

divisional financial statements should be read in conjunction with Acacia

Research's consolidated financial statements and related notes.

TREASURY AND CASH MANAGEMENT POLICIES

Acacia Research will manage most treasury and cash management activities on a de-centralized basis, with each separate group separately managing its own treasury activities. Pursuant to treasury and cash management policies adopted by the Board, after the date on which the AR-CombiMatrix stock and the AR-Acacia Technologies stock is first issued, the following will apply:

- Acacia Research will attribute each future issuance of AR-Acacia Technologies stock (and the proceeds thereof) to the Acacia Technologies group and will attribute each future issuance of AR-CombiMatrix stock (and the proceeds thereof) to the CombiMatrix group;
- o Acacia Research will attribute each future incurrence or issuance of external debt or preferred stock (and the proceeds thereof) between the two groups or entirely to one group as determined by the Board, based on the extent to which Acacia Research incurs or issues the debt or preferred stock for the benefit of the CombiMatrix group and the Acacia Technologies group;
- Dividends on AR-Acacia Technologies stock will be charged against the Acacia Technologies group, and dividends on AR-CombiMatrix stock will be charged against the CombiMatrix group;
- Repurchases of AR-Acacia Technologies stock will be charged against the Acacia Technologies group and Repurchases of AR-CombiMatrix stock will be charged against the CombiMatrix group;
- As of immediately prior to the first issuance of AR-CombiMatrix stock and AR-Acacia Technologies stock, the CombiMatrix group and the Acacia Technologies group shall be deemed to be allocated the cash and cash equivalents held by the respective groups as of that date;
- Acacia Research will account for any cash transfers from Acacia 0 Research to or for the account of a group, from a group to or for the account of Acacia Research, or from one group to or for the account of the other group (other than transfers in return for assets or services rendered) as short-term loans unless (A) the Board determines that a given transfer (or type of transfer) should be accounted for as a long-term loan, (B) the Board determines that a given transfer (or type of transfer) should be accounted for as a capital contribution or (iii) the Board determines that a given transfer (or type of transfer) should be accounted for as a return of capital. There are no specific criteria to determine when Acacia Research will account for a cash transfer as a long-term loan, a capital contribution or a return of capital rather than an inter-group revolving credit advance; provided, however, that cash advances from Acacia Research to the Acacia Technologies group or to the CombiMatrix group up to \$25 million on a cumulative basis shall be accounted for as short-term or long-term loans at interest rates at which Acacia Research could borrow such funds and shall not be accounted for as a capital contribution. The Board will make such a determination in the exercise of its business judgment at the time of such transfer based upon all relevant circumstances. Factors the Board may consider include, without limitation, the current and projected financing needs and objectives of the recipient group; the availability, cost and time associated with alternative financing sources; and prevailing interest rates and general economic conditions; and

 Any cash transfers accounted for as short-term loans will bear interest at the rate at which Acacia Research could borrow such funds. In addition, any cash transfers accounted for as a long-term loan will have interest rates, amortization, maturity, redemption and other terms that reflect the then-prevailing terms on which Acacia Research could borrow such funds.

-181-

CORPORATE GENERAL AND ADMINISTRATIVE SERVICES AND FACILITIES

Acacia Research will allocate the cost of corporate general and administrative services and facilities between the Acacia Technologies group and the CombiMatrix group, generally based upon utilization. Where determinations based on utilization alone are impracticable, Acacia Research will use other methods and criteria that management believes to be equitable and to provide a reasonable estimate of the cost attributable to each group. Except as otherwise determined by management, the allocated costs of providing such services and facilities will include, without limitation, all costs and expenses of personnel employed in connection with such services and facilities, including, without limitation, all direct costs of such personnel, such as payroll, payroll taxes and fringe benefit costs (calculated at the appropriate annual composite rate therefor) and all overhead costs and expenses directly related to such personnel and the services or facilities provided by them. In addition, allocated costs will include all materials used in connection with such services or facilities, billed at their net cost to the provider of the services or facilities plus all overhead costs and expenses related to such materials.

Except as may otherwise be specifically provided pursuant to the terms of any agreements among Acacia Research and the groups or any resolutions of the Board, the corporate general and administrative services and facilities to be allocated between the Acacia Technologies group and the CombiMatrix group, will include, without limitation, legal services, accounting services (tax and financial), insurance and deductibles payable in connection therewith, employee benefit plans and administration thereof, investor relations, stockholder services, and services relating to the board of directors.

ALLOCATION OF FEDERAL AND STATE INCOME TAXES

Acacia Research will determine its federal income taxes and the federal income taxes of its subsidiaries that own assets allocated between the Acacia Research on a consolidated basis. Acacia Research will allocate consolidated federal income tax provisions and related tax payments or refunds between the Acacia Research based principally on the taxable income and tax credits directly attributable to each group. Such allocations will reflect each group's contribution, whether positive or negative, to Acacia Research's consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits. Inter-group transactions will be treated as taxed on a separate return basis.

Depending on the tax laws of the respective jurisdictions, state and local income taxes are calculated on either a consolidated or combined basis between the groups based on their respective contribution to such consolidated or combined state taxable incomes. State and local income tax provisions and related tax payments or refunds which are determined on a separate corporation basis will be allocated between the groups in a manner designed to reflect the respective contributions of the groups to Acacia Research's separate or local taxable income.

REVENUE RECOGNITION. To date, the Acacia Technologies group's revenues have consisted primarily of fees from the licensing of its television V-chip technology to television manufacturers.

As described below, significant management judgments must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of revenue recognized for any period if management made different judgments.

Television V-chip License Fees: The Acacia Technologies group's television V-chip technology settlement and/or license agreements provide for the payment of contractually determined license fees to us in consideration for the grant to certain television manufacturers of a non-exclusive, retroactive and future licenses to manufacture and/or sell products covered by Soundview Technologies' U.S. Patent No. 4,554,584, through July 2003. While payments recognized to date have been one-time payments for the grant of V-chip patent licenses, certain of the agreements also provide for future royalties or additional required payments based on future television sales or the outcome of future litigation and settlement activities. The agreements executed with the various television manufacturers include certain release provisions with respect to Soundview Technologies' ongoing patent infringement and anti-trust enforcement efforts. Amounts received under the settlement and license agreements are recorded as license fee income in the Acacia Technologies group's statement of operations.

-182-

License fee income is recognized as revenue when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable and (iv) collectibility of amounts is reasonably assured. Pursuant to the terms of the agreements, the Acacia Technologies group has no further obligation with respect to the sale of the non-exclusive retroactive and future license, including no express or implied obligation on the Acacia Technologies group's part to maintain or upgrade the technology or license, or provide future support or services. Generally, the agreements provide for the grant of the license upon receipt by Soundview Technologies of payment of the contractual license fee. As such, the earnings process is generally complete upon the receipt of payment from the television manufacturer, and revenue is recognized when all of the criteria above are met.

License fee payments received by the Acacia Technologies group that do not meet the revenue recognition criteria above are recorded as deferred revenues, along with any related direct costs, until the criteria are met. In the event that license fee amounts due from television manufacturers have been accrued, the Acacia Technologies group assesses collection based on a number of factors, including past transaction history and credit-worthiness. If it is determined that collection of an accrued license fee is not reasonably assured, the fee is deferred and is recognized as revenue upon receipt of cash.

LITIGATION, CLAIMS AND ASSESSMENTS. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Specifically, management must make estimates of whether (i) it is probable that an asset has been impaired or a liability has been incurred at the date of the financial

statements and (ii) whether the amount of loss can be reasonably estimated. In the event that, in management's estimation it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and amounts of loss can be reasonably estimated, the estimated contingent loss is accrued by a charge to income.

Because of the uncertainties related to both probabilities of outcome and amounts and ranges of potential loss associated with outstanding claims and pending litigation at December 31, 2001, management is unable to make a reasonable estimate of the likelihood of outcome or the liability that could result from an unfavorable outcome. As such, the Acacia Technologies group has not accrued for any loss contingencies as of December 31, 2001. As additional information becomes available, the potential liability related to pending litigation, claims or assessments will be assessed and the previous estimates may be revised. Such revisions in the estimates of the potential liability could materially impact the Acacia Technologies group's results of operation and financial position.

ACCOUNTING FOR INCOME TAXES. As part of the process of preparing the Acacia Technologies group's financial statements, management is required to estimate Acacia Research's income taxes in each of the jurisdictions in which Acacia Research operates. This process involves the estimating of actual current tax exposure together with assessing temporary differences resulting from differing treatment of items, such as deferred revenue, amortization of intangibles and asset depreciation for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the Acacia Technologies group's balance sheet. Acacia Research must then assess the likelihood that deferred tax assets will be recovered from future taxable income and to the extent that management believes that recovery is not likely, a valuation allowance must be established. To the extent a valuation allowance is established or increased in a period, an expense must be reflected within the tax provision in the group statement of operations.

Significant management judgment is required in determining the Acacia Technologies group's provision for income taxes, the deferred tax assets and liabilities and the valuation allowance. A full valuation allowance has been recorded against net deferred tax assets of \$29.5 million as of December 31, 2001, due to uncertainties related to the ability to utilize the deferred tax assets, primarily consisting of certain net operating losses carried forward, before they expire. In assessing the need for a valuation allowance, consideration has been given estimates of future taxable income, the period over which deferred tax assets may be recoverable, history of losses and the assessment of the probability of continuing losses in the foreseeable future. In management's estimate, any positive indicators, including forecasts of potential future profitability of businesses, are outweighed by the uncertainties surrounding the estimates and judgments of potential future taxable income. In the event that actual results differ from these estimates or Acacia Research adjusts these estimates should it believe it would be able to realize these deferred tax

-183-

assets in the future, an adjustment to the valuation allowance would increase income in the period such determination was made. Any changes in the valuation allowance could materially impact the financial position and results of operations.

If the recapitalization proposal is approved, Acacia Research will determine its federal income taxes and the federal income taxes of its

subsidiaries that own assets allocated between the Acacia Research on a consolidated basis. Consolidated federal income tax provisions and related tax payments or refunds will be allocated between the Acacia Research based principally on the taxable income and tax credits directly attributable to each group. Such allocations will reflect each group's contribution, whether positive or negative, to Acacia Research's consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits.

VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. The Acacia Technologies group assesses the impairment of identifiable intangibles, long-lived assets and related goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors the Acacia Technologies group considers important, which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business;
- o significant negative industry or economic trends; and
- o significant decline in the Acacia Technologies group's stock price for a sustained period.

When the carrying value of intangibles, long-lived assets and related goodwill is determined to be unrecoverable based upon the existence of one or more of the above indicators of impairment, the impairment is measured based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in the Acacia Technologies group's current business model. Net intangible assets, long-lived assets and goodwill amounted to \$7.7 million as of December 31, 2001.

In 2002, SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), became effective and as a result, goodwill totaling approximately \$1.8 million will cease to be amortized effective January 1, 2002. The Acacia Technologies group recorded approximately \$0.2 million of amortization of goodwill during 2001. In lieu of amortization, an initial impairment review of goodwill will be performed in 2002 and an annual impairment review thereafter. In connection with the adoption of SFAS No. 142, the Acacia Technologies group performed a transitional goodwill impairment assessment and determined that there was no impairment of goodwill. However there can be no assurance that a material impairment charge will not be recorded in future periods.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. SFAS No. 144, which was adopted effective January 1, 2002 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In conjunction with such tests, it may be necessary to review depreciation estimates and methods as required by APB Opinion No. 20, "Accounting Changes," or the amortization period as required by SFAS No. 142. The adoption of SFAS No. 144 did not have a material impact on the Acacia Technologies group financial position or results of operations. ACACIA TECHNOLOGIES GROUP

| | FOR THE YE | ARS ENDED DE | CEMBER 31, | FOR MON J |
|--|-------------------|--------------|------------|-----------------|
| RESULTS OF OPERATIONS (IN THOUSANDS) | 2001 | 2000 | 1999 | 2002 |
| | | | | (UN |
| Net revenues | \$ 24,180 | \$ 40 | \$ 122 | \$ |
| Research and development expenses | | (52) | | _ |
| Marketing, general and administrative expenses | (5,258) | (8,983) | (3,198) | (2,06 |
| Legal expenses | (11,572) | (984) | (287) | (53 |
| Amortization of patents and goodwill | (1,492) | (1,611) | (1,592) | (46 |
| Loss on disposal of subsidiaries | | (1,016) | | - |
| Other (expense) income, net | 2,111 | (2,897) | (818) | (90 |
| Benefit (provision) for income taxes | (935) | (6) | (18) | 3 |
| Minority interests | (1,277) | 866 | (27) | 12 |
| Loss from discontinued operations of Soundbreak. | | | | |
| com | | (9,554) | (776) | |
| Division net income (loss) | \$ 5 , 757 | \$(24,197) | \$(6,594) | \$(3,80 |
| | | | | |

THREE AND SIX MONTHS ENDED JUNE 30, 2002 TO THE THREE AND SIX MONTHS ENDED JUNE 30, 2001

LICENSE FEE INCOME. During the three months ended June 30, 2002, license fee income was \$0 as compared to \$10.0 million in license fee income during the three months ended June 30, 2001. During the six months ended June 30, 2002, license fee income was \$0 as compared to \$12.4 million in license fee income during the six months ended June 30, 2001. The license fee income for the three and six months ended June 30, 2001 includes license fees received from television manufacturers with whom Soundview Technologies executed separate settlement and/or license agreements during the respective periods. Pursuant to the terms of the respective settlement and/or license agreements with each of the television manufacturers, Soundview Technologies received one-time license fee payments in exchange for the grant of non-exclusive licenses for its patented V-chip technology to each of the respective manufacturers. Soundview Technologies did not record any license fee income during the first and second quarters of 2002. The Acacia Media Technologies Group continues to pursue both licensing and strategic business alliances with other television manufacturers and leading companies in the media technologies industry.

Acacia Media Technologies Group's patent on the V-chip technology expires in July 2003. The Acacia Media Technologies Group may continue to collect license fees on televisions sold in the United States during the patent term, subsequent to the July 2003 patent expiration date. The Acacia Media Technologies Group is beginning to market its digital media transmission technology and is looking to acquire other technologies. The eventual licensing and sale of these technologies is intended to replace the revenue generated by licensing the V-chip technology. If we do not succeed in acquiring such technologies or are unable to commercially license our existing and future technologies, our financial condition may be adversely impacted. FOD

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. Marketing, general and administrative expenses were \$2.1 million during the three months ended June 30, 2002, as compared to \$1.1 million in the same period in 2001. Marketing, general and administrative expenses were \$3.4 million during the three and six months ended June 30, 2002 and 2001. The increase during the three months ended June 30, 2002 as compared to the same period in 2001 is primarily due to increased costs incurred related to Acacia Media Technologies Corporation's ongoing patent marketing and commercialization efforts, including increased personnel costs relating to the hiring of several key executives and costs related to outside intellectual property consulting services.

Included in marketing, general and administrative expenses are allocated corporate charges of \$1.3 million and \$0.8 million for the three months ended June 30, 2002 and 2001, respectively. Included in marketing, general and administrative expenses are allocated corporate charges of \$2.4 million and \$2.6 million for the six months ended June 30, 2002 and 2001, respectively.

-185-

LEGAL FEES. Legal fees were \$0.5 million during the three months ended June 30, 2002 as compared to \$4.7 million during the same period in 2001. Legal fees were \$1.0 million during the six months ended June 30, 2002 as compared to \$5.8 million during the same period in 2001. The decrease in legal fees expense is primarily due to a decrease in legal expenses related to Soundview Technologies' patent licensing and related infringement settlements. Legal fees related to the license fee agreements executed with television manufacturers are generally incurred on a contingency basis, based on license fee payments received. The decrease in legal fees was partially offset by fees incurred in connection with on going legal work associated with the Acacia Technologies group's V-Chip and digital media patent portfolio.

AMORTIZATION OF PATENTS AND GOODWILL. Amortization of patents and goodwill during the three months ended June 30, 2002 was \$0.5 million as compared to \$0.3 million in the same period in 2001. Amortization of patents and goodwill during the six months ended June 30, 2002 was \$0.9 million as compared to \$0.7 million in the same period in 2001. Amortization expense relating to patents and goodwill for the three and six months ended June 30, 2002 excludes \$45,000 and \$89,000 of amortization expense pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"), which was adopted by the Acacia Technologies group effective January 1, 2002 and requires goodwill to be tested for impairment under certain circumstances, and written off when determined to be impaired, rather than being amortized as previous standards required. The reduction in goodwill amortization in the three and six months ended June 30, 2002 was partially offset by an increase in patent amortization related to the increase in Acacia Research Corporation's ownership interest in Acacia Media Technologies Corporation (formerly, "Greenwich Information Technologies," a limited liability company) from 33% to 100% in November 2001. As a result of the acquisition of Acacia Media Technologies Corporation, the Acacia Technologies group will be recording additional patent amortization of \$0.2 million on a quarterly basis over the related patents economic useful lives (approximately 10 years) related to the intangibles identified in connection with the application of the purchase method of accounting.

OTHER INCOME (EXPENSE), NET. During the three months ended June 30, 2002, other income (expense), net (primarily comprised of interest income, realized and unrealized gains and losses on trading securities, equity in losses of affiliate and other) was \$0.9 million in net other expenses as compared to \$0.5 million in net other income in 2001. During the six months ended June 30, 2002, other income (expense), net (primarily comprised of interest income, realized

and unrealized gains and losses on trading securities, equity in losses of affiliate and other) was \$1.5 million in net other expense as compared to \$0.9 million in net other income in 2001.

INTEREST INCOME. During the three months ended June 30, 2002, interest income was \$0.1 million as compared to \$0.5 million in the same period in 2001. During the six months ended June 30, 2002, interest income was \$0.3 million as compared to \$0.9 million in the same period in 2001. The decrease in interest income during 2002 was primarily due to the impact of a decrease in interest rates on the Acacia Technologies group's short-term investments related to sharp interest rate cuts by the Federal Open Market Committee and other external economic factors negatively impacting rates of return on short-term investments occurring during the third and fourth quarters of 2001.

REALIZED AND UNREALIZED LOSSES ON SHORT-TERM INVESTMENTS. During the three months ended June 30, 2002, net realized losses on short-term investments was \$0.9 million as compared to no realized losses on short-term investments in the same period in 2001. During the six months ended June 30, 2002, net realized losses on short-term investments was \$1.5 million as compared to no realized losses on short-term investments in the same period in 2001. During the three months ended June 30, 2002, net unrealized losses were \$0.2 million as compared to no unrealized losses in the same period in 2001. During the six months ended June 30, 2002, net unrealized losses were \$0.5 million as compared to no unrealized losses in the same period in 2001. The increase in realized and unrealized losses recorded on certain trading securities of the Acacia Technologies group during the three and six months ended June 30, 2002. The Acacia Technologies group did not hold any trading securities during the three and six months ended June 30, 2001.

The Acacia Technologies group conducted a portion of its investing activity through a limited partnership, of which a wholly-owned subsidiary of Acacia Research Corporation is the general partner. As a result of the significant control that Acacia Research Corporation exercises over the limited partnership, the assets and liabilities and results of operations have been consolidated by Acacia Research Corporation at June 30, 2002 and December 31, 2001. The assets, liabilities and results of the limited partnership, which includes

-186-

certain health sciences securities, have been attributed to the Acacia Technologies group. The limited partnership ceased operations as of the end of the second quarter of 2002.

EQUITY IN LOSSES OF AFFILIATE. During the three months ended June 30, 2002, equity in losses of affiliate was \$0 as compared to \$55,000 in the same period in 2001. During the six months ended June 30, 2002, equity in losses of affiliate was \$0 as compared to \$110,000 in the same period in 2001. Equity in losses of affiliate during the three and six months ended June 30, 2001 was comprised of a loss of \$55,000 and \$110,000, respectively, for Acacia Research Corporation's non-controlling equity investment in Acacia Media Technologies. As of December 31, 2001, Acacia Research Corporation no longer accounts for any of its investments under the equity method as it directly or indirectly owns more that 50% of the outstanding voting securities of all of its subsidiaries and as a result, consolidates these investments.

MINORITY INTERESTS. Minority interests in the (income) losses of consolidated subsidiaries were (\$125,000) during the three months ended June 30, 2002 as compared to \$1.0 million during the same period in 2001. Minority

interests in the (income) losses of consolidated subsidiaries were (\$162,000) during the six months ended June 30, 2002 as compared to \$1.3 million during the same period in 2001. Minority interests in the losses of consolidated subsidiaries for the three and six months ended June 30, 2002 were primarily comprised of minority interests in the net losses of the Acacia Technologies group's investment limited partnership. Minority interests in the net income of consolidated subsidiaries for the three and six months ended June 30, 2001 were comprised primarily of \$1.0 million and \$1.3 million, respectively, of minority interests in the net income of Soundview Technologies recorded prior to the increase in Acacia Research's ownership interest in Soundview Technologies to 100% in June 2001.

2001 COMPARED TO 2000

LICENSE FEE INCOME. In 2001, license fee income was \$24.2 million as compared to no license fee income during 2000. The increase for 2001 resulted primarily from the settlement of patent infringement litigation brought by Soundview Technologies and includes one-time license fees in exchange for the grant of V-chip patent licenses, received from eleven of the twelve television manufacturers with whom Soundview Technologies executed separate settlement and/or license agreements during 2001 and 2000. Pursuant to the terms of the respective settlement and license agreements with each of the television manufacturers, Soundview Technologies granted to such manufacturers, non-exclusive licenses for its U.S. Patent No. 4,554,584.

The Acacia Technologies group, and Acacia Research as a whole, has generated substantially all of its revenues from licensing the patented V-chip technology to television manufacturers. Acacia Technologies group's patent on the V-chip technology will expire in July 2003, although the Acacia Technologies group may still collect revenues from the sale of televisions in the U.S. before that date. The Acacia Technologies group is beginning to market its digital media transmission technology and is developing other technologies and products. The eventual licensing and sale of these technologies is intended to replace the revenue currently being generated by licensing its V-chip technology. If the Acacia Technologies group does not succeed in developing such technologies or is unable to commercially license its existing and future technologies, its financial condition will be adversely impacted.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. The Acacia Technologies group incurred marketing, general and administrative expenses of \$5.3 million in 2001 as compared to \$9.0 million in 2000. These costs consist primarily of salaries and related expenses for executive, financial and other administrative personnel, travel and meals, recruitment and relocation, professional services, investor relations, insurance, facilities costs and other corporate expenses. Management expects marketing, general and administrative expenses to increase in the future to support the execution of the Acacia Technologies group's business strategies.

Marketing, general and administrative expenses included \$0.9 million and \$0.7 million of non-cash stock compensation charges for 2001 and 2000, respectively. Included in the marketing, general and administrative expenses of the Acacia Technologies group are allocated corporate charges of \$4.6 million and \$7.7 million in 2001 and 2000, respectively.

LEGAL EXPENSES. In 2001, legal expense was \$11.6 million as compared to \$1.0 million in 2000. The increase in 2001 was due to approximately \$11.0 million of legal costs incurred in connection with the execution of Soundview Technologies' V-chip license and settlement agreements with twelve television manufacturers during

2001. Legal fees incurred in connection with the Acacia Technologies group's V-Chip licensing arrangements are generally incurred on a contingency basis and include legal costs incurred in connection with the negotiation of license agreements, drafting of legal documents, discovery and certain other legal expenses.

AMORTIZATION OF PATENTS AND GOODWILL. In 2001, amortization expense relating to patents and goodwill was \$1.5 million as compared to \$1.6 million in 2000. As a result of the purchase of additional equity securities in various subsidiaries, the Acacia Technologies group is incurring amortization expense for periods ranging from three to five years relating to the intangible assets acquired.

As a result of the increase in Acacia Research's ownership interest in Acacia Media Technologies from 33% to 100% through the purchase of the ownership interest of Acacia Media Technologies' other member in November 2001, the Acacia Technologies group will incur additional amortization expense of approximately \$0.5 million per year in future periods relating to the intangible assets acquired. See "Recent Accounting Pronouncements" for summary of pronouncements affecting amortization of goodwill in future periods and impairment analysis required for long-lived assets.

LOSS ON DISPOSAL OF CONSOLIDATED SUBSIDIARIES. In 2001, loss on disposal of consolidated subsidiaries was \$0 as compared to \$1.0 million in 2000. In the fourth quarter of 2000, the Acacia Technologies group recorded \$1.0 million in write-offs of early stage investments.

OTHER INCOME (EXPENSE), NET. In 2001, other income, net was \$2.1 million (primarily comprised of interest income, realized and unrealized gains and losses on trading securities, equity in losses of affiliates and other), as compared to \$2.9 million of net other expense in 2000, as a result of equity investment write-offs and losses attributable to equity investees.

INTEREST INCOME. In 2001, interest income was \$1.6 million as compared to \$1.4 million in 2000. The increase during 2001 was due to higher cash balances during 2001 as compared to 2000, resulting from various private equity financings and the receipt of significant license fee payments by Soundview Technologies during the year. The increase was partially offset by the impact of a decrease in interest rates on short-term investments related to sharp interest rate cuts by the Federal Open Market Committee and other external economic factors negatively impacting rates of return on short-term investments occurring during the third and fourth quarters of 2001.

REALIZED GAINS ON SHORT-TERM INVESTMENTS. In 2001, net realized gains on short-term investments were \$0.4 million as compared to no realized gains on short-term investments in 2000. The increase during 2001 was due to realized gains recorded on short-term investments classified as trading securities during 2001. In 2000, the Acacia Technologies group did not classify any investments as trading securities.

UNREALIZED GAINS ON SHORT-TERM INVESTMENTS. In 2001, net unrealized gains were \$0.2 million as compared to no unrealized gains in 2000. The increase is due to the investment in equity securities during 2001 classified as trading securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Pursuant to SFAS No. 115, unrealized gains and losses on trading securities are recorded in the statement of operations. In 2000, all of the Acacia Technologies group's short-term investments were classified as available-for-sale, and pursuant to SFAS No. 115, unrealized gains and losses were recorded as a separate component of comprehensive income (loss)

in Acacia Technologies group equity until realized.

EQUITY IN LOSSES OF AFFILIATES. In 2001, equity in losses of affiliates was \$0.2 million as compared to \$1.7 million in 2000. Losses during 2001 were comprised of a loss of \$0.2 million for Acacia Research's investment in Acacia Media Technologies, as determined by the equity method of accounting through November 1, 2001. Acacia Research increased its ownership percentage in Acacia Media Technologies to 100% on November 1, 2001. Losses during 2000 were comprised of a loss of \$0.3 million, \$0.2 million, \$0.1 million and \$1.1 million for Acacia Research's investments in Signature-mail.com, Acacia Media Technologies, Whitewing Labs and Mediaconnex, respectively, as determined by the equity method of accounting. Acacia Research wrote-off its equity investments in Signature-mail.com, Whitewing Labs and Mediaconnex, as of December 31, 2000.

-188-

PROVISION FOR INCOME TAXES. In 2001, the provision for income taxes was \$0.9 million as compared to a provision of \$6,000 in 2000. The increase in 2001 was primarily due to a significant increase in taxable income generated by Soundview Technologies related to its patent infringement settlement and patent licensing activities as compared to the 2000 period.

DISCONTINUED OPERATIONS. On February 13, 2001, the board of directors of Soundbreak.com resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the company. Accordingly, the Acacia Technologies group reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in its statement of operations. Discontinued operations of Soundbreak.com included \$7.4 million of loss from discontinued operations in 2000 and \$2.1 million of accrued expenses in connection with its cessation of operations.

2000 COMPARED TO 1999

OTHER INCOME. Other income was \$0.04 million in 2000 as compared to \$0.1 million in 1999. Other income in 2000 represents advertising income recorded by or subsidiary. Other income in 1999 relates to capital management fees earned by Acacia Research Capital Management division, which was the general partner in two domestic private investment partnerships and an investment advisor to two offshore private investment corporations. The Acacia Research Capital Management division was closed in December 1999.

MARKETING, GENERAL AND ADMINISTRATIVE EXPENSES. The Acacia Technologies group incurred marketing, general and administrative expenses of \$9.0 million in 2000, as compared to expenses of \$3.2 million in 1999. The increase in 2000 was primarily due to the general expansion of Acacia Technologies group operations, including an increase in business development expenses as the Acacia Technologies group explored new business opportunities, including an increase in personnel and benefits costs, the extensive use of consultants to assist in solving specialized issues or providing specific services, and an increase in general office costs. Included in the marketing, general and administrative expenses of the Acacia Technologies group are allocated corporate charges of \$7.7 million and \$3.1 million in 2000 and 1999, respectively.

LEGAL EXPENSES. In 2000, legal expense was \$1.0 million as compared to \$0.3 million in 1999. The increase was primarily due to a general increase in the amount of third party legal services required by the Acacia Technologies group in 2000 related to various business transactions and other general legal and professional services costs.

AMORTIZATION OF PATENTS AND GOODWILL. Amortization expense relating to patents and goodwill was \$1.6 million in 2000 and 1999, and relates to Acacia Research's purchase of additional equity interests in Soundview Technologies in July 1997 and January 1998, and in MerkWerks in January 1998 and June 1999.

LOSS ON DISPOSAL OF SUBSIDIARIES. In 2000, loss on disposal of subsidiaries was \$1.0 million as compared to zero in 1999. In the fourth quarter of 2000, the Acacia Technologies group recorded \$1.0 million in write-offs of early stage investments.

OTHER EXPENSE, NET. In 2000, other expense, net (primarily comprised of interest income, write-off of equity investments, equity in losses of affiliates and other) of \$2.9 million as compared to other expense, net of \$0.8 million in 1999. The increase in 2000 was primarily due to \$2.6 million of write-offs of equity investments in Signature-mail.com, Whitewing Labs and Mediaconnex, and an increase in equity in losses of affiliates, partially offset by an increase in interest income in 2000.

INTEREST INCOME. In 2000, interest income was \$1.4 million as compared to \$0.3 million in 1999. The increase was due to higher cash balances in 2000 as compared to 1999. The Acacia Technologies group received gross proceeds of \$38.5 million from outside investors in connection with Acacia Research's warrant call and private equity financings in 2000.

EQUITY IN LOSSES OF AFFILIATES. In 2000, equity in losses of affiliates was \$1.7 million as compared to \$1.1 million in 1999. In 2000, losses were primarily attributable to a loss of \$1.1 million for Acacia Research's

-189-

investment in Mediaconnex. This amount was offset by a decrease in the recognized losses for Whitewing Labs, Acacia Media Technologies and Signature-mail.com totaling \$0.6 million in 2000 as compared to \$1.1 million in 1999.

DISCONTINUED OPERATIONS. On February 13, 2001, the board of directors of Soundbreak.com resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the company. Accordingly, the Acacia Technologies group reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the statements of operations in 2000. Discontinued operations of Soundbreak.com included \$7.4 million of loss from discontinued operations in 2000 and \$2.1 million of accrued expenses to be incurred in connection with its cessation of operations. Operating results in 1999 were restated to present Soundbreak.com as discontinued operations resulting in a loss from discontinued operations of \$0.8 million in 1999.

INFLATION

Inflation has not had a significant impact on the Acacia Technologies group in the current or previous periods.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2002 and December 31, 2001, the Acacia Technologies group had cash and short-term investments of \$43.6 million and \$51.2 million, respectively, including discontinued operations. Working capital was \$40.5 million and \$47.6 million at June 30, 2002 and December 31, 2001, respectively. The Acacia Technologies group's short-term investments are held primarily in

money market accounts and marketable equity securities.

Net cash used in continuing operating activities was \$2.8 million during the six months ended June 30, 2002. Net cash used in continuing operating activities was primarily due to a net loss from continuing operations of \$5.3 million, net sales of trading securities of \$3.1 million and a decrease in working capital of \$0.7 million. The Acacia Technologies group did not conduct any significant investing and financing activities during the six months ended June 30, 2002.

Net cash provided by continuing operating activities was \$6.8 million in 2001. The Acacia Technologies group's net income (loss) from continuing operating activities was \$5.8 million, \$(14.6) million and \$(5.8) million in 2001, 2000 and 1999. In 2001, Acacia Technologies' positive cash flows provided by continuing operating activities was primarily due to the receipt of \$24.2 million in settlement and license fee payments from several television manufactures related to Acacia Technologies' V-chip technology, offset by related legal expenses of \$11.5 million associated with the various license and/or settlement agreements. As discussed above, the V-chip patent expires in July 2003. In addition, cash flows from continuing operations was increased by the receipt of \$1.5 million in license fee payments that have been recorded as deferred revenues at December 31, 2001, and reduced by the purchase of \$4.1million in equity securities classified as trading securities. Included in division net income from continuing operating activities is \$2.6 million in non-cash expenses including depreciation, amortization and stock compensation charges. In 2001, the Acacia Technologies group had an additional \$2.2 million of net cash used in operating activities of discontinued operations.

The Acacia Technologies group's net cash used in investing activities of continuing operations was \$5.9 million in 2001. Significant investing activities allocated to the Acacia Technologies group in 2001 include net purchases of common stock from minority stockholders by Soundview Technologies totaling \$2.6 million and the purchase by Acacia Research Corporation of the minority interests in Acacia Media Technologies Corporation totaling \$3.3 million. The Acacia Technologies group had an additional \$0.1 million used in investing activities of discontinued operations.

Net cash attributed to the Acacia Technologies group was \$18.7 million, \$21.7 million and \$39.8 million in 2001, 2000 and 1999. Cash provided by financing activities in 2001 was primarily due to \$17.8 million of net proceeds allocated to the Acacia Technologies group related to Acacia Research Corporation institutional private

-190-

equity financing in January 2001 and allocated proceeds from the exercise of Acacia Research Corporation stock options and warrants totaling \$1.8 million.

In 2001, the Acacia Technologies group recorded net income of \$5.8 million. Prior to 2001, the Acacia Technologies group has sustained losses since its inception, contributing to an accumulated net loss of \$37.2 million (excluding impact of \$21.7 million related to 10% stock dividend in 2001), which includes income from continuing operations of \$5.8 million in 2001 and losses from continuing operations of \$6.6 million for the six months ended June 30, 2002, and \$(14.6) million and \$(5.8) million in 2000 and 1999, respectively. There can be no assurance that the Acacia Technologies group will continue to be profitable.

The Acacia Technologies group has no significant commitments for capital

expenditures in 2001. The Acacia Technologies group's minimum rental commitments on operating leases related to continuing operations total \$0.4 million through November 2003 (excluding any allocated rent expenses). The Acacia Technologies group has no committed lines of credit or other significant committed funding. However, the Acacia Technologies group anticipates that existing working capital reserves will provide sufficient funds for its operating expenses for at least the next twelve months in the absence of making any major new investments.

RECENT ACCOUNTING PRONOUNCEMENTS

Refer to Note 12 to the Acacia Technologies group financial statements included elsewhere herein.

-191-

ADOPTION OF 2002 COMBIMATRIX STOCK INCENTIVE PLAN AND 2002 ACACIA TECHNOLOGIES STOCK INCENTIVE PLAN

SUMMARY OF THE INCENTIVE PLANS

INTRODUCTION

The 2002 Acacia Technologies Stock Incentive Plan and the 2002 CombiMatrix Stock Incentive Plan, referred to below as the incentive plans, are intended to serve as successor plans to the Acacia Research 1996 Stock Option Plan. The 2002 CombiMatrix Plan is intended to serve as the successor plan to CombiMatrix Corporation's existing stock option plans, the 1995 CombiMatrix Corporation Stock Option Plan, the CombiMatrix Corporation 1998 Stock Option Plan and the CombiMatrix Corporation 2000 Stock Awards Plan.

Upon the consummation of the recapitalization, all outstanding options to purchase Acacia Research common stock under the Acacia Research 1996 Plan will be converted to replacement options to purchase AR-Acacia Technologies stock and AR-CombiMatrix stock and transferred to the 2002 Acacia Technologies Plan and the 2002 CombiMatrix Plan, respectively. Upon the consummation of the merger, all outstanding options to purchase CombiMatrix Corporation common stock under the existing CombiMatrix Corporation plans will be converted to replacement options to purchase AR-CombiMatrix stock and transferred to the 2002 CombiMatrix Plan.

The replacement options will continue to be governed by the terms of the original options unless our compensation committee decides to extend one or more features of the 2002 Acacia Technologies Plan or the 2002 CombiMatrix Plan to those options. Neither the Acacia Research 1996 Plan nor the existing CombiMatrix Corporation plans will be terminated. However, no further option grants will be made under those plans.

The terms of each of the incentive plans are identical except that AR-Acacia Technologies stock may be issued only under the 2002 Acacia Technologies Plan and AR-CombiMatrix stock may be issued only under the 2002 CombiMatrix Plan.

AR-ACACIA TECHNOLOGIES STOCK

The number of shares of AR-Acacia Technologies stock that will be authorized under the 2002 Acacia Technologies Plan will be equal to 5,700,000 minus the total number of shares of Acacia Research common stock issued upon the exercise of options granted under the Acacia Research 1996 Plan as of the effective date of the merger and recapitalization (whether such shares were

issued before, or will be issued after, the date of this proxy statement). As of November 1, 2002, a total of 492,145 shares of Acacia Research common stock had been issued upon the exercise of options granted under the Acacia Research 1996 Plan. Also as of that date, options to purchase 3,487,505 shares of Acacia Research common stock were outstanding under the Acacia Research 1996 Plan. Assuming no change in these numbers between November 1, 2002 and the effective date of the merger, the number of shares authorized under the 2002 Acacia Technologies Plan would be 5,207,855, the number of shares subject to outstanding options issued would be 3,487,505, and the number of shares remaining and available for issuance pursuant to new option grants would be 1,720,350.

The share reserve under the 2002 Acacia Technologies Plan will automatically increase on the first trading day in January each calendar year, beginning with calendar year 2003, by an amount equal to three percent of the total number of shares of AR-Acacia Technologies stock outstanding on the last trading day of December in the prior calendar year, but in no event will any such annual increase exceed 500,000 shares and in no event will the total number of shares of AR-Acacia Technologies stock in the share reserve (as adjusted for all such annual increases) exceed 20,000,000 shares. No participant in the 2002 Acacia Technologies Plan may be granted stock options, direct stock issuances or share right awards for more than 500,000 shares of AR-Acacia Technologies stock in total in any calendar year.

-192-

AR-COMBIMATRIX STOCK

The number of shares of AR-CombiMatrix stock that will be authorized under the 2002 CombiMatrix Plan will be equal to 9,000,000 minus the sum of (i) the exchange ratio in the merger of Acacia Research common stock for AR-CombiMatrix stock times the total number of shares of Acacia Research common stock issued upon the exercise of options granted under the Acacia Research 1996 Plan prior to the merger and recapitalization (whether such shares were issued before, or will be issued after, the date of this proxy statement) plus (ii) the total number of shares of CombiMatrix Corporation common stock issued upon the exercise of options granted under all of CombiMatrix Corporation's stock option plans prior to the effective time of the merger and recapitalization.

As of November 1, 2002, the exchange ratio would have been 0.5582, a total of 492,145 shares of Acacia Research common stock had been issued upon the exercise of options granted under the Acacia Research 1996 Plan, and a total of 232,970 shares of CombiMatrix Corporation common stock had been issued upon the exercise of options granted under all of CombiMatrix Corporation's stock option plans. Also as of that date, options to purchase 3,487,505 shares of Acacia Research common stock were outstanding under the Acacia Research 1996 Plan and options to purchase 3,717,660 shares of CombiMatrix Corporation common stock were outstanding under all of CombiMatrix Corporation common stock were outstanding under all of CombiMatrix Corporation's stock option plans. Assuming no change in these numbers between November 1, 2002 and the effective date of the merger, the number of shares authorized under the 2002 CombiMatrix Plan would be 8,492,315, the number of shares subject to outstanding options would be 5,664,385, and the number of shares remaining and available for issuance pursuant to new option grants would be 2,827,930.

The share reserve under the 2002 CombiMatrix Plan will automatically increase on the first trading day in January each calendar year, beginning with calendar year 2003, by an amount equal to three percent of the total number of shares of AR-CombiMatrix stock outstanding on the last trading day of December in the prior calendar year, but in no event will any such annual increase exceed

600,000 shares and in no event will the total number of shares of AR-CombiMatrix stock in the share reserve (as adjusted for all such annual increases) exceed 20,000,000 shares. No participant in the 2002 CombiMatrix Plan may be granted stock options, direct stock issuances or share right awards for more than 1,000,000 shares of AR-CombiMatrix stock in total in any calendar year.

PROGRAMS

GENERAL

Each of the incentive plans has four separate programs:

- o the discretionary option grant program, under which our compensation committee may grant (1) non-statutory options to purchase shares of AR-Acacia Technologies stock and AR-CombiMatrix stock, as applicable, to eligible individuals in the employ or service of Acacia Research or our subsidiaries (including employees, non-employee board members and consultants) at an exercise price not less than 85% of the fair market value of those shares on the grant date and (2) incentive stock options to purchase shares of AR-Acacia Technologies stock and AR-CombiMatrix stock, as applicable, to eligible employees at an exercise price not less than 100% of the fair market value of those shares on the grant date (not less than 110% of fair market value if such employee actually or constructively owns more than 10% of our voting stock or the voting stock of any of our subsidiaries);
- o the stock issuance program, under which eligible individuals may be issued shares of AR-Acacia Technologies stock and AR-CombiMatrix stock, as applicable, directly, upon the attainment of performance milestones or the completion of a specified period of service or as a bonus for past services;
- o the automatic option grant program, under which option grants will automatically be made at periodic intervals to eligible non-employee members of our board of directors to purchase shares of AR-Acacia Technologies stock and AR-CombiMatrix stock, as applicable, at an exercise price equal to 100% of the fair market value of those shares on the grant date; and

-193-

o the director fee option grant program, under which non-employee members of our board of directors may be given the opportunity to apply a portion of any retainer fee otherwise payable to them in cash each year to the acquisition of special below-market option grants.

Eligibility. The individuals eligible to participate in the incentive plans include officers, employees, board members and consultants of Acacia Research and our subsidiaries. However, only non-employee members of our board of directors are eligible to participate in the automatic option grant program and the director fee option grant program.

Administration. Our compensation committee will administer the discretionary option grant and stock issuance programs. This committee will determine which eligible individuals are to receive option grants or stock issuances under those programs, the time or times when the grants or issuances are to be made, the number of shares subject to each grant or issuance, the status of any granted option as either an incentive stock option or a non-statutory stock option under the federal tax laws, the vesting schedule to

be in effect for the option grant or stock issuance and the maximum term for which any granted option is to remain outstanding.

DISCRETIONARY OPTION GRANT PROGRAM. Under this program, employees, third party service providers and non-employee board members may be granted incentive stock options or non-statutory stock options.

Program Features. The discretionary option grant program will include the following features:

- o The exercise price for any option granted under the incentive plans may be paid in cash, or in shares of AR-Acacia Technologies stock if the options are for the purchase of AR-Acacia Technologies stock or in shares of AR-CombiMatrix stock if the options are for the purchase of AR-CombiMatrix stock. Any such stock used to pay all or a portion of the exercise price must have been held by the optionee for at least six months as of the exercise date and shall be valued at fair market value on the exercise date. The option may also be exercised through a same-day sale program without any cash outlay by the optionee.
- o The compensation committee will have the authority to cancel outstanding options under the discretionary option grant program in return for the grant of new options for the same or different number of option shares with an exercise price per share based upon the fair market value of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, on the new grant date.
- o Stock appreciation rights may be issued under the discretionary option grant program. These rights will provide the holders with the election to surrender their outstanding options for a payment from us equal to the fair market value of the shares subject to the surrendered options less the exercise price payable for those shares. We may make the payment in cash or in shares of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable.

CHANGE IN CONTROL. Unless otherwise set forth in the documents evidencing an option, in the event that we are acquired by merger, asset sale, or a successful tender offer for more than fifty percent of outstanding voting stock or there is a change in the majority of our board through one or more contested elections, each outstanding option under the discretionary option grant program, whether or not assumed by the successor corporation, will immediately become exercisable for all the option shares, and all outstanding unvested shares will immediately vest. In addition, our repurchase rights with respect to those shares shall automatically terminate.

STOCK ISSUANCE PROGRAM. Eligible individuals may be issued shares of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, through direct issuances in amounts to be determined by the compensation committee. Shares of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, may also be issued pursuant to awards that entitle the recipients to receive shares upon the attainment of designated performance goals. Under this program, the purchase price for the shares shall not be less than 100% of the fair market value of the shares on the date of issuance, and payment may be in the form of cash or past services rendered. In the event of a change of control, our repurchase rights for unvested shares under this program will terminate and all shares of stock subject to those rights shall immediately vest in full, except to the extent limited by the plan administrator.

AUTOMATIC OPTION GRANT PROGRAM. Each individual who first becomes a non-employee board member at any time after the date of the adoption of the incentive plans by our board of directors will automatically receive an option to purchase 20,000 shares of AR-Acacia Technologies stock and 20,000 shares of AR-CombiMatrix stock on the date the individual joins the board. In addition, on the first business day in each calendar year following the adoption of the incentive plans by our board of directors, each non-employee board member then in office, including each of our current non-employee board members who is then in office, will automatically be granted an option to purchase 15,000 shares of AR-Acacia Technologies stock and 15,000 shares of AR-CombiMatrix stock, provided that the individual has served on the board for at least six months.

Each automatic grant will have an exercise price per share equal to the fair market value per share of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, on the grant date and will have a term of 10 years, subject to earlier termination following the optionee's cessation of board service. Each 20,000-share initial grant and each annual 15,000-share option grant shall become exercisable in a series of four equal quarterly installments upon the optionee's completion of each three months of service as a board member over the 12-month period measured from the option grant date.

Under the Acacia Research 1996 Plan, each non-employee director automatically receives a nondiscretionary grant of options to purchase 22,000 shares of Acacia Research common stock upon initially joining the board of directors. In addition, provided that the individual has served on the board for at least six months, on the first day in each calendar year, each non-employee director will receive a nondiscretionary grant of options to purchase 13,200 shares of Acacia Research's common stock. All such grants are made at an exercise price equal to the fair market value of the Acacia Research common stock on the date of grant.

In the event of a change in control of our company while the optionee remains on our board, each outstanding option under this program will automatically accelerate so that each option shall vest and become exercisable immediately prior to the change in control.

DIRECTOR FEE OPTION GRANT PROGRAM. If this program is put into effect in the future, then each non-employee member of our board may elect to apply all or a portion of any cash retainer fee for the year to the acquisition of a below-market option grant. The option grant will automatically be made on the first trading day in January in the year for which the non-employee board member would otherwise be paid the cash retainer fee in the absence of his or her election. The option will have an exercise price per share equal to one-third of the fair market value of the option shares on the grant date, and the number of shares subject to the option will be determined by dividing the amount of the retainer fee applied to the program by two-thirds of the fair market value per share of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, on the grant date. As a result, the option will be structured so that the fair market value of the option shares on the grant date less the aggregate exercise price payable for those shares will be equal to the portion of the retainer fee applied to that option. The option will become exercisable in a series of twelve equal monthly installments over the calendar year for which the election is in effect. However, the option will become immediately exercisable for all the option shares upon the death or disability of the optionee while serving as a board member. In the event of a change in control while the optionee remains on our board, each outstanding option under this program will automatically accelerate so that each option shall vest and become exercisable immediately prior to the change in control.

ADDITIONAL PROGRAM FEATURES. The incentive plans will also have the following features:

Limited stock appreciation rights will automatically be included as 0 part of each grant made under the automatic and director fee option grant programs, and these rights may also be granted to one or more of our officers as part of their option grants under the discretionary option grant program. Options with this feature may be surrendered to us upon the successful completion of a hostile tender offer for more than 50% of our outstanding voting stock or a change in the majority of our board through one or more contested elections. In return for the surrendered option, the optionee will be entitled to a cash payment from us in an amount per surrendered option share based upon the highest price per share of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, paid in a tender offer, or the fair market value per share of AR-Acacia Technologies stock or AR-CombiMatrix stock, as applicable, on the effective date of a change in the majority of our board.

-195-

o Our board may amend or modify the incentive plans at any time, subject to any required stockholder approval. The incentive plans will terminate no later than the tenth anniversary of the approval of the incentive plans by our stockholders.

NEW PLAN BENEFITS

The following table sets forth the beneficial ownership of the AR-CombiMatrix stock and the AR-Acacia Technologies stock, based on share ownership information known to us as of November 1, 2002 and assuming that the recapitalization and merger were effective as of such date and assuming that each share of Acacia Research common stock would convert into 0.5582 of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock.

The following table sets forth pro forma information regarding the option issuances to be made under the 2002 Acacia Technologies Stock Incentive Plan and the 2002 CombiMatrix Stock Incentive Plan by the conversion of all options currently outstanding under the Acacia Research 1996 Stock Option Plan and the existing stock option plans of CombiMatrix Corporation, based on information known to us as of November 1, 2002 and assuming that: (i) the recapitalization and merger were effective as of such date, (ii) the stockholders have approved each of the proposals to be voted on at the special meeting and (iii) each share of Acacia Research common stock would convert into 0.5582 of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock:

| | NUMBEI | R OF UNITS |
|--|--|--|
| NAME AND POSITION | 2002 COMBIMATRIX STOCK INCENTIVE PLAN | 2002 ACACIA TECHNOLOGIES STOCK INCENTIVE PLAN |
| Paul R. Ryan, Chairman and Chief Executive Officer Robert L. Harris, II, | 534,974 | 841,963 |
| Amit Kumar, Ph.D., | 478,666 | 759,001 |

NEW PLAN BENEFITS

| Chief Executive Officer and President of | | |
|--|------------------|-----------|
| CombiMatrix Corporation | 571 , 658 | 397,103 |
| Executive Group | 1,622,139 | 2,064,067 |
| Non-Executive Director Group | 161,223 | 190,300 |
| Non-Executive Officer Employee Group | 2,816,026 | 1,189,899 |

-196-

EQUITY COMPENSATION PLAN INFORMATION

Below is a tabular presentation of information regarding the existing stock option plans of Acacia Research as of the end Acacia Research's last fiscal year:

| PLAN CATEGORY | <pre>(A) NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS</pre> | (B) WEIGHTED-AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS AND RIGHTS | AV IS (E REF |
|--|--|--|---------------------------|
| Equity compensation plans approved by security holders(1) | 3,482,245 | \$16.94 | |
| Equity compensation plans not approved by security holders(2) | N/A | N/A | |
| TOTAL | 3,482,245 | \$16.94 | |

- (1) The sole plan under which equity securities of Acacia Research are authorized for issuance is its Acacia Research Corporation 1996 Stock Option Plan, which has previously been approved by security holders. Acacia Research proposes herein to adopt two new plans, the 2002 Acacia Technologies Stock Incentive Plan and the 2002 CombiMatrix Stock Incentive Plan. For a description of our proposed new stock option plans, please see the discussion above.
- (2) Acacia Research has not authorized the issuance of its equity securities under any plan not approved by security holders.

MATERIAL UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

We believe that, based upon the laws as in effect on the date of this document, the following are the material United States federal income tax consequences to participants and us of awards granted under the incentive plans. State, local and foreign laws are not discussed. The discussion assumes that participants acquiring stock under the incentive plans will hold such stock as a capital asset. THIS SUMMARY IS NOT A COMPLETE ANALYSIS OF ALL POTENTIAL TAX CONSEQUENCES RELEVANT TO US AND PARTICIPANTS UNDER THE INCENTIVE PLANS AND DOES NOT DESCRIBE TAX CONSEQUENCES BASED ON PARTICULAR CIRCUMSTANCES. FOR THESE REASONS, PARTICIPANTS SHOULD CONSULT THEIR OWN TAX ADVISORS AS TO ANY SPECIFIC

QUESTIONS REGARDING THE TAX CONSEQUENCES OF AWARDS GRANTED UNDER THE INCENTIVE PLANS.

INCENTIVE STOCK OPTIONS

The grant of an incentive stock option does not give rise to federal income tax to the option holder. Similarly, the exercise of an incentive stock option generally does not give rise to federal income tax to the option holder, as long as the option holder is continuously employed by us or our subsidiaries from the date the option is granted until three months prior to the date the option is exercised. This employment requirement is subject to certain limited exceptions. Under proposed regulations issued by the Internal Revenue Service ("IRS") in 2001, FICA and Medicare tax withholding will be required upon the exercise of an incentive stock option on or after January 1, 2003. The proposed regulations will not become effective unless and until they are published as final regulations. The exercise of an incentive stock option may cause the option holder to incur alternative minimum tax liability.

If the option holder holds the option shares acquired upon exercise of an incentive stock option for more than two years from the date the option is granted and more than one year from the date of exercise, any gain or loss recognized on the sale or other disposition of the option shares will be capital gain or loss, measured by the difference between the sales price and the amount paid for the shares by the option holder. The capital gain or loss will be long-term or short-term, depending on the option holder's holding period for the shares. If the option holder disposes of the option shares before the end of the required holding period, the option holder will recognize taxable ordinary income at the time of the disposition equal to the excess, if any, of (i) the fair market value of the option shares at the time of exercise (or, under certain circumstances, the selling price, if lower) over (ii) the exercise price

-197-

paid by the option holder. Any additional amount received by the option holder will be treated as capital gain, which will be long-term or short-term, depending on the holding period for the shares.

We are generally not entitled to a tax deduction at any time with respect to an incentive stock option. If, however, the option holder does not satisfy the employment or holding period requirements described above, we will be allowed a deduction in an amount equal to the ordinary income recognized by the option holder, subject to certain limitations and W-2 reporting requirements.

NON-STATUTORY STOCK OPTIONS

The grant of a non-statutory stock option generally does not result in federal income tax to the option holder. However, the option holder will recognize taxable ordinary income upon the exercise of a non-statutory option equal to the excess of the fair market value of the option shares on the exercise date over the exercise price paid by the option holder. However, if stock acquired under an option is subject to certain transfer restrictions and vesting requirements, rules similar to those discussed below under "Stock Grants Under Stock Issuance Program" will apply with respect to the timing and amount for ordinary income to be recognized by the option holder and the availability of an election under Section 83(b) of the Internal Revenue Code (the "Code").

On the sale of shares acquired under an option, the option holder will recognize capital gain or loss in an amount equal to the difference between the sales price and the sum of the exercise price paid by the option holder for the

shares plus any amount recognized as ordinary income upon the exercise of the option.

With respect to employees, we are required to withhold income and employment taxes based on the amount of ordinary income recognized by the option holder. If the option holder is required to recognize ordinary income under the above rules, we will be allowed a tax deduction in the amount of such ordinary income, subject to certain limitations and W-2 or 1099 reporting requirements.

STOCK GRANTS UNDER STOCK ISSUANCE PROGRAM

The recipient will generally recognize taxable ordinary income on the receipt of a direct grant of stock in an amount equal to the fair market value of the shares on the date of grant. However, to the extent the stock is subject to certain transfer restrictions and vesting requirements imposed when the stock is granted, no taxable income will be recognized by the recipient upon the grant of such stock unless the recipient makes an election under Section 83(b) of the Code. If the recipient does not file a timely Section 83(b) election with the IRS with respect to such unvested shares, he or she will recognize ordinary income at the time his or her interest in the shares becomes vested. The amount of this ordinary income will be equal to the fair market value of the shares on the date or dates the shares become vested, less the amount, if any, the recipient paid for the shares.

If the recipient files a Section 83(b) election with the IRS on a timely basis, the recipient will recognize ordinary income equal to the fair market value of the shares received on the date of grant (rather than the date the shares become vested), less the amount, if any, paid for the shares by the recipient.

If the recipient forfeits shares for which he or she has made a Section 83(b) election because the recipient failed to satisfy the vesting requirements, he or she will not be entitled to a deduction for the ordinary income previously recognized as a result of the election. Recipients of stock grants should consult their tax advisor regarding the possible use of a Section 83(b) election, which must be made within 30 days following the grant of the shares to the recipient.

On the sale of shares acquired under a stock grant, the recipient will recognize capital gain or loss in an amount equal to the difference between the sales price and the sum of the purchase price paid by the recipient, if any, for the shares plus any amount recognized as ordinary income upon the receipt or vesting of the shares or pursuant to a Section 83(b) election.

With respect to employees, we are required to withhold income and employment taxes based on the amount of ordinary income recognized by the recipient on the receipt or vesting of shares or in connection a Section 83(b)

-198-

election made by the recipient. If the recipient is required to recognize ordinary income under the above rules, we will be allowed a tax deduction in the amount of such ordinary income, subject to certain limitations and W-2 or 1099 reporting requirements.

CAPITAL GAINS AND LOSSES

Under current law, capital gain or loss on the sale of stock acquired by participants under the incentive plans will be long-term if the participant's

holding period for the shares is more than one year and short-term if the participant's holding period for the shares is one year or less. Under current law, there is a maximum federal tax rate of 20% for long-term capital gains and short-term capital gains are taxed at the same rates as ordinary income. The deductibility of capital losses is subject to certain limitations.

CHANGE IN CONTROL

In general, if the total payments to an individual that are contingent upon a "change in control" of Acacia Research (as defined in Section 280G of the Code), including payments or rights under the incentive plans that vest upon a "change in control," equal or exceed three times the individual's "base amount" (generally, such individual's average annual compensation for the five calendar years preceding the change in control), then, subject to certain exceptions, the payments may be treated as "parachute payments" under the Code. The excess of the parachute payments to an individual over the individual's base amount is not deductible by us and the individual is subject to a 20% excise tax on the non-deductible portion of the parachute payments.

CERTAIN LIMITATIONS ON DEDUCTIBILITY OF EXECUTIVE COMPENSATION

Section 162(m) of the Code generally denies a deduction to publicly held corporations for compensation paid to certain executive officers in excess of \$1 million per executive per taxable year (including any deduction attributable to stock options or stock grants). Certain kinds of compensation, including qualified "performance-based compensation," are disregarded for purposes of the deduction limitation. Compensation attributable to stock options will qualify as performance-based compensation if the exercise price of the options is no less than the fair market value of the underlying stock on the date of grant, the options are granted by a compensation committee comprised solely of "outside directors" (as defined in the Treasury Regulations issued under Section 162(m)) and certain other requirements are met. Compensation attributable to stock grants or share right awards may also qualify as performance-based compensation if the grant or vesting of the stock is based on the attainment of a specific performance goal and otherwise satisfies the standards for performance-based compensation.

The incentive plans are not subject to any provisions of the Employee Retirement Income Security Act of 1974 ("ERISA") and are not qualified under Section 401(a) of the Code.

VOTE REQUIRED

Approval of each incentive plan proposal requires the favorable vote of a majority of the shares present or represented and entitled to vote at the special meeting.

RECOMMENDATION OF OUR BOARD OF DIRECTORS

OUR BOARD OF DIRECTORS HAS CAREFULLY CONSIDERED EACH INCENTIVE PLAN PROPOSAL AND BELIEVES THAT THESE PROPOSALS ARE IN THE BEST INTERESTS OF ACACIA RESEARCH AND OUR STOCKHOLDERS. OUR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT YOU APPROVE THESE PROPOSALS.

-199-

OTHER ITEMS

PRICE RANGE AND DIVIDENDS ON EXISTING COMMON STOCK

Our common stock currently is listed on the NASDAQ National Market ("NASDAQ") under the symbol "ACRI". The table below sets forth, for the fiscal periods indicated, the high and low sale prices per share of our common stock on the NASDAQ and the cash distributions declared relating to such periods.

| | SALES PRICE PE OUR COMMON | | | |
|---|--|--|--------------------------------------|--|
| | HIGH | LOW | DISTRIBUTION DECLARED(1) | |
| 2002 | | | | |
| First Quarter Second Quarter Third Quarter Fourth Quarter (through November 7, 2002) | \$13.260 \$11.500 \$ 7.150 \$ 5.300 | \$8.470 \$5.900 \$3.500 \$3.650 | \$0.00 \$0.00 \$0.00 N/A | |
| 2001 First Quarter Second Quarter Third Quarter Fourth Quarter | \$18.977 \$16.136 \$16.655 \$13.418 | \$5.227 \$4.687 \$5.827 \$8.291 | \$0.00 \$0.00 \$0.00 \$0.00 | |

(1) A ten percent stock dividend was declared on October 22, 2001.

The closing sale price of our common stock on the NASDAQ was \$9.33 per share on March 19, 2002, the trading day prior to our announcement of the merger and recapitalization proposal, and \$5.02 per share on November 7, 2002, the last trading day prior to the date of this proxy statement. As of November 1, 2002, 19,640,808 shares of our common stock were outstanding and we had 199 holders of record.

INFORMATION ABOUT STOCKHOLDER PROPOSALS

Proposals of stockholders intended to be presented at the 2003 Annual Meeting must be received by Acacia Research by January 14, 2003 to be considered for inclusion in Acacia Research's proxy statement relating to that meeting. Stockholders desiring to present a proposal at the 2003 Annual Meeting but who do not desire to have the proposal included in the proxy materials distributed by Acacia Research must deliver written notice of such proposal to Acacia Research on or after January 14, 2003 and on or before February 13, 2003, or the persons appointed as proxies in connection with the 2003 Annual Meeting will have discretionary authority to vote on any such proposal.

EXPENSES OF SOLICITATION

We will pay the cost of soliciting proxies for the special meeting. In addition to soliciting by mail, our directors, officers and other employees may solicit proxies in person, or by telephone, facsimile transmission or other means of electronic communication. We will also pay brokers, nominees, fiduciaries and other custodians their reasonable fees and expenses for sending proxy materials to beneficial owners and obtaining their instructions. We have retained Georgeson Shareholder to perform various solicitation services. We will pay Georgeson Shareholder a fee of \$6,500, plus phone and other related expenses, in connection with their solicitation services. -200-

LEGAL OPINIONS

Allen Matkins Leck Gamble & Mallory LLP, Los Angeles, California, has rendered an opinion concerning the validity of the common stock. PricewaterhouseCoopers LLP has rendered an opinion regarding the tax treatment of the transactions.

EXPERTS

The consolidated financial statements of Acacia Research as of December 31, 2000 and 2001 and for each of the three years in the period ended December 31, 2001 included in this proxy statement have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The financial statements of CombiMatrix Corporation (a development stage company) as of December 31, 2000 and 2001 and for each of the three years in the period ended December 31, 2001 and the period from inception (October 4, 1995) to December 31, 2001, included in this proxy statement have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The divisional financial statements of the CombiMatrix group (a development stage division of Acacia Research) as of December 31, 2000 and 2001 and for each of the three years in the period ended December 31, 2001 and the period from inception (October 4, 1995) to December 31, 2001, included in this proxy statement have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants given on the authority of said firm as experts in auditing and accounting.

The divisional financial statements of the Acacia Technologies group (a division of Acacia Research) as of December 31, 2000 and 2001 and for each of the three years in the period ended December 31, 2001 included in this proxy statement have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

Representatives of PricewaterhouseCoopers LLP will attend the special meeting and will have an opportunity to make a statement and to respond to appropriate questions that you pose.

-201-

INDEX

FINANCIAL INFORMATION

Acacia Research Corporation Report of Independent Accountants Consolidated Balance Sheets Consolidated Statements of Operations and Comprehensive Loss Consolidated Statements of Stockholders' Equity Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

CombiMatrix Corporation (a development stage company) Report of Independent Accountants Consolidated Balance Sheets Consolidated Statements of Operations Consolidated Statements of Stockholders' Equity and Comprehensive Loss Consolidated Statements of Cash Flows Notes to Consolidated Financial Statements *Acacia Technologies Group (a division of Acacia Research Corporation) Report of Independent Accountants Balance Sheets Statements of Operations Statements of Funds Allocated by Acacia Research Corporation and Accumulated Net Losses Statements of Cash Flows Notes to Financial Statements *CombiMatrix Group (a development stage division of Acacia Research Corporation) Report of Independent Accountants Balance Sheets Statements of Operations Statements of Funds Allocated by Acacia Research Corporation and Accumulated Net Losses Statements of Cash Flows

*NOTE: WE ARE PRESENTING, ALONG WITH OUR FINANCIAL STATEMENTS, THE SEPARATE FINANCIAL STATEMENTS FOR THE COMBIMATRIX GROUP AND THE ACACIA TECHNOLOGIES GROUP. THE SEPARATE FINANCIAL STATEMENTS AND ACCOMPANYING NOTES OF THE TWO GROUPS ARE BEING PROVIDED AS ADDITIONAL DISCLOSURE REGARDING THE HISTORICAL FINANCIAL PERFORMANCE OF THE TWO DIVISIONS AND TO PROVIDE INVESTORS WITH INFORMATION REGARDING THE POTENTIAL VALUE AND PROFITABILITY OF THE RESPECTIVE BUSINESSES, WHICH MAY AFFECT THE RESPECTIVE SHARE VALUES. THE SEPARATE FINANCIAL STATEMENTS SHOULD BE REVIEWED IN CONJUNCTION WITH ACACIA RESEARCH CORPORATION'S FINANCIAL STATEMENTS AND ACCOMPANYING NOTES. THE PRESENTATION OF SEPARATE FINANCIAL STATEMENTS IS NOT INTENDED TO INDICATE THAT WE HAVE CHANGED THE TITLE TO ANY OF OUR ASSETS OR CHANGED THE RESPONSIBILITY FOR ANY OF OUR LIABILITIES, NOR IS IT INTENDED TO INDICATE THAT THE RIGHTS OF OUR CREDITORS HAVE BEEN CHANGED. WE, AND NOT THE INDIVIDUAL GROUPS, WILL BE THE ISSUER OF THE SECURITIES. HOLDERS OF THE TWO SECURITIES WILL CONTINUE TO BE STOCKHOLDERS OF ACACIA RESEARCH AND WILL NOT HAVE A SEPARATE AND EXCLUSIVE INTEREST IN THE RESPECTIVE GROUPS.

F-1

ACACIA RESEARCH CORPORATION

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Acacia Research Corporation

Notes to Financial Statements

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity, and of cash flows present fairly, in all material respects, the financial position of Acacia Research Corporation ("Acacia" or "we") and its subsidiaries at December

31, 2001 and December 31, 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of Acacia's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2001, Acacia changed its balance sheet classification for accrued subsidiary employee stock-based compensation charges, resulting in no cumulative effect on income.

As discussed in Note 2 to the consolidated financial statements, effective October 1, 2000, Acacia adopted Emerging Issues Task Force Consensus on Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," resulting in a charge of \$246,000 in the year ended December 31, 2000 for cumulative effect of change in accounting principle due to beneficial conversion feature of debt.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California February 25, 2002, except as to Note 14, which is as of March 27, 2002 and except as to Note 18, which is as of May 2, 2002

F-2

ACACIA RESEARCH CORPORATION CONSOLIDATED BALANCE SHEETS (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

| | AT DECEMBER 31, | | , AT J | |
|---|--------------------|--------------------|--------|--|
| | 2001 | 2000 | | |
| | | | (UNAU | |
| ASSETS | | | | |
| CURRENT ASSETS: | | | | |
| Cash and cash equivalents | \$ 59 , 451 | \$ 36 , 163 | \$ 4 | |
| Short-term investments | 25,110 | 40,600 | 1 | |
| Prepaid expenses, other receivables and other assets | 1,613 | 1,471 | | |
| Total current assets | 86,174 | 78,234 | | |
| Property and equipment, net of accumulated depreciation | 4,906 | 3,727 | | |
| Investment in affiliate, at equity | | 346 | | |
| Investment in affiliate, at cost | 3,000 | 3,000 | | |
| Patents, net of accumulated amortization | 11,855 | 9,038 | 1 | |
| | | | | |

| Goodwill, net of accumulated amortization Other assets | 297 | 3,904 267 |
|---|-------------------|---------------------------------|
| | \$ 110,859 | \$ 98,516 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Accounts payable, accrued expenses and other | \$ 5 , 756 | |
| Current portion of deferred revenues | 7,088 | |
| Current portion of capital lease obligation | 934 | |
| Accrued stock compensation (Note 2) | | 10,392 |
| Total current liabilities | | 18,159 |
| Deferred income taxes | | 2,689 |
| Deferred revenues, net of current portion | 372 | |
| Capital lease obligation, net of current portion | 1,845 | |
| | | |
| Total liabilities | 19,824 | 20,848 |
| COMMITMENTS AND CONTINGENCIES (NOTE 12): | | |
| Minority interests | 32,303 | 17,524 |
| <pre>STOCKHOLDERS' EQUITY: Preferred stock, par value \$0.001 per share; 20,000,000 shares authorized; no shares issued or outstanding Common stock, par value \$0.001 per share; 60,000,000 shares authorized; 19,592,459 and 16,090,587 (Notes 1 and 7) shares issued and outstanding as of December 31, 2001 and 2000, respectively, and 19,640,808 at June 30, 2002 Additional paid-in capital Warrants to purchase common stock Comprehensive (loss) income Accumulated deficit Total stockholders' equity</pre> | 199 (4) | 116,017 86 77 (56,052) |
| Total stockholders' equity | 58,732 | |
| | \$ 110,859 | \$ 98,516 |
| | | |

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

F-3

ACACIA RESEARCH CORPORATION CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION)

| | | FOR | THE | YEARS | ENDED |
|--|--|-----|-----|-------|-------|
|--|--|-----|-----|-------|-------|

| 2001 | 2000 |
|------|------|
| | |

REVENUES:

| License fee income | \$ | 24,180 | \$ | |
|---|-----|-----------|-----|---------------|
| Grant revenue | | 456 | | |
| Other income | | | | |
| | | | | |
| Total revenues | | 24,636 | | |
| | | | | |
| OPERATING EXPENSES: | | | | |
| Research and development expenses | | 11,656 | | 8,4 |
| Non-cash stock compensation expense - research and development | | 7,183 | | 3,3 |
| Marketing, general and administrative expenses | | 32,664 | | |
| Non-cash stock compensation expense - marketing, general and | | 52,004 | | 17 , / |
| administrative | | 13,636 | | 7,3 |
| | | 2,695 | | |
| Amortization of patents and goodwill | | | | |
| Loss on disposal of consolidated subsidiaries | | | | 1,0 |
| | | | | |
| Total operating expenses | | 67,834 | | 37,2 |
| | | | | |
| Operating loss | | (43,198) | | (37,1 |
| | | | | |
| OTHER INCOME (EXPENSE): | | | | |
| Write-off of equity investments | | | | (2,6 |
| Interest income | | 3,762 | | 3,0 |
| Realized gains (losses) on short-term investments | | 350 | | |
| Unrealized gains (losses) on short-term investments | | 237 | | |
| Interest expense | | (65) | | |
| Equity in losses of affiliates | | (195) | | (1,7) |
| Other income | | 77 | | |
| | | | | |
| Total other income (expense) | | 4,166 | | (1,2) |
| | | -, | | |
| Loss from continuing operations before income taxes and minority | | | | |
| interests | | (39,032) | | (38 3) |
| (Provision) benefit for income taxes | | (780) | | (30,3 |
| (FIGVISION) Denetic for income caxes | | (780) | | |
| Loss from continuing operations before minority interests | | | | (20 2 |
| Loss from continuing operations before minority interests | | (39,812) | | |
| Minority interests | | 17,540 | | 9,1 |
| | | (22, 272) | | (00 1 |
| Loss from continuing operations | | (22,272) | | (29,1 |
| Discontinued operations | | | | |
| Loss from discontinued operations of Soundbreak.com | | | | (7,4) |
| Estimated loss on disposal of Soundbreak.com | | | | (2,1 |
| | | | | |
| Loss before cumulative effect of change in accounting principle | | (22,272) | | (38,7) |
| Cumulative effect of change in accounting principle due to beneficial | | | | |
| conversion feature of debt | | | | (2) |
| | | | | |
| Net loss | | (22,272) | | (38,9 |
| Unrealized (loss) gain on short-term investments | | (9) | | |
| Unrealized loss on foreign currency translation | | (72) | | |
| | | | | |
| Comprehensive loss | \$ | (22,353) | \$ | (38,8) |
| - | === | ======= | | ====== |
| Loss per common share: | | | | |
| Basic | | | | |
| Loss from continuing operations | \$ | (1.16) | \$ | (1. |
| Loss from discontinued operations | Ŷ | (1.10) | Ŷ | (0. |
| | | | | (0. |
| Cumulative effect of change in accounting principle | | | | (0. |
| Not loss | ~ | /1 1 () | ~ | |
| Net loss | Ş | (1.16) | Ş | (2. |
| | === | | ==: | |
| Diluted | | | | |
| Loss from continuing operations | \$ | (1.16) | \$ | (1. |
| | | | | |

| Loss from discontinued operations Cumulative effect of change in accounting principle | | | | (0.5 (0.0 | |
|---|--------|--------|--------|---|--|
| Net loss | \$ | (1.16) | \$ | (2.3 | |
| Weighted average number of common and potential common shares outstanding used in computation of loss per share: Basic Diluted | , , | | , | <pre>====================================</pre> | |

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

F-4

ACACIA RESEARCH CORPORATION CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS (IN THOUSANDS, EXCEPT SHARE AND PER SHARE INFORMATION) (UNAUDITED)

| | | THREE MONTHS ENDED | | |
|--|----------|--------------------|--|--|
| | JUNE 30, | JUNE 30, 2001 | | |
| Revenues: | | | | |
| License fee income | \$ | \$ 10,000 | | |
| Product revenue | 274 | | | |
| Grant revenue | 164 | 91 | | |
| Total revenues | 438 | , | | |
| Operating expenses: | | | | |
| Cost of sales | 253 | | | |
| Research and development expenses | 5,026 | 2,651 | | |
| Non-cash stock compensation expense - research and development | 692 | 2,013 | | |
| Marketing, general and administrative expenses Non-cash stock compensation expense - marketing, general and | 5,516 | 9,550 | | |
| administrative | 1,451 | 5,176 | | |
| Amortization of patents and goodwill | 564 | | | |
| Total operating expenses | 13,502 | 20,028 | | |
| Operating loss | |) (9,937 | | |
| Other (expense) income: | | | | |
| Interest income | 293 | 1,029 | | |
| Realized losses on short-term investments | |) | | |
| Unrealized losses on short-term investments | (156) |) | | |
| Interest expense | (57) |) | | |
| Equity in losses of affiliate | | (55 | | |
| Other income | 34 | ÷. | | |
| | | | | |

| Total other (expense) income | | (816) | | 1,031 |
|--|-----------|---------------------|-----------|--------------------|
| Loss from operations before income taxes and minority interests Benefit (provision) for income taxes | | (13,880) 75 | | (8,906) (228) |
| Loss from operations before minority interests Minority interests | | (13,805) 4,104 | | (9,134) 4,362 |
| Net loss Unrealized gains (losses) on short-term investments Unrealized gains on foreign currency translation | | (9,701) 47 62 | | (4,772) |
| Comprehensive loss | \$ === | (9,592) | \$ === | (4,772) |
| Loss per common share: | | | | |
| Basic | \$ === | (0.49) | | (0.25) |
| Diluted | | (0.49) | \$ === | (0.25) |
| Weighted average number of common and potential common shares outstanding used in computation of loss per share: Basicanddiluted | 19 === | ,634,549 ====== | 19 === | ,503,645 ====== |

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

F-5

ACACIA RESEARCH CORPORATION CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (IN THOUSANDS, EXCEPT SHARE INFORMATION)

| | COMMON SHARES | COMMON STOCK | ADDITIONAL PAID-IN CAPITAL | WARRANTS TO PURCHASE COMMON STOCK | ACCUM DEF |
|--|------------------|-----------------|----------------------------------|--|--------------|
| 1999 | | | | | |
| Balance at December 31, 1998 | 10,190,815 | \$10 | \$ 26,727 | \$ 100 | \$ (|
| Net loss | | | | | (|
| Units issued in private | | | | | |
| placements, net | 974,771 | 1 | 19,014 | 58 | |
| Shares issued to purchase | CO 107 | | 0.00 | | |
| equity investments | 60,107 | | 288 | | |
| Stock options exercised | 326,450 | | 757 | | |
| Warrants exercised Increase in capital due to issuance | 2,055,050 | 2 | 14,542 | (100) | |
| of stock by subsidiaries Compensation expense relating to | | | 928 | | |
| stock options and warrants | | | 27 | | |
| Balance at December 31, 1999 | 13,607,193 | 14 | 62,283 | 58 | (1 |

| Net loss | | | | | (3 |
|--|--------------------|-------------|------------------|------------|-------|
| Units issued in private placements, net Stock options exercised Stock issuance related to acquisition | 872,638 543,961 | 1 1 | 22,199 2,131 | 86 | |
| of additional CombiMatrix shares Warrants exercised | 488,557 578,238 | | 11,634 14,878 | (58) | |
| Increase in capital due to issuance of stock by subsidiaries Compensation expense relating | | | 2,293 | | |
| to stock options and warrants Unrealized gain on short-term investments | | | 599 | | |
| 1 | | | | | |
| Balance at December 31, 2000 | 16,090,587 | 16 | 116,017 | 86 | (5 |
| 2001 Net loss Units issued in private | | | | | (2 |
| placement, net | 1,127,274 | 1 | 18,247 | 113 | |
| Stock options exercised Increase in capital due to issuance | 596,888 | 1 | 1,251 | | |
| of stock by subsidiaries Compensation expense relating to | | | 1,283 | | |
| stock options and warrants | 1 777 710 | 0 | 47 | | () |
| Stock dividend (Note 1 and 7) Unrealized loss on short-term investments | 1,777,710 | 2 | 21,684 | | (2 |
| Unrealized loss on foreign currency translation | | | | | |
| Balance at December 31, 2001 | 19,592,459 | 20 | 158,529 | 199 | (10 |
| FOR THE SIX MONTHS ENDED JUNE 30, 2002 (UNAUDITED) | | | | | |
| Net loss Stock options exercised | 48,349 | | 136 | | (1 |
| Compensation expense relating to stock options and warrants | | | 19 | | |
| Unrealized loss on short-term investments | | | | | |
| Unrealized gain on foreign currency translation | | | | | |
| Other | | | (12) | | |
| Balance at June 30, 2002 (Unaudited) | 19,640,808 | \$20 === | \$158,672 | \$ 199 | \$(11 |
| | | === | | ===== | |

THE ACCOMPANYING NOTES ARE AN INTEGRAL PART OF THESE CONSOLIDATED FINANCIAL STATEMENTS.

F-6

ACACIA RESEARCH CORPORATION CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

| | FOR THE YEARS ENDED DECE | |
|--|--------------------------|----------------|
| | 2001 | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Loss from continuing operations Adjustments to reconcile net loss to net cash used in operating | \$(22 , 272) | \$(29,159) |
| activities: | 2 0 0 0 | |
| Depreciation and amortization | 3,869 | 2,657 1,746 |
| Equity in losses of affiliates | 195 | (9,166) |
| Minority interests in net loss Compensation expense relating to stock options and warrants | 20,819 | 10,704 |
| Charge for acquired in-process research and development | 20,019 | 2,508 |
| Deferred tax benefit | (182) | (81) |
| Write-off of other assets | 918 | (01) |
| Write-off of equity investments | | 2,603 |
| Net (purchases) sales of trading securities | (4,135) | • |
| Unrealized (gains) losses on short-term investments | (237) | |
| Other | 354 | 293 |
| 00001 | 551 | 295 |
| CHANGES IN ASSETS AND LIABILITIES, NET OF EFFECTS OF ACQUISITIONS: | | |
| Prepaid expenses, other receivables and other assets | (713) | (2,029) |
| Accounts payable, accrued expenses and other | 1,085 | |
| Deferred revenues | 7,460 | 2,010 |
| | | |
| Net cash used in operating activities of continuing operations | (10,379) | (17, 884) |
| Net cash used in operating activities of discontinued operations | | (16,600) |
| | | |
| Net cash used in operating activities | (12,561) | (34,484) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of equity investments | | (54) |
| Purchase of additional equity in consolidated subsidiaries | (3,304) | (970) |
| Deposit on investment | (0,001) | |
| Withdrawals from partnerships | | |
| Purchase of property and equipment | (3,775) | (2,476) |
| Proceeds from sale and leaseback arrangement | 3,000 | |
| Sale of available-for-sale investments | 76,275 | 3,975 |
| Purchase of available-for-sale investments | (56,686) | (43,606) |
| Purchase of common stock from minority stockholders of subsidiaries | (2,550) | (10) 000) |
| Other | (2,000) | |
| | | |
| Net cash provided by (used in) investing activities of continuing | | |
| operations | 12,960 | (43,131) |
| Net cash (used in) provided by investing activities of discontinued | | |
| operations | (145) | (1,173) |
| Net cash provided by (used in) investing activities | 12,815 | |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from exercise of stock options and warrants | 1,774 | 17,771 |
| Capital contributions from minority stockholders of subsidiaries | 3,257 | 37,322 |
| Capital distributions to minority shareholders of subsidiaries | 5,257 | 57,522 |
| Proceeds from sale of common stock, net of issuance costs | 18,349 | 22,199 |
| Repayment of capital lease obligations | (221) | |
| Other | (221) | 28 |
| | | 20 |

| Net cash provided by (used in) financing activities | 23,159 | 77,320 |
|---|--------------------|--------------------|
| Increase (decrease) in cash and cash equivalents | 23,413 | (1,468) |
| Cash and cash equivalents, beginning | 36,163 | 37 , 631 |
| Effect of exchange rate on cash | (125) | |
| | | |
| Cash and cash equivalents, ending | \$ 59 , 451 | \$ 36 , 163 |
| | | |

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

F-7

ACACIA RESEARCH CORPORATION NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Acacia Research Corporation ("Acacia" or "we") develops, licenses and provides products for the media technology and life science sectors.

Acacia's media technologies business, collectively referred to as, "Acacia Media Technologies Group," owns intellectual property related to the telecommunications field, including a television blanking system, also known as the "V-chip," which it licenses to television manufacturers. In addition, Acacia Media Technologies Group owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems. Acacia Media Technologies Group is responsible for the development, licensing and protection of its intellectual property and proprietary technologies. Our media technologies group continues to pursue both licensing and strategic business alliances with leading companies in the rapidly growing media technologies industry.

Acacia's life sciences business, collectively referred to as "Acacia Life Sciences Group" is comprised of CombiMatrix Corporation ("CombiMatrix") and Advanced Material Sciences, Inc. ("Advanced Material Sciences"). Our core technology opportunity in the life sciences sector has been developed through our majority-owned subsidiary, CombiMatrix. CombiMatrix is a life science technology company with a proprietary system for rapid, cost competitive creation of DNA and other compounds on a programmable semiconductor chip. This proprietary technology has significant applications relating to genomic and proteomic research. Our majority-owned subsidiary, Advanced Material Sciences, holds the exclusive license for CombiMatrix's biological array processor technology in certain fields of material sciences.

We were incorporated on January 25, 1993 under the laws of the State of California. In December 1999, we changed our state of incorporation from California to Delaware. Acacia owns and operates emerging corporations with intellectual property rights, certain of which are involved in developing new or unproven technologies. There is no assurance that any or all such technologies will be successful, and even if successful, that the development of such technologies can be commercialized.

Below is a summary of our most significant wholly and majority-owned

subsidiaries and our related ownership percentages on an as-converted basis:

| COMPANY NAME | DESCRIPTION OF BUSINESS |
|-------------------------------------|---|
| ACACIA MEDIA TECHNOLOGIES GROUP: | |
| Soundview Technologies Incorporated | A media technology company that owns intellectual prop to the telecommunications field, including a televisio system, also known as "V-chip," which it is licensing manufacturers. |

F-8

| COMPANY NAME | DESCRIPTION OF BUSINESS |
|---|--|
| Acacia Media Technologies Corporation (formerly Greenwich Information Technologies LLC) | A media technology company that owns a worldwide portf pioneering patents relating to audio and video transmi receiving systems, commonly known as audio-on-demand a video-on-demand, used for distributing content via var including computer networks, cable television systems broadcasting satellite systems. |
| ACACIA LIFE SCIENCES GROUP: | |
| CombiMatrix Corporation | A life science technology company with a proprietary s rapid, cost competitive creation of DNA and other comp programmable semiconductor chip. This proprietary tech significant applications relating to genomic and prote research. |
| Advanced Material Sciences, Inc | A development stage company that holds the exclusive l CombiMatrix's biological array processor technology in fields of material science. |

⁽¹⁾ We are a party to a stockholder agreement with an officer of CombiMatrix, which provides for (a) the collective voting of shares (representing 69.5% of the voting interests of CombiMatrix) for the election of certain directors to CombiMatrix's board of directors and (b) certain restrictions on the sale or transfer of the officer's shares of common stock in CombiMatrix.

(2) Advanced Material Sciences is 58.1% owned by us, 28.5% owned by CombiMatrix and 13.4% owned by third-parties. We have a 74.5% economic interest in Advanced Material Sciences by virtue of our 58.1% direct ownership interest in Advanced Material Sciences and our 57.5% interest in CombiMatrix.

ACACIA RESEARCH CORPORATION

In January 2001, we completed an institutional private equity financing raising gross proceeds of \$19.0 million through the issuance of 1,107,274 units. Each unit consists of one share of our common stock and one three-year callable common stock purchase warrant. Each common stock purchase warrant entitles the holder to purchase 1.10 shares of our common stock at a price of \$19.09 per share and is callable by us once the closing bid price of our common stock averages \$23.86 or above for 20 or more consecutive trading days on the NASDAQ National Market System. We issued an additional 20,000 units in lieu of cash payments for finders' fees in conjunction with the private placement.

In June 2001, our ownership interest in Soundview Technologies Incorporated ("Soundview Technologies") increased from 67% to 100%, following Soundview Technologies' completion of a stock repurchase transaction with its former minority stockholders. Soundview Technologies repurchased the stock of its former minority stockholders in exchange for a cash payment and the grant to such stockholders of the right to receive 26% of future net revenues generated by Soundview Technologies' current patent portfolio, which includes its V-chip patent.

On October 22, 2001, our board of directors declared a ten percent (10%) stock dividend. The stock dividend totaling 1,777,710 shares of our common stock was distributed on December 5, 2001 to stockholders of record as of November 21, 2001. All references to the number of shares (other than common stock issued or outstanding on the 2000 consolidated balance sheet and 2001, 2000 and 1999 consolidated statements of stockholders' equity), per share amounts and any other reference to shares in the consolidated financial statements and accompanying notes to the consolidated financial statements, unless otherwise noted, have been adjusted to reflect the stock dividend on a retroactive basis.

F-9

In November 2001, we increased our ownership interest in Acacia Media Technologies Corporation ("Acacia Media Technologies"), formerly Greenwich Information Technologies LLC, from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. In December 2001, we converted the company from a limited liability company to a corporation and changed the name of the company to Acacia Media Technologies.

In the third quarter of 2000, we completed a private offering of 861,638 units at \$27.50 per unit for gross proceeds of approximately \$23.7 million. Each unit consists of one share of common stock and one common stock purchase warrant entitling the holder to purchase 1.10 shares of common stock at an exercise price \$30.00 per share, subject to adjustment, expiring in three years. The warrants are callable by Acacia once the closing bid price of Acacia's common stock averages \$36.00 or above for 20 consecutive trading days on the NASDAQ National Market System. We issued an additional 11,000 units in lieu of cash payments for finders' fees in conjunction with the private placement.

In the fourth quarter of 1999, we completed a private placement consisting of the sale of units, each composed of one share of Acacia's common stock and one-half of a common stock purchase warrant. We issued 974,771 units at an offering price of \$21.50 per unit. Approximately \$21.0 million was raised from this financing. During the first quarter of 2000, we issued a 30-day redemption notice for these warrants. As a result, all of these warrants were exercised prior to the redemption date with Acacia receiving proceeds of approximately \$14.8 million. ACACIA MEDIA TECHNOLOGIES GROUP

SOUNDVIEW TECHNOLOGIES

In June 2001, Soundview Technologies repurchased the stock of the former minority stockholders of Soundview Technologies in exchange for a cash payment and the grant to the former stockholders of the right to receive 26% of future net revenues generated by Soundview Technologies' current patent portfolio, which includes its V-chip patent. As of December 31, 2001, total consideration paid combined with amounts accrued pursuant to the stock repurchase agreements totaled \$2,767,000 (\$2,550,000 paid in cash and \$217,000 accrued as of December 31, 2001). Acacia Research Corporation accounts for contingent purchase consideration as an additional cost of the acquired enterprise. As a result of the stock repurchase transaction our ownership interest in Soundview Technologies increased from 67% to 100%.

During 2001, Soundview Technologies executed separate settlement and/or license agreements with Samsung Electronics, Hitachi America, Ltd., LG Electronics, Inc., Funai Electric Co. Ltd., Daewoo Electronics Corporation of America, Sanyo Manufacturing Corporation, Thomson Multimedia, Inc., JVC Americas Corporation, Matsushita Electric Industrial Co., Ltd. and Orion Electric Co., Ltd. In addition, Soundview Technologies settled its lawsuits with Pioneer Electronics (USA) Incorporated, an affiliate of Pioneer Corporation, and received payments from Philips Electronics pursuant to a settlement and license agreement signed in December 2000. Certain of these license agreements constitute settlements of patent infringement litigation brought by Soundview Technologies. As of December 31, 2001, we received license fee payments totaling \$25,630,000 from the settlement and license agreements and have granted non-exclusive, retroactive and future licenses of Soundview Technologies' U.S. Patent No. 4,554,584 to the respective television manufacturers. Certain of the settlement and license agreements provide for future royalty payments to Soundview Technologies. We received and recognized as revenue \$2,390,000, \$10,000,000, \$10,740,000 and \$1,000,000 of the license fee payments during the first, second, third and fourth quarters of 2001, respectively. License fee payments received during 2001 totaling \$1,500,000 are included in deferred revenues pursuant to the terms of the respective agreements.

In the second quarter of 2000, Soundview Technologies announced that it filed a federal patent infringement and antitrust lawsuit against Sony Corporation of America, Philips Electronics North America Corporation, the Consumer Electronics Manufacturers Association and the Electronics Industries Alliance d/b/a Consumer Electronics Association. In its lawsuit, Soundview Technologies alleged that Sony and Philips Television sets fitted with "V-chips" infringe Soundview Technologies' patent and that the Consumer Electronics Manufacturers Association had induced infringement of the patent.

F - 10

ACACIA MEDIA TECHNOLOGIES

Acacia Media Technologies, formally Greenwich Information Technologies LLC, owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

In November 2001, we increased our ownership interest in Acacia Media Technologies from 33% to 100% through the purchase of the ownership interest of

the former limited liability company's other member. In December 2001, we converted the company from a limited liability company to a corporation, and changed the name of the company to Acacia Media Technologies Corporation.

ACACIA LIFE SCIENCES GROUP

COMBIMATRIX

In July 2001, CombiMatrix entered into a non-exclusive worldwide license, supply, research and development agreement with Roche Diagnostics GmbH ("Roche"). Under the terms of the agreement, Roche will purchase, use and resell CombiMatrix's microarray and related technologies for rapid production of customizable biochips. Additionally, CombiMatrix and Roche will develop a platform technology, providing a range of standardized biochips for use in research applications. The agreement has a 15-year term and provides for minimum payments by Roche to CombiMatrix over the first three years, including milestone achievements, payments for products, royalties and research and development projects. In the third and fourth quarters of 2001, CombiMatrix received up-front and milestone payments totaling \$5.3 million from Roche, which are included in deferred revenues in the accompanying December 31, 2001 consolidated balance sheet.

In August 2001, CombiMatrix entered into a license and supply agreement with the National Aeronautics and Space Administration ("NASA"). The agreement has a two-year term and provides for the license, purchase and use by the NASA Ames Research Center of CombiMatrix's active biochips (microarrays) and related technology to conduct biological research in terrestrial laboratories and in space. As of December 31, 2001, CombiMatrix Corporation has received non-refundable cash payments from NASA for their purchase of a microarray synthesizer system as well as a license to use the technology for a 2-year period. The existing agreement also provides for the sale of microarrays to NASA in future periods. The NASA agreement contains customary contract provisions regarding termination, including termination by either party in the event of a breach of contract terms.

In October 2001, CombiMatrix formed a joint venture with Marubeni Japan, one of Japan's leading trading companies. The joint venture, based in Tokyo, will focus on development and licensing opportunities for CombiMatrix's biochip technology with pharmaceutical and biotechnology companies in the Japanese market. Marubeni made an investment of \$1.0 million to acquire a ten percent (10%) minority interest in the joint venture.

In the first quarter of 2000, CombiMatrix Corporation completed a private equity financing raising gross proceeds of \$17.5 million through the sale of 3,500,000 shares of CombiMatrix Corporation common stock. Acacia invested \$10.0 million in this private placement to acquire 2,000,000 shares of CombiMatrix Corporation common stock. The transaction was accounted for as a step acquisition using the purchase method of accounting. The total purchase price was allocated to the fair value of assets acquired and liabilities assumed. As a result of the transaction, we increased our consolidated ownership interest in CombiMatrix Corporation from 50.01% to 51.8%.

In the third quarter of 2000, Acacia Research increased its consolidated ownership interest in CombiMatrix Corporation from 51.8% to 61.4% by acquiring from existing stockholders of CombiMatrix Corporation 1,163,850 shares of CombiMatrix Corporation common stock in exchange for 488,557 shares of Acacia Research's common stock. The transaction was accounted for as a step acquisition using the purchase method of accounting. The fair value of the Acacia Research shares issued in the transaction was based on the quoted market price of Acacia Research's stock averaged over a five-day period (including two days before and after the June 28, 2000 announcement date). The total purchase price of \$11.6 million was allocated to the fair value of assets acquired and F - 11

liabilities assumed, including acquired in-process research and development. The amount attributable to goodwill was \$2.9 million, which is amortized using the straight-line method over the estimated remaining useful life of five years. (See Note 2) The amount attributable to in-process research and development of \$2.5 million was charged to expense and is included in the consolidated statement of operations and comprehensive loss for the year ended December 31, 2000.

In the third quarter of 2000, CombiMatrix Corporation completed a private equity financing raising gross proceeds of \$36.0 million through the sale of 4,000,000 shares of CombiMatrix Corporation common stock. Acacia invested \$17.5 million in this private placement to acquire 1,944,445 shares. The transaction was accounted for as a step acquisition using the purchase method of accounting. As a result of the transaction, our consolidated interest in CombiMatrix Corporation decreased from 61.4% to 58.4%, and we recognized a gain which has been reflected in stockholder's equity as a direct increase to capital in excess of par.

ADVANCED MATERIAL SCIENCES

In May 2001, Advanced Material Sciences completed a private equity financing raising gross proceeds of \$2.0 million through the issuance of 2,000,000 shares of common stock. Acacia invested \$155,000 in this private placement to acquire 155,000 shares. As a result of the transaction, our equity ownership in Advanced Material Sciences decreased from 66.7% to 58.1%. We accounted for the purchase of 155,000 shares of Advanced Material Sciences as a step acquisition using the purchase method of accounting. The total purchase price was allocated to the fair value of assets acquired and liabilities assumed. As a result of the decrease in our ownership interest due to our disproportionate purchase of additional shares in Advanced Material Sciences, we recorded a gain reflected in the statement of stockholders' equity as a direct increase to capital in excess of par. Advanced Material Sciences issued an additional 29,750 shares of common stock, in lieu of cash payments, and warrants to purchase approximately 54,000 shares of common stock, for finders' fees in connection with the private placement. Each common stock purchase warrant entitles the holder to purchase shares of Advanced Material Sciences common stock at a price of \$1.10 per share.

Advanced Material Sciences was formed in November 2000 and holds an exclusive license to CombiMatrix's biological processor technology within the field of material science. Initial investments in Advanced Material Sciences consisted of \$2.0 million from Acacia Research Corporation for the purchase of 6,000,000 shares and \$1.0 million from CombiMatrix for the purchase of 4,000,000 shares.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ACCOUNTING PRINCIPLES AND FISCAL YEAR END. The consolidated financial statements and accompanying notes are prepared on the accrual basis of accounting in accordance with generally accepted accounting principles in the United States of America. We have a December 31 year end.

PRINCIPLES OF CONSOLIDATION. The accompanying consolidated financial statements include the accounts of Acacia and its wholly-owned and majority-owned subsidiaries. Material intercompany transactions and balances have been eliminated in consolidation. Investments in companies in which we

maintain an ownership interest of 20% to 50% or exercise significant influence over operating and financial policies are accounted for under the equity method. The cost method is used where we maintain ownership interests of less than 20% and do not exercise significant influence over the investee.

REVENUE RECOGNITION. We recognize revenue in accordance with Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"). License fee income is recognized as revenue when (i) persuasive evidence of an arrangement exists, (ii) all obligations have been performed pursuant to the terms of the license agreement, (iii) amounts are fixed or determinable and (iv) collectibility of amounts is reasonably assured. Revenue from government grant and contract activities is accounted for in the period the services are performed on a percentage-of-completion method of accounting (determined by comparing actual costs incurred to total estimated costs) when the services have been approved by the grantor and collectibility is reasonably assured. Each arrangement for government grant or contract activities is accounted for separately. Typically these contracts and arrangements involve single accounting elements. For the Department of Defense ("DOD") grant that is currently in progress, payment milestones are achieved when interim progress reports are prepared and delivered to

F-12

the DOD. Amounts recognized under the percentage-of-completion method are limited to amounts due from customers based on contract or grant terms. Revenues recognized under the percentage of completion method of accounting for government grants and contracts were \$456,000, \$17,000 and \$144,000 for the years ending December 31, 2001, 2000 and 1999, respectively.

Revenue from the sale of products and services is recognized when (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the fees are fixed and determinable and (iv) collectibility is reasonably assured.

Revenues from multiple-element arrangements involving license fees, up-front payments and milestone payments, which are received or billable by us in connection with other rights and services that represent continuing obligations of ours, are deferred until all of the elements have been delivered or until we have established objective and verifiable evidence of the fair value of the undelivered elements.

Deferred revenue arises from payments received in advance of the culmination of the earnings process. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability. At December 31, 2001, we recorded \$7.5 million as deferred revenues related to payments received under multiple-element arrangements and other advances, which will be recognized as revenue in future periods when the applicable revenue recognition criteria as describe above are met. Approximately \$5.3 million of this amount was from payments received from Roche by CombiMatrix for milestones achieved as of December 31, 2001. At that time, certain elements remained undelivered. Management expects the remaining milestones will be completed and that objective reliable evidence of fair value for the remaining undelivered elements will exist by the end of 2002.

CASH AND CASH EQUIVALENTS. We consider all highly liquid, short-term investments with original maturities of three months or less when purchased to be cash equivalents.

SHORT-TERM INVESTMENTS. Our short-term investments are held in a variety of

interest bearing instruments including high-grade corporate bonds, commercial paper, money market accounts and other marketable securities. Investments in securities with maturities of greater than three months and less than one year are classified as short-term investments. Investments are classified into categories in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). Certain of our investments are classified as available-for-sale, which are reported at fair value with related unrealized gains and losses in the value of such securities recorded as a separate component of comprehensive income (loss) in stockholders' equity until realized. Certain of our investments are classified as trading securities, which are reported at fair value. Realized and unrealized gains and losses in the value of trading securities are included in net income (loss) in the consolidated statements of operations and comprehensive loss.

The fair value of our investments is primarily determined by quoted market prices. Realized and unrealized gains and losses are recorded based on the specific identification method. For investments classified as available-for-sale, unrealized losses that are other than temporary are recognized in net income.

CONCENTRATION OF CREDIT RISKS. Cash and cash equivalents are invested in deposits with certain financial institutions and may, at times, exceed federally insured limits. We have not experienced any losses on our deposits of cash and cash equivalents.

PROPERTY AND EQUIPMENT. Property and equipment are recorded at cost. Major additions and improvements are capitalized. When these assets are sold or otherwise disposed of, the asset and related depreciation are relieved, and any gain or loss is included in income for the period of sale or disposal. Depreciation is computed on a straight-line basis over the estimated useful lives of the assets, ranging from three to ten years.

Certain equipment held under capital lease is included in property, plant and equipment and amortized using the straight line method over the lease term. The related capital lease obligation is recorded as a liability in the consolidated balance sheet. Capital lease amortization is included in depreciation expense in the consolidated statement of operations and comprehensive loss.

F-13

PREPAID PUBLIC OFFERING COSTS. As of September 30, 2001, CombiMatrix capitalized \$1,353,000 of costs incurred in connection with the filing of a registration statement with the Securities and Exchange Commission ("SEC") in November 2000. Deferred costs totaling \$918,000 are included in current assets in our December 31, 2000 consolidated balance sheet. In the fourth quarter of 2001, all of these deferred costs were charged to operations.

 $\ensuremath{\mathsf{ORGANIZATION}}$ COSTS. Costs of start-up activities, including organization costs, are expensed as incurred.

MANAGEMENT FEES. Capital management fees in 1999 include asset-based and performance-based fees earned from two domestic private investment partnerships in which we were a general partner and two offshore investment corporations for which we served as an investment advisor. These capital management fees were recognized when earned in accordance with the respective partnership and management agreements. Management fees also include income from other consulting and management services provided by Acacia to other parties. These fees are

recognized when the related services are provided. On December 31, 1999, we closed the Acacia Capital Management division.

PATENTS AND GOODWILL. Patents, once issued, and goodwill are amortized on the straight-line method over their estimated remaining useful lives, ranging from three to twenty years. Amortization charged to operations relating to goodwill amounted to \$1,078,000, \$921,000 and \$465,000 at December 31, 2001, 2000 and 1999, respectively. Accumulated amortization of goodwill amounted to \$3,651,000 and \$1,894,000 at December 31, 2001 and 2000, respectively. Amortization charged to operations relating to patents amounted to \$1,617,000, \$1,330,000 and \$1,157,000 at December 31, 2001, 2000 and 1999, respectively. Accumulated amortization of patents amounted to \$5,655,000 and \$4,038,000 at December 31, 2001 and 2000, respectively.

POTENTIAL IMPAIRMENT OF LONG-LIVED ASSETS. We review long-lived assets and intangible assets for potential impairment when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. In the event the sum of the expected undiscounted future cash flows resulting from the use of the asset is less than the carrying amount of the asset, an impairment loss equal to the excess of the asset's carrying value over its fair value is recorded. If an asset is determined to be impaired, the loss is measured based on quoted market prices in active markets, if available. If quoted market prices are not available, the estimate of fair value is based on various valuation techniques, including a discounted value of estimated future cash flows.

FAIR VALUE OF FINANCIAL INSTRUMENTS. The carrying value of cash and cash equivalents, other receivables, accounts payable and accrued expenses approximate fair value due to their short-term maturity. The carrying value of our capital lease obligation approximates its fair value based on the current interest rate for similar type instruments. The fair values of our investments are primarily determined by quoted market prices.

FOREIGN CURRENCY TRANSLATION. The functional currency of our foreign entity is the local currency. Foreign currency translation is reported pursuant to SFAS No. 52, "Foreign Currency Translation" ("SFAS No. 52"). Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Translation adjustments resulting from this process are charged or credited to other comprehensive income. Revenue and expenses are translated at average rates of exchange prevailing during the year.

STOCK-BASED COMPENSATION. Compensation cost of stock options issued to employees is accounted for in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations. Compensation cost attributable to such options is recognized based on the difference, if any, between the closing market price of the stock on the date of grant and the exercise price of the option. Compensation cost is deferred and amortized on an accelerated basis over the vesting period of the individual option awards using the amortization method prescribed in Financial Accounting Standards Board ("FASB") Interpretation No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans" ("FIN No. 28"). We have adopted the disclosure only requirements of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") with respect to options issued to employees. Compensation cost of stock options and warrants issued to non-employee service providers is accounted for under the fair value method required by SFAS No. 123 and Emerging Issues Task Force Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services."

See "ACCOUNTING CHANGES" for change in accounting policy for accrued subsidiary employee stock-based compensation charges.

RESEARCH AND DEVELOPMENT EXPENSES. Research and development expenses consist of costs incurred for direct and overhead-related research expenses and are expensed as incurred. Costs to acquire technologies which are utilized in research and development and which have no alternative future use are expensed when incurred. Costs related to filing and pursuing patent applications are expensed as incurred, as recoverability of such expenditures is uncertain. Software developed for use in our products is expensed as incurred until both (i) technological feasibility for the software has been established and (ii) all research and development activities for the other components of the system have been completed. We believe these criteria are met after we have received evaluations from third-party test sites and completed any resulting modifications to the products. Expenditures to date have been classified as research and development expense.

INCOME TAXES. Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in Acacia's financial statements or tax returns. A valuation allowance is established to reduce deferred tax assets if all, or some portion, of such assets will more than likely not be realized.

ACCOUNTING FOR SALES OF STOCK BY A SUBSIDIARY. Gains resulting from a subsidiary's sale of stock to third-parties at a price per share in excess of Acacia's average carrying amount per share are generally reflected in stockholders' equity as a direct increase to capital in excess of par or stated value. See Note 7 for description of current year gains reflected in stockholders' equity as a result of our subsidiaries sales of stock to third-parties.

COMPREHENSIVE (LOSS) INCOME. Comprehensive income is the change in equity from transactions and other events and circumstances other than those resulting from investments by owners and distributions to owners.

SEGMENT REPORTING. We use the management approach, which designates the internal organization that is used by management for making operating decisions and assessing performance as the basis of Acacia's reportable segments. At December 31, 2001, our reporting segments were modified to include Soundview Technologies and Acacia Media Technologies in our Acacia Media Technologies Group segment. In addition, CombiMatrix and Advanced Material Sciences comprise our Acacia Life Sciences Group segment. Segment information has been adjusted for all periods presented.

USE OF ESTIMATES. The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

LOSS PER SHARE. Loss per share is presented on both a basic and diluted basis. A reconciliation of the denominator of the basic EPS computation to the denominator of the diluted EPS computation is as follows:

1

| Weighted Average Number of Common Shares Outstanding Used in Computation of Basic EPS Dilutive Effect of Outstanding Stock Options and Warrants (a) | 19,259,256 | 16,346,099 | 12,6 |
|---|------------|----------------|------|
| Weighted Average Number of Common and Potential Common Shares Outstanding Used in Computation of Diluted EPS | 19,259,256 | 16,346,099 | 12,6 |

(a) Potential common shares of 719,471, 1,046,072 and 940,002 at December 31, 2001, 2000 and 1999, respectively, have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive.

RECLASSIFICATIONS. Certain immaterial reclassifications of prior year amounts have been made to conform to the 2001 presentation.

F-15

ACCOUNTING CHANGES. Effective January 1, 2001, we changed our accounting policy for balance sheet classification of employee stock-based compensation resulting from awards in consolidated subsidiaries. Historically, the consolidated financial statements have accounted for cumulative earned employee stock-based compensation related to subsidiaries as a liability, under the caption "accrued stock compensation." Management believes a change to reflect these cumulative charges as minority interests is preferable as it better reflects the underlying economics of the stock-based compensation transaction. As a result of the change, effective January 1, 2001, minority interests has been increased by \$10.4 million, and accrued stock compensation of \$10.4 million has been decreased. The change in accounting policy does not affect previously reported consolidated net income.

During March 1998, CombiMatrix issued \$1,450,000 principal amount of 6% unsecured subordinated convertible promissory notes due in 2001. The notes had a contingent beneficial conversion feature with intrinsic value of \$246,000. We adopted Emerging Issues Task Force Consensus of Issues No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments" ("EITF 00-27"), in the fourth quarter of 2000. The adoption of EITF 00-27 resulted in a charge of \$246,000 in the year ended December 31, 2000 for the cumulative effect of a change in accounting principle in accordance with APB Opinion No. 20, "Accounting Changes."

RECENT ACCOUNTING PRONOUNCEMENTS. In June 2001, the FASB issued SFAS No. 141, "Business Combinations" ("SFAS No. 141"), and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 141 addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, "Business Combinations." Changes made by SFAS No. 141 include (1) requiring the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and (2) established specific criteria for the recognition of intangible assets separately from goodwill. These provisions are effective for business combinations for which the date of acquisition is subsequent to June 30, 2001.

SFAS No. 142 addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. This standard provides that goodwill is not subject to amortization. Instead, it is subject to a periodic review that must occur at least annually at

a reporting unit level for possible impairment. This review is known as the "two-step" impairment test and provides that the initial "first-step" reviews of each reporting unit must be completed within six months of the adoption of the standard. The "first step" of the goodwill impairment test, used to identify potential impairment, compares the fair value of a reporting unit with its carrying amount, including goodwill. The fair value of our two reporting units will be estimated using the expected present value of future cash flows, based on the characteristics of the reporting units including discount rates and growth rates based on management's estimates. If upon completion of these initial reviews an impairment of goodwill is indicated, the "second step" will be performed which will compare the implied fair value of each reporting unit goodwill with the carrying amount of goodwill. While we have yet to complete the initial review, we expect to do so during the second quarter of 2002. The "second step" of the valuation of the impairment, if necessary, is to occur as soon as possible, but no later than the end of our current fiscal year. Any impairment resulting from the "second step" would be reported as a change in accounting principle and would require retroactive recognition to the beginning of this fiscal year. We currently do not expect to record an impairment charge upon completion of the impairment review; however, there can be no assurance that at the time the review is completed a material impairment charge will not be recorded. We have \$4,627,000 of goodwill at December 31, 2001 (net of \$3,569,000 of accumulated amortization) and recorded approximately \$1.1 million of goodwill amortization expense during 2001. The only identifiable intangible assets we have are patents of \$11,855,000 at December 31, 2001 (net of \$5,655,000 of accumulated amortization), which we do not expect to be impacted by the adoption of this standard.

We adopted SFAS No. 142 effective January 1, 2002 and ceased amortizing goodwill on that date. (See also Note 16.) Our net income and earnings per share, adjusted to exclude goodwill amortization expense, for the twelve months ended December 31, 2001, 2000 and 1999, are as follows (in thousands, except for earnings per share amounts):

| F-1 | ٢6 |
|-----|----|
|-----|----|

| | FOR THE YEAR ENDED DECEMBER 31, | | |
|--|---------------------------------|---|--------------------|
| | 2001 | 2000 | 1999 |
| Reported net loss Add back: Goodwill amortization | | \$(38,959) 921 | 465 |
| Adjusted net loss | \$(21,194) ====== | \$(38,038) | \$(7 , 732) |
| BASIC EARNINGS PER SHARE: Reported net loss Goodwill amortization Adjusted net loss | \$ 0.06 | \$ (2.38) \$ 0.06 \$ (2.32) | \$ 0.04 |
| DILUTED EARNINGS PER SHARE: Reported net loss Goodwill amortization Adjusted net loss | | \$ (2.38) \$ 0.06 \$ (2.32) | \$ 0.04 |
| Aujusteu net 1055 | \$ (1.10) ====== | ş (2.52) ====== | , |

The gross carrying amounts and accumulated amortization related to acquired intangible assets, all related to patents, as of December 31, 2001 and 2000, are as follows (in thousands):

| | AT DECE | AT DECEMBER 31, | | |
|---|---------------------|-----------------|--|--|
| | 2001 | 2000 | | |
| Gross carrying amount - patents Accumulated amortization | \$17,510 (5,655) | | | |
| Patents, net | \$11,855 | \$ 9,038 | | |

The estimated aggregate amortization expense for each of the five succeeding years is as follows (in thousands):

| | ESTIMATED |
|-------------------------|--------------|
| | AMORTIZATION |
| YEAR ENDED DECEMBER 31, | EXPENSE |
| | |
| 2002 | 1,862 |
| 2003 | 841 |
| 2004 | 841 |
| 2005 | 841 |
| 2006 | 841 |
| | |

At December 31, 2001, all of Acacia Research's acquired intangible assets were subject to amortization.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations -Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for segments of a business to be disposed of. SFAS No. 144 also amends ARB No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a temporarily controlled subsidiary. SFAS No. 144 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In conjunction with such tests, it may be necessary to review depreciation estimates and methods as required by APB Opinion No. 20, "Accounting Changes," or the amortization period as required by SFAS No. 142. We will adopt SFAS No. 144 effective January

F - 17

1, 2002. We are currently assessing the impact of SFAS No. 144 on our operating results and financial condition upon adoption.

3. SHORT-TERM INVESTMENTS

Short-term investments consists of the following at December 31, 2001 and 2000 (in thousands):

AMORTIZED FAIR

| 2001 | COST | VALUE |
|---|--------------------|--------------------|
| Trading securities | \$ | \$ 4,372 |
| Available-for-sale-securities: Corporate bonds and notes U.S. government securities | 14,427 5,643 | 14,869 5,869 |
| | \$20,070 ====== | \$25,110 ====== |
| 2000 | AMORTIZED COST | FAIR VALUE |
| Available-for-sale-securities: Corporate bonds and notes U.S. government securities | \$37,689 1,971 | \$38,622 1,978 |
| | \$39,660 ====== | \$40,600 ====== |

Gross unrealized gains and losses related to available-for-sale securities were not material for 2001 and 2000.

Contractual maturities for investments in debt securities classified as available-for-sale as of December 31, 2001 are as follows (in thousands):

| | | FAIR |
|--------------------------------------|----------|-------------------|
| | COST | VALUE |
| | | |
| Due within one year | \$ 5,103 | \$ 5,669 |
| Due after one year through two years | 14,967 | 15,069 |
| | | |
| | \$20,070 | \$20 , 738 |
| | | |

4. PROPERTY AND EQUIPMENT

Property and equipment consists of the following at December 31, 2001 and 2000 (in thousands):

| | 2001 | 2000 |
|---|-------------------|----------------|
| Machine shop and laboratory equipment Furniture and fixtures | \$ 844 445 | \$1,250 550 |
| Computer hardware and software | 1,203 565 | 1,085 228 |
| Facilities and equipment held under capital lease Construction in progress | 3,000 84 | 1,346 |
| Less: accumulated depreciation and amortization | 6,141 (1,235) | 4,459 (732) |
| | \$ 4,906 | \$3,727 |

F-18

Depreciation expense was \$1,174,000, \$471,000 and \$248,000 for the years

ended December 31, 2001, 2000 and 1999, respectively. Amortization of assets held under capital lease was \$161,000 for the year ended December 31, 2001.

5. BALANCE SHEET COMPONENTS

Accounts payable, accrued expenses and other consists of the following at December 31, 2001 and December 31, 2000 (in thousands):

| | 2001 | 2000 |
|--|------------------|------------------|
| | | |
| Accounts payable | \$ 837 | \$2 , 285 |
| Payroll, vacation and other employee benefits | 1,740 | 711 |
| Accrued liabilities of discontinued operations | 1,342 | 3,599 |
| Taxes payable | 356 | |
| Accrued subsidiary stockholder redemption payments | 217 | |
| Other accrued liabilities | 1,264 | 1,172 |
| | | |
| | \$5 , 756 | \$7 , 767 |
| | | |

Deferred revenues consist of the following at December 31, 2001 (in thousands):

| | === | ==== |
|---|-----|---------------|
| | \$ | 372 |
| Less: current portion | | ,460 ,088) |
| Milestone and up-front payments License fee payments | | ,960 ,500 |
| | 20 | 01 |

6. INVESTMENTS

At December 31, 2000, we carried our 33% ownership interest in Acacia Media Technologies, formerly Greenwich Information Technologies LLC, under the equity method at a carrying value of \$346,000. In November 2001, we increased our ownership interest in Acacia Media Technologies from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. In December 2001, Acacia Media Technologies was incorporated under the laws of the State of Delaware and we changed the name from Greenwich Information Technologies LLC to Acacia Media Technologies Corporation. The ownership interest purchase has been accounted for as a purchase transaction in accordance with SFAS No. 141. The excess purchase price was allocated to Acacia Media Technologies' patent portfolio and is being amortized over the remaining life of the respective patents, which is approximately 10 years. The results of operations have been included in the consolidated statement of operations and comprehensive loss from the date of acquisition. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or aggregate basis.

In the first quarter of 2000, Acacia acquired a 7.6% interest in Advanced Data Exchange for \$3.0 million out of a \$17.3 million private placement of "non-voting" Series B preferred stock. Advanced Data Exchange is a corporation engaged in business-to-business Internet exchange transactions that allow mid-sized companies to exchange its purchase orders, purchase order acknowledgments, advance ship notices, invoices and other business documents over the Internet with supply chain partners and emerging digital marketplaces. Subsequent to an additional \$30 million equity financing completed in the second quarter of 2000, we currently own a 4.9% interest in Advanced Data Exchange and

have no board of directors representation. Additional rounds of financing may further dilute our interest. We do not have the ability to control decision making at Advanced Data Exchange.

F-19

In the fourth quarter of 2000, in connection with a review of the carrying value of our investment portfolio, we determined that certain of our early stage investments accounted for under the equity method and certain consolidated subsidiaries had experienced significant losses in value that were determined to be other than temporary. The decline in value of these investments, which were primarily start up phase businesses, was attributed to the existence of continuing operating losses, management's determination that the associated business models were no longer viable and in some cases the cessation of operations of the respective entities, and management's assessment that such investments were not recoverable. We recorded \$1,016,000 in write-offs of early stage investments and \$2,603,000 in write-offs of certain equity investments. The investments written-off were not individually material.

7. STOCKHOLDERS' EQUITY

The authorized capital stock of Acacia consists of 60,000,000 shares of common stock, \$0.001 par value, of which 19,592,459 and 17,699,646 (as adjusted for ten percent (10%) stock dividend distributed on December 5, 2001) shares were issued and outstanding as of December 31, 2001 and 2000, respectively, and 20,000,000 shares of preferred stock, \$0.001 par value, no shares of which are issued or outstanding. Under the terms of Acacia's Certificate of Incorporation, the board of directors may determine the rights, preferences and terms of our authorized but unissued shares of preferred stock. Holders of common stock are entitled to one vote per share on all matters to be voted on by the stockholders, and to receive ratably such dividends, if any, as may be declared by the board of directors out of funds legally available therefore. Upon the liquidation, dissolution or winding up of Acacia, the holders of common stock are entitled to share ratably in all assets of Acacia which are legally available for distribution, after payment of all debts and other liabilities. Holders of common stock have no preemptive, subscription, redemption or conversion rights.

On October 22, 2001, our board of directors declared a ten percent (10%) stock dividend. The stock dividend totaling 1,777,710 shares of our common stock was distributed on December 5, 2001 to stockholders of record as of November 21, 2001. The fair value of the stock dividend paid, based on the market value of our common stock on the date of declaration as adjusted for the dilutive effect of the stock dividend declared, is reflected as a reclassification of accumulated deficit in the amount of \$21,688,000, to permanent capital, represented by our common stock and additional paid-in capital accounts. All references to the number of shares (other than common stock issued or outstanding on the 2000 consolidated balance sheet and 2001, 2000 and 1999 consolidated statements of stockholders' equity), per share amounts and any other reference to shares in the consolidated financial statements, unless otherwise noted, have been adjusted to reflect the stock dividend on a retroactive basis.

In May 2001, Advanced Material Sciences completed a private equity financing raising gross proceeds of \$2.0 million through the issuance of 2,000,000 shares of common stock. Acacia invested \$155,000 in this private placement to acquire 155,000 shares. As a result of the transaction, our equity ownership in Advanced Material Sciences decreased from 66.7% to 58.1%. Additionally, in October 2001, a subsidiary of CombiMatrix sold 10% of its

voting common stock to a joint venture partner in Japan. The gain, totaling \$1,283,000, resulting from our subsidiaries sale of stock to third-parties at a price per share in excess of our carrying amount per share has been reflected as a direct increase to additional paid-in capital in consolidated stockholders' equity.

F-20

8. PROVISIONS FOR INCOME TAXES

Provision (benefit) for income taxes consists of the following (in thousands):

| | 2001 | 2000 | 1999 |
|------------------|--------|--------|------|
| | | | |
| Current: | | | |
| U.S. Federal tax | \$ 776 | \$2 | \$12 |
| State taxes | 186 | 4 | 8 |
| | | | |
| | 962 | 6 | 20 |
| | | | |
| Deferred: | | | |
| U.S. Federal tax | (182) | (79) | |
| State taxes | | | |
| | | | |
| | (182) | (79) | |
| | | | |
| | \$ 780 | \$(73) | \$20 |
| | | ==== | === |

The tax effects of temporary differences and carry forwards that give rise to significant portions of deferred assets and liabilities consist of the following at December 31, 2001 and 2000 (in thousands):

| | 2001 | 2000 |
|--|---|--|
| Basis of investments in affiliates Intangibles Depreciation and amortization Stock compensation Accrued liabilities Net operating loss carry forwards and credits | \$ 16,789 (3,829) (4) 6,993 1,061 25,084 | \$ 9,362 (2,689) (118) 2,737 740 27,257 |
| Less: valuation allowance | 46,094 (49,923) | 37,289 |

A reconciliation of the federal statutory income tax rate and the effective income tax rate is as follows:

| | 2001 | 2000 | 1999 |
|--|-------|-------|-------|
| | | | |
| Statutory federal tax rate | (34%) | (34%) | (34%) |
| State income taxes, net of federal benefit | (3%) | (3%) | (3응) |
| Amortization of intangible assets | 2% | 1% | 5% |
| Stock compensation | 7% | 3% | 0% |
| Valuation allowance | 30% | 33% | 32% |

| 2% | 0% | 0% |
|----|------|----|
| | ==== | |

At December 31, 2001, we had U.S. Federal and California state income tax net operating loss carry forwards ("NOLs") of approximately \$29,680,000 and \$16,531,000, expiring between 2002 and 2021, excluding NOLs at CombiMatrix and other subsidiaries. In addition, we had tax credit carryforwards of approximately \$102,000.

The aggregate tax NOLs at CombiMatrix and other subsidiaries are approximately \$40,225,000 and \$8,999,000 for federal and state income tax purposes, respectively, expiring between 2002 and 2021. CombiMatrix and other subsidiaries also have tax credit carryforwards of approximately \$840,000, which begin expiring in 2011. However, the use of these NOLs and tax credits are limited to the separate earnings of the respective subsidiaries. In addition, ownership changes may also restrict the use of NOLs and tax credits.

As of December 31, 2001, approximately \$9,507,000 of the valuation allowance related to the tax benefits of stock option deductions included in Acacia's NOLs. At such time as the valuation allowance is released, the benefit will be credited to additional paid-in capital.

F-21

9. DISCONTINUED OPERATIONS

On February 13, 2001, the board of directors of Soundbreak.com Incorporated ("Soundbreak.com"), a majority-owned subsidiary of Acacia, resolved to cease operations as of February 15, 2001 and liquidate the remaining assets and liabilities of the subsidiary. Accordingly, we reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the 2000 consolidated statements of operations and comprehensive loss.

Following is summary financial information for the discontinued operations (in thousands):

| | 2001 | 2000 |
|---|---------------------|---------------------|
| Net sales | \$ 4 ====== | \$ ====== |
| Loss from discontinued operations: Before minority interests Minority interests | \$16,437 (8,994) | \$ 1,784 (1,008) |
| Net | \$ 7,443 | \$ 776 ====== |
| Estimated loss on disposal: Before minority interests Minority interests | \$ 5,066 (2,955) | \$ |
| Net | \$ 2,111 | \$ ====== |

Discontinued operations did not have an impact on the December 31, 2001 consolidated statement of operations and comprehensive loss.

The assets and liabilities of the discontinued operations at December 31, 2001 consist primarily of \$4,014,000 of cash and cash equivalents and \$1,342,000 of accounts payable and accrued expenses.

The assets and liabilities of the discontinued operations at December 31, 2000 primarily consist of \$6,620,000 of cash and cash equivalents, \$10,000 of management fees and other receivables, \$74,000 of prepaid expenses, \$164,000 of other assets, \$207,000 in property and equipment and \$3,599,000 of accounts payable and accrued expenses.

10. STOCK OPTIONS AND WARRANTS

We have three stock option plans currently in effect: the 1993 Stock Option Plan (the "1993 Plan"), the 1996 Executive Stock Bonus Plan (the "Bonus Plan") and the 1996 Stock Option Plan (the "1996 Plan").

Options under the 1993 plan authorize the granting of both options intended to qualify as "incentive stock options" under Section 422A of the Internal Revenue Code ("Incentive Stock Options") and stock options that are not intended to so qualify ("Nonqualified Stock Options") to officers, directors, employees, consultants and others expected to provide significant services to Acacia or its subsidiaries. The 1993 Plan covers an aggregate of 2,000,000 shares of common stock. We have reserved 2,000,000 shares of common stock in connection with the 1993 Plan. Under the terms of the 1993 Plan, options may be exercised upon terms approved by Acacia's board of directors and expire at a maximum of ten years from the date of grant. Incentive Stock Options are granted at prices equal to or greater than fair market value at the date of grant. Nonqualified Stock Options are generally granted at prices equal to or greater than 85% of the fair market value at the date of grant. All of the shares under the 1993 Plan have been awarded.

The Bonus Plan provided for a one-time grant of options to purchase an aggregate of 720,000 shares of our common stock to directors, officers and other key employees performing services for our affiliates and us. Under each option agreement of the Bonus Plan, 25% of the options become exercisable on each of the first four anniversaries of the grant date. The options granted under the Bonus Plan expire in March 2001. All of the shares under the Bonus Plan have been awarded.

F-22

In April 1996, the board of directors adopted the 1996 Plan, which was approved by the stockholders in May 1996. The 1996 Plan provides for the grant of Nonqualified Stock Options and Incentive Stock Options to key employees, including officers of Acacia and its subsidiaries and certain other individuals. The 1996 Plan also provides for the automatic grant of 20,000 shares of Nonqualified Stock Options to non-employee directors upon initial election to the board of directors and 2,000 shares thereafter on an annual basis under the Non-Employee Director Program. These options are generally exercisable six months to one year after grant and expire five years after grant for directors or up to ten years after grant for key employees. In May 1998, stockholders approved amendments to the 1996 Stock Option Plan, which increased the authorized number of shares of common stock subject to the amended plan by 500,000 shares. In May 1999, stockholders approved amendments to the 1996 Stock Option Plan, which increased the authorized number of shares of common stock subject to the amended plan by 2,000,000 shares. In May 2000, stockholders approved amendments to the 1996 Stock Option Plan, which increased the authorized number of shares of common stock subject to the amended plan by

1,000,000 shares. At the years ended December 31, 2001 and 2000, 1,482,000 and 1,129,000 shares were available for grant, respectively.

The following is a summary of common stock option activities:

| | SHARES | EXERCISE PRICES | WEIGHTED AVERAGE PRICE |
|----------------------------------|-----------|-----------------|---------------------------|
| Balance at December 31, 1998 | 1,829,000 | \$ 0.91 \$ 7.85 | \$ 2.95 |
| Options Granted | 799,000 | \$ 3.89 \$21.59 | \$12.22 |
| Options Exercised | (359,000) | \$ 0.91 \$ 4.24 | \$ 2.11 |
| Options Cancelled | (51,000) | \$ 3.28 \$ 7.16 | \$ 4.72 |
| Balance at December 31, 1999 | 2,218,000 | \$ 0.91 \$21.59 | \$ 6.38 |
| Options Granted | 2,709,000 | \$14.55 \$50.28 | \$27.90 |
| Options Exercised | (585,000) | \$ 2.39 \$14.55 | \$ 3.41 |
| Options Cancelled | (717,000) | \$ 1.82 \$46.79 | \$19.48 |
| Balance at December 31, 2000 | 3,625,000 | \$ 2.77 \$50.28 | \$20.51 |
| Options Granted | 1,390,000 | \$ 5.65 \$16.08 | \$ 7.14 |
| Options Exercised | (790,000) | \$ 2.77 \$14.55 | \$ 3.48 |
| Options Cancelled | (743,000) | \$ 3.18 \$48.69 | \$30.48 |
| Balance at December 31, 2001 | 3,482,000 | \$ 3.47 \$50.28 | \$16.94 |
| Exercisable at December 31, 2000 | 1,181,000 | \$ 2.77 \$46.79 | |
| Exercisable at December 31, 2001 | 1,315,000 | \$ 3.47 \$50.28 | |

Options outstanding at year ended December 31, 2001 are summarized as follows:

| RANGE OF EXERCISE PRICES | NUMBER OF OUTSTANDING OPTIONS | WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE | OUTSTANDING WEIGHTED AVERAGE EXERCISE PRICE | NUMBER EXERCISABLE | EX WEIG EXE |
|--------------------------|-------------------------------------|---|---|-----------------------|-----------------------|
| \$ 0.00 - \$ 5.00 | 103,000 | 0.5 | \$ 3.54 | 103,000 | |
| \$ 5.01 - \$10.00 | 1,354,000 | 8.6 | \$ 6.29 | 373,000 | |
| \$10.01 - \$15.00 | 135,000 | 5.2 | \$12.72 | 27,000 | |
| \$15.01 - \$20.00 | 179,000 | 8.8 | \$17.04 | 103,000 | |
| \$20.01 - \$25.00 | 761,000 | 7.6 | \$22.07 | 260,000 | |
| \$25.01 - \$30.00 | 615,000 | 7.5 | \$27.55 | 251,000 | |
| \$30.01 - \$35.00 | 212,000 | 6.8 | \$30.17 | 126,000 | |
| \$35.01 - \$40.00 | | | \$ | | |
| \$40.01 - \$45.00 | 116,000 | 8.2 | \$41.96 | 68,000 | |
| \$45.01 - \$52.00 | 7,000 | 8.2 | \$50.28 | 4,000 | |
| | | | | | |
| | 3,482,000 | | | 1,315,000 | |
| | | | | | |

At year ended December 31, 2001, the total number of warrants outstanding represent rights to purchase 960,000 and 1,240,000 shares of Acacia's common stock at a per share exercise price of \$30.00 and \$19.09, respectively. At December 31, 2000, the total number of warrants outstanding represent rights to purchase 960,000 shares of Acacia's common stock at a per share exercise price

of \$30.00.

We have adopted the disclosure only requirements of SFAS No. 123 with respect to options issued to employees. The weighted average fair value of options granted during 2001, 2000 and 1999 for which the exercise price equals the fair market price on the grant date was \$4.19, \$20.17 and \$13.33, respectively. The weighted

F-23

average fair value of options granted during 1999 for which the exercise price is less than fair market value on grant date was \$16.70. There were no options granted during 2001 or 2000 with exercise price less than the market value.

As of December 31, 2001, CombiMatrix had a total of 3,534,000 shares of options and warrants outstanding, of which, 1,798,000 shares are exercisable. As of December 31, 2000, CombiMatrix had a total of 4,539,000 shares of options and warrants outstanding, of which 1,062,000 shares are exercisable. As of December 31, 1999, CombiMatrix had a total of 798,000 shares of options and warrants outstanding, of which 444,000 shares are exercisable.

Had we accounted for stock compensation expense related to stock options issued to employees in accordance with SFAS No. 123, our pro forma loss from continuing operations and loss per share would have been as follows:

| | 2001 | 2000 |
|---|------------------------|--|
| Loss from continuing operations as reported Loss from continuing operations, pro forma Basic loss per share from continuing operations as reported | \$(30,806,000) | \$(29,159,000) \$(37,671,000) \$(1.78) |
| Basic loss per share from continuing operations, pro forma Diluted loss per share from continuing operations as reported Diluted loss per share from continuing operations, pro forma | \$ (1.60) \$ (1.16) | \$ (2.31) \$ (1.78) |

The fair value of the options was determined using the Black-Scholes option-pricing model, assuming weighted average risk free annual interest of 4.52%, 6.31% and 5.79% in 2001, 2000 and 1999, respectively, volatility of approximately 75%, with expected lives of approximately four years and no expected dividends.

11. DEFERRED NON-CASH STOCK COMPENSATION CHARGES

During the year ended December 31, 2000, our majority-owned subsidiary, CombiMatrix, recorded deferred non-cash stock compensation charges aggregating approximately \$53.8 million in connection with the granting of stock options. Pursuant to Acacia's policy, the stock options were granted at exercise prices equal to the fair value of the underlying CombiMatrix stock on the date of grant as determined by Acacia. However, such exercise prices were subsequently determined to be below fair value due to a substantial step-up in the fair value of CombiMatrix pursuant to a valuation provided by an investment banker in contemplation of a potential CombiMatrix initial public offering in 2000. In connection with the proposed CombiMatrix initial public offering and pursuant to SEC rules and guidelines, we were required to reassess the value of stock options issued during the one-year period preceding the potential initial public offering and utilize the stepped-up fair value provided by the investment banker

for purposes of determining whether such stock option issuances were compensatory, resulting in the calculation of the \$53.8 million in deferred non-cash stock compensation charges in 2000. Deferred non-cash stock compensation charges are being amortized by CombiMatrix over the respective option grant vesting periods, which range from one to four years. The table below reflects the gross deferred non-cash stock compensation charges recorded by CombiMatrix related to stock option grants, the amortization of deferred non-cash stock compensation for 2001 and 2000, and the impact of certain other CombiMatrix stock option transactions during 2001, as follows (in thousands):

During the third and fourth quarters of 2001, certain CombiMatrix unvested stock options were forfeited. Pursuant to the provisions of APB No. 25 and related interpretations, the reversal of previously recognized non-cash stock compensation expense on forfeited unvested stock options, in the amount of \$4,698,000, has been reflected in

F-24

the consolidated statements of operations and comprehensive loss as a reduction in 2001 non-cash stock compensation expense. In addition, the forfeiture of certain unvested options during 2001 results in a reduction of the remaining deferred non-cash stock compensation expense scheduled to be amortized in future periods.

The remaining deferred non-cash stock compensation balance as of December 31, 2001 related to stock options issued by CombiMatrix represents the future non-cash deferred stock compensation expense that will be reflected in our consolidated statements of operations and comprehensive loss as non-cash stock compensation charges over the next twelve quarters from January 1, 2002 through December 31, 2004 as follows (in thousands):

| YEAR | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | FOURTH QUARTER | TOTAL |
|------|---------------|----------------|---------------|----------------|----------|
| | | | | | |
| | | | | | |
| 2002 | \$2,273 | \$2,311 | \$2,212 | \$1,276 | \$ 8,072 |
| 2003 | 1,036 | 1,041 | 997 | 510 | 3,584 |
| 2004 | 366 | 360 | 329 | 55 | 1,110 |
| | | | | | |
| | | | | | \$12,766 |

Non-cash deferred stock compensation expense scheduled to be recognized in future periods reflected above may be impacted by certain subsequent stock option transactions including modification of terms, cancellations, forfeitures and other activity.

12. COMMITMENTS AND CONTINGENCIES

SALE AND LEASEBACK ARRANGEMENT

In September 2001, CombiMatrix entered into a sale and leaseback arrangement with a bank, providing up to \$7,000,000 in financing for equipment and other capital purchases. Pursuant to the terms of the agreement, certain equipment and leasehold improvements, totaling \$2,557,000 in net book value were sold to the bank at a purchase price of \$3,000,000, resulting in a deferred gain on the sale of assets of \$443,000. The deferred gain is being amortized over 4 years, the term of the related lease arrangement. In addition, CombiMatrix entered into a capital lease arrangement to lease the fixed assets from the bank. The capital lease agreement provides CombiMatrix with the option to purchase the equipment for a nominal amount at the end of the lease term, which expires in September 2004.

Future minimum lease payments under scheduled capital leases that have initial or remaining non-cancelable terms in excess of one year are as follows (in thousands):

YEAR

| 2002 2003 2004 | 1,141 |
|--|-------------------|
| Total minimum payments Less: amount representing interest | |
| Obligations under capital lease Less: current portion | |
| | \$1,845 ====== |

F-25

OPERATING LEASES

We lease certain office furniture and equipment and laboratory and office space under various operating lease agreements expiring over the next 7 years. Minimum annual rental commitments on operating leases of continuing operations having initial or remaining non-cancelable lease terms in excess of one year are as follows (in thousands):

YEAR

| 2002 | \$ 1,642 |
|------------|----------|
| 2003 | 1,894 |
| 2004 | 1,650 |
| 2005 | 1,721 |
| 2006 | 1,735 |
| Thereafter | 3,312 |

Total minimum lease payments..... \$11,954

Rent expenses of continuing operations at year ended December 31, 2001, 2000 and 1999 approximated \$1,979,289, \$1,032,000 and \$431,000, respectively.

LITIGATION

On November 28, 2000, Nanogen, Inc. ("Nanogen") filed suit against CombiMatrix and one of its principal stockholders, who is also a member of CombiMatrix's board of directors. Nanogen alleged breach of contract, trade secret misappropriation and that United States Patent No. 6,093,302 and other proprietary information belonging to CombiMatrix are instead the property of Nanogen. The litigation is in early stages, and CombiMatrix cannot predict its outcome. While CombiMatrix believes it has strong defenses to Nanogen's claims, if Nanogen were to prevail in its suit against CombiMatrix and obtain the injunction and monetary relief that is being sought, CombiMatrix could incur significant financial liabilities that would materially affect our consolidated financial condition and results of operations.

Acacia is subject to other claims and legal actions that arise in the ordinary course of business. Management believes that the ultimate liability with respect to these claims and legal actions, if any, will not have a material effect on our financial position, results of operations or cash flows.

13. SEGMENT INFORMATION

Acacia has two reportable segments as follows:

ACACIA MEDIA TECHNOLOGIES GROUP - Acacia Media Technologies Group owns intellectual property related to the telecommunications field, including a television blanking system, also known as the "V-chip," which it licenses to television manufacturers. In addition, our media technologies group owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

ACACIA LIFE SCIENCES GROUP - CombiMatrix is developing a proprietary biochip array processor system that integrates semiconductor technology with new developments in biotechnology and chemistry. Our majority-owned subsidiary, Advanced Material Sciences, holds the exclusive license for CombiMatrix's biological array processor technology in certain fields of material sciences.

We evaluate segment performances based on revenue earned and cost versus earnings potential of future completed products or services. Material intercompany transactions and transfers have been eliminated in consolidation. The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Corporate and other includes corporate costs, certain assets and liabilities and other

F-26

investment activities, which are included in our consolidated financial statements but are not allocated to the reportable segments.

The table below presents information about our reportable segments in

continuing operations for the years ended December 31, 2001, 2000 and 1999 (in thousands):

| 2001 | ACACIA MEDIA TECHNOLOGIES GROUP | ACACIA LIFE SCIENCES GROUP | CORPOR OT |
|---|------------------------------------|-------------------------------|--------------|
| Revenue | \$ 24,130 | \$ 456 | \$ |
| | 49 | \$ 450 | Ŷ |
| Amortization of patents and goodwill | 49 | | ۷ |
| | 1.37 | 2 120 | 1 |
| Interest income | 137 | 2,120 | Ť |
| Interest expense | | 65 | |
| Realized gains on investments | | | |
| Unrealized gains on investments | | | |
| Equity in losses of affiliate | | | |
| Loss (income) from continuing operations before | | | |
| operations before minority interests and taxes | (12,311) | 44,416 | 6 |
| Non-cash stock compensation charges | | 19,963 | |
| Segment assets | 10,339 | 40,161 | 56 |
| Investments in affiliate, at cost | | | 3 |
| Purchase of property and equipment | 7 | 3,756 | Ĩ |

| 2000 | ACACIA MEDIA TECHNOLOGIES GROUP | ACACIA LIFE SCIENCES GROUP | CORPOR OT |
|---|------------------------------------|-------------------------------|--------------|
| Revenue | \$ | \$ 17 | \$ |
| Amortization of patents and goodwill | 15 | | 2 |
| Other income | | | |
| Interest income | | 1,661 | 1 |
| Equity in losses of affiliates Loss from continuing operations before minority | | | 1 |
| interests and taxes | 335 | 19,045 | 19 |
| Non-cash stock compensation charges | | 10,205 | |
| Segment assets | 146 | 52,173 | 39 |
| Investments in affiliate, at equity | | | |
| Investments in affiliate, at cost | | | 3 |
| Purchase of property and equipment | 13 | 2,921 | |

| 1999 | ACACIA MEDIA TECHNOLOGIES GROUP | ACACIA LIFE SCIENCES GROUP | CORPOR OT |
|---|------------------------------------|-------------------------------|--------------|
| | | | |
| Revenue | \$ | \$ 144 | \$ |
| Amortization of patents and goodwill | 14 | | 1 |
| Interest income | | 40 | |
| Interest income | | 253 | |
| Equity in losses of affiliates Loss from continuing operations before minority | | | 1 |
| interests and taxes | 240 | 2,507 | 5 |
| Non-cash stock compensation charges | | 19 | |
| Segment assets | 150 | 1,908 | 43 |
| Investments in affiliate, at equity | | | 4 |
| Purchase of property and equipment | | 85 | |

Segment information has been restated to exclude Soundbreak.com for the years ended December 31, 2001, 2000 and 1999. See Note 9 to consolidated financial statements.

F-27

14. SUBSEQUENT EVENTS

In February 2002, CombiMatrix, a majority-owned subsidiary, was awarded a Phase I National Institutes of Health grant for the development of its protein biochip technology. The title of the grant is "Self-Assembling Protein Microchips." This grant is in addition to a three-year Phase I and a Phase II SBIR Grant from the U.S. Department of Defense for the development of multiplexed chip based assays for chemical and biological warfare agent detection.

In February 2002, in conjunction with the relocation of our corporate headquarters, we entered into a non-cancelable lease agreement to lease approximately 7,143 square feet of office space in Newport Beach, California through February 2007. Minimum annual rental commitments under this operating lease are \$255,000 in 2002; \$286,000 in 2003; \$295,000 in 2004; \$303,000 in 2005; \$312,000 in 2006; and \$39,000, thereafter.

In February 2002, we executed a sublease agreement, expiring in November 2003, to sublet the Pasadena, California office space. In 2002 and 2003, rent expense will be offset by \$142,399 and \$154,418 respectively, related to rental payments due pursuant to the terms of the sublease agreement.

On March 20, 2002, we announced that our board of directors approved a plan to divide our common stock into two new classes - new "CombiMatrix" common stock, that would reflect the performance of our CombiMatrix subsidiary, and new "Acacia Technologies" common stock, that would reflect the performance of our media technology businesses, including Soundview Technologies and Acacia Media Technologies. The plan will be submitted to our stockholders for approval. If the recapitalization proposal were approved, our stockholders would receive shares of both of the new classes of stock in exchange for existing Acacia shares. The new share classes are intended to be separately listed on the NASDAQ National Market System.

We also announced that our board of directors and CombiMatrix's board of directors have approved an agreement for Acacia to acquire the minority stockholder interests in CombiMatrix. The proposed acquisition would be accomplished through a merger in which the minority stockholders of CombiMatrix would receive shares of the new "CombiMatrix" common stock, in exchange for their existing shares. The proposed transaction will be submitted to the stockholders of Acacia and CombiMatrix for approval.

The proposed recapitalization and merger are subject to several important conditions, including receipt of stockholder approval, receipt of satisfactory tax and accounting opinions, approval of the proposed merger by a special committee of the CombiMatrix board of directors, receipt of a fairness opinion, approval for listing of both of the new shares on the NASDAQ National Market and other customary conditions. We expect to present these proposals to our stockholders for approval at a special meeting.

15. SUPPLEMENTAL CASH FLOW INFORMATION (IN THOUSANDS)

| | FOR TH | | | |
|---|--------|-----------------|----|--------------|
| | | 2001 | | |
| | | | | |
| Supplemental disclosures of cash flow information: | | | | |
| Cash paid for interest Cash paid for income taxes | \$ | 42 597 | Ş | 79 |
| Supplemental schedule of non-cash investing and financing activities: | | | | |
| Issuance of common stock for additional equity in consolidated subsidiary and affiliates Liabilities assumed in acquisition of minority ownership interest in | | | 11 | , 634 |
| subsidiary Increase in minority interests due to conversion of subsidiary notes | | 200 | | |
| payable | | | | |
| Fixed assets purchased with accounts payable | 13 | 3,000) | | 917 |
| Purchase of equipment under capital lease agreement Capital lease obligation incurred Accrued payments for purchase of common stock from former minority | | 3,000) 3,000 | | |
| stockholders of subsidiary | | 217 | | |

F-28

16. INTERIM FINANCIAL INFORMATION (UNAUDITED)

UNAUDITED INTERIM INFORMATION

The unaudited Acacia Research Corporation condensed consolidated financial statements as of June 30, 2002, and for the three and six month periods ended June 30, 2002 and 2001, have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, certain information and footnotes required by generally accepted accounting principles in annual financial statements are not included herein. These interim condensed consolidated financial statements should be read in conjunction with the Acacia Research Corporation consolidated financial statements and notes thereto for the year ended December 31, 2001.

The unaudited interim Acacia Research Corporation condensed consolidated financial statements include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation of our financial position as of June 30, 2002, the results of our operations for the three and six months ended June 30, 2002 and 2001, our cash flows for the six months ended June 30, 2002 and our stockholders' equity for the six months ended June 30, 2002. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the results to be expected for the entire year.

LOSS PER SHARE

Loss per share is presented on both a basic and diluted basis. A reconciliation of the denominator of the basic loss per share computation to the denominator of the diluted loss per share computation is as follows:

| | THREE MOI | SIX MONT | |
|--|---------------|---------------|---------------|
| | JUNE 30, 2002 | JUNE 30, 2001 | JUNE 30, 2002 |
| Weighted Average Number of Common Shares Used in Computation of Basic EPS Dilutive Effect of Outstanding Stock Options and Warrants (a) | 19,634,549 | 19,503,645 | 19,622,363 |
| Weighted Average Number of Common and Potential Shares Outstanding Used in Computation of Diluted EPS | 19,634,549 | 19,503,645 | 19,622,363 |

(a) Potential common shares of 444,875 and 163,882 during the three months ended June 30, 2002 and 2001, respectively, have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive. Potential common shares of 536,154 and 671,090 during the six months ended June 30, 2002 and 2001, respectively, have been excluded from the per share calculation because the effect of their inclusion would be anti-dilutive.

RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" ("SFAS No. 141"), and SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 141 addresses financial accounting and reporting for business combinations and supersedes Accounting Principles Board ("APB") Opinion No. 16, "Business Combinations." Changes made by SFAS No. 141 include (1) requiring the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and (2) establishing specific criteria for the recognition of intangible assets separately from goodwill. These provisions are effective for business combinations for which the date of acquisition is subsequent to June 30, 2001.

We adopted SFAS No. 142 effective January 1, 2002 and ceased amortizing goodwill on that date. SFAS No. 142 addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. This standard provides that goodwill is not subject to amortization. Instead, it is subject to a periodic review that must occur at least annually at a reporting unit level for possible impairment. This review is known as the "two-step" impairment test and provides that the initial "first-step" reviews of each reporting unit must be completed within six months of the adoption of the standard. The "first-step" of the goodwill

F-29

impairment test, used to identify potential impairment, compares the fair value of each reporting unit with its carrying amount, including goodwill. If upon completion of these initial reviews an impairment of goodwill is indicated, the "second-step" is required to be performed, which will compare the implied fair value of each reporting unit goodwill with the carrying amount of goodwill. In

connection with the adoption of SFAS No. 142, we performed a transitional goodwill impairment assessment and determined that there was no impairment of goodwill. The fair value of our two reporting units was estimated using a discounted cash flow analysis. There can be no assurance that a future goodwill impairment test will not result in a charge to earnings.

The Acacia Media Technologies Group had \$1,776,000 of goodwill at June 30, 2002 and December 31, 2001 (net of \$2,258,000 of accumulated amortization) and recorded approximately \$45,000 and \$89,000 of goodwill amortization expense during the three and six months ended June 30, 2001, respectively. The Acacia Life Sciences Group had \$2,851,000 of goodwill at June 30, 2002 and December 31, 2001 (net of \$1,311,000 of accumulated amortization) and recorded approximately \$203,000 and \$402,000 of goodwill amortization expense during the three and six months ended June 30, 2001, respectively.

Our net loss and loss per share, adjusted to exclude goodwill amortization expense, for the three and six months ended June 30, 2002 and 2001 are as follows (in thousands, except earnings per share amounts):

| | THREE MOI | NTHS ENDED | SIX MONTHS ENDED | | | | |
|---|---------------|-------------------|------------------|-------------------|--|--|--|
| | JUNE 30, | JUNE 30, | JUNE 30, | JUNE 30, | | | |
| | 2002 | 2001 | 2002 | 2001 | | | |
| Reported net loss | \$(9,701) | \$(4,772) | \$(16,127) | \$(14,251) | | | |
| Add back: goodwill amortization | | 248 | | 491 | | | |
| Adjusted net loss | \$(9,701) | \$(4,524) | \$(16,127) | \$(13,760) | | | |
| | ===== | ===== | ====== | ====== | | | |
| LOSS PER SHARE (BASIC AND DILUTED): Reported net loss Goodwill amortization | \$ (0.49) | \$ (0.25) 0.01 | \$ (0.82) | \$ (0.74) 0.03 | | | |
| Adjusted net loss | \$ (0.49) | \$ (0.24) | \$ (0.82) | \$ (0.71) | | | |
| | ====== | ====== | ====== | ====== | | | |

Acacia's only identifiable intangible assets are patents totaling \$10,857,000 and \$11,855,000 at June 30, 2002 and December 31, 2001 (net of \$6,753,000 and \$5,655,000 of accumulated amortization, respectively). The gross carrying amounts and accumulated amortization related to acquired intangible assets, all related to patents, by segment, as of June 30, 2002 and December 31, 2001 are as follows (in thousands):

| | ACACIA MEDIA ' | TECHNOLOGIES GROUP | LIFE SCIENCES GROUP | | | | |
|---------------------------------|----------------|--------------------|---------------------|-------------------|--|--|--|
| | AT JUNE 30, | AT DECEMBER 31, | AT JUNE 30, | AT DECEMBER 31, | | | |
| | 2002 | 2001 | 2002 | 2001 | | | |
| Gross carrying amount – patents | \$10,798 | \$10,698 | \$6,812 | \$6,812 | | | |
| Accumulated amortization | (6,072) | (5,144) | (681) | (511) | | | |
| Patents, net | \$ 4,726 | \$ 5,554 ====== | \$6,131 ====== | \$6,301 ====== | | | |

Aggregate patent amortization expense was \$564,000 (\$465,000 and \$99,000 for the Acacia Technologies Group and the Acacia Life Sciences Group, respectively) and \$390,000 (\$291,000 and \$99,000 for the Acacia Technologies

Group and the Acacia Life Sciences Group, respectively) for the three months ended June 30, 2002 and 2001, respectively. Aggregate patent amortization expense was \$1,128,000 (\$930,000 and \$198,000 for the Acacia Technologies Group and the Acacia Life Sciences Group, respectively) and \$780,000 (\$582,000 and \$198,000 for the Acacia Technologies Group and the Acacia Life Sciences Group, respectively) for the six months ended June 30, 2002 and 2001, respectively.

F-30

The estimated aggregate amortization expense for the years ended December 31, 2002 through 2006 is as follows (in thousands):

| | ESTIMATED |
|--------------|--------------|
| YEAR ENDED | AMORTIZATION |
| DECEMBER 31, | EXPENSE |
| | |
| 2002 | 1,862 |
| 2003 | 841 |
| 2004 | 841 |
| 2005 | 841 |
| 2006 | 841 |

At June 30, 2002 and December 31, 2001, all of our acquired intangible assets were subject to amortization.

On January 1, 2002, we adopted SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), which addresses financial accounting and reporting for the impairment of long-lived assets and for long-lived assets to be disposed of. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 also supersedes the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations -Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for segments of a business to be disposed of. SFAS No. 144 also amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a temporarily controlled subsidiary. SFAS No. 144 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. In conjunction with such tests, it may be necessary to review depreciation estimates and methods as required by APB Opinion No. 20, "Accounting Changes," or the amortization period as required by SFAS No. 142. The adoption of SFAS No. 144 did not have a material effect on our consolidated results of operations or financial position.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," ("SFAS No. 145"), which is effective for transactions occurring after May 15, 2002. SFAS No. 145 rescinds SFAS No. 4 and SFAS No. 64, which addressed the accounting for gains and losses from extinguishment of debt. SFAS No. 44 set forth industry-specific transitional guidance that did not apply to us. SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. SFAS No. 145 also makes technical corrections to certain existing pronouncements that are not substantive in nature. We do not expect the adoption of SFAS No. 145 to have a significant impact on our financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs

Associated with Exit or Disposal Activities" ("SFAS No. 146"). SFAS No. 146 nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity," under which a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized at fair value when the liability is incurred. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS No. 146 to have a significant impact on our financial position or results of operations.

INVESTMENTS IN CONSOLIDATED SUBSIDIARIES

On April 25, 2002, our majority-owned subsidiary, CombiMatrix, purchased our interest in Advanced Material Sciences. CombiMatrix issued 180,982 shares of its common stock in exchange for our 58% interest in Advanced Material Sciences. As a result of the sale of our interest in Advanced Material Sciences, CombiMatrix currently owns 87% of Advanced Material Sciences and the remaining interests are owned by unaffiliated entities.

F-31

The purchase was accounted for pursuant to APB Opinion No. 16, "Business Combinations," and related interpretations and EITF 90-5, "Exchanges of Ownership Interests between Entities under Common Control." Accordingly, the transaction was accounted for using Acacia's basis in the net assets of Advanced Material Sciences and as a result, Acacia's consolidated financial statements continue to reflect the assets and liabilities of Advanced Material Sciences at historical cost.

SEGMENT INFORMATION

Acacia has two reportable segments as follows:

Acacia Media Technologies Group - Acacia Media Technologies Group owns intellectual property related to the telecommunications field, including a television blanking system, also known as the "V-chip," which it licenses to television manufacturers. In addition, our media technologies group owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

Acacia Life Sciences Group - Acacia Life Science Group includes our majority-owned subsidiary, CombiMatrix, which is developing a proprietary biochip array processor system that integrates semiconductor technology with new developments in biotechnology and chemistry. CombiMatrix's majority-owned subsidiary, Advanced Material Sciences, holds the exclusive license for CombiMatrix's biological array processor technology in certain fields of material sciences (see Note 4).

We evaluate segment performances based on revenue earned and cost versus earnings potential of future completed products or services. Material intercompany transactions and transfers have been eliminated in consolidation.

The accounting policies of the segments are the same as those described in our Annual Report on Form 10-K. Corporate and other includes corporate costs, certain assets and liabilities and other investment activities (including

certain intangibles recorded in connection with the acquisition of various ownership interests in our subsidiaries), which are included in our consolidated financial statements but are not allocated to the reportable segments.

We use the management approach, which designates the internal organization that is used by management for making operating decisions and assessing performance as the basis of our reportable segments. At December 31, 2001, our reporting segments were adjusted to include our wholly owned subsidiaries Soundview Technologies Incorporated ("Soundview Technologies") and Acacia Media Technologies Corporation, in our Acacia Media Technologies Group segment. In addition, CombiMatrix and its subsidiaries comprise our Acacia Life Sciences Group segment. Segment information has been adjusted for all periods presented.

The table below presents information about our reportable segments in continuing operations for the three months ended June 30, 2002 and 2001:

| THREE MONTHS ENDED JUNE 30, 2002 | TECHN | A MEDIA IOLOGIES ROUP | AC# | C A | |
|---|-------|-----------------------------|-----|------------|----|
| Revenue | \$ | | \$ | 438,000 | \$ |
| Amortization of patents | | 19,000 | | | |
| Other income | | 5,000 | | | |
| Interest income | | 6,000 | | 143,000 | |
| Interest expense | | | | 56,000 | |
| Realized losses on investments | | | | | |
| Unrealized losses on investments | | | | | |
| Loss from operations before income taxes and minority interests | | 583,000 | (| 9,432,000 | |
| Non-cash stock compensation charges | | | 4 | 2,135,000 | |
| Segment assets | 10, | 146,000 | 28 | 3,721,000 | 5 |
| Investment in affiliate, at cost | | | | | |
| Purchase of property and equipment | | | | 289,000 | |

F-32

| THREE MONTHS ENDED JUNE 30, 2001 | ACACIA MEDIA TECHNOLOGIES GROUP | ACACI LIFE SCIENC GROU |
|--|--|---------------------------------|
| Revenue | \$10,000,000 | \$ 91 |
| Amortization of patents and goodwill | 5,000 | |
| Other income | | |
| Interest income | 32,000 | 559 |
| Equity in losses of affiliate | | |
| (Income) loss from operations before income taxes and minority interests | (5,055,000) | 12 , 589 |
| Non-cash stock compensation charges | | 7,177 |
| Segment assets | 6,326,000 | 44,000 |
| Investment in affiliate, at equity | | |
| Investment in affiliate, at cost | | |
| Purchase of property and equipment | 2,000 | 1,083 |

The table below presents information about our reportable segments in continuing operations for the six months ended June 30, 2002 and 2001:

| SIX MONTHS ENDED JUNE 30, 2002 | ACACIA MEDIA TECHNOLOGIES GROUP | | | ACACI LIFE CIENC GROU |
|---|--|--------|----|--------------------------------|
| Revenue | \$ | | \$ | 687 |
| Amortization of patents | | 39,000 | | |
| Other income | | 5,000 | | |
| Interest income | | 14,000 | | 393 |
| Interest expense | | | | 115 |
| Realized losses on investments | | | | |
| Unrealized losses on investments | | | | |
| Loss from operations before income taxes and minority interests | ç | 56,000 | 1 | 5,083 |
| Non-cash stock compensation charges | | | | 3,547 |
| Segment assets | 10,1 | 46,000 | 2 | 8,721 |
| Investment in affiliate, at cost | | | | |
| Purchase of property and equipment | | | | 467 |

| SIX MONTHS ENDED JUNE 30, 2002 | ACACIA MEDIA TECHNOLOGIES GROUP | ACACI LIFE SCIENC GROU |
|--|--|---------------------------------|
| Revenue | \$12,390,000 | \$ 274 |
| Amortization of patents and goodwill | 10,000 | |
| Other income | | |
| Interest income | 35,000 | 1,292 |
| Equity in losses of affiliate | | |
| (Income) loss from operations before income taxes and minority interests | (6,121,000) | 25 , 586 |
| Non-cash stock compensation charges | | 14 , 775 |
| Segment assets | 6,326,000 | 44,000 |
| Investment in affiliate, at equity | | |
| Investment in affiliate, at cost | | |
| Purchase of property and equipment | 6,000 | 2 , 559 |

Segment information excludes discontinued operations related to Soundbreak.com as of and for the three and six months ended June 30, 2002 and 2001.

COMMITMENTS AND CONTINGENCIES

On November 28, 2000, Nanogen, Inc. filed a complaint in the United States District Court for the Southern District of California against CombiMatrix and Donald D. Montgomery, Ph.D., Senior Vice President,

Chief Technology Officer and a director of CombiMatrix. Dr. Montgomery was employed by Nanogen as a senior research scientist between May 1994 and August 1995. The Nanogen complaint alleges, among other things, breach of contract, trade secret misappropriation and that U.S. Patent No. 6,093,302 and other proprietary information belonging to CombiMatrix are instead the property of Nanogen. The complaint seeks, among other things, correction of inventorship on the patent, the assignment of rights in the patent and pending patent applications to Nanogen, an injunction preventing disclosure of trade secrets, damages for trade secret misappropriation and the imposition of a constructive trust. On December 15, 2000, CombiMatrix and Dr. Montgomery filed a motion to dismiss the lawsuit, which was denied in part and granted in part on February 1, 2001. On March 9, 2001, CombiMatrix and Dr. Montgomery filed a counterclaim, alleging breach of express covenants not to sue or otherwise interfere with Dr. Montgomery arising out of a release signed by Nanogen in 1996. On April 4, 2001, Nanogen filed a motion to dismiss the counterclaim, which the court denied in its entirety on July 27, 2001. On July 31, 2002, the court denied a motion filed by CombiMatrix for partial summary judgment regarding Donald Montgomery's prior settlement agreement with Nanogen. See Subsequent Events above.

SUBSEQUENT EVENTS

In July 2002, Acacia was granted a patent for its digital media transmission technology in Japan. The patent provides coverage through January 2, 2012. The granting of the Japanese patent strengthens Acacia's worldwide intellectual property position, which includes five patents in the United States and issued patents in 17 foreign countries.

In July 2002, Acacia executed a license agreement with Loewe Opta GmbH, whereby Acacia will receive payment and grant a non-exclusive license of its patented V-chip technology to Loewe Opta GmbH, a manufacturer of televisions sold under the Loewe brand name.

In July 2002, CombiMatrix completed a prototype electrochemical detection system and is set to deliver the system to the U.S. Department of Defense. CombiMatrix developed its sensor technology through grants from the U.S. Department of Defense. The focus of the grants was aimed at developing an ultrasensitive hand-held biochip system for detecting the deployment of chemical and biological warfare agents.

In August 2002, Soundview Technologies filed a federal patent infringement lawsuit against seventeen television manufacturers in the United States District Court for the District of Nevada. In this lawsuit, Soundview alleges that television sets fitted with V-chips and sold in the United States infringe Soundview Technologies' patent. As a result of the summary judgment ruling in the case before the United States District Court for the District of Connecticut, in October 2002, Soundview Technologies voluntarily filed to dismiss, without prejudice, the Nevada infringement lawsuit. By voluntarily dismissing this lawsuit at this time, Soundview Technologies will be able to refile the action in the event that a favorable final decision is reached with respect to the issue of infringement in the Connecticut lawsuit.

On September 30, 2002, CombiMatrix Corporation and Dr. Donald Montgomery, an officer and stockholder of CombiMatrix Corporation, entered into a settlement agreement with Nanogen, Inc. to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, CombiMatrix Corporation agreed to pay Nanogen \$500,000 within 30 days of the settlement and an additional \$500,000 within one year of the settlement. CombiMatrix Corporation also agreed to make quarterly payments to Nanogen equal to 12.5% of total sales of products developed by CombiMatrix Corporation and its affiliates and based on the patents that had been in dispute in the litigation, up to an annual maximum of \$1,500,000. The minimum quarterly payments under the settlement agreement will be \$37,500 per quarter for the period from October 1,

2003 through October 1, 2004, and \$25,000 per quarter thereafter until the patents expire. Also pursuant to the settlement agreement, CombiMatrix Corporation agreed to issue 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, to Nanogen, subject to antidilution provisions under specified circumstances, including the exercise of outstanding options and warrants and issuances of additional capital stock of CombiMatrix Corporation, for a period of up to three years.

The issuance of shares by CombiMatrix Corporation to Nanogen, Inc. decreases Acacia Research Corporations consolidated ownership interest in CombiMatrix Corporation from 58% to 48%. Acacia Research Corporation continues to possess the ability to direct or cause the direction of the management and policies of CombiMatrix Corporation, primarily through Acacia Research Corporation's ability to elect the majority of the

F-34

board of directors of CombiMatrix Corporation, pursuant to a stockholder agreement with an officer of CombiMatrix Corporation. This stockholder agreement stipulates that, collectively, Acacia Research Corporation and the officer who is party to the stockholder agreement, will vote their shares such that the board will be comprised of the directors nominated by Acacia Research Corporation and the stockholder. The stockholder is generally prohibited from selling his shares and Acacia Research Corporation has a right of first refusal should the stockholder wish to sell his shares. Accordingly, the Company will continue to account for its investment in CombiMatrix Corporation under the consolidation method of accounting.

CombiMatrix Corporation will account for the issuance of the CombiMatrix Corporation common shares in settlement of the litigation with Nanogen, Inc. as a nonmonetary transaction. Accordingly, in the third quarter of 2002, CombiMatrix Corporation will record a litigation settlement charge in the consolidated statement of operations of approximately \$18.0 million, which is based on the fair value of the CombiMatrix Corporation common shares issued to Nanogen, Inc. The fair value of the common shares issued and the related litigation charge was based on a third-party valuation of CombiMatrix Corporation.

In September 2002, we recorded an impairment charge of \$2.7 million for an other-than-temporary decline in the fair value of our cost method investment.

In October 2002, CombiMatrix was in non-compliance with one of its covenants under its capital lease obligation with a commercial bank. CombiMatrix paid the remaining balance of the obligation in the amount of \$2.1 million on November 1, 2002.

17. QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table sets forth unaudited consolidated statement of operations data for the eight quarters in the period ended December 31, 2001. This information has been derived from our unaudited condensed consolidated financial statements that have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of the information when read in conjunction with the audited consolidated financial statements and related notes thereto. Our quarterly results have been in the past and may in the future be subject to significant fluctuations. As a result, we believe that results of operations for interim periods should not be relied upon as any indication of the results to be

expected in any future periods.

F-35

| | QUARTER ENDED | | | | | | | | |
|---|--------------------------------|-------------------|-----------------|------------------|-----------------|-----|--------------|--|--|
| | MAR. 31, JUN. 30, 2001 2001 | | SE | SEP. 30, | | | | | |
| | (IN | THOUSANDS, | | | | PER | SHARE | | |
| Revenues: License fee income Grant revenue Other income | | 2,440 183 | | 10,000 91 | | 10, | 91 | | |
| | | 2,623 18,424 | | 10,091 | | 10, | ,831 ,527 | | |
| Operating loss Other income (expense) | | (15,801) 1,144 | | (9,937) | | | ,696) 796 | | |
| Loss from continuing operations before income taxes and minority interests | | | | (8,906) | | (6, | ,900) | | |
| Loss from continuing operations before minority interests Minority interests | | | | (9,134) 4,362 | | | ,851 | | |
| Loss from continuing operations Loss from discontinued operations | | (9,479) | | | | | | | |
| Loss before cumulative effect of change in accounting principle Cumulative effect of change in accounting principle due to beneficial conversion | | (9,479) | | (4,772) | | (2, | 827) | | |
| feature | | | | | | | | | |
| Net loss | | (9,479) | | | | (2, | | | |
| Loss per common share: Basic | | | | | | | | | |
| Loss from continuing operations Loss from discontinued operations Cumulative effect of change in accounting | \$ \$ | (0.50) | | (0.25) | | ((| D.15) | | |
| principle | \$ | | \$ | | \$ | | | | |
| Net loss | \$ | (0.50) | \$ | (0.25) | \$ | ((| 0.15) | | |
| Diluted Loss from continuing operations Loss from discontinued operations Cumulative effect of change in accounting | === \$ \$ | (0.50) | === \$ \$ | (0.25) | === \$ \$ | | | | |
| principle | \$ | | \$ | | \$ | | | | |
| Net loss | \$ | (0.50) | \$ | (0.25) | \$ | ((| 0.15) | | |

| Weighted average number of common and potential shares outstanding used in computation of loss per share: | | | | | | | | | |
|--|--|----------|---------------|--------------|------------------|--------------------|--|--|--|
| Basic Diluted | 18,985,864 19,503,645 18,985,864 19,503,645 | | | | | | | | |
| Market price per share: High Low | \$ 18.9 \$ 5.2 | 8 9 | \$ 16 \$ 4 | .14 .69 | \$ \$ | 16.66 5.83 | | | |
| | | | | UARTE | | DED | | | |
| | MAR. 31, JUN. 30, 2000 2000 | | | SEI | SEP. 30, 2000 | | | | |
| | (IN THOUSA | | | | | | | | |
| Revenues: License fee income | \$ – | | | | | | | | |
| Grant revenue Other income | 1 | _ | | 22 | | 18 | | | |
| Total revenues Operating expenses | 1 | 7 0 | 4, | 22 150 | | 18 | | | |
| Operating loss Other income (expense) | (3,23 | 3) 9 | (4, | 128) 21 | | | | | |
| Loss from continuing operations before income taxes and minority interests | (3,13 | 4) 5) | (4, | 107) (2) | | | | | |
| Loss from continuing operations before minority interests Minority interests | | 9) 1 | (4, | 109) 659 | | (11,368) 2,528 | | | |
| Loss from continuing operations | | 8) 4) | (3, (2, | 450) 787) | | (8,840) (2,057) | | | |
| Loss before cumulative effect of change in accounting principle Cumulative effect of change in accounting | (3,56 | | | 237) | | (10,897) | | | |
| principle due to beneficial conversion feature | \$ (24 | 6) 5 | \$ | | \$ | | | | |
| Net loss | \$ (3,80 ====== | - | \$(6 , | 237) | \$ ==== | (10,897) | | | |
| Loss per common share: Basic | | | | | | | | | |
| Loss from continuing operations Loss from discontinued operations Cumulative effect of change in accounting | \$ (0.1 \$ (0.0 | | | .21) .17) | \$ \$ | (0.51) (0.12) | | | |
| principle | \$ (0.0 | 2) 5 | \$ | | \$ | | | | |
| Net loss | \$ (0.2 | - | \$ (C | .38) | \$ ==== | (0.63) | | | |
| Diluted Loss from continuing operations Loss from discontinued operations Cumulative effect of change in accounting | \$ (0.1 \$ (0.0 | 7) S | \$ (C | .21) .17) | \$ \$ | (0.51) (0.12) | | | |

| principle | \$ | (0.02) | \$ | | \$ | |
|---|--------------------------|----------------|------------|----------------------|------------|----------------------|
| Net loss | \$ ==== | (0.25) | \$ ==== | (0.38) | \$ ==== | (0.63) |
| Weighted average number of common and potential shares outstanding used in computation of loss per share: | | | | | | |
| Basic Diluted | 15,630,070 15,630,070 | | | ,292,859 ,292,859 | | ,502,640 ,502,640 |
| Market price per share: High Low | \$ \$ | 53.64 26.82 | \$ \$ | 39.09 12.16 | \$ \$ | 32.05 19.89 |

F-36

18. CONSOLIDATING FINANCIAL INFORMATION

On March 20, 2002, Acacia Research's board of directors (the "Board") approved a plan that would create two new classes of common stock called Acacia Research Corporation-CombiMatrix common stock ("AR-CombiMatrix stock") and Acacia Research Corporation-Acacia Technologies common stock ("AR-Acacia Technologies stock") (the "Recapitalization Proposal"). AR-CombiMatrix stock is intended to reflect separately the performance of the CombiMatrix group. AR-Acacia Technologies stock is intended to reflect separately the performance of Acacia Research Corporation's media technology business. Each share of existing Acacia Research Corporation common stock will be converted into approximately 0.5582 of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. Acacia Research Corporation intends to list the AR-CombiMatrix stock and the AR-Acacia Technologies stock on the NASDAQ National Market under the symbols "CBMX" and "ACTG," respectively. The Board also approved an agreement whereby Acacia Research Corporation would acquire the minority stockholder interest in CombiMatrix Corporation. The acquisition would be accomplished through a merger in which the minority stockholders of CombiMatrix Corporation would receive one share of the to be formed AR-CombiMatrix stock in exchange for one share of their existing CombiMatrix Corporation common stock. The acquisition is subject to approval by the stockholders of Acacia Research Corporation.

Presented below is the consolidating financial information reflecting the businesses of the Acacia Technologies group and the CombiMatrix group. Earnings attributable to each group has been determined in accordance with accounting principles generally accepted in the United States.

AR-CombiMatrix stock and AR-Acacia Technologies stock are intended to reflect the separate performance of the respective division of Acacia Research Corporation. The CombiMatrix group and the Acacia Technologies group are not separate legal entities. Holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will be stockholders of Acacia Research Corporation. As a result, holders of AR-CombiMatrix stock and AR-Acacia Technologies stock will continue to be subject to all of the risks of an investment in Acacia Research Corporation and all of its businesses, assets and liabilities. The assets Acacia Research Corporation attributes to one of the groups could be subject to the liabilities of the other group. The group financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, and taken together, comprise all the accounts included in the corresponding consolidated financial statements of Acacia Research Corporation. The financial statements of the groups reflect the financial

condition, results of operations, and cash flows of the businesses included therein. The financial statements of the groups include the accounts or assets of Acacia Research Corporation specifically attributed to the groups and were prepared using amounts included in Acacia Research Corporation's consolidated financial statements.

Minority interests represent participation of other stockholders in the net equity and in the division earnings and losses of the groups and are reflected in the caption "Minority interests" in the group financial statements. Minority interests adjust group net results of operations to reflect only the group's share of the division earnings or losses of non-wholly-owned investees.

Financial effects arising from one group that affect Acacia Research Corporation's results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group and the market price of the class of common stock relating to the other group. Any division net losses of the CombiMatrix group or of the Acacia Technologies group, and dividends or distributions on, or repurchases of, AR-CombiMatrix stock or AR-Acacia Technologies stock, will reduce the assets of Acacia Research Corporation legally available for payment of dividends on AR-CombiMatrix stock or AR-Acacia Technologies stock.

MANAGEMENT ALLOCATION POLICIES. The management and allocation policies applicable to the preparation of the financial statements of the CombiMatrix group and the Acacia Technologies group may be modified or rescinded, or additional policies may be adopted, at the sole discretion of the Board at any time without approval of the stockholders. The CombiMatrix group's financial statements reflect the application of the management and allocation policies adopted by the Board to various corporate activities, as described below. Management has no plans to change allocation methods or the composition of the groups. The CombiMatrix group financial statements should be read in conjunction with the Acacia Research Corporation consolidated financial statements and related notes.

F-37

TREASURY AND CASH MANAGEMENT POLICIES. Cash and short-term investments were attributed to the groups based on the respective cash and short term investments balances of the entities comprising each group. Corporate cash balances have been attributed to the Acacia Technologies group. All cash raised by CombiMatrix Corporation and Advanced Material Sciences have been attributed to the CombiMatrix group. The Company does not currently have any short term or long-term debt. Should debt arise in future periods, the Company will attribute each future incurrence or issuance of external debt or preferred stock (and the proceeds thereof) between the groups or entirely to one group as described below. Acacia Research Corporation will manage most treasury activities on a decentralized basis, with each separate group separately managing its own treasury activities. Pursuant to treasury and cash management policies adopted by the Board, after the date on which AR-CombiMatrix stock and AR-Acacia Technologies stock is first issued, the following will apply:

- Acacia Research Corporation will attribute each future issuance of AR-Acacia Technologies stock (and the proceeds thereof) to the Acacia Technologies group and will attribute each future issuance of AR-CombiMatrix stock (and the proceeds thereof) to the CombiMatrix group;
- Acacia Research Corporation will attribute each future incurrence or issuance of external debt or preferred stock (and the proceeds

thereof) between the groups or entirely to one group as determined by the Board, based on the extent to which Acacia Research Corporation incurs or issues the debt or preferred stock for the benefit of the CombiMatrix group or the Acacia Technologies group;

- Dividends on AR-Acacia Technologies stock will be charged against the AR-Acacia Technologies group, and dividends on AR-CombiMatrix stock will be charged against the CombiMatrix group;
- Repurchases of AR-Acacia Technologies stock will be charged against the Acacia Technologies group and Repurchases of AR-CombiMatrix stock will be charged against the CombiMatrix group;
- As of immediately prior to the first issuance of AR-CombiMatrix stock and AR-Acacia Technologies stock, the CombiMatrix group and the Acacia Technologies group shall be deemed to be allocated the cash and cash equivalents held by the respective groups as of that date;
- Acacia Research Corporation will account for any cash transfers from 0 Acacia Research Corporation to or for the account of a group, from a group to or for the account of Acacia Research Corporation, or from one group to or for the account of the other group (other than transfers in return for assets or services rendered) as short-term loans unless (A) the Board determines that a given transfer (or type of transfer) should be accounted for as a long-term loan, (B) the Board determines that a given transfer (or type of transfer) should be accounted for as a capital contribution or (iii) the Board determines that a given transfer (or type of transfer) should be accounted for as a return of capital. There are no specific criteria to determine when Acacia Research Corporation will account for a cash transfer as a long-term loan, a capital contribution or a return of capital rather than an inter-group revolving credit advance; provided, however, that cash advances from Acacia Research Corporation to the Acacia Technologies group or to the CombiMatrix group up to \$25 million on a cumulative basis shall be accounted for as short-term or long-term loans at interest rates at which Acacia Research Corporation could borrow such funds and shall not be accounted for as a capital contribution. The Board will make such a determination in the exercise of its business judgment at the time of such transfer based upon all relevant circumstances. Factors the Board may consider include, without limitation, the current and projected capital structure of each group; the financing needs and objectives of the recipient group; the availability, cost and time associated with alternative financing sources; and prevailing interest rates and general economic conditions; and
- Any cash transfers accounted for as short-term loans will bear interest at the rate at which Acacia Research Corporation could borrow such funds. In addition, any cash transfers accounted for as a long-term loan will have interest rates, amortization, maturity, redemption and other terms that reflect the then-prevailing terms on which Acacia Research Corporation could borrow such funds.

ASSETS AND LIABILITIES. In general, Acacia Research Corporation's assets and liabilities have been attributed to the Acacia Technologies group and the CombiMatrix group based on the respective asset and liabilities of the business comprising each group. Net intangible assets recorded at the Acacia Research Corporation level, primarily consisting of acquired patents and goodwill balances, have been attributed to the respective businesses comprising each group to which the intangibles and goodwill relate.

CORPORATE GENERAL AND ADMINISTRATIVE SERVICES AND FACILITIES. Acacia Research Corporation allocates the cost of corporate general and administrative services and facilities between the groups generally based upon utilization. Where determinations based on utilization alone are impracticable, Acacia Research Corporation will use other methods and criteria that management believes to be equitable and to provide a reasonable estimate of the cost attributable to each group. Except as otherwise determined by management, the allocated costs of providing such services and facilities include, without limitation, all costs and expenses of personnel employed in connection with such services and facilities, including, without limitation, all direct costs of such personnel, such as payroll, payroll taxes and fringe benefit costs (calculated at the appropriate annual composite rate therefor) and all overhead costs and expenses directly related to such personnel and the services or facilities provided by them. In addition, allocated costs include all materials used in connection with such services or facilities, billed at their net cost to the provider of the services or facilities plus all overhead costs and expenses related to such materials. Except as may otherwise be specifically provided pursuant to the terms of any agreements among Acacia Research Corporation and the groups or any resolutions of the Board, the corporate general and administrative services and facilities to be allocated between the groups include, without limitation, legal services, accounting services (tax and financial), insurance and deductibles payable in connection therewith, employee benefit plans and administration thereof, investor relations, stockholder services, and services relating to the board of directors.

Management believes that the methods and criteria used to allocate costs are equitable and provide a reasonable estimate of the cost attributable to the groups. Based on the allocation methods used, the Company believes that the allocation of expenses as presented in the accompanying financial statements for the groups reflects a reasonable estimation of expenses that would be recognized if the groups were separate stand alone registrants.

ALLOCATION OF FEDERAL AND STATE INCOME TAXES. Acacia Research Corporation determines its federal income taxes and the federal income taxes of its subsidiaries that own assets allocated between the groups on a consolidated basis. Acacia Research Corporation allocates consolidated federal income tax provisions and related tax payments or refunds between the Acacia Technologies' group and CombiMatrix group based principally on the taxable income and tax credits directly attributable to each group. Such allocations reflect each group's contribution, whether positive or negative, to Acacia Research Corporation's consolidated federal taxable income and consolidated federal tax liability and tax credit position. Acacia Research Corporation will credit tax benefits that cannot be used by the group generating those benefits but can be used on a consolidated basis to the group that generated such benefits.

Inter-group transactions will be treated as taxed as if each group was a stand-alone company. Depending on the tax laws of the respective jurisdictions, state and local income taxes are calculated on either a consolidated or combined basis between the groups based on their respective contribution to such consolidated or combined state taxable incomes. State and local income tax provisions and related tax payments or refunds which are determined on a separate corporation basis will be allocated between the groups in a manner designed to reflect the respective contributions of the groups to Acacia Research Corporation's separate or local taxable income. F-39

CONSOLIDATING STATEMENT OF FINANCIAL POSITION AT DECEMBER 31, 2001

| | ACACIA TECHNOLOGIES GROUP | COMBIMA GROU |
|--|---------------------------------|---------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$46,859 | \$12 , 5 |
| Short-term investments | 4,372 | 20,7 |
| Prepaid expenses, other receivables and other assets | 800 | 8 |
| Total current assets | 52,031 | 34,1 |
| Property and equipment, net of accumulated depreciation | 358 | 4,5 |
| Receivable from CombiMatrix group | 30 | |
| Investment in affiliate, at cost | 3,000 | |
| Patents, net of accumulated amortization | 5,554 | 6,3 |
| Goodwill, net of accumulated amortization | 1,776 | 2,8 |
| Other assets | 177 | 1 |
| | \$62,926 | \$47 , 9 |
| Current liabilities: Accounts payable, accrued expenses and other Current portion of deferred revenues | \$ 2,925 1,500 | \$ 2,8 5,5 |
| Current portion of capital lease obligation | | 9 |
| Total current liabilities | 4,425 | 9,3 |
| Payable to Acacia Technologies group | | |
| Deferred income taxes | 1,298 | 2,5 |
| Deferred revenues, net of current portion | | 3 |
| Capital lease obligation, net of current portion | | 1,8 |
| Total liabilities | 5,723 | 14,1 |
| Minority interests | 2,194 | 30,1 |
| Stockholders' equity: | | |
| AR-Acacia Technologies stockAR-CombiMatrix stock | 55,009 | 3,7 |
| Total stockholders' equity | 55,009 | 3 , 7 |
| | \$62,926 | \$47 , 9 |
| | ====== | ===== |
| | | |

CONSOLIDATING STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2001

| | ACACIA TECHNOLOGIES GROUP | COMBIMA GROU |
|--|---------------------------------|-----------------|
| Revenues: | | |
| License fee income | \$ 24,180 | \$ |
| Grant revenue | | 4 |
| Total revenues | 24,180 | 4 |
| Operating expenses: | | |
| Research and development expenses | | 18,8 |
| Marketing, general and administrative expenses | 5,258 | 29,4 |
| Legal expenses | 11 , 572 | |
| Amortization of patents and goodwill | 1,492 | 1,2 |
| Total operating expenses | 18,322 | 49,5 |
| Operating income (loss) | 5,858 | (49,0 |
| Other income (expenses): | | |
| Write-off of equity investments | | |
| Interest income | 1,642 | 2,1 |
| Realized gains on short-term investments | 350 | |
| Unrealized gains on short-term investments | 237 | |
| Interest expense | | (|
| Equity in losses of affiliates | (195) | |
| Other income | 77 | |
| Total other income (expense) | 2,111 | 2,0 |
| Income (loss) from continuing operations before income taxes and | | |
| minority interests | 7,969 | (47,0 |
| (Provision) benefit for income taxes | (935) | 1 |
| Income (loss) from continuing operations before minority interests | 7,034 | (46,8 |
| Minority interests | (1,277) | 18,8 |
| Net income (loss) | \$ 5,757 ====== | \$(28,0 |

F-41

CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2001

| ACACIA | |
|--------------|---------|
| TECHNOLOGIES | COMBIMA |
| GROUP | GROU |
| | |

| CASH FLOWS FROM OPERATING ACTIVITIES: | | ¢ () 0 0 |
|--|-------------------|-----------------|
| Income (loss) from continuing operationsAdjustments to reconcile net income (loss) to net cash used in | \$ 5 , 757 | \$(28,0 |
| operating activities: | | |
| Depreciation and amortization | 1,710 | 2,1 |
| Equity in losses of affiliates | 195 | |
| Minority interests in net income (loss) | 1,277 | (18,8 |
| Compensation expense relating to stock options and warrants | 856 | 19,9 |
| Deferred tax benefit | (27) | (1 |
| Write-off of other assets Net purchases of trading securities | (4,135) | 9 |
| Unrealized gain on short-term investments | (237) | |
| Other | 40 | 3 |
| Changes in assets and liabilities, net of effects of acquisitions: | | |
| Prepaid expenses, other receivables and other assets | (378) | (2 |
| Accounts payable, accrued expenses and other | 233 | 7 |
| Deferred revenues | 1,500 | 5,9 |
| Net cash provided by (used in) operating activities of continuing | | |
| operations | 6,791 | (17,1 |
| Net cash used in operating activities of discontinued operations | (2,182) | × , |
| | | |
| Net cash provided by (used in) operating activities | 4,609 | (17,1 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of additional equity in consolidated subsidiaries | (3,304) | |
| Purchase of property and equipment | (19) | (3,7 |
| Proceeds from sale and leaseback arrangement | | 3,0 |
| Sale of available-for-sale investments | 25,921 | 50,3 |
| Purchase of available-for-sale investments | (25,921) | (30,7 |
| Purchase of common stock from minority stockholders of subsidiaries | (2,550) | |
| | (2, 330) | |
| Net cash (used in) provided by investing activities of continuing | | |
| operations | (5,873) | 18,8 |
| Net cash used in investing activities of discontinued operations | (145) | |
| Net cash (used in) provided by investing activities | (6,018) | 18,8 |
| Net cash (abea in) provided by investing activities | | |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | 10 555 | |
| Net cash attributed to the Acacia Technologies group | 18,663 | |
| Net cash attributed to the CombiMatrix group | | 4,4 |
| Net cash provided by financing activities | 18,663 | 4,4 |
| | , | |
| Increase in cash and cash equivalents | 17,254 | 6,1 |
| Cash and cash equivalents, beginning | 29,605 | 6,5 |
| Effect of exchange rate on cash | | (1 |
| Cash and cash equivalents, ending | \$ 46,859 | \$ 12,5 |
| cash and cash equivalence, chaing | ======= | 9 12 , 5 |
| | | |

F-42

CONSOLIDATING STATEMENT OF FINANCIAL POSITION AT DECEMBER 31, 2000

| | ACACIA TECHNOLOGIES GROUP | COMBIMA GROUP |
|--|---------------------------------|------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$29 , 605 | \$ 6 , 5 |
| Short-term investments Prepaid expenses, other receivables and other assets | 323 | 40,6 1,1 |
| Total current assets | 29,928 | 48,3 |
| Property and equipment, net of accumulated depreciation | 871 | 2,8 |
| Receivable from CombiMatrix group | 107 | |
| Investment in affiliate, at equity | 346 | |
| Investment in affiliate, at cost | 3,000 | |
| Patents, net of accumulated amortization | 2,215 | 6,8 |
| Goodwill, net of accumulated amortization | 426 | 3,4 |
| Other assets | 169 | |
| | \$37,062 | \$61,5 ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities: Accounts payable, accrued expenses and other Accrued stock compensation | \$ 5,075 | \$ 2,8 10,2 |
| Total current liabilities | 5,075 | 13,0 |
| Payable to Acacia Technologies group Deferred income taxes | | 1 2,6 |
| Total liabilities | 5,075 | 15,8 |
| | | 15,5 |
| Minority interests | 2,012 | |
| Stockholders' equity: | | - |
| | 29,975 | 30,1 |
| Stockholders' equity: AR-Acacia Technologies stock | | |

F-43

CONSOLIDATING STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2000

| | | COMBIMA GROU | |
|--|-----------------------------------|------------------|--|
| Revenues: Grant revenue | \$ | Ş | |
| Other income | 40 | | |
| Total revenues | 40 | | |
| Operating expenses: | | | |
| Research and development expenses Marketing, general and administrative expenses Legal expenses | 52 8,983 984 | 11,8 12,1 | |
| Amortization of patents and goodwill Loss on disposal of consolidated subsidiaries | 1,611 1,016 | 6 | |
| Total operating expenses | 12,646 | 24,5 | |
| Operating loss | (12,606) | (24,5 | |
| Other income (expense): Write-off of equity investments Interest income Equity in losses of affiliates Other income | (2,603) 1,424 (1,746) 28 | 1,6 | |
| Total other income (expense) | (2,897) | 1,6 | |
| Loss from continuing operations before income taxes and minority interests | (15,503) (6) | (22,8 | |
| Loss from continuing operations before minority interests | (15,509) 866 | (22,8 8,3 | |
| Loss from continuing operations | (14,643) | (14,5 | |
| Discontinued operations: Loss from discontinued operations of Soundbreak.com Estimated loss on disposal of Soundbreak.com | (7,443) (2,111) | | |
| Loss before cumulative effect of change in accounting principle Cumulative effect of change in accounting principle due to beneficial | (24,197) | (14,5 | |
| conversion feature of debt | | (2 | |
| Net loss | \$(24,197) | \$(14,7 ===== | |

F - 44

CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 2000

| | TECHNOLOGIES GROUP | COMBIMA GROU |
|--|-----------------------|-----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: Loss from continuing operations | \$(14,643) | \$(14,5 |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization Equity in losses of affiliates | 1,751 1,746 | 9 |
| Minority interests in net loss | (866) | (8,3 |
| Compensation expense relating to stock options and warrants | 709 | 9,9 |
| Charge for acquired in-process research and development | | 2,5 |
| Write-off of other assets | (2) 2,603 | (|
| Other | 398 | (1 |
| Changes in assets and liabilities, net of effects of acquisitions: Prepaid expenses, other receivables and other assets | (1,053) | (9 |
| Accounts payable, accrued expenses and other | 162 | 1,8 |
| Net cash used in operating activities of continuing operations | (9,195) | (8,6 |
| Net cash used in operating activities of discontinued operations | (16,600) | |
| Net cash used in operating activities | (25,795) | (8,6 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital contribution to equity investments | 1,000 | |
| Purchase of additional equity in consolidated subsidiaries | (970) | |
| Purchase of property and equipment | (472) | (2,0 |
| Sale of available-for-sale investments | | 3,9 |
| Purchase of available-for-sale investmentsOther | (54) | (44,6 |
| Net cash used in investing activities of continuing operations | (496) | (42,6 |
| Net cash used in investing activities of discontinued operations | (1,173) | |
| Net cash used in investing activities | (1,669) | (42,6 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net cash attributed to the Acacia Technologies group | 20,897 | |
| Net cash attributed to the CombiMatrix group | | 56 , 4 |
| Net cash provided by financing activities | 20,897 | 56 , 4 |
| (Decrease) Increase in cash and cash equivalents | (6,567) | 5,0 |
| Cash and cash equivalents, beginning | 36,172 | 1,4 |
| Effect of exchange rate on cash | | |
| Cash and cash equivalents, ending | \$ 29,605 ====== | \$6,5 ===== |

F-45

CONSOLIDATING STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 1999

| | ACACIA TECHNOLOGIES GROUP | COMBIMA GROU |
|---|---------------------------------|-----------------|
| Revenues: | <u>^</u> | <u> </u> |
| Grant revenue Other income | \$ 122 | \$ 1 |
| Total revenue | 122 | 1 |
| Operating expenses: | | |
| Research and development expenses Marketing, general and administrative expenses Legal expenses | 3,198 287 | 1,8 9 |
| Amortization of patents and goodwill | 1,592 | |
| Total operating expenses | 5,077 | 2,7 |
| Operating loss | (4,955) | (2,6 |
| Other income (expense): Interest income Interest expense | 286 | (2 |
| Equity in losses of affiliates Other income | (1,121) 17 | |
| Total other income (expense) | (818) | (2 |
| Loss from continuing operations before income taxes and minority interests Provision for income taxes | (5,773) (18) | (2,8 |
| Loss from continuing operations before minority interests Minority interests | (5,791) (27) | (2,8 1,2 |
| Loss from continuing operations Discontinued operations: | (5,818) | (1,6 |
| Loss from discontinued operations of Soundbreak.com | (776) | |
| Net loss | \$(6,594) | \$(1,6 |

F-46

CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE YEAR ENDED DECEMBER 31, 1999

| ACACIA | |
|--------------|---------|
| TECHNOLOGIES | COMBIMA |
| GROUP | GROU |
| | |

CASH FLOWS FROM OPERATING ACTIVITIES:

298

| Loss from continuing operations | \$(5,818) | \$(1,6 |
|--|-----------------|------------|
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 1,688 | |
| Equity in losses of affiliates | 1,121 | |
| Minority interests in net loss | 27 | (1,2 |
| Compensation expense relating to stock options and warrants | 110 | |
| Other | 101 | 1 |
| Changes in assets and liabilities, net of effects of acquisitions: | | |
| Prepaid expenses, other receivables and other assets | 3,244 | (|
| Accounts payable, accrued expenses and other | 492 | (3,0 |
| Net cash used in operating activities of continuing operations | 965 | (5,6 |
| Net cash used in operating activities of discontinued operations | (1,420) | . , |
| Net seek word in encycling activities | | |
| Net cash used in operating activities | (455) | (5,6 |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | (0, 0,0,7) | |
| Purchase of additional equity in consolidated subsidiaries | (2,387) | |
| Deposit on investment | (3,000) | |
| Withdrawals from partnerships | 1,710 | , |
| Purchase of property and equipment | (153) | (|
| Other | (83) | |
| Net cash used in investing activities of continuing operations | (3,913) | (|
| Net cash used in investing activities of discontinued operations | (649) | |
| Net cash used in investing activities | (4,562) | |
| Net cash used in investing activities | (4, 502) | |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net cash attributed to the Acacia Technologies group | 36,753 | 4 1 |
| Net cash attributed to the CombiMatrix group | | 4,1 |
| Net cash provided by financing activities | 36 , 753 | 4,1 |
| Increase (decrease) in cash and cash equivalents | 31,736 | (1,6 |
| Cash and cash equivalents, beginning | 4,436 | 3,0 |
| Cash and cash equivalents, ending | \$36,172 | \$ 1,4 |
| cash and cash equivatores, charing | ====== | ===== |
| | | |

F-47

CONSOLIDATING STATEMENT OF FINANCIAL POSITION AS OF JUNE 30, 2002 (UNAUDITED)

| | ACACIA TECHNOLOGIES GROUP | COMBIMATRIX GR |
|--|------------------------------|----------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$42,874 | \$ 6,838 |
| Short-term investments | 765 | 15,934 |
| Prepaid expenses, other receivables and other assets | 1,087 | 1,595 |
| | | |

| Total current assets | 44,726 | 24,367 |
|---|----------------------------|----------|
| Property and equipment, net of accumulated depreciation | 315 | 4,260 |
| Receivable from CombiMatrix group | 88 | , |
| Investment in affiliate, at cost | 3,000 | |
| Patents, net of accumulated amortization | 4,726 | 6,131 |
| Goodwill, net of accumulated amortization | 1,776 | 2,851 |
| Other assets | 694 | . 94 |
| | \$55,325 | \$37,703 |
| | | ====== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable, accrued expenses and other | \$ 2,745 | \$ 2,954 |
| Current portion of deferred revenues | 1,500 | 7,342 |
| Current portion of capital lease obligation | | 976 |
| Total current | 4,245 | 11,272 |
| Payable to Acacia Technologies group | | |
| Deferred income taxes | 1,227 | 2,452 |
| Deferred revenues, net of current portion | 1,227 | 266 |
| Capital lease obligation, net of current portion | | 1,346 |
| capital lease obligation, net of cullent polition | | 1,540 |
| Total liabilities | 5,472 | 15,424 |
| Minority interests | 1,899 | 27,480 |
| | | |
| Stockholders' equity: | | |
| AR-Acacia Technologies stock | 47,954 | |
| AR-CombiMatrix stock | | (5,201) |
| Total stockholders' equity | 47,954 | (5,201) |
| | \$55,325 | \$37,703 |
| | ¢33 , 323 ====== | ====== |
| | | |

F-48

CONSOLIDATING STATEMENT OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2002 (UNAUDITED)

| | | T. | HREE M | IONTHS EN | DED JUNE 30, 20 |
|-----------------|-------|-----------------------------|--------|------------------|-----------------|
| | TECHN | ACIA OLOGIES ROUP | | SIMATRIX ROUP | ELIMINATIONS |
| Revenues: | | | | | |
| Grant revenue | \$ | | \$ | 164 | \$ |
| Product revenue | | | | 274 | |
| | | | | | |
| Total revenues | | | | 438 | |

| Operating expenses: | | | |
|---|---------------------|------------|--------|
| Cost of sales | | 253 | |
| Research and development expenses | | 5,026 | |
| Non-cash stock compensation expense - R&D | | 692 | |
| Marketing, general and administrative expenses | 2,589 | 2,927 | |
| Non-cash stock compensation expense - MG&A | 8 | 1,443 | |
| Amortization of patents and goodwill | 465 | 99 | |
| Total operating expenses | 3,062 | 10,440 | |
| | | | |
| Operating loss | (3,062) | (10,002) | |
| | | | |
| Other expense (income): | | | |
| Interest income | 147 | 146 | |
| Realized losses on short-term investments | (930) | | |
| Unrealized losses on short-term investments | (156) | | |
| Interest expense | | (57) | |
| Other income | 34 | | |
| | | | |
| Total other expense (income) | (905) | 89 | |
| Loss from continuing operations before income | | | |
| taxes and minority interests | (3,967) | (9,913) | |
| | (3, 507) | (),)1) | |
| Benefit for income taxes | 36 | 39 | |
| | | | |
| Loss from continuing operations before minority | | | |
| interests | (3,931) | (9,874) | |
| | | | |
| Minority interests | 125 | 3,979 | |
| Net loss | \$(3,806) | \$ (5,895) | \$ |
| Acc 1000 | \$ (5 ; 000) | ÷ (3, 693) | -=== |
| | | | |

SIX MONTHS ENDED JUNE 30, 200

| | ACACIA TECHNOLOGIES GROUP | COMBIMATRIX GROUP | ELIMINATIONS |
|--|---------------------------------|----------------------|--------------|
| Revenues: | | | |
| Grant revenue | \$ | \$ 413 | \$ |
| Product revenue | | 274 | |
| | | | |
| Total revenues | | 687 | |
| | | | |
| Operating expenses: | | | |
| Cost of sales | | 253 | |
| Research and development expenses | | 7,694 | |
| Non-cash stock compensation expense - R&D | | 1,113 | |
| Marketing, general and administrative expenses | 4,376 | 5,211 | |
| Non-cash stock compensation expense - MG&A | 19 | 2,434 | |
| Amortization of patents and goodwill | 930 | 198 | |
| Total operating expenses | 5,325 | 16,903 | |
| | | | |

| Edgar Filing: ACACIA RESEARCH CORP - Form S | 5-4/A |
|---|-------|
|---|-------|

| Operating loss | (5,325) | (16,216) | |
|---|---------------------|------------|-----------|
| | | | |
| Other expense (income): | | | |
| Interest income | 301 | 399 | |
| Realized losses on short-term investments | (1,483) | | |
| Unrealized losses on short-term investments | (477) | | |
| Interest expense | | (121) | |
| Other income | 112 | | |
| Total other expense (income) | (1,547) | 278 | |
| Loss from continuing operations before income | | | |
| taxes and minority interests | (6,872) | (15,938) | |
| Benefit for income taxes | 65 | 79 | |
| Loss from continuing operations before minority | | | |
| interests | (6,807) | (15,859) | |
| Minority interests | 162 | 6,377 | |
| | | | ĉ |
| Net loss | \$(6,645) ====== | \$ (9,482) | \$ === |
| | = | | === |

F-49

CONSOLIDATING STATEMENT OF OPERATIONS FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2001 (UNAUDITED)

| | | HREE MONTHS EN | DED JUNE 30, 20 |
|--|---------------------------------|----------------|-----------------|
| | ACACIA TECHNOLOGIES GROUP | | ELIMINATIONS |
| Revenues: | | | |
| License fee income | \$10,000 | \$ | \$ |
| Grant revenue | | 91 | |
| Product revenue | | | |
| | | | |
| Total revenues | 10,000 | 91 | |
| | | | |
| Operating expenses: | | | |
| Research and development expenses | | 2,651 | |
| Non-cash stock compensation expense - R&D | | 2,013 | |
| Marketing, general and administrative expenses | 5,803 | 3,747 | |
| Non-cash stock compensation expense - MG&A | 10 | 5,166 | |
| Amortization of patents and goodwill | 337 | 301 | |
| Total operating expenses | 6,150 | | |
| Operating income (loss) | 3,850 | (13,787) | |
| | | | |

| Other income (expense): Interest income Equity in losses of affiliate Other income | 471 (55) 57 | 558 | |
|---|-------------------|-----------------------|----------|
| Total other income (expense) | 473 | 558 | |
| Loss from continuing operations before income taxes and minority interests | 4,323 | (13,229) | |
| (Provision) Benefit for income taxes | (267) | 39 | |
| Loss from continuing operations before minority interests | 4,056 | (13,190) | |
| Minority interests | (959) | 5,321 | |
| Net income (loss) | \$ 3,097 | \$ (7,869) ======= | \$ \$ |

SIX MONTHS ENDED JUNE 30, 200

| | ACACIA TECHNOLOGIES GROUP | COMBIMATRIX GROUP | ELIMINATIONS |
|---|---------------------------------|----------------------|--------------|
| | | | |
| Revenues: | | | |
| License fee income | \$12,440 | \$ | \$ |
| Grant revenue | | 274 | |
| Product revenue | | | |
| Total revenues | 12,440 | 2.74 | |
| | | | |
| Operating expenses: | | | |
| Research and development expenses | | 5,802 | |
| Non-cash stock compensation expense - R&D | | 4,411 | |
| Marketing, general and administrative expenses | 8,325 | 7,446 | |
| Non-cash stock compensation expense - MG&A | 833 | 10,364 | |
| Amortization of patents and goodwill | 672 | 599 | |
| | | | |
| Total operating expenses | 9,830 | 28,622 | |
| | | | |
| Operating income (loss) | 2,610 | (28,348) | |
| | | | |
| Other income (expense): | | | |
| Interest income | 933 | 1,291 | |
| Equity in losses of affiliate | (110) | | |
| Other income | 61 | | |
| Total other income (expense) | 884 | 1,291 | |
| Loss from continuing operations before income | | | |
| taxes and minority interests | 3,494 | (27,057) | |
| | | | |
| (Provision) Benefit for income taxes | (316) | 75 | |
| Loss from continuing operations before minority | | | |

Loss from continuing operations before minority

| | | | === |
|--------------------|----------|------------|-----|
| Net income (loss) | \$ 1,892 | \$(16,143) | \$ |
| | | | |
| Minority interests | (1,286) | 10,839 | |
| interests | 3,178 | (26,982) | |
| | | | |

F-50

CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2002 (UNAUDITED)

| | ACACIA TECHNOLOGIES GROUP | COMBIMATRIX GROUP |
|--|---------------------------------------|-------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: Loss from continuing operations Adjustments to reconcile net loss to net cash used in operating activities: | \$(6 , 645) | \$ (9,482) |
| Depreciation and amortization Minority interests in net loss Compensation expense relating to stock options and warrants Deferred tax benefit Net sales of trading securities | 1,007 (162) 19 (71) 3,133 | 866 (6,377) 3,547 (79) |
| Unrealized loss on available-for-sale investments Other Changes in assets and liabilities, net of effects of acquisitions: Prepaid expenses, other receivables and other assets Accounts payable, accrued expenses and other | 477 87 (867) 180 | 26 (697) 180 |
| Deferred revenues Net cash used in operating activities of continuing operations Net cash used in operating activities of discontinued operations | (2,842) (415) | 1,648 (10,368) |
| Net cash used in operating activities | (3,257) | (10,368) |
| CASH FLOWS FROM INVESTING ACTIVITIES: Purchase of property and equipment Sale of available-for-sale investments Purchase of available-for-sale investments Other | (70) (100) | (367) 9,877 (5,158) |
| Net cash (used in) provided by investing activities from continuing operations | (170) | 4,352 |
| Net cash (used in) investing activities from discontinued operations | (4) | |
| Net cash (used in) provided by investing activities | (174) | 4,352 |
| CASH FLOWS FROM FINANCING ACTIVITIES: Net cash attributed to the Acacia Technologies group | (554) | |

| Net cash attributed to the CombiMatrix group | | 171 |
|---|----------|----------|
| Net cash (used in) provided by financing activities | (554) | 171 |
| Decrease in cash and cash equivalents | (3,985) | (5,845) |
| Cash and cash equivalents, beginning | 46,859 | 12,592 |
| Effect of exchange rate on cash | | 91 |
| Cash and cash equivalents, ending | \$42,874 | \$ 6,838 |

F-51

CONSOLIDATING STATEMENT OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2001 (UNAUDITED)

| | ACACIA TECHNOLOGIES GROUP | COMBIMATRIX GROUP |
|--|---------------------------------|----------------------|
| | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: Income (loss) from continuing operations Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | \$ 1,892 | \$(16,143) |
| Depreciation and amortization | 788 | 952 |
| Equity in losses of affiliate | 110 | |
| Minority interests in net income (loss) | 1,286 | (10,839) |
| Compensation expense relating to stock options and warrants | 833 | 14,775 |
| Deferred tax benefit | | (79) |
| Other Changes in assets and liabilities, net of effects of acquisitions: | 309 | 52 |
| Prepaid expenses, other receivables and other assets | (278) | (644) |
| Accounts payable, accrued expenses and other | 1,195 | 169 |
| Net cash provided by (used in) operating activities of continuing | | |
| operations | 6,135 | (11,757) |
| Net cash used in operating activities of discontinued operations | (1,698) | |
| Net cash provided by (used in) operating activities | 4,437 | (11,757) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (17) | (2,537) 11,923 |
| Purchase of available-for-sale investments Purchase of common stock from minority stockholders | (11,120) | |
| of subsidiaries | (584) | |
| Net cash (used in) provided by investing activities of continuing | (11 701) | 0.200 |
| operations Net cash provided by investing activities of discontinued | (11,721) | 9,386 |
| operations | 137 | |
| | | |

| Net cash (used in) provided by investing activities | (11,584) | 9,386 |
|---|-----------|----------|
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES: Net cash attributed to the Acacia Technologies group Net cash attributed to the CombiMatrix group | 18,012 | 3,263 |
| Net cash provided by financing activities | 18,012 | 3,263 |
| Increase in cash and cash equivalents | 10,865 | 892 |
| Cash and cash equivalents, beginning | 29,605 | 6,558 |
| Cash and cash equivalents, ending | \$ 40,470 | \$ 7,450 |

F-52

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of CombiMatrix Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and comprehensive loss and of cash flows present fairly, in all material respects, the financial position of CombiMatrix Corporation and its subsidiaries (a development stage company) at December 31, 2000 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 and the period from inception (October 4, 1995) to December 31, 2001 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 13, Acacia Research Corporation has a majority ownership in the Company, has entered into transactions with the Company and has the ability to influence the strategic direction of the Company.

/s/ PricewaterhouseCoopers LLP

Seattle, Washington January 25, 2002, except as to Note 14, which is as of April 25, 2002 COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED BALANCE SHEETS (IN THOUSANDS, EXCEPT SHARE DATA)

| | 2001 |
|--|--|
| ASSETS | |
| Current assets Cash and cash equivalents Short-term investments Interest receivable Accounts receivable and employee advances Inventory Prepaid expenses and other Prepaid public offering costs | \$ 7,868 20,187 551 143 464 205 |
| Total current assets | 29,418 |
| Investment in joint venture Property and equipment, net Deposits and other assets | 1,376 4,548 94 |
| Total assets | \$ 35,436 |
| LIABILITIES AND STOCKHOLDERS' EQUITY Current liabilities Accounts payable Accrued expenses Payable to Acacia Research Corporation Deferred revenue Current portion of capital lease obligation | \$ 623 2,191 22 5,588 934 |
| Total current liabilities | 9,358 |
| Deferred revenue Capital lease obligation, net of current portion | 372 1,845 |
| Total liabilities | 11,575 |
| Minority interest in consolidated subsidiary | 142 |
| Commitments and contingencies (Note 10) | |
| Stockholders' equity | |
| Preferred stock, \$0.001 par value, 50,000,000 shares authorized at 2001 and 2000, 1,000,000 shares authorized at 2002; none issued and outstanding Common stock \$0.001 par value, 300,000,000 shares authorized at 2001 and 2000, 30,000,000 at 2002; 18,691,723, 18,437,703 and 18,934,205 shares issued and | |

outstanding

Additional paid-in capital

19

105,409

AT DEC

| Deferred stock compensation Accumulated other comprehensive (loss) income Deficit accumulated during the development stage | (8) |
|--|-----------|
| Total stockholders' equity | 23,719 |
| Total liabilities and stockholders' equity | \$ 35,436 |

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

F-54

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF OPERATIONS (IN THOUSANDS, EXCEPT SHARE DATA)

| | | | S ENDED DEG | • |
|---|---|------------------|----------------|----------|
| | 2 | 2001 | 2000 | 1999 |
| evenues | | | | |
| Grants and contracts Products | | | 17 | |
| Total revenues | | 456 | 17 | |
| perating expenses | | | | |
| Cost of revenues | | | | |
| Research and development* | | 11,655 | 6,276 4,698 | 2,379 |
| Marketing, general and administrative* Amortization of deferred stock compensation | | 14,939 19,963 | 4,698 9,709 | 78 36 |
| Amortization of deferred stock compensation | | | | |
| Total operating expenses | | 46,557 | 20,683 | 2,493 |
| oss from operations | | | | |
| nterest income | | 1,976 | 1,644 | 43 |
| nterest expense | | (65) | | (213) |
| oss on investment in joint venture | | (54) | (6) | |
| inority interest in net loss of subsidiary | | 16 | | |
| et loss before cumulative effect of accounting | | | | |
| change umulative effect of accounting change | | | (246) | |
| et loss | | | (19,274) | |

| Basic and diluted net loss per share before cumulative effect of accounting change Cumulative effect of accounting change | Ş | (2.37) | \$ | (1.25) (.01) | \$ | (.29) | |
|---|---------------|-----------------|-----------|---------------------------|------------|---------|----------------|
| Basic and diluted net loss per share | \$ | (2.37) | \$ | (1.26) | \$ | (.29) | |
| Weighted-average shares used in computing basic and diluted net loss per share | | ,639,953 | 15 | , 254 , 862 | 8, | 763,749 | |
| *Excludes charges for amortization of deferred stock compensation as follows: | | | | | | | |
| Research and development Marketing, general and administrative | \$ | 7,183 12,780 | \$ | 3,189 6,520 | \$ | 34 2 | \$ 11 21 |
| | \$ === | 19,963 | \$ === | 9,709 | \$ ==== | 36 | \$ 33 ===== |

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

F-55

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF OPERATIONS, CONTINUED (IN THOUSANDS, EXCEPT SHARE DATA)

| | | | E 30, | | | 30, |
|--|----|-------|-------|----------------|------------|--------|
| | 2 | 002 | 2 | 2001 | 2002 | 2 |
| | | | | | (UNAUI | DITED) |
| Revenues | | | | | | |
| Grants and contracts | \$ | 164 | \$ | 91 | \$ 413 | \$ |
| Products | | 274 | | | 274 | |
| Total revenues | | 438 | | 91 | 687 | |
| Operating expenses | | | | | | |
| Cost of revenues | | 253 | | | 253 | |
| Research and development* | | 5,026 | | 2,590 | 7,694 | |
| Marketing, general and administrative* Amortization of deferred stock | | 2,537 | | 3,316 | 4,499 | |
| compensation | | 2,117 | | 7 , 178 | 3,509 | |
| Total operating expenses | | 9,933 | | 13,084 | 15,955 | |
| Loss from operations | | | | | | (|
| Interest income | | 137 | | 521 | 366 | |
| Interest expense | | (55) | | | (115) | |
| Loss on investment in joint venture | | (4) | | (16) | (15) | |
| Minority interest in net loss of subsidiary | | 18 | | | 30 | |

| Net loss before cumulative effect of accounting change Cumulative effect of accounting change | | (9,399) | | (12,488) | | (15,002) | | | | | | | | | | | | | | |
|---|------------|--------------|-----|----------|------------|----------------|------------|--|------------|--|------------|--|------------|--|------------|--|----|-----------|---|-----------|
| Net loss | \$ | (9,399) | \$ | | \$ | (15,002) | | | | | | | | | | | | | | |
| Basic and diluted net loss per share before cumulative effect of accounting change | | | | | | | | | | | | | | | | | | | | |
| Cumulative effect of accounting change | | | | | | | | | | | | | | | | | | | | |
| Basic and diluted net loss per share | | . , | | . , | | (.80) | | | | | | | | | | | | | | |
| Weighted-average shares used in computing basic and diluted net loss per share | 18,884,495 | | | | 18,884,495 | | 18,884,495 | | 18,884,495 | | 18,884,495 | | 18,884,495 | | 18,884,495 | | 18 | 3,666,343 | 1 | 8,806,678 |
| *Excludes charges for amortization of deferred stock compensation as follows: | | | === | | ==: | | | | | | | | | | | | | | | |
| Research and development Marketing, general and administrative | | 692 1,425 | | | | 1,113 2,396 | | | | | | | | | | | | | | |
| | \$ | 2,117 | | 7,178 | | 3,509 | | | | | | | | | | | | | | |
| | === | | === | | ==: | ======== | | | | | | | | | | | | | | |

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

F-56

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE LOSS (IN THOUSANDS, EXCEPT SHARE DATA)

| | COMMON ST | OCK | PAI | TIONAL D-IN ITAL | DEFERR COMPE |
|--|-----------|-----|-----|------------------------|-----------------|
| Balances at inception (October 4, 1995) Common stock issued in April 1996 to founders at \$0.021 | | \$ | \$ | | Ş |
| per share Common stock issued in May 1996 at \$1.00 per share, | 7,000,000 | 7 | | 140 | |
| net of offering costs Common stock issued in March 1997 in connection with | 566,470 | 1 | | 512 | |
| stock option exercises at \$1.00 per share Common stock issued in June and July 1997 at \$2.00 per | 25,000 | | | 25 | |
| share, net of offering costs Issuance of common stock warrants in March 1998 in connection with the issuance of 6% unsecured | 343,500 | | | 656 | |
| subordinated promissory notes | | | | 246 | |

| Common stock issued in August 1999 at \$2.00 per share, net of offering costs Common stock issued in December 1999 in connection with conversion of 6% unsecured subordinated | 2,010,100 | 2 | 3,842 | |
|--|------------|----|----------|----|
| promissory notes Deferred stock compensation from inception (October 4, | 725,000 | 1 | 1,290 | |
| 1995) to December 31, 1999 Amortization of deferred stock compensation from | | | 214 | |
| inception (October 4, 1995) to December 31, 1999 Imputed fees for management services from inception | | | | |
| 0(October 4, 1995) to December 31, 1999 Net loss for the period from inception (October 4, | | | 48 | |
| 1995) to December 31, 1999 | | | | |
| Balances, December 31, 1999 Common stock issued in March 2000 at \$5.00 per share, | 10,670,070 | 11 | 6,973 | |
| net of offering costs Common stock issued in connection with stock option | 3,500,000 | 3 | 17,134 | |
| exercise at \$2.00 per share | 8,750 | | 18 | |
| exercise at \$2.00 per share Common stock issued in June 2000 at \$2.00 per share | 44,550 | | 116 | |
| (includes compensation expense of \$210) Common stock issued in July 2000 at \$5.00 and \$6.50 | 125,000 | | 460 | |
| per share (includes compensation expense of \$76) Common stock issued in August 2000 at \$9.00 per share, | 56,000 | | 413 | |
| net of offering costs | 4,033,333 | 4 | 35,696 | |
| Issuance of stock options to employee of parent | | | 1,150 | |
| Dividend to parent | | | (1,150) | |
| Cumulative effect of accounting change | | | 246 | |
| Deferred stock compensation | | | 53,769 | (5 |
| Amortization of deferred stock compensation | | | | |
| Net loss | | | | |
| Unrealized gain on short-term investments | | | | |
| Comprehensive loss | | | | |
| Balances, December 31, 2000 Common stock issued in connection with stock warrant | 18,437,703 | 18 | 114,825 | (4 |
| exercise at \$2.00 per share Common stock issued in connection with stock option | 134,300 | | 272 | |
| exercise at \$1.00 to \$5.00 per share | 119,720 | 1 | 261 | |
| Change of interest in consolidated subsidiary | | | 951 | |
| Change of interest in investment in joint venture | | | 435 | |
| Stock option modifications Stock option cancellations, net of deferred stock | | | 1,156 | |
| compensation | | | (12,491) | 1 |
| Amortization of deferred stock compensation | | | | 1 |
| Net loss | | | | |
| Unrealized loss on short-term investments | | | | |
| Foreign currency translation | | | | |
| Comprehensive loss | | | | |
| Balances, December 31, 2001 For the six months ended June 30, 2002 (Unaudited): Common stock issued in connection with stock option | | 19 | 105,409 | (1 |
| exercise at \$1.00 to \$5.00 per share | 61,500 | | 78 | |
| Stock option granted to consultant | | | 38 | |
| Stock option modifications | | | 100 | |
| Acquisition of Advanced Material Sciences Stock option cancellations, net of deferred | 180,982 | | 2,668 | |
| | | | | |

| stock compensation | | | (1,755) | |
|---|------------|------|-----------|------|
| Amortization of deferred stock compensation | | | | |
| Net loss | | | | |
| Unrealized loss on short-term investments | | | | |
| Foreign currency translation | | | | |
| | | | | |
| Comprehensive loss | | | | |
| | | | | |
| Balances, June 30, 2002 (unaudited) | 18,934,205 | \$19 | \$106,538 | \$ (|
| | | === | | |

| | ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) | DEFICIT ACCUMULATED DURING THE DEVELOPMENT STAGE | TOTA STOCKHOL EQUIT |
|---|--|--|---------------------------|
| Balances at inception (October 4, 1995) | \$ | \$ | \$ |
| Common stock issued in April 1996 to founders at \$0.021 per share Common stock issued in May 1996 at \$1.00 per share, | | | 1 |
| net of offering costs | | | 5 |
| stock option exercises at \$1.00 per share Common stock issued in June and July 1997 at \$2.00 per | | | |
| share, net of offering costs | | | 6 |
| connection with the issuance of 6% unsecured subordinated promissory notes | | | 2 |
| Common stock issued in August 1999 at \$2.00 per share, | | | |
| net of offering costs Common stock issued in December 1999 in connection with conversion of 6% unsecured subordinated | | | 3,8 |
| promissory notes Deferred stock compensation from inception (October 4, | | | 1,2 |
| 1995) to December 31, 1999 Amortization of deferred stock compensation from | | | |
| inception (October 4, 1995) to December 31, 1999 Imputed fees for management services from inception | | | 2 |
| 0(October 4, 1995) to December 31, 1999 Net loss for the period from inception (October 4, | | | |
| 1995) to December 31, 1999 | | (5,433) | (5,4 |
| Balances, December 31, 1999 Common stock issued in March 2000 at \$5.00 per share, | | (5,433) | 1,5 |
| net of offering costs Common stock issued in connection with stock option | | | 17,1 |
| exercise at \$2.00 per share Common stock issued in connection with stock warrant | | | |
| exercise at \$2.00 per share Common stock issued in June 2000 at \$2.00 per share | | | 1 |
| (includes compensation expense of \$210) Common stock issued in July 2000 at \$5.00 and \$6.50 | | | 4 |
| per share (includes compensation expense of \$76) Common stock issued in August 2000 at \$9.00 per share, | | | 4 |
| net of offering costs | | | 35,7 |
| Issuance of stock options to employee of parent | | | 1,1 |
| Dividend to parentCumulative effect of accounting change | | | (1,1 |
| Deferred stock compensation | | | Ζ. |

| Amortization of deferred stock compensation | | | 9,7 |
|---|-------|------------|------------------|
| Net loss Unrealized gain on short-term investments | 132 | (19,274) | (19,2 1 |
| Comprehensive loss | | | (19,1 |
| Balances, December 31, 2000 Common stock issued in connection with stock warrant | 132 | (24,707) | 46,2 |
| exercise at \$2.00 per share Common stock issued in connection with stock option | | | 2 |
| exercise at \$1.00 to \$5.00 per share | | | 2 |
| Change of interest in consolidated subsidiary | | | 9 |
| Change of interest in investment in joint venture | | | 4 |
| Stock option modifications Stock option cancellations, net of deferred stock | | | 1,1 |
| compensation | | | |
| Amortization of deferred stock compensation | | | 18,8 |
| Net loss | | (44,228) | (44,2 |
| Unrealized loss on short-term investments | (15) | | (|
| Foreign currency translation | (125) | | (1 |
| Comprehensive loss | | | (44,3 |
| Balances, December 31, 2001 For the six months ended June 30, 2002 (Unaudited): Common stock issued in connection with stock option | (8) | (68,935) | 23,7 |
| exercise at \$1.00 to \$5.00 per share | | | |
| Stock option granted to consultant | | | |
| Stock option modifications | | | 1 |
| Acquisition of Advanced Material Sciences Stock option cancellations, net of deferred | | | 2,6 |
| stock compensation | | | |
| Amortization of deferred stock compensation | | | 3,4 |
| Net loss | | (15,002) | (15,0 |
| Unrealized loss on short-term investments | (83) | | (|
| Foreign currency translation | 91 | | |
| Comprehensive loss | | | (14,9 |
| | | | |
| Balances, June 30, 2002 (unaudited) | \$ | \$(83,937) | \$ 15 , 0 |
| | ===== | | |

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

F-57

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) CONSOLIDATED STATEMENTS OF CASH FLOWS (IN THOUSANDS)

| | FOR THE YEARS ENDED DECEMBER 31, | | | |
|---|----------------------------------|---------------|--------------------|--|
| | 2001 | 2000 | 1999 | |
| OPERATING ACTIVITIES | | | | |
| Net loss Adjustments to reconcile net loss to net cash used in | \$(44,228) | \$(19,274) | \$(2 , 520) | |
| operating activities | | 0.4.6 | | |
| Cumulative effect of accounting change Depreciation and amortization | 955 | 246 266 | 52 | |
| Amortization of deferred stock compensation Compensation for common stock purchased below fair | 19,963 | 9,709 | 36 | |
| market value | | 286 | | |
| Imputed fees for management services | | | 33 | |
| Write-off of prepaid public offering costs | 1,353 | | | |
| Accretion of discount on short-term investments | | (29) | | |
| Loss on investment in joint venture | 54 | 6 | | |
| Loss on disposal of property and equipment | 123 | | | |
| Minority interest in loss of subsidiary Amortization of discount on note payable and debt | (16) | | | |
| issuance costs Changes in operating assets and liabilities | | | 128 | |
| Interest receivable | 257 | (808) | | |
| Accounts receivable and employee advances | (126) | 11 | (27) | |
| Inventory | (285) (111) | (109) (88) | 16 | |
| Prepaid expenses and other Deposits and other assets | (111) (77) | (88) | 10 | |
| Accounts payable | (684) | 1,280 | (33) | |
| Accrued expenses | 1,533 | 550 | (2) | |
| Payable to Acacia Research Corporation | (48) | 26 | (42) | |
| Deferred revenue | 5 , 960 | | | |
| Net cash used in operating activities | (15,377) | (7,914) | (2,359) | |
| INVESTING ACTIVITIES | | | | |
| Purchases of property and equipment | (3,778) | (2,004) | (88) | |
| Cash from sale of property and equipment Cash acquired from acquisition of Advanced Material | 22 | (2,001) | | |
| Sciences | | | | |
| Investment in joint venture | | (1,000) | | |
| Purchase of short-term investments | (30,765) | (43,606) | | |
| Sale of short-term investments | 50,354 | 3,975 | | |
| Net cash provided by (used in) investing | | | | |
| activities | 15,833 | (42,635) | | |
| FINANCING ACTIVITIES | | | | |
| Prepaid public offering costs | (435) | (918) | | |
| Proceeds from capital lease obligation and notes payable | 3,000 | | | |
| Advances from Acacia Research Corporation | | | 1,260 | |
| Repayments to Acacia Research Corporation | | | (4,270) | |
| Repayment of note payable | (221) | | | |
| Debt issuance costs | | | | |
| Proceeds from issuances of common stock, net of costs Proceeds from issuance of common stock of subsidiary | 1,109 | 53,558 | 3,844 | |
| Net cash provided by (used in) financing | | | | |
| activities | 3,987 | 52,640 | 834 | |

| Net (decrease) increase in cash and cash equivalents | 4 | ,443 | | 2,091 | | (1,613) |
|--|--------------|----------|----------|-------|----------|----------------|
| Cash and cash equivalents, beginning of period | 3 | 8,550 | | 1,459 | | 3,072 |
| Effect of exchange rate on cash | | (125) | | | | |
| Cash and cash equivalents, end of period | \$ 7 ==== | ,868 | \$ == | 3,550 | \$ == | 1,459 ===== |
| SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | | | | | |
| Conversion of promissory notes to common stock | \$ | | \$ | | \$ | 1,291 |
| Fair value of options and warrants issued for services | \$ | | \$ | 1,239 | \$ | 36 |
| Fixed assets purchased with accounts payable | \$ | (917) | \$ | 917 | \$ | |
| Cash paid for interest | \$ | 42 | \$ | | \$ | |

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

F-58

COMBIMATRIX CORPORATION (A DEVELOPMENT STAGE COMPANY) NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. THE COMPANY AND NATURE OF OPERATIONS

CombiMatrix Corporation (the "Company"), a Delaware corporation, was incorporated on October 4, 1995. The Company is a development stage company engaged in research and development to commercialize its proprietary technology to, among other things, rapidly synthesize or immobilize genetic material, building blocks of proteins or small molecules on a modified semiconductor chip, known as biochips or microarrays.

As of December 31, 2001, the Company was 57.7% owned by Acacia Research Corporation ("Acacia"), based in Pasadena, California. The Company's financial statements include all charges to reflect its cost of doing business, including allocated expenses from Acacia. These allocated expenses primarily relate to director and officer insurance.

In May 2001, the Company formed CombiMatrix International Holdings Corporation ("Holdings"), a Delaware corporation and a wholly owned subsidiary of the Company. Additionally, the Company formed CombiMatrix K.K. (the "KK"), a Japanese corporation, which was a wholly owned subsidiary of Holdings at formation. In October 2001, the KK sold 10% of its voting common stock to an unrelated company. The KK, which is based in Tokyo, Japan, will focus on development and licensing opportunities for the Company's microarray technology with pharmaceutical and biotechnology companies in the Asian market.

Since inception, the Company has been in the development stage and its activities have principally consisted of obtaining financing, recruiting personnel, and conducting research and development. The Company is working on several long-term development projects that involve experimental technology and may require several years and substantial expenditures to complete. No revenues have been recognized to date from the Company's planned principal operations. Management believes that existing cash and cash equivalents and short-term

investments are adequate to fund the Company's operations through December 31, 2002. However, the Company's ability to meet its business objectives is dependent upon its ability to raise additional financing, substantiate its technology and ultimately to fund its operations from revenues.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries in which the Company has a greater than 50% ownership interest. Investments in business entities in which the Company does not have control, but has the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method. All intercompany accounts and transactions have been eliminated.

Foreign currency translation

The financial statements of the KK, whose functional currency is the Japanese yen, have been translated into U.S. dollars. Accordingly, all assets and liabilities of the KK have been translated at the year-end exchange rate. All revenues and expenses of the KK have been translated at average exchange rates for the period. The resulting translation adjustment has been reported as a component of comprehensive loss.

Cash and cash equivalents

The Company considers all highly liquid investments with purchased maturities of three months or less to be cash and cash equivalents.

Short-term investments

F-59

Short-term investments are diversified among high-credit quality securities in accordance with the Company's investment policy. Investments in securities with maturities of less than one year, or for which management's intent is to use the investments to fund current operations, are classified as short-term investments. The Company classifies its securities as available-for-sale, which are reported at fair market value, with the related unrealized gains and losses included as a separate component in stockholders' equity. Realized gains and losses and declines in value of securities judged to be other than temporary are included in other income (expense). The fair value of the Company's investments is based on quoted market prices. The carrying value of those investments approximates their fair value. Realized and unrealized gains and losses are based on the specific identification method.

The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income (expense). Interest and dividends on all securities are included in interest income.

Concentration of credit risk

Cash and cash equivalents are invested in deposits with financial institutions, which may exceed federally insured limits. The Company has not experienced any losses on its deposits of cash and cash equivalents.

Fair value of financial instruments

The recorded amounts of certain financial instruments, including cash and cash equivalents, short-term investments, interest receivable, accounts receivable and employee advances, accounts payable and accrued expenses, approximate fair value due to their relatively short maturities.

Inventory

Inventory, which consists primarily of raw materials to be used in the production of the Company's microarray products, is stated at the lower of cost or market using the first-in, first-out method.

Property and equipment

Property and equipment is recorded at cost. Depreciation is provided over the estimated useful lives of the depreciable assets, ranging from two to ten years, using the straight-line method. Leasehold improvements are amortized over the shorter of the applicable lease or useful life of the asset. Certain leasehold improvements, furniture and equipment held under capital leases are classified as property and equipment and are amortized over their useful lives using the straight-line method. Lease amortization is included in depreciation expense. Additions and improvements that increase the value or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred. Disposals are removed at cost less accumulated depreciation or amortization and any gain or loss from disposition is reflected in the statement of operations in the year of disposition.

Prepaid public offering costs

On November 14, 2000, the Company's Board of Directors authorized management to file a registration statement on Form S-1 with the Securities and Exchange Commission ("SEC") relating to an initial public offering of the Company's common stock. The registration statement was filed with the SEC on November 22, 2000. At December 31, 2000, the Company had capitalized \$918,000 of prepaid public offering costs. During 2001, the Company capitalized an additional \$435,000 of prepaid public offering costs. During the fourth quarter of 2001, management decided to indefinitely delay the Company's initial public offering. As a result, the Company expensed prepaid offering costs totaling approximately \$1.35 million during the year ended December 31, 2001. This charge has been included as component of marketing, general and administrative expense.

F-60

Impairment of long-lived assets

The Company assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset might not be recoverable. When such an event occurs, management determines whether there has been an impairment by comparing the anticipated undiscounted future net cash flows of the asset to its carrying value. The Company has not recognized any impairment losses through December 31, 2001.

Income taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the

differences are expected to reverse. A valuation allowance is recorded when it is more likely than not the net deferred tax asset will not be recovered.

Revenue recognition

Revenues from the sale of products and services are recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the fees are fixed and determinable and collectibility is reasonably assured.

All of the revenue recognized since inception of the Company has been from government grants and contracts. Revenues from government grants and contracts are recognized as the related services are performed and when the services have been approved by the grantor and collectibility is reasonably assured. Amounts recognized are limited to amounts due from customers based upon the contract or grant terms.

Revenues from multiple-element arrangements involving license fees, up-front payments and milestone payments, which are received or billable in connection with other rights and services that represent continuing obligations of the Company, are deferred until all of the multiple elements have been delivered or the Company has established objective and verifiable evidence of the fair value of the undelivered elements. Deferred revenue arises from payments received in advance of the culmination of the earnings process. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Software development costs

The costs of software developed for use in the Company's products is expensed as incurred until technological feasibility for the software has been established. Software development costs incurred to date have been classified as research and development expenses.

The costs of software developed or obtained for internal use is expensed as incurred until certain capitalization criteria have been met. Capitalized software development costs are reported as a component of property and equipment. To date, such costs have not been significant.

Research and development expenses

Research and development expenses consist of costs incurred for direct and overhead-related research expenses and are expensed as incurred. Costs to acquire technologies which are utilized in research and development and which have no alternative future use are expensed when incurred. Costs related to filing and pursuing patent applications are expensed as incurred, as recoverability of such expenditures is uncertain.

Stock-based compensation

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," as interpreted by Financial Accounting Standards Board Interpretation ("FIN") No. 44 and related interpretations, and complies with the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 123,

"Accounting for Stock-Based Compensation." Under APB Opinion No. 25 and related interpretations, compensation expense is based on the difference, if any, between the fair value of the Company's stock and the exercise price of the option as of the date of grant. These differences are deferred and amortized on an accelerated basis over the vesting period of the individual option awards using the amortization method prescribed in FIN No. 28, "Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans."

The Company accounts for equity instruments issued to nonemployees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring or in Conjunction with Selling Goods or Services" and related interpretations.

Net loss per share

Basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period. The Company has excluded all outstanding options and warrants to purchase common stock from the calculation of diluted net loss per share, as such securities are antidilutive for all periods presented. These antidilutive securities are as follows:

| | YEARS ENDED DECEMBER 31, | | | |
|---------------------|--------------------------|----------------------|---------|--|
| | 2001 | 2000 | 1999 | |
| Options Warrants | | 4,366,721 172,350 | | |
| | 3,533,661 ====== | 4,539,071 | 798,100 | |

Comprehensive income (loss)

The Company has adopted the provisions of SFAS No. 130, "Reporting Comprehensive Income," which requires the disclosure of comprehensive income (loss) and its components in a complete set of general-purpose financial statements. Comprehensive income (loss) is defined as the change in equity from transactions and other events and circumstances other than those resulting from investments by owners and distributions to owners. Other comprehensive income (loss) consists of unrealized gains and losses on investments and foreign currency translation adjustments.

Segments

The Company has adopted SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information," which establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about its products, services, geographic areas and major customers. Management has determined that the Company operates in one segment.

Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and that effect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain risks and uncertainties

The Company is in the development stage and its planned products and services will be concentrated in a highly competitive market that is characterized by rapid technological advances, frequent changes in customer requirements and evolving regulatory requirements and industry standards. Failure to anticipate or respond adequately to technological advances, changes in customer requirements, changes in regulatory requirements or

F-62

industry standards, or any significant delays in the development or introduction of planned products or services, could have a material adverse effect on the Company's business and operating results.

Recent accounting pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Financial Instruments and for Hedging Activities," which provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000 and it did not have an impact on the Company's results of operations or financial condition when adopted, as the Company holds no derivative financial instruments and does not currently engage in hedging activities.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 eliminated the pooling-of-interests method of accounting for business combinations. As a result, all business combinations must now be accounted for using the purchase method. The provisions of this statement apply to all business combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill may no longer be amortized to earnings, but instead must be reviewed for impairment periodically. The Company will be required to comply with the provisions of this statement beginning January 1, 2002. Management does not believe that the adoption of these statements will have a significant impact on the Company's financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121. This Statement also supersedes the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for segments of a business to be disposed of. This Statement also amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a temporarily controlled subsidiary. The adoption date for SFAS No. 144 will be January 1, 2002. Management does not believe the adoption of this pronouncement will have a significant impact on the Company's financial position or results of operations.

Reclassifications

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

3. SHORT-TERM INVESTMENTS

Short-term investments consists of the following (in thousands):

| | AMORTIZED COST | GROSS UNREALIZED GAINS | GROSS UNREALIZED LOSSES | FAIR VALUE |
|---|-------------------|------------------------------|-------------------------------|------------|
| At December 31, 2001 Available-for-sale securities | | | | |
| Corporate notes and bonds | \$14,427 | \$172 | \$(117) | \$14,482 |
| U.S. government securities | 5,643 | 197 | (135) | 5,705 |
| | | | | |
| | \$20 , 070 | \$369 | \$(252) | \$20,187 |
| | ====== | ==== | ===== | ====== |
| At December 31, 2000 | | | | |
| Available-for-sale securities | | | | |
| Corporate notes and bonds | \$37,689 | \$125 | \$ | \$37,814 |
| U.S. government securities | 1,971 | 7 | | 1,978 |
| | \$39,660 | \$132 | \$ | \$39,792 |
| | ======= | ==== | ===== | ======= |

F-63

The cost and estimated fair value of the securities, by contractual maturity, consists of the following at December 31, 2001 (in thousands):

| | COST | FAIR VALUE |
|---------------------|----------|-------------------|
| | | |
| Due within one year | \$ 5,103 | \$ 5,118 |
| Due after one year | 14,967 | 15,069 |
| | | |
| | | |
| Total | \$20,070 | \$20 , 187 |
| | | |

4. INVESTMENT IN JOINT VENTURE

The Company's investment in joint venture consists of an investment in Advanced Material Science, Inc. ("AMS"), which is accounted for under the equity method. AMS was formed in 2000. The Company contributed \$1 million for a 33.3% minority interest in AMS, which was diluted to 28.6% during 2001, as discussed below. The remaining portion of AMS is owned by Acacia and other third-party investors. AMS's total assets and liabilities at December 31, 2001 and net loss for the period ended December 31, 2001 were approximately \$4.7 million, \$24,000 and \$176,000, respectively. The Company's share of AMS's losses for the years ending December 31, 2001 and 2000 totaled \$53,000 and \$6,000, respectively.

During 2001, AMS sold shares of its common stock to unrelated investors. The per-share price paid for those shares exceeded the price per share paid by the Company. As a result, the Company recorded increases in its investment in AMS and additional paid-in capital totaling approximately \$435,000. As of December 31, 2001, the Company owns approximately 28.6% of the outstanding common stock of AMS.

5. PROPERTY AND EQUIPMENT

During 2001, the Company entered into a sales and leaseback transaction with a commercial bank. Approximately \$3 million of the Company's property and equipment was sold, resulting in a deferred gain of approximately \$443,000. The gain was deferred and is being amortized over four years, which is the weighted-average remaining useful life of the leased assets. The deferred gain has been classified as reduction of property and equipment disclosed below. The leased property and equipment and the related obligations qualify for capital lease treatment under SFAS No. 13, "Accounting for Leases." As a result, the full amount of the leased assets and the related obligations are reflected in the Company's consolidated balance sheet at December 31, 2001.

Property and equipment consist of the following (in thousands):

| | DECEMBER 31, 2001 | | | DECEMBER 31 | | |
|---|----------------------------|-----------------|--|--------------------------------------|---------------|--|
| | OWNEI |) LEASED | TOTAL | OWNED | LEASED | |
| Equipment Furniture and fixtures Computer hardware and software Leasehold improvements Construction-in-progress | \$ 84 12 88 38 | 25 38 33 253 | \$2,670 163 1,136 1,263 84 | \$1,225 110 440 72 1,346 | \$ | |
| | 2,31 | | 5,316 | 3,193 | | |
| Less: Accumulated depreciation and amortization | (60 \$1,70 ===== | | (768) \$4,548 ====== | (336) \$2,857 ===== | \$ === | |

At December 31, 2001 and 2000, accounts payable included approximately 0 and 918,000, respectively, related to the acquisition of property and equipment.

F-64

6. ACCRUED EXPENSES

Accrued expenses consists of the following (in thousands):

| | DECEMBER 31, | |
|------------------------------|------------------|-------|
| | | |
| | 2001 | 2000 |
| | | |
| Salaries, wages and benefits | \$1 , 312 | \$454 |
| Legal expenses | 415 | 161 |
| Other accrued expenses | 464 | 43 |
| | | |
| | \$2,191 | \$658 |
| | ====== | |

7. LONG-TERM OBLIGATIONS

Note payable

In March 1998, the Company issued \$1.45 million of convertible promissory notes that were converted to common stock during 1999. The promissory notes had a beneficial conversion feature as defined by EITF Issue No. 98-15 "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" with an intrinsic value of \$246,000. This amount was measured and recognized during the year ended December 31, 2000 in a manner similar to a cumulative effect of a change in accounting principle. The beneficial conversion feature resulted in \$246,000 of expense and a corresponding increase to additional paid-in capital.

Capital lease obligation

In September 2001, the Company executed a capital lease obligation with a commercial bank for \$3 million, which is collaterized by the property and equipment under lease. The term of the lease is three years, during which the Company must make monthly principal and interest payments of approximately \$95,000. The Company is required to maintain certain financial covenants during the term of the lease. As of December 31, 2001, the Company was in compliance with all covenants. At December 31, 2001, the fair value of the Company's capital lease obligation was approximately \$2.8 million.

8. INCOME TAXES

At December 31, 2001, the Company has net deferred tax assets totaling approximately \$20.4 million, which are fully offset by a valuation allowance due to management's determination that the criteria for recognition have not been met.

At December 31, 2001, the Company had net operating loss carryforwards of approximately \$38.1 million, which will begin to expire in 2010 through 2021. Utilization of net operating loss carryforwards is subject to the "change of ownership" provisions under Section 382 of the Internal Revenue Code. The amount of such limitations, if any, has not yet been determined.

The effects of temporary differences and carryforwards that give rise to deferred tax assets and liabilities are as follows (in thousands):

F-65

| | DECEMBER 31, | | |
|---|--------------------|-------------------|--|
| | 2001 | 2000 | |
| Deferred tax assets | | | |
| Net operating loss carryforwards | \$ 12 , 986 | \$ 5 , 012 | |
| Stock based compensation | 6,260 | 2,231 | |
| Research and development credit carryforwards | 813 | 273 | |
| Other | 369 | 21 | |
| Deferred tax liability | 20,428 | 7,537 | |
| - | (41) | (AA) | |
| | (++) | (44) | |
| | 20,387 | 7,493 | |
| Less: Valuation allowance | (20,387) | (7,493) | |
| | \$ | \$ | |
| | | | |

The differences between the provision for income taxes and the amount computed by applying the federal statutory income tax rate of 34% to net loss before taxes are as follows (in thousands):

| | YEARS ENDED DECEMBER 31, | | | |
|---|--------------------------|--------------------|---------|--|
| | 2001 | 2000 | 1999 | |
| Expected income tax benefit Increase (decrease) in income taxes resulting from | \$(15,038) | \$(6 , 553) | \$(857) | |
| Change in valuation allowance | 12,894 | 5,589 | 896 | |
| Research and development credits | (539) | (155) | (40) | |
| Non-deductible stock compensation | 2,715 | 1,112 | | |
| Other | (32) | 7 | 1 | |
| | | | | |
| | \$ | \$ | \$ | |
| | | | | |

9. COLLABORATIVE AND RESEARCH AGREEMENTS

In July 2001, the Company entered into a non-exclusive worldwide license, supply, research and development agreement with Roche Diagnostics GmbH ("Roche"). Under the terms of the agreement, the Company will supply microarray and related technologies to Roche for rapid production of customizable biochips. Additionally, the Company and Roche will develop a platform technology, providing a range of standardized biochips for use in research applications. The agreement has a 15-year term and provides for minimum payments by Roche to the Company over the first three years, including milestone achievements, royalties and research and development projects. For the year ended December 31, 2001, the Company received \$5.25 million in milestone payments and product sales, which have been classified as deferred revenue in the accompanying December 31, 2001 consolidated balance sheet.

10. COMMITMENTS AND CONTINGENCIES

Research and development

In January 2001, the Company entered into a design commitment to develop a next generation microarray. If this design project is completed successfully, the Company will be obligated to a one-year commitment to purchase a specific number of semiconductor wafers at a total cost of \$1.1 million.

In November 2000, the Company entered into a licensing and supply agreement with Acacia to provide commercial active biochips within the field of toxicology to a newly formed affiliate of Acacia. The term of the

F-66

agreement is for five years. If the Company successfully develops an active biochip for commercial use in the toxicology field, the Company will receive a 10% ownership interest in this newly formed company. The agreement also provides for a one-time licensing fee to use and resell active biochips within the toxicology field of \$1 million payable to the Company in four quarterly installments, beginning upon the affiliate's first commercial order of active biochips. The ownership interest and one-time licensing fee will be accounted for as capital contributions.

Human resources

In October 2001, the Company's Board of Directors amended its existing general severance plan for executive officers, which provides that if the Company terminates an executive who is a vice president or higher for other than cause, death or disability, the executive will receive payments equal to three months' base salary and target bonus and other benefits on a bi-weekly basis over a three-month period. If termination occurs as a result of a change in control transaction, these benefits will be extended by three months.

The Company also offers a general severance plan providing all employees with certain benefits upon their termination of employment due to lack of work. Under this plan, terminated employees will be provided with either four-weeks' notice or four-weeks' salary in lieu of notice, and paid a lump-sum amount based on the employee's length of service, plus accrued benefits. The terminated employees will also be provided continuing medical and dental benefits, as well as continuation of life insurance, for a period ranging from two to 26 weeks subsequent to the date of termination, depending upon the employee's length of service.

Leases

In October 2000, the Company entered into a non-cancelable operating lease for office space. A security deposit in the form of a \$783,000 letter of credit was issued November 1, 2000, which was increased to \$1.2 million during 2001. The Company's future minimum operating and capital lease payments as of December 31, 2001 are as follows (in thousands):

| YEARS ENDING DECEMBER 31, | OPERATING | CAPITAL |
|--|---|---------------------------------|
| 2002 2003 2004 2005 2006 Thereafter | \$ 1,452 1,720 1,650 1,721 1,735 3,312 | \$1,141 1,141 855 |
| | \$11,590 | 3,137 |
| Less imputed interest at 8.8% | | (358) |
| Present value of capital lease obligation | | 2,779 (934) |
| Capital lease obligation, net of current portion | | \$1,845 |

Rent expense for the years ended December 31, 2001, 2000 and 1999 was \$1.45 million, \$411,000 and \$259,000, respectively. Rent expense was \$2.4 million for the cumulative period from October 4, 1995 (date of inception) to December 31, 2001.

Litigation

On November 28, 2000, Nanogen, Inc. filed suit against the Company and one of its principal stockholders, executive officers and members of the Company's Board of Directors. The Nanogen suit alleges, among other things, that the Company's issued patent and certain pending patent applications, trade secrets and related technologies were inappropriately obtained by the Company and that Nanogen is the legal owner of the patents, trade secrets and related technologies. The suit seeks, among other things, correction of inventorship on the F-67

Company's issued patent, the assignment of rights in the issued patent and pending patent applications to Nanogen, an injunction preventing disclosure of trade secrets, damages for trade secret misappropriation and the imposition of a constructive trust.

The litigation is in the early stages, and the Company cannot predict its outcome. While the Company believes it has defenses to Nanogen's claims, if Nanogen were to prevail in its suit against the Company and obtain the injunction, monetary and other relief that is being sought, the Company would incur significant financial liabilities which would materially affect the Company's financial condition and operating results, and the Company may be forced to cease operations.

11. STOCKHOLDERS' EQUITY

In November 2000, the Board of Directors approved a restated certificate of incorporation, which, among other things, increased the number of authorized shares of common stock to 300 million and the number of authorized shares of preferred stock to 50 million.

Common stock

The holders of common stock are entitled to one vote for each share held of record on all matters submitted to a vote of the stockholders, including the election of directors and do not have cumulative voting rights. Subject to preferences that may be applicable to any then outstanding preferred stock, holders of common stock are entitled to receive dividends, if any, as may be declared by the Board of Directors. Upon liquidation, dissolution or winding up of the Company, the holders of common stock will be entitled to share ratably in the net assets legally available for distribution to stockholders, after the payment of all debts and other liabilities, subject to the prior rights of any preferred stock then outstanding.

During February 2000, an officer of the Company entered into an employment agreement with the Company. Among other items, the agreement required the officer to purchase 125,000 shares of common stock at \$2.00 per share. The shares were purchased in June 2000 resulting in cash proceeds to the Company of \$250,000.

During October 2001, the KK issued 10% of its common stock to an unrelated company for \$1.1 million. The per-share price paid for these shares exceeded the price per share paid by Holdings to capitalize the KK. As a result, the Company recognized a change of interest gain of approximately \$951,000. The gain has been recorded as an increase to additional paid-in capital.

Preferred stock

The Company's Board of Directors has the authority, without further action by the stockholders, to issue from time to time preferred stock in one or more series and to fix the number of shares, designations, preferences, powers and relative, participating, optional or other special rights and the qualifications or restrictions of the preferred stock. The preferences, powers, rights and restrictions of different series of preferred stock may differ with respect to dividend rates, amounts payable on liquidation, voting rights, conversion rights, redemption provisions, sinking fund provisions and other matters. There are no shares of preferred stock outstanding.

Warrants

Pursuant to the issuance of convertible promissory notes in March 1998 as discussed in Note 7, the Company issued warrants to purchase 145,000 shares of its common stock at a price of \$2.00 per share. These warrants were exercised in 2001 and 2000, resulting in proceeds to the Company of \$257,000 and \$33,000, respectively.

During 2000, the Company issued 31,050 warrants for the purchase of shares of common stock. These warrants, which were issued in connection with the issuance of common stock, were immediately exercisable at prices of \$2.20 per share and \$5.50 per share. These warrants begin to expire in 2003 through 2010.

As of December 31, 2001 and 2000, the Company has reserved 38,050 and 172,350 shares, of its common stock, respectively, for the exercise of these warrants.

F-68

Stock options

In 1996 and 1998, the Company approved the 1996 Stock Option Plan and the 1998 Stock Option Plan (the "Plans") for employees, directors, consultants and independent contractors under which 500,000 and 5 million shares, respectively, of common stock were reserved. Pursuant to the Plans, either the Board of Directors or the Compensation Committee has the authority to grant nonqualified and incentive stock options and to establish the vesting period, exercise price and expiration period of the awards. Options generally vest over a four-year period and expire 10 years from the date of grant. Certain options have been granted that are immediately exercisable, subject to the Company's right of repurchase, which expires over a four-year period.

In November 2000, the Board of Directors and Acacia, as the Company's majority stockholder, approved the 2000 Stock Awards Plan and ceased issuance of additional options under the Plans. This new plan provides for the award of incentive or non-qualified stock options, restricted stock awards, stock appreciation rights, performance awards and phantom stock awards. At December 31, 2001, 1,850,919 shares of common stock were available for grant under the 2000 Stock Awards Plan.

In February 2001, the Board of Directors and the stockholders approved the 2001 Employee Stock Purchase Plan. Eligible employees can contribute up to 10% of their base compensation to purchase shares of the Company's common stock at a discount of up to 15% of the fair value of the common stock. This plan provides for the purchase of up to a maximum of 20,000 shares, and any shares purchased under this plan reduce the number of shares available under the 2000 Stock Awards Plan. No shares have been purchased under this plan.

During 2000, the Company issued 25,000 stock options to an employee of Acacia. The options have an exercise price of \$9.00 and vest monthly over two years. The Company has accounted for the grant of these options in accordance with the provisions SFAS No. 123. The fair value of these option grants was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions; no dividend yield, a risk-free interest rate of 5.81%, volatility of 75% and an expected option term of 10 years. The fair value of these options totaling \$1.15 million was recorded as a dividend to Acacia, with an offset to additional paid-in capital at the date of grant. These options expire in 2010.

F-69

Option activity for the period from inception (October 4, 1995) to December 31, 2001 is as follows:

OPTIONS OUTSTANDING _____ WEIGHTED-SHARES AVERAGE AVAILABLE FOR NUMBER OF EXERCISE PRICE EXERCISE SHARES GRANT PER SHARE PRICE _____ _____ _____ _____ Shares reserved 500,000 ___ (41,000) 41,000 \$ 1.00-\$ 1.50 \$ 1.49 Options granted in 1996 459,000 41,000 \$ 1.00-\$ 1.50 \$ 1.49 Balance, December 31, 1996 ... (181,250) 181,250 \$ 1.00-\$ 2.00 \$ 1.46 Options granted (25,000) \$ 1.00 \$ 1.00 Options exercised --_____ _____ 277**,**750 197,250 \$ 1.00-\$ 2.00 \$ 1.53 Balances, December 31, 1997 ... Additional Shares reserved ... 2,500,000 ___ ___ ___ Balances, December 31, 1998 .. 2,777,750 197,250 \$ 1.00-\$ 2.00 \$ 1.53 Options granted (427,000) 427,000 \$ 2.00 \$ 2.00 _____ _____ 2,350,750 624,250 \$ 1.00-\$ 2.00 Balances, December 31, 1999 .. \$ 1.85 Additional shares reserved ... 2,500,000 ___ ___ ___ 3,837,500\$ 2.00-\$24.00\$ 7.05(8,750)\$ 2.00\$ 2.00(86,279)\$ 1.00-\$ 5.00\$ 3.29 (3,837,500) Options granted Options exercised ___ 86,279 Options canceled ···· _____ Balances, December 31, 2000 ... 4,366,721 \$ 1.00-\$24.00 1,099,529 \$ 6.39 (816,000)816,000\$12.00-\$24.00\$18.27--(119,720)\$ 1.00-\$ 9.00\$ 2.181,567,390(1,567,390)\$ 1.00-\$ 9.00\$ 7.59 Options granted Options exercised Options canceled 3,495,611 \$ 1.00-\$24.00 \$ 8.75 Balances, December 31, 2001 .. 1,850,919 _____ _____

The following table summarizes information about options outstanding at December 31, 2001:

| | (| OPTIONS OUTSTANDIN | IG | OPTIONS EX | ERCISABLE |
|----------|--------|--------------------|-----------|------------|-----------|
| | | | | | |
| | | WEIGHTED- | | | |
| | | AVERAGE | WEIGHTED- | | WEIGHTED- |
| | | REMAINING | AVERAGE | | AVERAGE |
| RANGE OF | NUMBER | CONTRACTUAL | EXERCISE | NUMBER OF | EXERCISE |

| EXERCISE PRICES | OUTSTANDING | LIFE (IN YEARS) | PRICE | SHARES | PRICE |
|-----------------|-------------|-----------------|---------|-----------|---------|
| | | | | | |
| \$ 1.00-\$ 2.00 | 643,673 | 5.1 | \$ 1.89 | 523,088 | \$ 1.86 |
| \$ 5.00-\$ 6.50 | 1,094,233 | 9.1 | \$ 9.96 | 710,465 | \$ 9.06 |
| \$ 9.00-\$12.00 | 1,218,216 | 9.1 | \$ 9.96 | 379,193 | \$ 9.06 |
| \$18.00-\$24.00 | 539,489 | 9.1 | \$21.73 | 147,143 | \$21.15 |
| | | | | | |
| | 3,495,611 | 8.1 | | 1,759,889 | \$ 6.30 |
| | ======== | | | ======== | |

F-70

At December 31, 2001, 2000, 1999, 1998 and 1997, options for 1,759,889; 889,531; 269,963; 111,121 and 52,750 shares were exercisable with a weighted-average exercise price of \$6.30; \$3.21; \$2.35; \$1.56 and \$1.56 per share, respectively.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions; no dividend yield, risk-free interest rates ranging from 3.18% to 6.48%, volatility of 0% for grants prior to the Company's initial public filing on November 22, 2000 and 75% subsequent to the initial public filing, and an expected option term of four years.

Had the Company applied the provisions of SFAS No. 123 to all stock option grants, the Company's net losses and net losses per share would have been increased to the pro forma amounts indicated below (in thousands, except per share amounts):

| | YEARS H | ENDED DECEMBE | R 31, | FOR THE PERIOD FROM INCEPTION (OCTOBER 4, 1995) TO DECEMBER 31, |
|---|---------|--------------------------|-------|--|
| | 2001 | 2000 | 1999 | 2001 |
| Net loss As reported Pro forma | | \$(19,274) \$(20,555) | | |
| Net loss per share, basic and diluted As reported Pro forma | , | \$ (1.26) \$ (1.35) | , | |

The weighted-average fair values and weighted-average exercise prices per share at the date of grant for options granted were as follows:

YEARS ENDED DECEMBER 31, ______ 2001 2000 1999

| Weighted-average fair value of options granted with exercise prices equal to the fair value of the stock at the date of grant | \$11.61 | \$ | \$0.42 |
|---|---------|---------|--------|
| Weighted-average exercise price of options granted with exercise prices equal to the fair value of the stock at the date of grant | \$16.75 | \$ — | \$2.00 |
| Weighted-average fair value of options granted with exercise prices less than the fair value of the stock at the date of grant | \$20.68 | \$16.73 | \$ |
| Weighted-average exercise price of options granted with exercise prices less than the fair value of the stock at the date of grant | \$24.00 | \$ 7.18 | \$ |
| Weighted-average fair value of options granted with exercise price greater than the market value of the stock at the date of grant | \$ | \$ 0.75 | \$ |
| Weighted-average exercise price of options granted with exercise prices greater than the market value of the stock at the date of grant | \$ | \$ 5.36 | \$ |

F-71

Deferred stock compensation

During the years ended December 31, 2001 and 2000, in connection with the granting of stock options to employees and members of the Board of Directors at exercise prices below fair market value, the Company recorded deferred compensation aggregating \$729,000 and \$52.5 million, respectively, which is being amortized over an accelerated vesting period as prescribed by FIN No. 28. Amortization expense associated with deferred stock compensation totaled approximately \$18.8 million and \$9.7 million for the years ended December 31, 2001 and 2000, respectively. As a result of stock option cancellations and forfeitures during 2001, deferred stock compensation and amortization of deferred stock compensation were reduced by approximately \$13.3 million and \$4.7 million, respectively. The impact of stock option cancellations and forfeitures to deferred stock compensation and amortization of deferred stock compensation and amortization for the years and forfeitures to deferred stock compensation were reduced by approximately \$13.3 million and \$4.7 million, respectively. The impact of stock option cancellations and forfeitures to deferred stock compensation and amortization of deferred stock compensation prior to 2001 and during the first quarter of 2001 were not significant.

Stock-based compensation expense related to stock options granted to non-employees is recognized as the stock options are earned. The fair value of these stock options granted during 2000 was calculated using the Black-Scholes option pricing model as prescribed by SFAS No. 123 using the following assumptions:

| Risk free interest rate | 5.04% to 6.52% |
|--------------------------|----------------|
| Expected life (in years) | 10 |
| Dividend yield | |
| Expected volatility | 75% |

In connection with the grant of stock options to non-employees, the Company recognized deferred stock-based compensation of approximately \$1.2 million during the year ended December 31, 2000. There were no stock options granted to

non-employees during 2001.

12. RETIREMENT SAVINGS PLAN

The Company has an employee savings and retirement plan under section 401(k) of the Internal Revenue Code. The Plan is a defined contribution plan in which eligible employees may elect to have a percentage of their compensation contributed to the Plan, subject to certain guidelines issued by the Internal Revenue Service. The Company may contribute to the Plan at the discretion of the Board of Directors. There were no contribution made by the Company during the years ended December 31, 2001, 2000 and 1999.

13. RELATED PARTIES

Acacia, the majority stockholder of the Company, has the sole discretion to determine the timing, structure and terms of any divestiture of its shares in the Company other than a divestiture pursuant to a merger or other transaction requiring approval of the Company's Board of Directors.

At December 31, 2001, Acacia owned a controlling interest in the Company's outstanding common stock. As a result, Acacia controls substantially all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, and exercises significant influence over matters requiring director approval. Acacia has advised the Company that it intends to retain a majority position in the Company.

Since inception, officers or directors of Acacia have represented a majority of the members of the Company's Board of Directors. Additionally, officers or directors of Acacia have served from time to time as the acting Chief Executive Officer of the Company. Until August 1, 2000, Acacia maintained the Company's accounting records. In addition, Acacia provided administrative, human resources, insurance, legal and other services to the Company. These services were provided by Acacia at no cost to the Company through December 31, 1999. Prior to 2000, fees for management services have been imputed and recorded with corresponding credits to additional paid-in capital. During the years ended December 31, 2001, 2000, 1999, and from inception (October 4, 1995) to December 31, 2001, the Company incurred \$165,000, \$133,000, \$62,000 and \$375,000, respectively, related to management fees and insurance allocations. The allocation of expenses was based on the number of Acacia personnel who dedicated time to the Company.

F-72

In November 2000, the Company entered into an exclusive license and development agreement with Acacia for the use and development of the Company's technology by AMS in the field of material sciences. The principal terms include an exclusive license to AMS and customary royalty arrangement on the net sales generated by AMS. The initial term of this agreement is 20 years.

In November 2000, the Company entered into a one-year consulting agreement with Acacia. Under this agreement, Acacia, as an independent contractor, supplied members of its staff to assist the Company in various business, research, analysis, development and general technical matters. Acacia charged the Company for these services based upon each staff member's monthly salary and the portion of time spent each month on the Company's business matters and reasonable expenses.

Since inception, Acacia has also made interest-free advances to the Company. At December 31, 2001 and 2000, the Company owed Acacia \$22,000 and

\$70,000, respectively.

Management of the Company owns shares of common stock of Acacia and options to purchase Acacia shares. The Acacia options were granted at the fair value at the date of grant.

14. SUBSEQUENT EVENT

On April 25, 2002, CombiMatrix Corporation purchased Acacia Research Corporation's interest in Advanced Material Sciences, Inc., a development stage company that holds the exclusive license for CombiMatrix Corporation's biological array processor technology in certain fields of material science. CombiMatrix Corporation issued 180,982 shares of its common stock in exchange for Acacia Research Corporation's 58% interest in Advanced Material Sciences, Inc. CombiMatrix Corporation currently owns 87% of Advanced Material Sciences and the remaining interests are owned by unaffiliated entities.

15. INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Unaudited Interim Information

The unaudited CombiMatrix Corporation consolidated financial statements as of June 30, 2002, and for the three and six month periods ended June 30, 2002 and 2001, have been prepared in accordance with generally accepted accounting principles for interim financial information. These condensed interim consolidated financial statements should be read in conjunction with the CombiMatrix Corporation consolidated financial statements and notes thereto for the year ended December 31, 2001.

The unaudited interim CombiMatrix Corporation condensed consolidated financial statements include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation of our financial position as of June 30, 2002, the results of our operations for the three and six months ended June 30, 2002 and 2001, and our cash flows and our stockholders' equity for the six months ended June 30, 2002. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the results to be expected for the entire year.

F-73

Loss Per Share

Basic and diluted net loss per share have been computed using the weighted-average number of shares of common stock outstanding during the period. The Company has excluded all outstanding options and warrants to purchase common stock from the calculation of diluted net loss per share, as such securities are antidilutive for all periods presented. These antidilutive securities are as follows:

| | | FOR THE THREE MONTHS FOR THE SIX MONTHS ENDED JUNE 30, ENDED JUNE 30, | | |
|---------------------|---------------------|--|---------------------|---------------------|
| | 2002 | 2001 | 2002 | 2001 |
| Options Warrants | 3,753,892 38,050 | 4,492,221 38,050 | 3,753,892 38,050 | 4,492,221 38,050 |
| | 3,791,942 | 4,530,271 | 3,791,942 | 4,530,271 |

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Financial Instruments and for Hedging Activities," which provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000 and it did not have an impact on the Company's results of operations or financial condition when adopted, as the Company holds no derivative financial instruments and does not currently engage in hedging activities.

In June 2001, the FASB issued SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 eliminated the pooling-of-interests method of accounting for business combinations. As a result, all business combinations must now be accounted for using the purchase method. The provisions of this statement apply to all business combinations initiated after June 30, 2001. SFAS No. 142 requires that goodwill may no longer be amortized to earnings, but instead must be reviewed for impairment periodically. The Company adopted SFAS No. 142 effective January 1, 2002. the adoption of these statements did not have a significant impact on the Company's financial position or results of operations.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which supersedes SFAS No. 121. This Statement also supersedes the accounting and reporting provisions of APB Opinion No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," for segments of a business to be disposed of. This Statement also amends Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to eliminate the exception to consolidation for a temporarily controlled subsidiary. The Company adopted SFAS No. 144 effective January 1, 2002. theThe adoption of this pronouncement did not have a significant impact on the Company's financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections," ("SFAS No. 145"), which is effective for transactions occurring after May 15, 2002. SFAS No. 145 rescinds SFAS No. 4 and SFAS No. 64, which addressed the accounting for gains and losses from extinguishment of debt. SFAS No. 44 set forth industry-specific transitional guidance that did not apply to us. SFAS No. 145 amends SFAS No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. SFAS No. 145 also makes technical corrections to certain existing pronouncements that are not substantive in nature. We do not expect the adoption of SFAS No. 145 to have a significant impact on our financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 nullifies Emerging Issues Task Force ("EITF") Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity," under which a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized at fair value when the liability is incurred. The provisions

of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. We do not expect the adoption of SFAS No. 146 to have a significant impact on our financial position or results of operations.

COMMITMENTS AND CONTINGENCIES

On November 28, 2000, Nanogen, Inc. filed a complaint in the United States District Court for the Southern District of California against CombiMatrix and Donald D. Montgomery, Ph.D., Senior Vice President, Chief Technology Officer and a director of CombiMatrix. Dr. Montgomery was employed by Nanogen as a senior research scientist between May 1994 and August 1995. The Nanogen complaint alleges, among other things, breach of contract, trade secret misappropriation and that U.S. Patent No. 6,093,302 and other proprietary information belonging to CombiMatrix are instead the property of Nanogen. The complaint seeks, among other things, correction of inventorship on the patent, the assignment of rights in the patent and pending patent applications to Nanogen, an injunction preventing disclosure of trade secrets, damages for trade secret misappropriation and the imposition of a constructive trust. On December 15, 2000, CombiMatrix and Dr. Montgomery filed a motion to dismiss the lawsuit, which was denied in part and granted in part on February 1, 2001. On March 9, 2001, CombiMatrix and Dr. Montgomery filed a counterclaim, alleging breach of express covenants not to sue or otherwise interfere with Dr. Montgomery arising out of a release signed by Nanogen in 1996. On April 4, 2001, Nanogen filed a motion to dismiss the counterclaim, which the court denied in its entirety on July 27, 2001. On July 31, 2002, the court denied a motion filed by CombiMatrix for partial summary judgment regarding Donald Montgomery's prior settlement agreement with Nanogen.

SUBSEQUENT EVENTS

On September 30, 2002, CombiMatrix Corporation and Dr. Donald Montgomery, an officer and stockholder of CombiMatrix Corporation, entered into a settlement agreement with Nanogen, Inc. to settle all pending litigation between the parties. Pursuant to the terms of the settlement agreement, CombiMatrix Corporation agreed to pay Nanogen \$500,000 within 30 days of the settlement and an additional \$500,000 within one year of the settlement. CombiMatrix Corporation also agreed to make quarterly payments to Nanogen equal to 12.5% of total sales of products developed by CombiMatrix Corporation and its affiliates and based on the patents that had been in dispute in the litigation, up to an annual maximum of \$1,500,000. The minimum quarterly payments under the settlement agreement will be \$37,500 per quarter for the period from October 1, 2003 through October 1, 2004, and \$25,000 per quarter thereafter until the patents expire. Also pursuant to the settlement agreement, CombiMatrix Corporation agreed to issue 4,016,346 shares, or 17.5% of its outstanding shares post-issuance, to Nanogen, subject to antidilution provisions under specified circumstances, including the exercise of outstanding options and warrants and issuances of additional capital stock of CombiMatrix Corporation, for a period of up to three years.

CombiMatrix Corporation will account for the issuance of the CombiMatrix Corporation common shares in settlement of the litigation with Nanogen, Inc. as a nonmonetary transaction. Accordingly, in the third quarter of 2002, CombiMatrix Corporation will record a litigation settlement charge in the consolidated statement of operations of approximately \$18.0 million, which is based on the fair value of the CombiMatrix Corporation common shares issued to Nanogen, Inc. The fair value of the common shares issued and the related litigation charge was based on a third-party valuation of CombiMatrix Corporation.

In October 2002, CombiMatrix was in non-compliance with one of its covenants under its capital lease obligation with a commercial bank. CombiMatrix paid the remaining balance of the obligation in the amount of \$2.1 million on

November 1, 2002.

F-75

ACACIA TECHNOLOGIES GROUP (A DIVISION OF ACACIA RESEARCH CORPORATION)

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of Acacia Research Corporation

In our opinion, the accompanying balance sheets and the related statements of operations, allocated net worth and cash flows present fairly, in all material respects, the financial position of the Acacia Technologies group (a division of Acacia Research Corporation as described in Note 1) at December 31, 2001 and December 31, 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of Acacia Research Corporation's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note 1 to the financial statements, Acacia Technologies group is a division of Acacia Research Corporation; accordingly, the financial statements of Acacia Technologies group should be read in conjunction with the consolidated financial statements of Acacia Research Corporation.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California May 2, 2002

F-76

ACACIA TECHNOLOGIES GROUP A DIVISION OF ACACIA RESEARCH CORPORATION BALANCE SHEETS (IN THOUSANDS)

> AT DECEMBER 31, AT JUNE 30, 2001 2000 2002

> > 335

(UNAUDITED)

| ASSETS | | | |
|--|---------------------|---------------|---------------------|
| Current assets: Cash and cash equivalents Short-term investments | \$ 46,859 4,372 | \$ 29,605 | \$ 42,874 765 |
| Prepaid expenses, other receivables and other assets | 800 | 323 | 1,087 |
| Total current assets | | 29,928 | 44,726 |
| Property and equipment, net of accumulated depreciation | 358 | 871 | 315 |
| Receivable from CombiMatrix group | 30 | 107 | 88 |
| Investment in affiliate, at equity | | 010 | |
| Investment in affiliate, at cost | 3,000 | 3,000 | 3,000 |
| Patents, net of accumulated amortization | 5,554 | 2,215 | 4,726 |
| Goodwill, net of accumulated amortization | 1,776 | 426 | 1,776 |
| Other assets | 177 | 169 | 694 |
| | \$ 62,926 ====== | | \$ 55,325 ====== |
| LIABILITIES AND ALLOCATED NET WORTH | | | |
| Current liabilities: | | | |
| Accounts payable, accrued expenses and other Deferred revenues | \$ 2,925 1,500 | \$ 5,075 | \$ 2,745 1,500 |
| Total current liabilities | | 5,075 | 4,245 |
| Deferred income taxes | 1,298 | | 1,227 |
| Total liabilities | 5,723 | • | 5,472 |
| Commitments and contingencies (Note 8) | | | |
| Minority interests | 2,194 | 2,012 | 1,899 |
| Allocated Net Worth: | | | |
| Funds allocated by Acacia Research Corporation | 107,270 | 66,305 | 106,860 |
| Accumulated net losses | (52,261) | (36,330) | (58,906) |
| Total allocated net worth | 55,009 | 29,975 | 47,954 |
| | \$ 62,926 ====== | \$ 37,062 | \$ 55,325 ====== |

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

F-77

ACACIA TECHNOLOGIES GROUP A DIVISION OF ACACIA RESEARCH CORPORATION STATEMENTS OF OPERATIONS (IN THOUSANDS)

| | FOR THE YEARS ENDED DECEMBER | | |
|---|------------------------------------|---------------------------------------|------------------------------|
| | 2001 | 2000 | 1999 |
| REVENUES: | | | |
| License fee income Other income | \$24,180 | \$ 40 | \$ 122 |
| Total revenues | 24,180 | 40 | 122 |
| OPERATING EXPENSES: | | | |
| Research and development expenses Marketing, general and administrative expenses Non-cash stock compensation expenses - marketing, | 4,402 | 52 8,274 | 3,088 |
| general and administrative | 856 11,572 | 709 984 | 110 287 |
| Amortization of patents and goodwill | 1,492 | 1,611 1,016 | 1,592 |
| Total operating expenses | 18,322 | 12,646 | 5,077 |
| Operating income (loss) | 5,858 | | (4,955) |
| OTHER INCOME (EXPENSE): | | | |
| Write-off of equity investments Interest income Realized gains (losses) on short-term investments Unrealized gains (losses) on short-term investments Equity in losses of affiliate Other income | 1,642 350 237 (195) 77 | (2,603) 1,424 (1,746) 28 | 286 (1,121) 17 |
| Total other income (expense) | 2,111 | (2,897) | (818) |
| Income (loss) from continuing operations before income taxes and minority interests | 7 , 969 | (15,503) | (5,773) |
| (Provision) benefit for income taxes | (935) | (6) | (18) |
| <pre>Income (loss) from continuing operations before minority interests</pre> | 7,034 | | (5,791) |
| Minority interests | (1,277) | 866 | (27) |
| Income (loss) from continuing operations Discontinued operations | 5,757 | (14,643) | (5,818) |
| Loss from discontinued operations of Soundbreak.com Estimated loss on disposal of Soundbreak.com | | (7,443) (2,111) | (776) |
| Division net income (loss) | \$ 5,757 | \$(24,197) | \$(6,594) |

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

ACACIA TECHNOLOGIES GROUP A DIVISION OF ACACIA RESEARCH CORPORATION STATEMENTS OF OPERATIONS (IN THOUSANDS)

| | THREE MON | THS ENDED | S |
|---|---------------|---------------|---------|
| | JUNE 30, 2002 | JUNE 30, 2001 | JUNE 30 |
| REVENUES: License fee income | \$ | \$ 10,000 | Ş |
| Other income | Ş | \$ 10,000 | ې |
| Total revenues | | 10,000 | |
| OPERATING EXPENSES: | | | |
| Marketing, general and administrative expenses Non-cash stock compensation expenses - marketing, | 2,053 | 1,063 | з, |
| general and administrative | 8 536 | 10 4,740 | 1, |
| Amortization of patents and goodwill Loss on disposal of subsidiaries | 465 | 337 | ± / |
| Total operating expenses | 3,062 | 6,150 | 5, |
| Operating income (loss) | (3,062) | 3,850 | (5, |
| OTHER INCOME (EXPENSE) : | | | |
| Interest income | 147 | 471 | |
| Realized gains (losses) on short-term investments | (930) | | (1, |
| Unrealized gains (losses) on short-term investments | (156) | (55) | (|
| Equity in losses of affiliateOther income | 34 | (55) 57 | |
| Total other income (expense) | (905) | 473 | (1, |
| <pre>Income (loss) from continuing operations before income taxes and minority interests</pre> | (3,967) | 4,323 | (6, |
| (Provision) benefit for income taxes | 36 | (267) | |
| <pre>Income (loss) from continuing operations before minority interests</pre> | (3,931) | 4,056 | (6, |
| Minority interests | 125 | (959) | |
| Division net income (loss) | \$(3,806) | \$ 3,097 | \$(6, |
| | | | ==== |

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

ACACIA TECHNOLOGIES GROUP (A DIVISION OF ACACIA RESEARCH CORPORATION) STATEMENTS OF ALLOCATED NET WORTH (IN THOUSANDS)

| Balance at December 31, 1998 | \$ 18,845 |
|---|---------------------|
| Net assets attributed to the Acacia Technologies group Division net loss | 32,241 (6,594) |
| Balance at December 31, 1999 | 44,492 |
| Net assets attributed to the Acacia Technologies group Division net loss | 9,680 (24,197) |
| Balance at December 31, 2000 | 29,975 |
| Net assets attributed to the Acacia Technologies group Division net income | 19,277 5,757 |
| Balance at December 31, 2001 | 55,009 |
| Net assets attributed to the Acacia Technologies group Division net loss | (410) (6,645) |
| Balance at June 30, 2002 (Unaudited) | \$ 47,954 ====== |

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

F-80

ACACIA TECHNOLOGIES GROUP A DIVISION OF ACACIA RESEARCH CORPORATION STATEMENTS OF CASH FLOWS (IN THOUSANDS)

| | FOR THE YEARS E DECEMBER 31 | |
|--|--------------------------------|--------------------|
| | 2001 | 2000 |
| Cash flows from operating activities: Division net income (loss) from continuing operations: Adjustments to reconcile division net income (loss) from continuing operations to net cash provided by (used in) operating activities: | \$ 5,757 | \$(14 , 643 |
| Depreciation and amortization | 1,710 | 1,751 |
| Equity in losses of affiliate | 195 | 1,746 |
| Stock-based compensation | 856 | 709 |
| Minority interests | 1,277 | (866 |
| Deferred tax benefit | (27) | (2 |
| Write-off of other assets | | 2,603 |

| Net purchases (sales) of trading securities | (4,135) | |
|---|-----------|-----------|
| Unrealized (gains) losses on short-term investments | (237) | |
| Other Changes in assets and liabilities: | 40 | 398 |
| Prepaid expenses, other receivables and other assets | (455) | (1,040 |
| Accounts payable, accrued expenses and other | 310 | 149 |
| Deferred revenues | 1,500 | |
| Net cash provided by (used in) operating activities of continuing | | |
| operations | 6,791 | (9,195 |
| Net cash used in operating activities of discontinued operations | (2,182) | (16,600 |
| Net cash provided by (used in) operating activities | 4,609 | (25,795 |
| Cash flows from investing activities: | | |
| Deposit on investments | | |
| Withdrawal from partnership | | |
| Capital contribution to equity investments | | 1,000 |
| Purchase of additional equity in consolidated subsidiaries | (3,304) | (970 |
| Purchase of property and equipment | (19) | (472 |
| Purchase of short-term investments | (25,921) | |
| Sale of short-term investments | 25,921 | |
| Purchase of common stock from minority stockholders of subsidiaries | (2,550) | |
| Other | | (54 |
| Net cash used in investing activities from continuing operations | (5,873) | (496 |
| Net cash (used in) provided by investing activities from discontinued | | (1 1 7 0 |
| operations | (145) | (1,173 |
| Net cash used in investing activities | (6,018) | (1,669 |
| Cash flows from financing activities: | | |
| Net cash attributed to the Acacia Technologies group | 18,663 | 20,897 |
| Increase (decrease) in cash and cash equivalents | 17,254 | (6,567 |
| Cash and cash equivalents, beginning | 29,605 | 36,172 |
| Cash and cash equivalents, ending | \$ 46,859 | \$ 29,605 |
| | | |

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

F-81

ACACIA TECHNOLOGIES GROUP A DIVISION OF ACACIA RESEARCH CORPORATION NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Acacia Research Corporation's continuing operations are comprised of two separate divisions: the Acacia Technologies group and the CombiMatrix group ("groups").

The Acacia Technologies group is primarily comprised of Acacia Research Corporation's interests in two wholly-owned media technologies subsidiaries: (1) Soundview Technologies, Inc., a Delaware corporation and (2) Acacia Media

Technologies Corporation, a Delaware corporation, and also includes all corporate assets, liabilities, and related transactions of Acacia Research Corporation attributed to the Acacia Technologies group.

The Acacia Technologies group's media technology businesses own intellectual property related to the telecommunications field, including a television blanking system, also known as the "V-chip," which it licenses to television manufacturers and a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems. Acacia Technologies group is responsible for the development, licensing and protection of its intellectual property and proprietary technologies. Acacia Technologies group continues to pursue both licensing and strategic business alliances with companies in the technologies industry.

In January 2001, Acacia Research Corporation completed an institutional private equity financing raising gross proceeds of \$19.0 million (\$17.8 million, net of issuance costs) through the issuance of 1,107,274 units. Proceeds from this equity financing were attributed to Acacia Technologies group.

In the third quarter of 2000, Acacia Research Corporation completed a private offering of 861,638 units at \$27.50 per unit for gross proceeds of approximately \$23.7 million (\$22.3 million, net of issuance costs). Proceeds from this equity financing were attributed to Acacia Technologies group.

In the fourth quarter of 1999, Acacia Research Corporation completed an institutional private equity financing raising gross proceeds of \$21.0 million (\$19.0 million, net of issuance costs) through the issuance of 974,771 units, consisting of one share of Acacia Research Corporation's common stock and one-half of a common stock purchase warrant. During the first quarter of 2000, Acacia Research Corporation issued a 30-day redemption notice for these warrants. As a result, all of these warrants were exercised prior to the redemption date with Acacia Research Corporation receiving proceeds of approximately \$14.8 million. Proceeds from this equity financing were attributed to Acacia Technologies group.

Acacia Research Corporation's cash and the cash held by its media technology businesses, including all cash raised through Acacia Research Corporation's offerings has been attributed to the technology group as these funds are intended to support the media technology businesses of Acacia Research.

SOUNDVIEW TECHNOLOGIES

In June 2001, Acacia Research Corporation's ownership interest in Soundview Technologies, Incorporated ("Soundview Technologies") increased from 67% to 100%, following Soundview Technologies' completion of a stock repurchase transaction with its former minority stockholders. Soundview Technologies repurchased the stock of its former minority stockholders in exchange for a cash payment and the grant to such stockholders of the right to receive 26% of future net revenues generated by Soundview Technologies' current patent portfolio, which includes its V-chip patent. As of December 31, 2001, total consideration paid combined with amounts accrued pursuant to the stock repurchase agreements totaled \$2,767,000 (\$2,550,000 paid in cash and \$217,000 accrued as of December 31, 2001). The increase in Acacia Research Corporation's interest in Soundview Technologies from 67% to 100% was accounted for as a step acquisition in accordance with the purchase method of accounting. Accordingly, the purchase price paid to date was allocated to the fair value of assets acquired and liabilities assumed. The excess of

F-82

the purchase price paid over the fair market value of the net assets acquired of \$1,485,000 was assigned to patents. Contingent purchase consideration is accounted for as an additional cost of the acquired enterprise.

During 2001, Soundview Technologies executed separate settlement and/or license agreements with Samsung Electronics, Hitachi America, Ltd., LG Electronics, Inc., Funai Electric Co. Ltd., Daewoo Electronics Corporation of America, Sanyo Manufacturing Corporation, Thomson Multimedia, Inc., JVC Americas Corporation, Matsushita Electric Industrial Co., Ltd. and Orion Electric Co., Ltd. In addition, Soundview Technologies settled its lawsuits with Pioneer Electronics (USA) Incorporated, an affiliate of Pioneer Corporation, and received payments from Philips Electronics pursuant to a settlement and license agreement signed in December 2000. Certain of these license agreements constitute settlements of patent infringement litigation brought by Soundview Technologies. As of December 31, 2001, Soundview Technologies received one-time license fee payments totaling \$25,630,000 from the settlement and license agreements and have granted non-exclusive, retroactive and future licenses of Soundview Technologies' U.S. Patent No. 4,554,584 to the respective television manufacturers. Certain of the settlement and license agreements provide for future royalty payments to Soundview Technologies. The Acacia Technologies group received and recognized as revenue \$2,390,000, \$10,000,000, \$10,740,000 and \$1,000,000 of the license fee payments during the first, second, third and fourth quarters of 2001, respectively. License fee payments received during 2001 totaling \$1,500,000 are included in deferred revenues pursuant to the terms of the respective agreements.

In the second quarter of 2000, Soundview Technologies announced that it filed a federal patent infringement and antitrust lawsuit against Sony Corporation of America, Philips Electronics North America Corporation, the Consumer Electronics Manufacturers Association and the Electronics Industries Alliance d/b/a Consumer Electronics Association. In its lawsuit, Soundview Technologies alleged that Sony and Philips Television sets fitted with "V-chips" infringe Soundview Technologies' patent and that the Consumer Electronics Manufacturers Association had induced infringement of the patent.

ACACIA MEDIA TECHNOLOGIES

In November 2001, Acacia Research Corporation increased its ownership interest in Acacia Media Technologies Corporation ("Acacia Media Technologies"), formerly Greenwich Information Technologies LLC ("Greenwich"), from 33% to 100% through the purchase of the ownership interest of the former limited liability company's other member. In December 2001, Acacia Research Corporation converted Greenwich from a limited liability company to a corporation and changed its name to Acacia Media Technologies. The ownership interest purchase has been accounted for as a purchase transaction in accordance with SFAS No. 141. The excess purchase price was allocated to Acacia Media Technologies' patent portfolio and is being amortized over the remaining economic life of the respective patents, which is approximately 10 years. The results of operations have been included in the statement of operations from the date of acquisition. Pro forma results of operations have not been presented because the effects of these acquisitions were not material on either an individual or aggregate basis.

Acacia Media Technologies owns a worldwide portfolio of pioneering patents relating to audio and video transmission and receiving systems, commonly known as audio-on-demand and video-on-demand, used for distributing content via various methods including computer networks, cable television systems and direct broadcasting satellite systems.

OTHER

The Acacia Technologies group includes the assets and liabilities of Soundbreak.com, a 66.9% held subsidiary of Acacia Research Corporation which ceased operations as of February 15, 2001. Accordingly, the Acacia Technologies group has reported the results of operations and the estimated loss on disposal of Soundbreak.com as results of discontinued operations in the 2000 and 1999 statements of operations.

The Acacia Technologies group conducts a portion of its investing activity through a limited partnership, of which a wholly-owned subsidiary of Acacia Research Corporation is the general partner. As a result of the significant control that Acacia Research Corporation exercises over the limited partnership, the assets and liabilities and results of operations have been consolidated by Acacia Research Corporation at December 31, 2001. The assets, liabilities and results of operations of the limited partnership, which includes certain health sciences

F-83

securities, have been attributed to the Acacia Technologies group. Subsequent to December 31, 2001, the limited partnership traded in certain derivative financial instruments which to date have not been significant.

THE PROPOSED TRANSACTION

On March 20, 2002, Acacia Research Corporation's Board of Directors (the "Board") approved a plan that would create two new classes of common stock called Acacia Research Corporation - CombiMatrix common stock ("AR-CombiMatrix stock") and Acacia Research Corporation - Acacia Technologies common stock ("AR-Acacia Technologies stock") (the "Recapitalization Proposal"). AR-CombiMatrix stock is intended to reflect separately the performance of the CombiMatrix group. AR-Acacia Technologies stock is intended to reflect separately the performance of Acacia Research Corporation's media technology business. Each share of existing Acacia Research Corporation common stock would be converted into approximately 0.5582 of a share of AR-CombiMatrix stock and one share of AR-Acacia Technologies stock. Acacia Research Corporation intends to list the AR-CombiMatrix stock and the AR-Acacia Technologies stock on the NASDAQ National Market System under the symbols "CBMX" and "ACTG", respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION. AR-Acacia Technologies stock is intended to reflect the separate performance of the respective division of Acacia Research Corporation. The Acacia Technologies group is not a separate legal entity. Holders of AR-Acacia Technologies stock will be stockholders of Acacia Research Corporation. As a result, holders of AR-Acacia Technologies stock will continue to be subject to all of the risks of an investment in Acacia Research Corporation and all of its businesses, assets and liabilities. The assets Acacia Research Corporation attributes to Acacia Technologies could be subject to the liabilities of the CombiMatrix group.

The Acacia Technologies group financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, and taken together with the CombiMatrix group financial statements, comprise all the accounts included in the corresponding consolidated financial statements of Acacia Research Corporation. The financial statements of Acacia Technologies group reflect the financial condition, results of operations, and

cash flows of the businesses included therein. The financial statements of the Acacia Technologies group include the accounts or assets of Acacia Research Corporation specifically attributed to the Acacia Technologies group and were prepared using amounts included in Acacia Research Corporation's consolidated financial statements.

Minority interests represents participation of other stockholders in the allocated net assets and in the division earnings and losses of the Acacia Technologies group and is reflected in the caption "Minority interests" in the Acacia Technologies group financial statements. Minority interests adjust the Acacia Technologies group's share of the division's earnings or loss of non-wholly owned subsidiaries.

Financial effects arising from one group that affect Acacia Research Corporation's results of operations or financial condition could, if significant, affect the results of operations or financial condition of the other group and the market price of the class of common stock relating to the other group. Any division net losses of the CombiMatrix group or the Acacia Technologies group and dividends or distributions on, or repurchases of, AR-CombiMatrix stock or AR-Acacia Technologies stock or repurchases of preferred stock of Acacia Research Corporation will reduce the assets of Acacia Research Corporation legally available for payment of dividends on AR-CombiMatrix stock or AR-Acacia Technologies stock.

MANAGEMENT ALLOCATION POLICIES. The management and allocation policies applicable to the preparation of the financial statements of the CombiMatrix group and the Acacia Technologies group may be modified or rescinded, or additional policies may be adopted, at the sole discretion of the Board at any time without approval of the stockholders. The Acacia Technologies group financial statements reflect the application of the management and allocation policies adopted by the Board to various corporate activities, as described below. Management has no plans to change allocation methods or the composition of the groups. The Acacia Technologies group financial statements should be read in conjunction with the Acacia Research Corporation consolidated financial statements and related notes.