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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2004

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission file number 0-28150

NEUROCRINE BIOSCIENCES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**33-0525145**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

12790 EL CAMINO REAL

SAN DIEGO, CALIFORNIA 92130
(Address of principal executive offices)

(858) 617-7600

(Registrant's telephone number, including area code)

10555 SCIENCE CENTER DRIVE

SAN DIEGO, CA 92121
(Former address if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes [X] No [ ]

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act): Yes [X] No [ ]

The number of outstanding shares of the registrant's common stock, par value $0.001 per share, was 36,412,178 as of August 1, 2004.

NEUROCRINE BIOSCIENCES, INC.

FORM 10-Q INDEX

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEUROCRINE BIOSCIENCES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except for share information)

	June 30, 2004	December 31, 2003
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 22,735	$ 105,854
Short-term investments, available-for-sale	303,802	347,314
Receivables under collaborative agreements	4,631	13,659
Other current assets	4,886	4,982
Total current assets	336,054	471,809
Property and equipment, net	93,957	56,236
Prepaid royalties	95,000	—
Deposits and restricted cash	17,694	25,539
Other non-current assets	3,774	1,371
Total assets	$ 546,479	$ 554,955
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 27,119	$ 56,386
Deferred revenues	36,438	49,666
Current portion of long-term debt	3,946	3,960
Total current liabilities	67,503	110,012
Long-term debt, net of current portion	54,934	32,473
Deferred revenues	8,512	18,241
Other liabilities	3,989	3,109
Total liabilities	134,938	163,835
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.001 par value; 50,000,000 shares authorized; issued and outstanding shares were 36,403,020 as of June 30, 2004 and 35,311,893 as of December 31, 2003	36	35
Additional paid-in capital	670,183	622,526
Deferred compensation	(550)	(784)
Notes receivable from stockholders	(139)	(139)
Accumulated other comprehensive (loss) income	(2,296)	1,664
Accumulated deficit	(255,693)	(232,182)
Total stockholders' equity	411,541	391,120
Total liabilities and stockholders' equity	$ 546,479	$ 554,955

See accompanying notes to the condensed consolidated financial statements.

NEUROCRINE BIOSCIENCES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except loss per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(unaudited)		(unaudited)	
Revenues:				
Sponsored research and development	$ 2,506	$ 33,346	$ 7,875	$ 64,071
License fees and milestones	12,388	11,320	23,707	17,987
Grant income	155	302	408	626
Total revenues	15,049	44,968	31,990	82,684
Operating expenses:				
Research and development	22,969	52,323	49,357	100,647
General and administrative	5,469	5,135	10,752	9,879
Total operating expenses	28,438	57,458	60,109	110,526
Loss from operations	(13,389)	(12,490)	(28,119)	(27,842)
Other income and (expenses):				
Interest income	2,444	2,593	4,797	4,794
Interest expense	(185)	(382)	(185)	(518)
Other income and (expense), net	(1)	56	(1)	104
Total other income, net	2,258	2,267	4,611	4,380
Loss before income taxes	(11,131)	(10,223)	(23,508)	(23,462)
Income taxes	—	2	3	153
Net loss	$(11,131)	$(10,225)	$(23,511)	$ (23,615)
Net loss per common share:				
Basic and diluted	$ (0.31)	$ (0.33)	$ (0.65)	$ (0.76)
Shares used in the calculation of net loss per common share:				
Basic and diluted	36,368	31,334	35,947	31,063

See accompanying notes to the condensed consolidated financial statements.

NEUROCRINE BIOSCIENCES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Six Months Ended June 30,	
	2004	2003
	(unaudited)	
CASH FLOW FROM OPERATING ACTIVITIES		
Net loss	$ (23,511)	$ (23,615)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,711	1,875
Deferred revenues	(22,957)	81,264
Deferred expenses	140	889
Loan forgiveness on notes receivable	52	—
Non-cash compensation expenses	280	1,147
Change in operating assets and liabilities:		
Accounts receivable and other current assets	8,524	(37,849)
Other non-current assets	587	(5,051)
Accounts payable and accrued liabilities	(29,873)	26,485
Net cash (used in) provided by operating activities	(64,047)	45,145
CASH FLOW FROM INVESTING ACTIVITIES		
Purchases of short-term investments	(471,806)	(213,751)
Sales/maturities of short-term investments	509,059	177,133
Deposits	7,845	(3,000)
Purchase of royalty stream	(50,000)	—
Purchases of property and equipment	(40,432)	(22,104)
Net cash used in investing activities	(45,334)	(61,722)
CASH FLOW FROM FINANCING ACTIVITIES		
Issuance of common stock	3,815	6,680
Proceeds received from debt	24,482	1,847
Principal payments on debt	(2,035)	(1,367)
Net cash provided by financing activities	26,262	7,160
Net decrease in cash and cash equivalents	(83,119)	(9,417)
Cash and cash equivalents at beginning of the period	105,854	44,313
Cash and cash equivalents at end of the period	$ 22,735	$ 34,896
Supplemental information:		
Increase in property and related debt resulting from increasing ownership percentage in Science Park Center LLC	$ —	$ 14,076

See accompanying notes to the condensed consolidated financial statements.

NEUROCRINE BIOSCIENCES, INC.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements included herein are unaudited. These statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions of the Securities and Exchange Commission (SEC) on Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, these financial statements include all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations, and cash flows for the periods presented. The results of operations for the interim period shown in this report are not necessarily indicative of results expected for the full year. The financial statements should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2003 included in our Annual Report on Form 10-K filed with the SEC.

In May 2003, Neurocrine Biosciences, Inc. (Neurocrine) increased its ownership interest in Science Park Center, LLC (Science Park) from 1% to 50.5% effective April 1, 2003. In May 2004, Neurocrine purchased the remaining 49.5% interest in Science Park. Accordingly, the financial statements of Science Park are included in the June 30, 2004 and December 31, 2003 condensed consolidated financial statements for the three and six months ended June 30, 2004 and 2003.

These financial statements should be read in conjunction with the “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Quantitative and Qualitative Disclosures About Market Risk” contained herein and the audited financial statements and notes thereto for the year ended December 31, 2003 included in our Annual Report on Form 10-K filed with the SEC.

The terms “Company” and “we” and “our” are used in this report to refer collectively to Neurocrine Biosciences, Inc. and its subsidiaries.

Stockholders’ Equity

The Company applies the intrinsic-value-based method prescribed in Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees,” in accounting for employee stock options. Accordingly, compensation expense is generally recognized only when options are granted with a discounted exercise price. Any resulting compensation expense is recognized ratably over the associated service period, which is generally the option vesting term.

The Company has determined pro forma net loss and related per share information as if the fair value method described in Statement of Financial Accounting Standard (SFAS) No. 123, “Accounting for Stock Based Compensation,” had been applied to its employee stock-based compensation. The pro forma effect on net loss and net loss per share is as follows for the three and six months ended June 30, 2004 and 2003 (in thousands, except for loss per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net loss:				
As reported	$(11,131)	$(10,225)	$(23,511)	$(23,615)
Stock option expense	(6,717)	(5,411)	(13,358)	(10,330)
Pro forma net loss	$(17,848)	$(15,636)	$(36,869)	$(33,945)
Loss per share as reported (basic and diluted)	$ (0.31)	$ (0.33)	$ (0.65)	$ (0.76)
Pro forma loss per share (basic and diluted)	$ (0.49)	$ (0.50)	$ (1.03)	$ (1.09)

2. USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

3. SHORT-TERM INVESTMENTS AVAILABLE-FOR-SALE

Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in comprehensive income. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in interest income or expense. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

4. IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” if indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the amount of such impairment by comparing the carrying value of the asset to the estimated fair value of the related asset, which is generally determined based on the present value of the expected future cash flows. While the Company’s current and historical operating and cash flow losses are indicators of impairment, the Company believes the future cash flows to be received from the long-lived assets will exceed the assets’ carrying value, and accordingly the Company has not recognized any impairment losses through June 30, 2004.

5. INCOME (LOSS) PER SHARE

The Company computes net income (loss) per share in accordance with SFAS No. 128, “Earnings Per Share.” Under the provisions of SFAS No. 128, basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and common equivalent shares outstanding during the period. Additionally, potentially dilutive securities, composed of incremental common shares issuable upon the exercise of stock options and warrants, are excluded from diluted loss per share because of their anti-dilutive effect. Potentially dilutive securities totaled 2.4 million and 1.9 million for the period ended June 30, 2004 and 2003, respectively.

6. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) is calculated in accordance with SFAS No. 130, “Comprehensive Income.” SFAS No. 130 requires the disclosure of all components of comprehensive income (loss), including net income (loss) and changes in equity during a period from transactions and other events and circumstances generated from non-owner sources. The Company’s components of comprehensive loss consist of the net loss and unrealized gains and losses on short-term investments. For the three and six months ended June 30, 2004, comprehensive loss was $15.5 million and $27.5 million, respectively. For the three and six months ended June 30, 2003, comprehensive loss was $9.3 million and $22.7 million, respectively.

7. REVENUE RECOGNITION

Revenue under collaborative research agreements and grants is recognized as research costs are incurred over the period specified in the related agreement or as the services are performed. These agreements are on a best-efforts basis and do not require scientific achievement as a performance obligation, and provide for payment to be made when costs are incurred or the services are performed. All fees are nonrefundable to the collaborators. Up-front,

nonrefundable payments for license fees and advance payments for sponsored research revenues received in excess of amounts earned are classified as deferred revenue and recognized as income over the contract or development period. Milestone payments are recognized as revenue upon achievement of pre-defined scientific events which require substantive effort. Revenues from government grants are recognized based on a percentage-of-completion basis as the related costs are incurred.

8. RESEARCH AND DEVELOPMENT EXPENSES

Research and development (R&D) expenses are recognized as incurred and include related salaries, contractor fees, facilities costs, administrative expenses and allocations of certain other costs. All such costs are charged to R&D expenses as incurred. These expenses result from our independent R&D efforts as well as efforts associated with collaborations, grants and in-licensing arrangements. In addition, the Company funds R&D, conducted on our behalf, at other companies and research institutions under agreements, which are generally cancelable. The Company reviews and accrues clinical trials expense based on work performed. Accrued clinical costs are subject to revisions as trials progress to completion. Revisions to accruals are charged to expense in the period in which the facts that give rise to the revision become known.

9. REAL ESTATE TRANSACTIONS

The Company is currently constructing a new facility, which it expects to complete during the third quarter of 2004. The Company estimates the construction costs for this facility at approximately $54.0 million and is financing these costs through the net proceeds of the sale of its previous headquarters, a construction loan and a subsequent permanent financing. Capitalized construction costs totaled $51.3 million at June 30, 2004.

The Company has secured a construction loan from a commercial bank for up to $60.6 million to finance the construction of the new facility. The loan requires a guaranty deposit of $17.5 million, which amount is included in deposits and restricted cash, to be maintained at the bank for the duration of the loan. The loan bears interest at the prime rate plus .75 percentage points, and interest is payable monthly. In accordance with SFAS No. 34, applicable interest cost will be capitalized during the construction period. As of June 30, 2004, $49.8 million was outstanding under the construction loan.

During the first quarter of 2004, the Company acquired a parcel of land adjacent to the new headquarters site for approximately $7.7 million to allow for future expansion.

10. PREPAID ROYALTIES

During the first quarter of 2004, the Company entered into several agreements with Wyeth and DOV pursuant to which we acquired Wyeth’s financial interest in indiplon (the Company’s lead clinical candidate for the treatment of insomnia) for $95.0 million, consisting of $50.0 million in cash and $45.0 million in Neurocrine Biosciences, Inc. common stock based on a 15 day average stock price prior to the date of the agreement. Wyeth’s financial interest in indiplon arises from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the indiplon technology to DOV in exchange for milestone payments and royalties on future sales of indiplon. The Company subsequently licensed the indiplon technology from DOV in exchange for milestones (a portion of which is payable by DOV to Wyeth) and royalties (a portion of which is payable by DOV to Wyeth). The agreements among the Company, Wyeth and DOV provide that the Company will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that the Company will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth. This decreases the Company’s overall royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction has been recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based upon indiplon sales.

11. NEW ACCOUNTING PRONOUNCEMENTS

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.” FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the

entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN 46R, a revision to FIN 46. FIN 46R provides a broad deferral of the latest date by which all public entities must apply FIN 46 to certain variable interest entities to the first reporting period ending after March 15, 2004. The adoption of FIN 46 or FIN 46R did not have a material impact upon our financial position, cash flows or results of operations.

In March 2004, the Emerging Issues Task Force ("EITF") reached a consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." EITF 03-1 provides guidance on other-than-temporary impairment models for marketable debt and equity securities accounted for under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." The EITF developed a basic three-step model to evaluate whether an investment is other-than-temporarily impaired. The provisions of EITF 03-1 will be effective for the Company's third quarter of fiscal 2004 and will be applied prospectively to all current and future investments. Quantitative and qualitative disclosures for investments accounted for under SFAS No. 115 are effective for the Company's fiscal year ending 2004. The Company does not expect the adoption of EITF 03-1 to have a material effect on its results of operations and financial condition.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations section contains forward-looking statements, which involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth below under the caption "Risk Factors." The interim financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Financial Statements and Notes thereto for the year ended December 31, 2003 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the year ended December 31, 2003.

OVERVIEW

We discover, develop and intend to commercialize drugs for the treatment of neurological and endocrine-related diseases and disorders. Our product candidates address some of the largest pharmaceutical markets in the world, including insomnia, anxiety, depression, various female and male health disorders, multiple sclerosis, diabetes and other neurological and endocrine related diseases and disorders. To date, we have not generated any revenues from the sale of products, and we do not expect to generate any revenues until the Food and Drug Administration approves a drug candidate. Our lead drug candidate (indiplon) is in phase III clinical trials, and we anticipate filing a New Drug Application (NDA) for indiplon in the fourth quarter of 2004. We have funded our operations primarily through private and public offerings of our common stock and payments received under research and development agreements. We are developing a number of products with corporate collaborators and will rely on existing and future collaborators to meet funding requirements. We expect to generate future net losses until one or more of our drug candidates receive regulatory approval from the FDA and are successfully commercialized. As of June 30, 2004, we have incurred a cumulative deficit of $255.7 million.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations is based upon financial statements that we have prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses, and related disclosures. On an on-going basis, we evaluate these estimates, including those related to revenues under collaborative research agreements and grants, clinical trial accruals (which affect research and development expense), facility lease, investments and fixed assets. Estimates are based on historical experience, information received from third parties and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ

from these estimates under different assumptions or conditions. The items in our financial statements requiring significant estimates and judgments are as follows:

Revenues under collaborative research agreements and grants are recognized as research costs are incurred over the period specified in the related agreement or as the services are performed. These agreements are on a best-efforts basis and do not require scientific achievement as a performance obligation, and provide for payment to be made when costs are incurred or the services are performed. All fees are nonrefundable to the collaborators. Up-front, nonrefundable payments for license fees and advance payments for sponsored research revenues received in excess of amounts earned are classified as deferred revenue and recognized as income over the contract or development period. Estimating the duration of the development period includes continual assessment of development stages and regulatory requirements. Milestone payments are recognized as revenue upon achievement of pre-defined scientific events, which require substantive effort, and achievement of the milestone was not readily assured at the inception of the agreement. Revenues from government grants are recognized based on a percentage-of-completion basis as the related costs are incurred.

Research and development (R&D) expenses include related salaries, contractor fees, facilities costs, administrative expenses and allocations of corporate costs. All such costs are charged to R&D expense as incurred. These expenses result from our independent R&D efforts as well as efforts associated with collaborations, grants and in-licensing arrangements. In addition, we fund R&D at other companies and research institutions under agreements, which are generally cancelable. We review and accrue clinical trials expenses based on work performed, which relies on estimates of total hours and costs incurred based on patient enrollment, completion of studies and other events. We follow this method since reasonably dependable estimates of the costs applicable to various stages of a research agreement or clinical trial can be made. Accrued clinical costs are subject to revisions as trials progress to completion. Revisions are charged to expense in the period in which the facts that give rise to the revision become known.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2004 AND 2003

The following table summarizes our primary sources of revenue:

	Three Months Ended June 30,	
	2004	2003
	(in thousands)	
Revenues under collaboration agreements:		
Pfizer	$12,618	$42,845
GlaxoSmithKline	2,276	1,821
Total revenue under collaboration agreements	14,894	44,666
Grant income	155	302
Total revenues	$15,049	$44,968

Revenues were $15.0 million for the second quarter of 2004 compared to $45.0 million for the respective period last year. The decrease in revenues for the three months ended June 30, 2004, compared to the respective period in 2003, results primarily from changes in revenue recognized under our collaboration agreement with Pfizer, Inc (Pfizer). During the second quarter of 2004 we recognized $1.1 million from Pfizer in the form of sponsored development funding compared to $31.9 million for the same period last year. The $30.8 million decrease is due to the winding down of the Phase III clinical program for indiplon. During the second quarter of 2004, we also recognized $11.5 million in license fees and milestones compared to $10.9 million for the same period last year. This increase is due to the achievement of a $3.0 million milestone for positive long-term administration results under our Phase III studies for indiplon during the second quarter of 2004, offset by a decrease in license fee revenue due to the timing of license fee recognition. Under our agreement with GlaxoSmithKline, we recognized $1.8 million in sponsored research revenue and license fees this quarter and $1.8 million in sponsored research revenue and license fees for the same quarter last year. We also recognized $0.5 million in milestone revenue during

the second quarter of 2004 under the GSK agreement for selection of a development candidate in our CRF research program.

Research and development expenses decreased to $23.0 million for the second quarter 2004 compared to $52.3 million for the respective period in 2003. This $29.3 million decrease in research and development expenses is primarily due to the winding down of our Phase III program for indiplon (for insomnia) which is near completion, offset by increased research and development expenses in other programs. External development costs incurred related to indiplon for the second quarter of 2004 were $4.8 million compared to $35.7 million for the same period last year. This decrease of $30.9 million is due to the tapering of our indiplon development program as it nears completion. We currently have 13 programs in various stages of research and development, including eight programs in clinical development. Additionally, personnel costs have increased by $1.3 million, from $6.3 million in the second quarter of 2003 to $7.6 million in the second quarter of 2004. Laboratory costs have increased from $3.0 million in the second quarter of 2003 to $3.4 million in the second quarter of 2004. The increase in personnel and laboratory costs is related to the expansion of non-indiplon research and development activities. We expect increases in non-indiplon related research and development expense in the future as we seek to continue to advance and build our product portfolio focused on neurological and endocrine-related diseases and disorders.

General and administrative expenses increased to $5.5 million for the second quarter 2004 compared with $5.1 million during the same period last year. The increase in expenses from 2003 to 2004 resulted primarily from the addition of administrative personnel needed to support expanding research and development activities and the implementation of our commercialization strategy and increased insurance costs ($0.2 million).

Interest income decreased to $2.4 million during the second quarter of 2004 compared to $2.6 million for the same period last year. The decrease primarily resulted from lower realized gains on investments.

Net loss for the second quarter of 2004 was $11.1 million, or $0.31 per share, compared to $10.2 million, or $0.33 per share, for the same period in 2003. The increase in the net loss resulted primarily from increased research and development costs in non-indiplon related programs. The decrease in net loss per share is due to a higher weighted average common shares outstanding due to our September 2003 stock offering. Net losses are expected to continue this year as our programs continue to advance through the various stages of the research and clinical development processes.

To date, our revenues have come from funded research and development, achievements of milestones under corporate collaborations, and licensing of product candidates. The nature, timing and amount of these revenues may fluctuate substantially from period to period, which would affect our quarterly revenues and earnings. Accordingly, results and earnings of one period are not predictive of future periods. Collaborations accounted for 99% of our revenue for the quarters ended June 30, 2004 and 2003.

SIX MONTHS ENDED JUNE 30, 2004 AND 2003

The following table summarizes our primary sources of revenue:

	Six Months Ended June 30,	
	2004	2003
	(in thousands)	
Revenues under collaboration agreements:		
Pfizer	$27,516	$77,258
GlaxoSmithKline	4,066	3,648
Taisho	—	1,144
Wyeth	—	8
Total revenue under collaboration agreements	31,582	82,058
Grant income	408	626
Total revenues	$31,990	$82,684

Revenues were $32.0 million for the first six months of 2004 compared to $82.7 million for the respective period last year. The decrease in revenues for the six months ended June 30, 2004, compared to the respective period in 2003, results primarily from changes in revenue recognized under our collaboration agreement with Pfizer. During the first half of 2004 we recognized $5.1 million from Pfizer in the form of sponsored development funding compared to $61.2 million for the same period last year. The $56.1 million decrease is due to the winding down of the Phase III clinical program for indiplon. During the first half of 2004, we also recognized $19.5 million from amortization of up-front license fees compared to $16.1 for the same period last year. This increase in license fee revenue is due to the timing of the license fee recognition which began in February 2003, upon approval of the collaboration agreement with Pfizer. We also recognized $3.0 million in milestone payments during the first half of 2004 related to positive results under our Phase III studies for indiplon for long-term administration. Under our agreement with GlaxoSmithKline, we recognized $3.5 million in sponsored research and license fees for both the first half of 2004 and 2003. We also recognized $.5 million in milestone revenue during the first half of 2004 under the GSK agreement for selection of a development candidate in our CRF research program. Revenues recognized under the Taisho agreement totaled $1.1 million for the six-month period ended June 30, 2003. This $1.1 million decrease in Taisho revenue is due to the restructuring of our collaboration agreement whereby we reacquired the worldwide rights to our diabetes drug candidate.

Research and development expenses decreased to $49.4 million for the first six months of 2004 compared with $100.6 million for the respective period in 2003. This $51.2 million decrease in research and development expenses is primarily due to the winding down of our Phase III program for indiplon (for insomnia) which is near completion, offset by increased research and development expenses in other programs. External development costs incurred related to indiplon for the first six-months of 2004 were $12.6 million compared to $68.7 million for the same period last year. This decrease of $56.1 million is due to the tapering of our indiplon program as it nears completion. Additionally, personnel costs have increased by $2.9 million, from $12.3 million in the first half of 2003 to $15.2 million in the first half of 2004. Laboratory costs have increased from $5.5 million in the first six-months of 2003 to $7.4 million in the first six-months of 2004. The increase in personnel and laboratory costs is related to the expansion of research and development activities. We expect increases in non-indiplon related research and development expense in the future as we seek to continue to advance and build our product portfolio focused on neurological and endocrine-related diseases and disorders.

General and administrative expenses increased to $10.8 million for the six months ended June 30, 2004 compared with $9.9 million during the same period last year. The increase in expenses from 2003 to 2004 resulted primarily from the addition of administrative personnel needed to support expanding research and development activities and the implementation of our commercialization strategy and increased insurance costs.

Interest income remained consistent for the six months ended June 30, 2004 and 2003 at $4.8 million.

Net loss for the first six months of 2004 was $23.5 million, or $0.65 per share, compared to $23.6 million, or $0.76 per share, for the same period in 2003. The decrease in net loss per share is due to a higher weighted average common shares outstanding due to our September 2003 stock offering. Net losses are expected to continue this year as our programs continue to advance through the various stages of the research and clinical development processes.

To date, our revenues have primarily come from funded research and achievements of milestones under corporate collaborations. The nature and amount of these revenues may fluctuate substantially from period to period, which would affect our quarterly revenues and earnings. Accordingly, results and earnings of one period are not predictive of future periods. Revenue from collaborations accounted for 99% of our revenues for the six months ended June 30, 2004 and 2003.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2004, our cash, cash equivalents, and short-term investments totaled $326.5 million compared with $453.2 million at December 31, 2003. The decrease in cash and investment balances from December 31, 2003 to June 30, 2004 resulted primarily from the cash payment to Wyeth of $50.0 million for its portion of the indiplon royalty stream, a $28.1 million reduction in payables related to clinical trials and our net loss of $23.5 million.

Net cash (used in) provided by operating activities during the first six-months of 2004 was $(64.0) million compared with $45.1 million during the same period last year. This fluctuation resulted primarily from the receipt of the initial licensing payment from Pfizer for $100.0 million in the first quarter of 2003.

Net cash used in investing activities during the first six-months of 2004 was $45.3 million compared to $61.7 million for the first half of 2003. This fluctuation resulted primarily from the cash payment of $50.0 million to Wyeth in the first quarter of 2004 for its portion of the indiplon royalty stream. The increase in net cash used in investing activities also resulted in part from timing differences in investment purchases, sales and maturities and the fluctuations in our portfolio mix between cash equivalents and short-term investment holdings. We expect similar fluctuations to continue in future periods. Purchases of property and equipment increased from $22.1 million in the first six-months of 2003 to $40.4 million for the same period in 2004 primarily due to the construction of our new corporate facility. The facility is near completion and is expected to be fully operational in July 2004. Capital equipment purchases for 2004 are expected to be approximately $11.0 million and will be financed primarily through debt arrangements.

Net cash provided by financing activities during the first half of 2004 was $26.3 million compared with net cash provided by financing activities of $7.2 million for the respective period last year. This fluctuation resulted primarily from financing $23.7 million through our construction loan. Cash proceeds from the issuance of common stock under option programs decreased by $2.9 million in the current six-month period compared to the same period last year. We expect similar fluctuations to occur throughout the year, as the amount and frequency of stock-related transactions are dependent upon the market performance of our common stock.

During the first quarter of 2004, we entered into several agreements with Wyeth and DOV Pharmaceutical, Inc. (“DOV”) pursuant to which, we acquired Wyeth’s financial interest in indiplon for approximately $95 million, consisting of $50 million in cash and $45 million in our common stock. Wyeth’s financial interest in indiplon arises from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the indiplon technology to DOV in exchange for milestone payments and royalties on future sales of indiplon. We subsequently licensed the indiplon technology from DOV in exchange for milestones (a portion of which is payable by DOV to Wyeth) and royalties (a portion of which is payable by DOV to Wyeth). The agreements among us, Wyeth and DOV provide that we will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that we will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth. This decreases our overall royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction was recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based upon indiplon sales.

We believe that our existing capital resources, together with interest income and future payments due under our strategic alliances, will be sufficient to satisfy our current and projected funding requirements for at least the next 12 months. However, we cannot guarantee that these capital resources and payments will be sufficient to conduct all of our research and development programs as planned. The amount and timing of expenditures will vary depending upon a number of factors, including progress of our research and development programs.

We will require additional funding to continue our research and product development programs, to conduct preclinical studies and clinical trials, for operating expenses, to pursue regulatory approvals for our product candidates, for the costs involved in filing and prosecuting patent applications and enforcing or defending patent claims, if any, the cost of product in-licensing and any possible acquisitions, and we may require additional funding to establish manufacturing and marketing capabilities in the future. We may seek to access the public or private equity markets whenever conditions are favorable. We may also seek additional funding through strategic alliances and other financing mechanisms. Adequate funding may not be available on terms acceptable to us, if at all. If adequate funds are not available, we may be required to curtail significantly one or more of our research or

development programs or obtain funds through arrangements with collaborators or others. This may require us to relinquish rights to certain of our technologies or product candidates.

We expect to experience negative cash flow for the near future as we fund our operating losses, in-licensing or acquisition opportunities, and capital expenditures. To the extent that we are unable to obtain third-party funding for such costs, we expect that increased expenses will result in increased losses from operations. We may not be successful in the development of our product candidates, and even if we are successful, any products marketed may not generate sufficient revenues to enable us to earn a profit.

CAUTION ON FORWARD-LOOKING STATEMENTS

Our business is subject to significant risks, including but not limited to, the risks inherent in our research and development activities, including the successful continuation of our strategic collaborations, the successful completion of clinical trials, the lengthy, expensive and uncertain process of seeking regulatory approvals, uncertainties associated both with the potential infringement of patents and other intellectual property rights of third parties, and with obtaining and enforcing our own patents and patent rights, uncertainties regarding government reforms and of product pricing and reimbursement levels, technological change and competition, manufacturing uncertainties and dependence on third parties. Even if our product candidates appear promising at an early stage of development, they may not reach the market for numerous reasons. Such reasons include the possibilities that the product will be ineffective or unsafe during clinical trials, will fail to receive necessary regulatory approvals, will be difficult to manufacture on a large scale, will be uneconomical to market or will be precluded from commercialization by proprietary rights of third parties. For more information about the risks we face, see “Risk Factors” included in Part I of our Annual Report on Form 10-K filed with the SEC and the discussions set forth below under the caption “Risk Factors.”

INVESTMENT AND INTEREST RATE RISK

We are exposed to interest rate risk on our short-term investments. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in highly liquid and high quality government and other debt securities. To minimize our exposure due to adverse shifts in interest rates, we invest in short-term securities and ensure that the maximum average maturity of our investments does not exceed 40 months. If a 10% change in interest rates were to have occurred on June 30, 2004, this change would not have had a material effect on the fair value of our investment portfolio as of that date. Due to the short holding period of our investments, we have concluded that we do not have a material financial market risk exposure.

RISK FACTORS

The following information sets forth risk factors that could cause our actual results to differ materially from those contained in forward-looking statements we have made in this Quarterly Report and those we may make from time to time. If any of the following risks actually occur, our business, operating results, prospects or financial condition could be harmed. Additional risks not presently known to us or that we currently deem immaterial may also affect our business operations.

Risks Related to the Company

We may not receive regulatory approvals for our product candidates or approvals may be delayed.

Regulation by government authorities in the United States and foreign countries is a significant factor in the development, manufacture and marketing of our proposed products and in our ongoing research and product development activities. Any failure to receive the regulatory approvals necessary to commercialize our product candidates would harm our business. The process of obtaining these approvals and the subsequent compliance with federal and state statutes and regulations require spending substantial time and financial resources. If we fail or our collaborators or licensees fail to obtain or maintain, or encounter delays in obtaining or maintaining, regulatory approvals, it could adversely affect the marketing of any products we develop, our ability to receive product or royalty revenues and our liquidity and capital resources. All of our products are in research and development and we have not yet requested or received regulatory approval to commercialize any product from the FDA or any other regulatory body. In addition, we have limited experience in filing and pursuing applications necessary to gain regulatory approvals, which may impede our ability to obtain such approvals.

In particular, human therapeutic products are subject to rigorous preclinical testing and clinical trials and other approval procedures of the FDA and similar regulatory authorities in foreign countries. The FDA regulates, among other things, the development, testing, manufacture, safety, efficacy, record keeping, labeling, storage, approval, advertising, promotion, sale and distribution of biopharmaceutical products. Securing FDA approval requires the submission of extensive preclinical and clinical data and supporting information to the FDA for each indication to establish the product candidate's safety and efficacy. The approval process may take many years to complete and may involve ongoing requirements for post-marketing studies. Any FDA or other regulatory approval of our product candidates, once obtained, may be withdrawn. If our potential products are marketed abroad, they will also be subject to extensive regulation by foreign governments.

Based on the results of the Phase III clinical trials on indiplon, we are currently assembling two NDAs, one for the immediate release formulation (IR) and one for the modified release formulation (MR) and we plan to file these NDAs in the fourth quarter of this year. We are currently finalizing our strategy for indiplon market differentiation, dose selection, product positioning and labeling. . We face the risk that the Company may not successfully complete and submit the regulatory filings on the Company's timelines including risk that the data necessary for filing may not be collected or compiled within the Company's projected timeframes. If we are forced to delay our filings or the FDA rejects our NDAs or finds them incomplete or insufficient, our business and reputation may be harmed and our stock price may decrease. In addition, even if our indiplon NDA is approved, the labeling granted by the FDA may limit the commercial success of the product. The FDA could also require Phase IV, or post-marketing, trials to study the long-term effects of indiplon and could withdraw its approval based on the results of those trials.

Our clinical trials may fail to demonstrate the safety and efficacy of our product candidates, which could prevent or significantly delay their regulatory approval.

Any failure or substantial delay in completing clinical trials for our product candidates may severely harm our business. Before obtaining regulatory approval for the sale of any of our potential products, we must subject these product candidates to extensive preclinical and clinical testing to demonstrate their safety and efficacy for humans. Clinical trials are expensive, time-consuming and may take years to complete. We are currently conducting Phase III clinical trials in our indiplon development program for insomnia. This is our most advanced clinical program and represents a significant portion of our total clinical development activities and expenditures. If our Phase III indiplon program is significantly delayed or fails to demonstrate that indiplon is safe and efficacious for the targeted patient

populations or if the FDA does not approve the proposed indiplon product labeling, our business and reputation would be harmed and our stock price would be negatively affected.

In connection with the clinical trials of indiplon and our other product candidates, we face the risks that:

- the product may not prove to be effective;
- we may discover that a product candidate may cause harmful side effects;
- the results may not replicate the results of earlier, smaller trials;
- we or the FDA may suspend the trials;
- the results may not be statistically significant;
- patient recruitment may be slower than expected; and
- patients may drop out of the trials.

Also, late stage clinical trials are often conducted with patients having the most advanced stages of disease. During the course of treatment, these patients can die or suffer other adverse medical effects for reasons that may not be related to the pharmaceutical agent being tested but which can nevertheless adversely affect clinical trial results.

We expect to rely on our collaboration with Pfizer for the funding of the completion of our indiplon clinical program and for commercialization of indiplon.

Pfizer has agreed to:

- fund substantially all third-party costs related to future indiplon development, manufacturing and commercialization activities;
- fund a 200-person Neurocrine sales force that will initially promote Zoloft® and, upon approval of the indiplon NDA, will co-promote indiplon in the Unites States;
- be responsible for obtaining all regulatory approvals outside of the United States and regulatory approvals in the United States after approval of the first indiplon NDA; and
- be responsible for sales and marketing of indiplon worldwide.

While our agreement with Pfizer requires them to use commercially reasonable efforts in the development and commercialization of indiplon, we cannot control the amount and timing of resources Pfizer may devote to our collaboration following FDA approval in the United States nor can we control when Pfizer will seek regulatory approvals outside of the United States. In addition, if Pfizer's development activities in pursuing new indications and uses of indiplon are not successful or Pfizer's sales and marketing activities for indiplon are not effective, indiplon sales and our business may be harmed.

Pfizer may terminate the collaboration at any time upon 180-days written notice, subject to payment of specified amounts related to ongoing clinical development activities. If Pfizer elects to terminate the collaboration prior to FDA approval, we will be responsible for Phase III indiplon development expenses while we seek another partner to assist us in the worldwide development and commercialization of indiplon. This could cause delays in obtaining marketing approvals and sales, and negatively impact our business. If Pfizer elects to terminate the collaboration after receipt of FDA approval, we would be forced to fund the Neurocrine sales force and/or seek new marketing partners for indiplon. This could lead to loss of sales and negatively impact our business. In the event the collaboration is terminated by Pfizer, we may not be successful in finding another collaboration partner on favorable

terms, or at all, and any failure to obtain a new partner on favorable terms could adversely affect indiplon development and commercialization and our business.

We have a history of losses and expect to incur losses and negative operating cash flows for the near future, and we may never achieve sustained profitability.

Since our inception, we have incurred significant net losses, including net losses of $23.5 million and $30.3 million for the six months ended June 30, 2004 and the year ended December 31, 2003, respectively. As a result of ongoing operating losses, we had an accumulated deficit of $255.7 million and $232.2 million as of June 30, 2004 and December 31, 2003, respectively. We were not profitable for the year ended December 31, 2003, and we do not expect to be profitable in 2004. We have not yet completed the development, including obtaining regulatory approvals, of any products and, consequently, have not generated revenues from the sale of products. Even if we succeed in developing and commercializing one or more of our drugs, we may not be profitable. We also expect to continue to incur significant operating and capital expenditures as we:

- seek regulatory approvals for our product candidates;
- develop, formulate, manufacture and commercialize our drugs;
- in-license or acquire new product development opportunities;
- implement additional internal systems and infrastructure; and
- hire additional clinical, scientific and marketing personnel.

We also expect to experience negative cash flow for the near future as we fund our operating losses, in-licensing or acquisition opportunities, and capital expenditures. We will need to generate significant revenues to achieve and maintain profitability and positive cash flow. We may not be able to generate these revenues, and we may never achieve profitability in the future. Our failure to achieve or maintain profitability could negatively impact the market price of our common stock. Even if we become profitable, we cannot assure you that we would be able to sustain or increase profitability on a quarterly or annual basis.

Because our operating results may vary significantly in future periods, our stock price may decline.

Our quarterly revenues, expenses and operating results have fluctuated in the past and are likely to fluctuate significantly in the future. Our revenues are unpredictable and may fluctuate, among other reasons, due to our achievement of product development objectives and milestones, clinical trial enrollment and expenses, research and development expenses and the timing and nature of contract manufacturing and contract research payments. A high proportion of our costs are fixed, due in part to our significant research and development costs. Thus, small declines in revenue could disproportionately affect operating results in a quarter. Because of these factors, our operating results in one or more future quarters may fail to meet the expectations of securities analysts or investors, which could cause our stock price to decline.

We depend on continuing our current strategic alliances and developing additional strategic alliances to develop and commercialize our product candidates.

We depend upon our corporate collaborators to provide adequate funding for a number of our programs. Under these arrangements, our corporate collaborators are responsible for:

- selecting compounds for subsequent development as drug candidates;
- conducting preclinical studies and clinical trials and obtaining required regulatory approvals for these drug candidates; and
- manufacturing and commercializing any resulting drugs.

Our strategy for developing and commercializing our products is dependent upon maintaining our current arrangements and establishing new arrangements with research collaborators, corporate collaborators and others. We have collaborations with Pfizer, GlaxoSmithKline, Wyeth and Eli Lilly and Company. Because we rely heavily on our corporate collaborators, the development of our projects would be substantially delayed if our collaborators:

- fail to select a compound that we have discovered for subsequent development into marketable products;
- fail to gain the requisite regulatory approvals of these products;
- do not successfully commercialize products that we originate;
- do not conduct their collaborative activities in a timely manner;
- do not devote sufficient time and resources to our partnered programs or potential products;
- terminate their alliances with us;
- develop, either alone or with others, products that may compete with our products;
- dispute our respective allocations of rights to any products or technology developed during our collaborations; or
- merge with a third party that may wish to terminate the collaboration.

These issues and possible disagreements with our corporate collaborators could lead to delays in the collaborative research, development or commercialization of many of our product candidates. Furthermore, disagreements with these parties could require or result in litigation or arbitration, which would be time-consuming and expensive. If any of these issues arise, it may delay the filing of our NDAs and, ultimately, our generation of product revenues.

We license some of our core technologies and drug candidates from third parties. If we default on any of our obligations under those licenses, we could lose our rights to those technologies and drug candidates.

We are dependent on licenses from third parties for some of our key technologies. These licenses typically subject us to various commercialization, reporting and other obligations. If we fail to comply with these obligations, we could lose important rights. For example, we have licensed indiplon from DOV Pharmaceutical. In addition, we license some of the core research tools used in our collaborations from third parties, including the CRF receptor we license from The Salk Institute and use in our CRF program collaboration with GlaxoSmithKline and the excitatory amino acid transporters we license from Oregon Health Sciences University and use in our collaboration with Wyeth. Other in-licensed technologies, such as the GnRH receptor we license from Mount Sinai School of Medicine and melanocortin subtype 4 we license from the University of Michigan, will be important for future collaborations for our GnRH and melanocortin programs. If we were to default on our obligations under any of our product licenses, such as our license to indiplon, we could lose some or all of our rights to develop, market and sell the product. Likewise, if we were to lose our rights under a license to use proprietary research tools, it could adversely affect our existing collaborations or adversely affect our ability to form new collaborations. We also face the risk that our licensors could, for a number of reasons, lose patent protection or lose their rights to the technologies we have licensed, thereby impairing or extinguishing our rights under our licenses with them.

Because the development of our product candidates is subject to a substantial degree of technological uncertainty, we may not succeed in developing any of our product candidates.

All of our product candidates are in research or development and we do not expect any of our product candidates to be commercially available within a year, if at all. Only a small number of research and development programs ultimately result in commercially successful drugs. Potential products that appear to be promising at early stages of development may not reach the market for a number of reasons. These reasons include the possibilities that the potential products may:

- be found ineffective or cause harmful side effects during preclinical studies or clinical trials;
- fail to receive necessary regulatory approvals on a timely basis or at all;
- be precluded from commercialization by proprietary rights of third parties;
- be difficult to manufacture on a large scale; or
- be uneconomical or fail to achieve market acceptance.

If any of our products encounters any of these potential problems, we may never successfully market that product.

We are currently conducting Phase III clinical trials for indiplon. Since this is our most advanced product program, our business and reputation would be particularly harmed, and our stock price likely would be harmed, if the product does not prove to be efficacious in these clinical trials or we fail to receive necessary regulatory approvals on a timely basis or achieve market acceptance.

We have no marketing experience, sales force or distribution capabilities, and if our products are approved, we may not be able to commercialize them successfully.

Although we do not currently have any marketable products, our ability to produce revenues ultimately depends on our ability to sell our products if and when they are approved by the FDA. We currently have no experience in marketing or selling pharmaceutical products. We are currently initiating marketing activities for indiplon by hiring staff with experience in pharmaceutical sales, marketing and distribution. We will rely on Pfizer to co-promote indiplon with us in the United States and rely exclusively on Pfizer to market indiplon outside of the United States.

We will also rely on Pfizer to provide distribution, customer service, order entry, shipping, billing, customer reimbursement assistance and managed care sales support related to indiplon. If we fail to establish successful marketing and sales capabilities or fail to enter into successful marketing arrangements with third parties, our product revenues will suffer.

The independent clinical investigators and contract research organizations that we rely upon to conduct our clinical trials may not be diligent, careful or timely, and may make mistakes, in the conduct of our trials.

We depend on independent clinical investigators and contract research organizations, or CROs, to conduct our clinical trials under their agreements with us. The investigators are not our employees, and we cannot control the amount or timing of resources that they devote to our programs. If independent investigators fail to devote sufficient time and resources to our drug development programs, or if their performance is substandard, it will delay the approval of our FDA applications and our introductions of new drugs. The CROs we contract with for execution of our clinical trials play a significant role in the conduct of the trials and the subsequent collection and analysis of data. Failure of the CROs to meet their obligations could adversely affect clinical development of our products. Moreover, these independent investigators and CROs may also have relationships with other commercial entities, some of which may compete with us. If independent investigators and CROs assist our competitors at our expense, it could harm our competitive position.

We have no manufacturing capabilities. If third-party manufacturers of our product candidates fail to devote sufficient time and resources to our concerns, or if their performance is substandard, our clinical trials and product introductions may be delayed and our costs may rise.

We have in the past utilized, and intend to continue to utilize, third-party manufacturers to produce the drug compounds we use in our clinical trials and for the potential commercialization of our future products. We have no experience in manufacturing products for commercial purposes and do not currently have any manufacturing facilities. Consequently, we depend on several contract manufacturers for all production of products for development and commercial purposes. If we are unable to obtain or retain third-party manufacturers, we will not be

able to commercialize our products. The manufacture of our products for clinical trials and commercial purposes is subject to specific FDA regulations. Our third-party manufacturers might not comply with FDA regulations relating to manufacturing our products for clinical trials and commercial purposes or other regulatory requirements now or in the future. Our reliance on contract manufacturers also exposes us to the following risks:

- contract manufacturers may encounter difficulties in achieving volume production, quality control and quality assurance, and also may experience shortages in qualified personnel. As a result, our contract manufacturers might not be able to meet our clinical schedules or adequately manufacture our products in commercial quantities when required;

- switching manufacturers may be difficult because the number of potential manufacturers is limited. It may be difficult or impossible for us to find a replacement manufacturer quickly on acceptable terms, or at all;

- our contract manufacturers may not perform as agreed or may not remain in the contract manufacturing business for the time required to successfully produce, store or distribute our products;

- drug manufacturers are subject to ongoing periodic unannounced inspection by the FDA, the Drug Enforcement Agency, and corresponding state agencies to ensure strict compliance with good manufacturing practices and other government regulations and corresponding foreign standards. We do not have control over third-party manufacturers' compliance with these regulations and standards; and

- if our primary contract manufacturer should be unable to manufacture indiplon for any reason, or should fail to receive FDA approval or Drug Enforcement Agency approval, commercialization of indiplon could be delayed, which would delay indiplon sales and negatively impact our business.

Our current dependence upon third parties for the manufacture of our products may harm our profit margin, if any, on the sale of our future products and our ability to develop and deliver products on a timely and competitive basis.

If we are unable to retain and recruit qualified scientists or if any of our key senior executives discontinues his or her employment with us, it may delay our development efforts.

We are highly dependent on the principal members of our management and scientific staff. The loss of any of these people could impede the achievement of our development objectives. Furthermore, recruiting and retaining qualified scientific personnel to perform research and development work in the future is critical to our success. We may be unable to attract and retain personnel on acceptable terms given the competition among biotechnology, pharmaceutical and health care companies, universities and non-profit research institutions for experienced scientists. In addition, we rely on members of our Scientific Advisory Board and a significant number of consultants to assist us in formulating our research and development strategy. All of our consultants and members of the Scientific Advisory Board are employed by employers other than us. They may have commitments to, or advisory or consulting agreements with, other entities that may limit their availability to us.

We may be subject to claims that we or our employees have wrongfully used or disclosed alleged trade secrets of their former employers.

As is commonplace in the biotechnology industry, we employ individuals who were previously employed at other biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

Governmental and third-party payors may impose sales and pharmaceutical pricing controls on our products that could limit our product revenues and delay profitability.

The continuing efforts of government and third-party payors to contain or reduce the costs of health care through various means may reduce our potential revenues. These payors' efforts could decrease the price that we receive for any products we may develop and sell in the future. In addition, third-party insurance coverage may not be available to patients for any products we develop. If government and third-party payors do not provide adequate coverage and reimbursement levels for our products, or if price controls are enacted, our product revenues will suffer.

If physicians and patients do not accept our products, we may not recover our investment.

The commercial success of our products, if they are approved for marketing, will depend upon the acceptance of our products as safe and effective by the medical community and patients.

The market acceptance of our products could be affected by a number of factors, including:

- the timing of receipt of marketing approvals;
- the safety and efficacy of the products;
- the success of existing products addressing our target markets or the emergence of equivalent or superior products; and
- the cost-effectiveness of the products.

In addition, market acceptance depends on the effectiveness of our marketing strategy, and, to date, we have very limited sales and marketing experience or capabilities. If the medical community and patients do not ultimately accept our products as being safe and effective, we may not recover our investment.

If we cannot raise additional funding, we may be unable to complete development of our product candidates.

We may require additional funding to continue our research and product development programs, including preclinical testing and clinical trials of our product candidates, for operating expenses and to pursue regulatory approvals for product candidates. We also may require additional funding to establish manufacturing and marketing capabilities in the future. We believe that our existing capital resources, together with interest income, and future payments due under our strategic alliances, will be sufficient to satisfy our current and projected funding requirements for at least the next 12 months. However, these resources might be insufficient to conduct research and development programs as planned. If we cannot obtain adequate funds, we may be required to curtail significantly one or more of our research and development programs or obtain funds through additional arrangements with corporate collaborators or others that may require us to relinquish rights to some of our technologies or product candidates.

Our future capital requirements will depend on many factors, including:

- continued scientific progress in our research and development programs;
- the magnitude of our research and development programs;
- progress with preclinical testing and clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in filing and pursuing patent applications and enforcing patent claims;
- competing technological and market developments;
- the establishment of additional strategic alliances;

- the cost of commercialization activities and arrangements, including manufacturing of our product candidates; and
- the cost of product in-licensing and any possible acquisitions.

We intend to seek additional funding through strategic alliances, and may seek additional funding through public or private sales of our securities, including equity securities. In addition, we have financed capital purchases and may continue to pursue opportunities to obtain additional debt financing in the future. However, additional equity or debt financing might not be available on reasonable terms, if at all, and any additional equity financings will be dilutive to our stockholders.

The price of our common stock is volatile.

The market prices for securities of biotechnology and pharmaceutical companies historically have been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. Over the course of the last 12 months, the price of our common stock has ranged from approximately $42 per share to approximately $70 per share. The market price of our common stock may fluctuate in response to many factors, including:

- the results of our clinical trials;
- developments concerning our strategic alliance agreements;
- announcements of technological innovations or new therapeutic products by us or others;
- developments in patent or other proprietary rights;
- future sales of our common stock by existing stockholders;
- comments by securities analysts;
- general market conditions;
- fluctuations in our operating results;
- government regulation;
- health care reimbursement;
- failure of any of our product candidates, if approved, to achieve commercial success; and
- public concern as to the safety of our drugs.

If any of the risks described in this “Risk Factors” section occurs, it could cause our stock price to fall dramatically and may expose us to class action securities lawsuits which, even if unsuccessful, would be costly to defend and a distraction to management.

Risks Related to Our Industry

We face intense competition, and if we are unable to compete effectively, the demand for our products, if any, may be reduced.

The biotechnology and pharmaceutical industries are subject to rapid and intense technological change. We face, and will continue to face, competition in the development and marketing of our product candidates from academic institutions, government agencies, research institutions and biotechnology and pharmaceutical companies. Competition may also arise from, among other things:

- other drug development technologies;
- methods of preventing or reducing the incidence of disease, including vaccines; and
- new small molecule or other classes of therapeutic agents.

Developments by others may render our product candidates or technologies obsolete or noncompetitive.

We are performing research on or developing products for the treatment of several disorders including insomnia, anxiety, depression, various female and male disorders, multiple sclerosis, diabetes and other neuro-endocrine related diseases and disorders, and there are a number of competitors to products in our research pipeline. If one or more of our competitors' products or programs are successful, the market for our products may be reduced or eliminated.

Compared to us, many of our competitors and potential competitors have substantially greater:

- capital resources;
- research and development resources, including personnel and technology;
- regulatory experience;
- preclinical study and clinical testing experience;
- manufacturing and marketing experience; and
- production facilities.

Any of these competitive factors could reduce demand for our products.

If we are unable to protect our intellectual property, our competitors could develop and market products based on our discoveries, which may reduce demand for our products.

Our success will depend on our ability to, among other things:

- obtain patent protection for our products;
- preserve our trade secrets;
- prevent third parties from infringing upon our proprietary rights; and
- operate without infringing upon the proprietary rights of others, both in the United States and internationally.

Because of the substantial length of time and expense associated with bringing new products through the development and regulatory approval processes in order to reach the marketplace, the pharmaceutical industry

places considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. Accordingly, we intend to seek patent protection for our proprietary technology and compounds. However, we face the risk that we may not obtain any of these patents and that the breadth of claims we obtain, if any, may not provide adequate protection of our proprietary technology or compounds.

We also rely upon unpatented trade secrets and improvements, unpatented know-how and continuing technological innovation to develop and maintain our competitive position, which we seek to protect, in part, by confidentiality agreements with our commercial collaborators, employees and consultants. We also have invention or patent assignment agreements with our employees and some, but not all, of our commercial collaborators and consultants. However, if our employees, commercial collaborators or consultants breach these agreements, we may not have adequate remedies for any such breach, and our trade secrets may otherwise become known or independently discovered by our competitors.

In addition, although we own a number of patents, the issuance of a patent is not conclusive as to its validity or enforceability, and third parties may challenge the validity or enforceability of our patents. We cannot assure you how much protection, if any, will be given to our patents if we attempt to enforce them and they are challenged in court or in other proceedings. It is possible that a competitor may successfully challenge our patents or that challenges will result in limitations of their coverage. Moreover, competitors may infringe our patents or successfully avoid them through design innovation. To prevent infringement or unauthorized use, we may need to file infringement claims, which are expensive and time-consuming. In addition, in an infringement proceeding a court may decide that a patent of ours is not valid or is unenforceable, or may refuse to stop the other party from using the technology at issue on the ground that our patents do not cover its technology. Interference proceedings declared by the United States Patent and Trademark Office may be necessary to determine the priority of inventions with respect to our patent applications or those of our licensors. Litigation or interference proceedings may fail and, even if successful, may result in substantial costs and be a distraction to management. We cannot assure you that we will be able to prevent misappropriation of our proprietary rights, particularly in countries where the laws may not protect such rights as fully as in the United States.

The technologies we use in our research as well as the drug targets we select may infringe the patents or violate the proprietary rights of third parties.

We cannot assure you that third parties will not assert patent or other intellectual property infringement claims against us or our collaboration partners with respect to technologies used in potential products. Any claims that might be brought against us relating to infringement of patents may cause us to incur significant expenses and, if successfully asserted against us, may cause us to pay substantial damages. Even if we were to prevail, any litigation could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. Furthermore, if a patent infringement suit were brought against us or our collaboration partners, we or our collaboration partners could be forced to stop or delay developing, manufacturing or selling potential products that are claimed to infringe a third party's intellectual property unless that party grants us or our collaboration partners rights to use its intellectual property. In such cases, we could be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products. However, we may not be able to obtain any licenses required under any patents or proprietary rights of third parties on acceptable terms, or at all. Even if our collaboration partners or we were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

We face potential product liability exposure far in excess of our limited insurance coverage.

The use of any of our potential products in clinical trials, and the sale of any approved products, may expose us to liability claims. These claims might be made directly by consumers, health care providers, pharmaceutical companies or others selling our products. We have obtained limited product liability insurance coverage for our clinical trials in the amount of $10 million per occurrence and $10 million in the aggregate. However, our insurance may not reimburse us or may not be sufficient to reimburse us for any expenses or losses we may suffer. Moreover, insurance coverage is becoming increasingly expensive, and we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. We intend to expand our

insurance coverage to include the sale of commercial products if we obtain marketing approval for product candidates in development, but we may be unable to obtain commercially reasonable product liability insurance for any products approved for marketing. On occasion, juries have awarded large judgments in class action lawsuits based on drugs that had unanticipated side effects. A successful product liability claim or series of claims brought against us would decrease our cash reserves and could cause our stock price to fall.

Our activities involve hazardous materials and we may be liable for any resulting contamination or injuries.

Our research activities involve the controlled use of hazardous materials. We cannot eliminate the risk of accidental contamination or injury from these materials. If an accident occurs, a court may hold us liable for any resulting damages, which may reduce our cash reserves and force us to seek additional financing.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

A discussion of our exposure to, and management of, market risk appears in Part I, Item 2 of this Quarterly Report on Form 10-Q under the heading "Interest Rate Risk."

ITEM 4. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the timelines specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decision regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the quarter covered by this report. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II: OTHER INFORMATION

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

(A) The Company's Annual Meeting of Stockholders was held on May 26, 2004 (the "Annual Meeting").

(B) The following Class II Directors were elected at the Annual Meeting:

Name	Position	Term Expires
Richard F. Pops	Class II Director	2007
Stephen A. Sherwin, M.D.	Class II Director	2007

The following Directors continue to serve their respective terms which expire on the Company's Annual Meeting of Stockholders in the year as noted:

Name	Position	Term Expires
Lawrence Steinman, M.D.	Class III Director	2005
Gary A. Lyons	Class III Director	2005
Corinne H. Lyle	Class II Director	2007
Joseph A. Mollica, Ph.D.	Class I Director	2006
Wylie W. Vale, Ph.D.	Class I Director	2006
W. Thomas Mitchell	Class I Director	2006

(C) At the Annual Meeting, stockholders voted on three matters: (i) the election of two Class II Directors for a term of three years expiring in 2006, (ii) the approval of an amendment to of the Company's 2003 Incentive Stock Plan to increase the number of shares of common stock reserved for issuance thereunder from 1,100,000 shares to 2,300,000 shares, and (iii) the ratification of the appointment of Ernst & Young LLP as the Company's independent auditors for the fiscal year ending December 31, 2004. The voting results were as follows:

(i) The election of two Class II Directors for a term of three years:

Richard F. Pops	For 29,621,574	Withhold 1,757,103
Stephen A. Sherwin, M.D.	For 29,910,759	Withhold 1,467,918

(ii) Approval of the amendment to the Company's 2003 Incentive Stock Plan to increase the number of shares of common stock reserved for issuance thereunder from 1,100,000 shares to 2,300,000 shares and the reservation of 2,300,000 of shares of common stock reserved for issuance, thereunder:

For 16,780,301	Against 10,698,472	Abstain 11,477

(iii) Ratification of the appointment of Ernst & Young, LLP as independent auditors for the fiscal year ending December 31, 2004:

For 30,073,534	Against 1,302,512	Abstain 2,631

ITEM 5. OTHER INFORMATION

On June 9, 2004, the Company announced the appointment of Corinne H. Lyle to the Board of Directors of Neurocrine Biosciences, Inc. She is the current Corporate Vice President, Chief Financial Officer and Treasurer of Edwards Lifesciences Corporation.

During the second quarter of 2004, D. Bruce Campbell, Senior Vice President of International Development announced his retirement from Neurocrine Biosciences, Inc. effective July 31, 2004.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(A) EXHIBITS.

3.1	Restated Certificate of Incorporation(1)
3.2	Bylaws(1)
3.3	Certificate of Amendment of Bylaws(1)
3.4	Certificate of Amendment to Bylaws dated May 28, 2004
10.1	2003 Incentive Stock Plan as amended May 25, 2004 and August 2, 2004
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934.
32*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(1)	Incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-03172)
*	These certifications are being furnished solely to accompany this quarterly report pursuant to 18. U.S.C. Section 1350, and are not being filed for purposes of Section 18 of the Securities Exchange Act of 1934 and are not to be incorporated by reference into any filing of Neurocrine Biosciences, Inc., whether made before or after the date hereof, regardless of any general incorporation language in such filing.

(B) REPORTS ON FORM 8-K.

None

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: August 9, 2004

/s/ Paul W. Hawran
Paul W. Hawran
Executive Vice President and Chief Financial Officer
(Duly authorized Officer and Principal Financial Officer)

EXHIBIT 3.4

CERTIFICATE OF AMENDMENT OF BY-LAWS OF NEUROCRINE BIOSCIENCES, INC. (A DELAWARE CORPORATION)

On May 28, 2004 the Board of Directors of Neurocrine Biosciences, Inc. approved the amendment of Section 3.2 of the By-Laws of the corporation to read as follows:

3.2 Number of Directors. The Board of Directors shall consist of eight (8) members. The number of Directors may be changed by an amendment to this by-law adopted by the Board of Directors or by the stockholders or by a duly adopted amendment to the certificate of incorporation. The Directors shall be divided into three classes, with the term of office of the first class (Class I Directors), which will initially consist of three Directors, to expire at the 2006 Annual Meeting of Shareholders; the term of office of the second class (Class II Directors), which will initially consist of three (3) Directors, to expire at the 2008 Annual Meeting of Shareholders; the term of office of the third class (Class III Directors), which will initially consist of two (2) Directors, to expire at the 2005 Annual Meeting of Shareholders; and thereafter for each such term to expire at each third succeeding Annual Meeting of Shareholders held after such election.

EXHIBIT 10.1

NEUROCRINE BIOSCIENCES, INC.

2003 INCENTIVE STOCK PLAN

AS AMENDED MAY 25, 2004 AND AUGUST 2, 2004

1. PURPOSE OF THE PLAN. The purposes of this Incentive Stock Plan are to attract and retain the best available personnel, to provide additional incentive to the employees of Neurocrine Biosciences, Inc. (the "Company") and to promote the success of the Company's business. Options granted hereunder may be either Incentive Stock Options or Nonstatutory Stock Options, at the discretion of the Board and as reflected in the terms of the written option agreement. The Board also has the discretion to grant Restricted Stock Awards and Stock Bonus Awards.

2. DEFINITIONS.

(a) "Award" shall mean any right granted under the Plan, including an Option, a Restricted Stock Award and a Stock Bonus Award.

(b) "Board" shall mean the Committee, if one has been appointed, or the Board of Directors of the Company, if no Committee is appointed.

(c) "Code" shall mean the Internal Revenue Code of 1986, as amended.

(d) "Committee" shall mean the Committee appointed by the Board in accordance with Section 4(a) of the Plan, if one is appointed.

(e) "Common Stock" shall mean the common stock of the Company, par value $.001 per share.

(f) "Company" shall mean Neurocrine Biosciences, Inc.

(g) "Consultant" shall mean any natural person who is engaged by the Company or any Parent or Subsidiary to render bona fide consulting services and is compensated for such consulting services, and any Director whether compensated for such services or not.

(h) "Continuous Status as an Employee or Consultant" shall mean the absence of any interruption or termination of service as an Employee or Consultant, as applicable. Continuous Status as an Employee or Consultant shall not be considered interrupted in the case of sick leave, military leave, or any other leave of absence approved by the Board; provided that such leave is for a period of not more than ninety (90) days or reemployment upon the expiration of such leave is guaranteed by contract or statute.

(i) "Director" means a member of the Board.

(j) "Employee" shall mean any persons, including officers and directors, employed by the Company or any Parent or Subsidiary of the Company. The payment of a director's fee by the Company shall not be sufficient to constitute "employment" by the Company.

(k) "Incentive Stock Option" shall mean an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

(l) "Nonstatutory Stock Option" shall mean an Option not intended to qualify as an Incentive Stock Option.

(m) "Option" shall mean a stock option granted pursuant to the Plan.

(n) "Optioned Stock" shall mean the Common Stock subject to an Option.

(o) "Optionee" shall mean an Employee or Consultant who receives an Option.

(p) "Outside Director" means a Director who is not an Employee.

(q) "Parent" shall mean a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(r) "Performance Criteria" shall mean the following business criteria with respect to the Company, any Subsidiary or any division or operating unit: (a) net income, (b) pre-tax income, (c) operating income, (d) cash flow, (e) earnings per share, (f) return on equity, (g) return on invested capital or assets, (h) cost reductions or savings, (i) funds from operations, (j) appreciation in the fair market value of Common Stock, and (k) earnings before any one or more of the following items: interest, taxes, depreciation or amortization; each as determined in accordance with generally accepted accounting principles or subject to such adjustments as may be specified by the Board.

(s) "Plan" shall mean this 2003 Incentive Stock Plan.

(t) "Purchaser" shall mean an Employee or Consultant who exercises a Restricted Stock Award or receives a Stock Bonus Award.

(u) "Restricted Stock Award" shall mean a right to purchase Common Stock pursuant to Section 11 of the Plan.

(v) "Section 162(m) Participant" shall mean any key Employee designated by the Board as a key Employee whose compensation for the fiscal year in which the key Employee is so designated or a future fiscal year may be subject to the limit on deductible compensation imposed by Section 162(m) of the Code.

(w) "Share" shall mean a share of the Common Stock, as adjusted in accordance with Section 12 of the Plan.

(x) "Stock Bonus Award" shall mean the right to receive a bonus of Common Stock for past services pursuant to Section 12 of the Plan.

(y) "Subsidiary" shall mean a "subsidiary corporation," whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. STOCK SUBJECT TO THE PLAN.

(a) Subject to the provisions of Section 14 of the Plan, the maximum aggregate number of shares under the Plan is two million three hundred thousand (2,300,000) shares of Common Stock. The Shares may be authorized but unissued, or reacquired Common Stock. If an Award should expire or become unexercisable for any reason without having been exercised in full, then the unpurchased Shares which were subject thereto shall, unless the Plan shall have been terminated, become available for future grant or sale under the Plan. Notwithstanding any other provision of the Plan, shares issued under the Plan and later repurchased by the Company shall not become available for future grant or sale under the Plan.

(b) The following limitations shall apply to grants of Awards to Employees:

(i) No Employee shall be granted, in any fiscal year of the Company, Awards pursuant to which more than an aggregate of two hundred and fifty thousand (250,000) Shares are issuable to such Employee.

(ii) In connection with his or her initial employment, an Employee may be granted Awards to purchase and/or receive up to an additional two hundred and fifty thousand (250,000) Shares which shall not count against the limit set forth in subsection (i) above.

(iii) The foregoing limitations shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 14.

(iv) If an Option is canceled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 14), the canceled Option shall be counted against the limit set forth in subsection (i) above.

4. ADMINISTRATION OF THE PLAN.

(a) Procedure.

(i) Multiple Administrative Bodies. The Plan may be administered by different Committees with respect to different groups of Employees and Consultants.

(ii) Section 162(m). To the extent that the Board determines it to be desirable to qualify Awards granted hereunder as "performance-based compensation"

within the meaning of Section 162(m) of the Code, the Plan shall be administered by a Committee of two or more "outside directors" within the meaning of Section 162(m) of the Code.

(iii) Rule 16b-3. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder shall be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) Other Administration. Other than as provided above, the Plan shall be administered by (A) the Board or (B) a Committee, which committee shall be constituted to satisfy applicable laws.

(b) Powers of the Board. Subject to the provisions of the Plan, the Board shall have the authority, in its discretion: (i) to grant Incentive Stock Options, Nonstatutory Stock Options, Restricted Stock Awards or Stock Bonus Awards; (ii) to determine, upon review of relevant information and in accordance with Section 7 of the Plan, the fair market value of the Common Stock; (iii) to determine the exercise price per share of each Award to be granted, if any, which exercise price shall be determined in accordance with Section 7 of the Plan; (iv) to determine the Employees or Consultants to whom, and the time or times at which, Awards shall be granted and, subject to the limitations of Section 3(b) above, the number of shares to be represented by each Award; (v) to interpret the Plan; (vi) to prescribe, amend and rescind rules and regulations relating to the Plan; (vii) to determine the terms and provisions of each Award granted (which need not be identical) and, with the consent of the holder thereof, modify or amend any provisions (including provisions relating to exercise price) of any Award; (viii) to accelerate or defer (with the consent of the Optionee) the exercise date of any Option, consistent with the provisions of Section 5 of the Plan; (ix) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Award previously granted by the Board; (x) to allow Optionees to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Award that number of Shares having a fair market value equal to the statutory minimum amount required to be withheld. The fair market value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by an Award holder to have Shares withheld for this purpose shall be made in such form and under such conditions as the Board may deem necessary or advisable; and (xi) to make all other determinations deemed necessary or advisable for the administration of the Plan.

(c) Effect of Board's Decision. All decisions, determinations and interpretations of the Board shall be final and binding on all Optionees, Purchasers and any other holders of any Awards granted under the Plan.

(d) Provisions Applicable to Section 162(m) Participants.

(i) The Board, in its discretion, may determine whether an Award is to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code.

(ii) Notwithstanding anything in the Plan to the contrary, the Board may grant any Award to a Section 162(m) Participant, including a Restricted Stock Award or Stock Bonus Award the restrictions with respect to which lapse upon the attainment of performance goals which are related to one or more of the Performance Criteria.

(iii) To the extent necessary to comply with the performance-based compensation requirements of Section 162(m)(4)(C) of the Code, with respect to any Restricted Stock Award or Stock Bonus Award granted under the Plan to one or more Section 162(m) Participants, no later than ninety (90) days following the commencement of any fiscal year in question or any other designated fiscal period or period of service (or such other time as may be required or permitted by Section 162(m) of the Code), the Board shall, in writing, (i) designate one or more Section 162(m) Participants, (ii) select the Performance Criteria applicable to the fiscal year or other designated fiscal period or period of service, (iii) establish the various performance targets, in terms of an objective formula or standard, and amounts of such Restricted Stock Awards and Stock Bonus Awards, as applicable, which may be earned for such fiscal year or other designated fiscal period or period of service, and (iv) specify the relationship between Performance Criteria and the performance targets and the amounts of such Restricted Stock Awards and Stock Bonus Awards, as applicable, to be earned by each Section 162(m) Participant for such fiscal year or other designated fiscal period or period of service. Following the completion of each fiscal year or other designated fiscal period or period of service, the Board shall certify in writing whether the applicable performance targets have been achieved for such fiscal year or other designated fiscal period or period of service. In determining the amount earned by a Section 162(m) Participant, the Board shall have the right to reduce (but not to increase) the amount payable at a given level of performance to take into account additional factors that the Board may deem relevant to the assessment of individual or corporate performance for the fiscal year or other designated fiscal period or period of service.

(iv) Furthermore, notwithstanding any other provision of the Plan, any Award which is granted to a Section 162(m) Participant and is intended to qualify as performance-based compensation as described in Section 162(m)(4)(C) of the Code shall be subject to any additional limitations set forth in Section 162(m) of the Code (including any amendment to Section 162(m) of the Code) or any regulations or rulings issued thereunder that are requirements for qualification as performance-based compensation as described in Section 162(m)(4)(C) of the Code, and the Plan shall be deemed amended to the extent necessary to conform to such requirements.

5. ELIGIBILITY.

(a) Awards may be granted to Employees and Consultants, provided that Incentive Stock Options may only be granted to Employees. An Employee or Consultant who has been granted an Award may, if such Employee or Consultant is otherwise eligible, be granted additional Awards.

Each Outside Director shall be eligible to be automatically granted Options at the times and in the manner set forth in Section 10.

(b) Each Option shall be designated in the written option agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate fair market value of the Shares with respect to which Options designated as Incentive Stock Options are exercisable for the first time by any Optionee during any calendar year (under all plans of the Company) exceeds one hundred thousand dollars ($100,000), such Options shall be treated as Nonstatutory Stock Options.

(c) For purposes of Section 5(b), Options shall be taken into account in the order in which they were granted, and the fair market value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

(d) The Plan shall not confer upon any Optionee or Purchaser any right with respect to continuation of employment by or the rendition of consulting services to the Company, nor shall it interfere in any way with his or her right or the Company's right to terminate his or her employment or services at any time, with or without cause.

6. TERM OF PLAN. The Plan shall become effective upon the earlier to occur of its adoption by the Board or its approval by vote of holders of a majority of the outstanding shares of the Company entitled to vote on the adoption of the Plan. It shall continue in effect until terminated under Section 15 of the Plan. Notwithstanding the foregoing, no Incentive Stock Option may be granted under this Plan after the first to occur of (a) the expiration of ten (10) years from the date the Plan is adopted by the Board or (b) the expiration of ten (10) years from the date the Plan is approved by the Company's stockholders under Section 20.

7. EXERCISE PRICE AND CONSIDERATION.

(a) The per Share exercise price for the Shares to be issued pursuant to exercise of an Option shall be no less than one hundred percent (100%) of the fair market value per Share on the date of grant; provided, however, that in the case of an Incentive Stock Option granted to an Employee who, at the time of grant of such Incentive Stock Option, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than one hundred and ten percent (110%) of the fair market value per Share on the date of grant. Notwithstanding the foregoing, Options may be granted with a per Share exercise price of less than one hundred percent (100%) of the fair market value per Share on the date of grant pursuant to a merger or other corporate transaction.

(b) The fair market value shall be determined by the Board in its discretion; provided, however, that where there is a public market for the Common Stock, the fair market value per Share shall be the mean of the bid and asked prices (or the closing price per share if the Common Stock is listed on the National Association of Securities Dealers Automated Quotation ("NASDAQ") National Market System) of the Common Stock for the date of grant, as reported in the Wall Street Journal (or, if not so reported, as otherwise reported by the NASDAQ System) or, in the event the

Common Stock is listed on a stock exchange, the fair market value per Share shall be the closing price on such exchange on the date of grant of the Option or Restricted Stock Award, as reported in the Wall Street Journal.

(c) The consideration to be paid for the Shares to be issued upon exercise of an Award, including the method of payment, shall be determined by the Board (and in the case of an Incentive Stock Option, shall be determined at the time of grant) and to the extent permitted under applicable laws may consist entirely of cash, check, promissory note, other Shares of Common Stock which (i) either have been owned by the Optionee for more than six (6) months on the date of surrender or were not acquired directly or indirectly, from the Company, and (ii) have a fair market value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised, or any combination of such methods of payment, or such other consideration and method of payment for the issuance of Shares to the extent permitted under applicable law.

8. TERM OF OPTION. The term of each Option shall be the term stated in the Option Agreement; provided, however, that the term shall be no more than ten (10) years from the date of grant thereof. In the case of an Incentive Stock Option granted to an Optionee who, at the time the Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Option shall be five (5) years from the date of grant thereof or such shorter term as may be provided in the Option Agreement.

9. EXERCISE OF OPTION.

(a) Procedure for Exercise; Rights as a Shareholder.

(i) Any Option granted hereunder shall be exercisable at such times and under such conditions as determined by the Board, including performance criteria with respect to the Company and/or the Optionee, and as shall be permissible under the terms of the Plan.

(ii) An Option may not be exercised for a fraction of a Share.

(iii) An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may, as authorized by the Board, consist of any consideration and method of payment allowable under Section 7 of the Plan. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a stockholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. Upon an Optionee's request, the Company shall issue (or cause to be issued) such stock certificate promptly upon exercise of the Option. To the extent an Option designated as an

Incentive Stock Option at grant that is treated as the exercise of a Nonstatutory Stock Option pursuant to Section 5(b), the Company shall issue a separate stock certificate evidencing the Shares treated as acquired upon exercise of an Incentive Stock Option and a separate stock certificate evidencing the Shares treated as acquired upon exercise of a Nonstatutory Stock Option and shall identify each such certificate accordingly in its stock transfer records. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 14 of the Plan.

(iv) Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) Termination of Status as an Employee or Consultant. In the event of termination of an Optionee's Continuous Status as an Employee or Consultant (as the case may be), such Optionee may, but only within such period of time as is determined by the Board, with such determination in the case of an Incentive Stock Option not exceeding three (3) months and in the case of Nonstatutory Stock Option not exceeding six (6) months after the date of termination (provided that such period shall be three (3) months in the case of an Option granted to an Outside Director pursuant to Section 10), with such determination in the case of an Incentive Stock Option being made at the time of grant of the Option, exercise the Option to the extent that such Employee or Consultant was entitled to exercise it at the date of such termination (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement). To the extent that such Employee or Consultant was not entitled to exercise the Option at the date of such termination, or if such Employee or Consultant does not exercise such Option (which such Employee or Consultant was entitled to exercise) within the time specified herein, the Option shall terminate.

(c) Disability of Optionee. Notwithstanding the provisions of Section 8(b) above, in the event of termination of an Optionee's Continuous Status as an Employee or Consultant as a result of such Employee's or Consultant's total and permanent disability (as defined in Section 22(e)(3) of the Code), such Employee or Consultant may, but only within six (6) months (twelve (12) months in the case of an Option granted to an Outside Director pursuant to Section 10) (or such other period of time not exceeding twelve (12) months as in determined by the Board, with such determination in the case of an Incentive Stock Option being made at the time of grant of the Option) from the date of such termination (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), exercise the Option to the extent the right to exercise would have accrued had the Optionee continued Continuous Status as an Employee or Consultant for a period of six (6) months following termination of Continuous Status by reason of disability. To the extent that such Employee or Consultant was not entitled to exercise an Option in this period, or if such Employee or Consultant does not exercise such Option (which such Employee or Consultant was entitled to exercise) within the time specified herein, the Option shall terminate.

(d) Retirement of Optionee. Notwithstanding the provisions of Section 9(b) above, in the event of termination of an Employee Optionee's Continuous Status as an Employee as a result of such Employee's retirement from the Company at age fifty five (55) or greater after having Continuous Status for (5) years or more, all Options held by such Optionee shall vest and such Employee may, but only within three (3) years from the date of such termination (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), exercise the Option to the extent such Employee was entitled to exercise it at the date of such termination.

(e) Death of Optionee. In the event of the death of an Optionee:

(i) during the term of the Option who is at the time of his or her death an Employee or Consultant of the Company and who shall have been in Continuous Status as an Employee or Consultant since the date of grant of the Option, the Option may be exercised, at any time within six (6) months (twelve (12) months in the case of an Option granted to an Outside Director pursuant to Section 10) (or at such later time as may be determined by the Board but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent that the right to exercise would have accrued had the Optionee continued living and remained in Continuous Status as an Employee or Consultant six (6) months (or such other period of time as in determined by the Board) after the date of death; or

(ii) within thirty (30) days (or such other period of time not exceeding three (3) months as is determined by the Board, with such determination in the case of an Incentive Stock Option being made at the time of grant of the Option) after the termination of Continuous Status as an Employee or Consultant, the Option may be exercised, at any time within six (6) months (twelve (12) months in the case of an Option granted to an Outside Director pursuant to Section 10) (or such other period of time as is determined by the Board at the time of grant of the Option) following the date of death (but in no event later than the date of expiration of the term of such Option as set forth in the Option Agreement), by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but only to the extent that the right to exercise that had accrued at the date of termination.

10. AUTOMATIC GRANTING OF OPTIONS TO OUTSIDE DIRECTORS.

(a) First Option Grants. Unless otherwise determined by the Board, each new Outside Director shall be automatically granted an Option to purchase twenty thousand (20,000) Shares (a "First Option") on the date on which such person first becomes a Director, whether through election by the stockholders of the Company or appointment by the Board to fill a vacancy.

(b) Subsequent Option Grants. Unless otherwise determined by the Board, each Outside Director and the Chairman of the Board of Directors shall be automatically granted an annual Option (a "Subsequent Option") to purchase, in the case of an Outside Director, twelve thousand (12,000) Shares, and in the case of the Chairman of the Board of Directors, fifteen thousand (15,000) Shares, each on the date of each annual meeting of the stockholders of the Company, if on such date, he or she shall have served on the Board for at least six (6) months.

(c) Terms of Options Granted to Outside Directors. Options granted to Outside Directors pursuant to this Section 10 shall have a per Share exercise price of no less than one hundred percent (100%) of the fair market value per Share on the date of grant. Subject to Section 9, the term of each Option granted to an Outside Director pursuant to this Section 10 shall be ten (10) years from the date of grant thereof. First Options and Subsequent Options shall become exercisable in cumulative monthly installments of 1/12 of the Shares subject to such Option on each of the monthly anniversaries of the date of grant of the Option, commencing with the first such monthly anniversary, such that each such Option shall be one hundred percent (100%) vested on the first anniversary of its date of grant.

11. RESTRICTED STOCK AWARDS.

(a) Rights to Purchase. After the Board determines that it will offer an Employee or Consultant a Restricted Stock Award, it shall deliver to the offeree a stock purchase agreement setting forth the terms, conditions and restrictions relating to the offer. Such agreement shall further specify the number of Shares which such person shall be entitled to purchase, and the time within which such person must accept such offer, which shall in no event exceed six (6) months from the date upon which the Board or its Committee made the determination to grant the Restricted Stock Award. The offer shall be accepted by execution of a stock purchase agreement in the form determined by the Board.

(b) Purchase Price. The Board shall establish the purchase price, if any, and form of payment for each Restricted Stock Award; provided, however, that such purchase price shall be no less than one hundred percent (100%) of the fair market value per Share on the date of grant; provided, further, however, that the purchase price per Share may be reduced on a dollar-for-dollar basis to the extent the Restricted Stock Award is granted to the Purchaser in lieu of cash compensation otherwise payable to the Purchaser. In all cases, legal consideration shall be required for each issuance of a Restricted Stock Award.

(c) Issuance of Shares. Forthwith after payment therefor, the Shares purchased shall be duly issued; provided, however, that the Board may require that the Purchaser make adequate provision for any Federal and State withholding obligations of the Company as a condition to the Purchaser purchasing such Shares.

(d) Repurchase Option. Unless the Board determines otherwise, the stock purchase agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the Purchaser's employment with the Company for any reason (including death or disability). Subject to applicable laws, if the Board so determines, the purchase price for

shares repurchased may be paid by cancellation of any indebtedness of the Purchaser to the Company. Subject to Section 4(d) with respect to Restricted Stock Awards granted to Section 162(m) Participants, the repurchase option shall lapse at such rate as the Board may determine.

(e) Other Provisions. The stock purchase agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Board.

12. STOCK BONUS AWARDS.

(a) Terms of Award. After the Board determines that it will offer an Employee or Consultant a Stock Bonus Award, it shall deliver to the offeree a stock bonus agreement setting forth the terms, conditions and restrictions relating to the offer and the number of shares to be awarded. The offer shall be accepted by execution of a stock bonus agreement in the form determined by the Board.

(b) Purchase Price. The Board shall establish the purchase price, if any, and form of payment for each Stock Bonus Award; provided, however, that such purchase price shall be no less than one hundred percent (100%) of the fair market value per Share on the date of grant; provided, further, however, that the purchase price per Share may be reduced on a dollar-for-dollar basis to the extent the Stock Bonus Award is granted to the Purchaser in lieu of cash compensation otherwise payable to the Purchaser.

(c) Issuance of Shares. Forthwith after payment therefor, the Shares purchased shall be duly issued; provided, however, that the Board may require that the Purchaser make adequate provision for any Federal and State withholding obligations of the Company as a condition to the Purchaser purchasing such Shares.

(d) Repurchase Option. Unless the Board determines otherwise, the stock bonus agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the Purchaser's employment with the Company for any reason (including death or disability). Subject to applicable laws, if the Board so determines, the purchase price for shares repurchased may be paid by cancellation of any indebtedness of the Purchaser to the Company. Subject to Section 4(d) with respect to Stock Bonus Awards granted to Section 162(m) Participants, the repurchase option shall lapse at such rate as the Board may determine.

(e) Other Provisions. The stock bonus agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Board.

13. NON-TRANSFERABILITY OF AWARDS. Unless determined otherwise by the Board, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Optionee, only by the Optionee. If the Board makes an Award transferable, such Award shall contain such additional terms and conditions as the Board deems appropriate.

14. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION OR MERGER.

(a) Changes in Capitalization. Subject to any action by the Company required by applicable law or regulations or the requirements of the Nasdaq Stock Market or an established stock exchange on which the Company's securities are traded, and subject to Section 14(d), the number and kind of shares of Common Stock (or other securities or property) covered by each outstanding Award, and the number and kind of shares of Common Stock (or other securities or property) which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of Common Stock (or other securities or property) covered by each such outstanding Award, shall be adjusted proportionately to the extent the Board determines that any increase, decrease or adjustment in the number or kind of issued shares of Common Stock (or other securities or property), dividend, distribution, stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, reorganization, merger, consolidation, split-up, repurchase, liquidation, dissolution, or sale, transfer, exchange or other disposition of all or substantially all of the assets of the Company, exchange of Common Stock or other securities of the Company, or other similar corporate transaction or event, in the Board's sole discretion, affects the Common Stock such that an adjustment is determined by the Board to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan or with respect to an Award. Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Board shall notify the Optionee or Purchaser at least fifteen (15) days prior to such proposed action. To the extent it has not been previously exercised, the Award shall terminate immediately prior to the consummation of such proposed action.

(c) Merger or Asset Sale. In the event of a merger, sale of all or substantially all of the assets of the Company, tender offer or other transaction or series of related transactions resulting in a change of ownership of more than fifty percent (50%) of the voting securities of the Company ("Change in Control") approved by the majority of the members of the Board on the Board prior to the commencement of such Change in Control, each outstanding Option shall be assumed or an equivalent option or right substituted by the successor corporation or a Parent or Subsidiary of the successor corporation; provided, however, in the event that within one year of the date of the completion of the Change in Control, the successor corporation or a Parent or Subsidiary of the successor corporation terminates the employment of an Optionee without Cause (as defined below), such Optionee shall fully vest in and have the right to exercise the options assumed or substituted for the Option as to all of the Optioned Stock, including Shares as to which it would not otherwise be exercisable. In the event that the successor corporation refuses to assume or substitute for the Option, the Optionee shall fully vest in and have the right to exercise the Option as to all of the Optioned Stock, including Shares as to which it would not otherwise be exercisable. If an Option becomes fully vested and exercisable in lieu of assumption or substitution in the event of a Change

of Control, the Board shall notify the Optionee in writing or electronically that the Option shall be fully vested and exercisable for a period of fifteen (15) days from the date of such notice, and the Option shall terminate upon the expiration of such period. For the purposes of this paragraph, the Option shall be considered assumed if, following the Change of Control, the option confers the right to purchase, for each Share of Optioned Stock subject to the Option immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) received in the Change of Control by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the Change of Control is not solely common stock of the successor corporation or its Parent, the Board may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option, for each Share of Optioned Stock subject to the Option, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the Change of Control. For purposes of this paragraph, termination shall be for "Cause" in the event of the occurrence of any of the following: (a) any intentional action or intentional failure to act by employee which was performed in bad faith and to the material detriment of the successor corporation or its Parent or Subsidiary; (b) employee willfully and habitually neglects the duties of employment; or (c) employee is convicted of a felony crime involving moral turpitude, provided that in the event that any of the foregoing events is capable of being cured, the successor corporation or its Parent or Subsidiary shall provide written notice to the employee describing the nature of such event and the employee shall thereafter have five (5) business days to cure such event.

In the event of a Change in Control which is not approved by the majority of the members of the Board on the Board prior to the commencement of a Change in Control, each Optionee shall fully vest in and have the right to exercise all outstanding Options as to all of the Optioned Stock, including Shares as to which it would not otherwise be exercisable.

(d) With respect to Awards which are granted to Section 162(m) Participants and are intended to qualify as performance-based compensation under Section 162(m)(4)(C), no adjustment or action described in this Section 14 or in any other provision of the Plan shall be authorized to the extent that such adjustment or action would cause such Award to fail to so qualify under Section 162(m)(4)(C), or any successor provisions thereto.

15. DATE OF GRANTING AWARDS. The date of grant of an Award shall, for all purposes, be the date on which the Board makes the determination granting such Award. Notice of the determination shall be given to each Employee or Consultant to whom an Award is so granted within a reasonable time after the date of such grant.

16. AMENDMENT AND TERMINATION OF THE PLAN.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend or discontinue the Plan, but no amendment, alteration, suspension or discontinuation shall be made which would impair the rights of any Optionee or Purchaser under any grant theretofore made, without his or her consent. In addition, to the extent necessary and desirable to comply with Section

422 of the Code (or any other applicable laws or regulation, the requirements of the Nasdaq Stock Market or an established stock exchange), the Company shall obtain stockholder approval of any Plan amendment in such a manner and to such a degree as required.

(b) Effect of Amendment or Termination. Any such amendment or termination of the Plan shall not affect Awards already granted, and such Awards shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Optionee or the Purchaser, as applicable, and the Board, which agreement must be in writing and signed by the Optionee or the Purchaser, as applicable, and the Company.

17. CONDITIONS UPON ISSUANCE OF SHARES. Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of the Nasdaq Stock Market or any stock exchange upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned relevant provisions of law.

18. RESERVATION OF SHARES. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

19. AWARD AGREEMENTS. Options shall be evidenced by written option agreements in such form as the Board shall approve. Upon the exercise of a Restricted Stock Award or a Stock Bonus Award, the Purchaser shall sign a stock purchase agreement or stock bonus agreement in such form as the Board shall approve.

20. STOCKHOLDER APPROVAL. Continuance of the Plan shall be subject to approval by the stockholders of the Company within twelve (12) months before or after the date the Plan is adopted. Such stockholder approval shall be obtained in the degree and manner required under applicable laws and the rules of the Nasdaq Stock Market or any stock exchange upon which the Common Stock is listed.

21. TOLLED VESTING DURING LEAVE OF ABSENCE. Unless otherwise determined by the Board, upon an Employee's approved leave of absence (whether sick leave, military leave, personal leave or any other leave pursuant to which an employee's active and continuous service to the Company is interrupted, collectively, a "Leave") the continued vesting of his or her Award shall be subject to this Section 21. In the event of an Employee's Leave, the vesting of any Award granted to such Employee shall continue for the first ninety (90) days of such Leave. To the extent an Employee's Leave continues for more than ninety (90) days and a termination of Continuous Status as an Employee does not occur, the vesting of any Award granted to such Employee shall be tolled during the remainder of such Leave. Upon the Employee's return to service following a Leave, the vesting of any Award granted to such Employee which was tolled during such Leave shall recommence in accordance with the original vesting schedule applicable to such Award; provided that the vesting commencement date of such Award shall be appropriately adjusted to reflect the period for which vesting was tolled."

"COMPANY"

NEUROCRINE BIOSCIENCES, INC., A DELAWARE CORPORATION

By: /s/ Paul W. Hawran
_____

Name: Paul W. Hawran
_____

Title: Executive Vice President and Chief Financial Officer
_____

EXHIBIT 31.1

CERTIFICATION OF CHIEF EXECUTIVE OFFICER PURSUANT
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Gary A. Lyons, President and Chief Executive Officer of Neurocrine Biosciences, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Neurocrine Biosciences, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during this period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of the internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: August 9, 2004

/s/ Gary A. Lyons

Gary A. Lyons
President and Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION OF CHIEF FINANCIAL OFFICER PURSUANT
TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Paul W. Hawran, Executive Vice President and Chief Financial Officer of Neurocrine Biosciences, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Neurocrine Biosciences, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during this period in which this report is being prepared;

   b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of the internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls over financial reporting.

Dated: August 9, 2004

/s/ Paul W. Hawran

Paul W. Hawran
Executive Vice President and
Chief Financial Officer

EXHIBIT 32

CERTIFICATIONS OF
CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Neurocrine Biosciences, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gary A. Lyons, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), of the Securities Exchange Act of 1934; and

(2) That information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 9, 2004

By: /s/ Gary A. Lyons

Name: Gary A. Lyons
Title: President and Chief Executive Officer

In connection with the Quarterly Report of Neurocrine Biosciences, Inc. (the "Company") on Form 10-Q for the period ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul W. Hawran, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

(3) The Report fully complies with the requirements of Section 13(a) or 15(d), of the Securities Exchange Act of 1934; and

(4) That information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

August 9, 2004

By: /s/ Paul W. Hawran

Name: Paul W. Hawran
Title: Executive Vice President and Chief Financial Officer