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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-22705

**NEUROCRINE BIOSCIENCES, INC.**

(Exact name of registrant as specified in its charter)

**DELAWARE**

(State or other jurisdiction of incorporation or organization)

**33-0525145**

(IRS Employer Identification No.)

**12780 EL CAMINO REAL, SAN DIEGO, CALIFORNIA**

(Address of principal executive office)

**92130**

(Zip Code)

**(858) 617-7600**

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of outstanding shares of the registrant's common stock, par value \$0.001 per share, was 39,089,868 as of July 24, 2009.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

NEUROCRINE BIOSCIENCES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(in thousands, except for share information)  
(unaudited)

	June 30, 2009	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 38,615	\$ 68,467
Short-term investments, available-for-sale	14,152	12,006
Receivables under collaborative agreements	3	39
Other current assets	1,014	911
Total current assets	53,784	81,423
Property and equipment, net	4,183	6,191
Long-term investments	21,242	21,057
Restricted cash	6,414	6,409
Other non-current assets	1,246	3,102
Total assets	<u>\$ 86,869</u>	<u>\$ 118,182</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 1,752	\$ 1,599
Accrued liabilities	10,104	10,905
Current portion of deferred revenues	2,921	2,936
Current portion of cease-use liability	15,414	7,870
Current portion of deferred gain on sale of real estate	2,826	2,784
Total current liabilities	33,017	26,094
Deferred revenues	10,216	11,676
Deferred gain on sale of real estate	31,436	32,867
Deferred rent	756	110
Cease-use liability	2,750	7,527
Other liabilities	1,346	3,134
Total liabilities	79,521	81,408
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$0.001 par value; 110,000,000 shares authorized; issued and outstanding shares were 39,089,868 as of June 30, 2009 and 38,598,789 as of December 31, 2008	39	39
Additional paid-in capital	744,479	741,568
Accumulated other comprehensive gain (loss)	1,038	(1,570)
Accumulated deficit	(738,208)	(703,263)
Total stockholders' equity	7,348	36,774
Total liabilities and stockholders' equity	<u>\$ 86,869</u>	<u>\$ 118,182</u>

See accompanying notes to the condensed consolidated financial statements.

**NEUROCRINE BIOSCIENCES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(in thousands, except loss per share data)**  
**(unaudited)**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
<b>Revenues:</b>				
Sponsored research and development	\$ 3	\$ 4	\$ 20	\$ 16
License fees and milestones	730	730	1,460	2,460
Grant revenue	—	—	—	9
Total revenues	<u>733</u>	<u>734</u>	<u>1,480</u>	<u>2,485</u>
<b>Operating expenses:</b>				
Research and development	10,808	16,186	21,656	30,413
General and administrative	4,827	4,665	9,022	12,951
Cease use expense	941	—	5,769	—
Total operating expenses	<u>16,576</u>	<u>20,851</u>	<u>36,447</u>	<u>43,364</u>
Loss from operations	<u>(15,843)</u>	<u>(20,117)</u>	<u>(34,967)</u>	<u>(40,879)</u>
<b>Other income and (expense):</b>				
Gain on sale/disposal of assets	21	164	162	198
Deferred gain on real estate	694	—	1,389	—
Gain (loss) on auction rate securities	230	—	(1,218)	—
Interest income	176	919	530	2,627
Interest expense	—	(1,914)	—	(3,835)
Other expense, net	(558)	(23)	(841)	(159)
Total other income (expense) net	<u>563</u>	<u>(854)</u>	<u>22</u>	<u>(1,169)</u>
Net loss	<u>\$ (15,280)</u>	<u>\$ (20,971)</u>	<u>\$ (34,945)</u>	<u>\$ (42,048)</u>
<b>Net loss per common share:</b>				
Basic and diluted	<u>\$ (0.39)</u>	<u>\$ (0.55)</u>	<u>\$ (0.90)</u>	<u>\$ (1.10)</u>
<b>Shares used in the calculation of net loss per common share:</b>				
Basic and diluted	<u>39,046</u>	<u>38,421</u>	<u>38,858</u>	<u>38,376</u>

See accompanying notes to the condensed consolidated financial statements.

**NEUROCRINE BIOSCIENCES, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(in thousands)**  
**(unaudited)**

	Six Months Ended	
	June 30,	
	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net loss	\$ (34,945)	\$ (42,048)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,850	4,067
Gain on sale of assets	(162)	(198)
Fair value adjustment for auction rate security rights	407	—
Loss (gain) on sale of investments	1,064	(148)
Fair value adjustment for auction rate securities	812	—
Cease-use expense	5,769	—
Deferred gain on sale of real estate	(1,389)	—
Deferred revenues	(1,475)	(1,469)
Deferred rent	646	—
Share-based compensation expense	2,911	4,436
Amortization of premiums/discounts on short term-investments	(3)	14
Change in operating assets and liabilities:		
Accounts receivable and other current assets	(67)	1,835
Other non-current assets	1,999	121
Accounts payable and accrued liabilities	(648)	(9,519)
Cease-use liability	(3,002)	—
Other non-current liabilities	(1,788)	(255)
Net cash used in operating activities	(28,021)	(43,164)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of investments	(15,346)	(19,056)
Sales/maturities of investments	13,200	56,187
Deposits and restricted cash	(5)	(157)
Proceeds from sales of property and equipment	345	450
Purchases of property and equipment, net	(25)	(1,155)
Net cash (used in) provided by investing activities	(1,831)	36,269
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of common stock	—	33
Principal payments on debt	—	(885)
Net cash used in financing activities	—	(852)
Net decrease in cash and cash equivalents	(29,852)	(7,747)
Cash and cash equivalents at beginning of the period	68,467	99,664
Cash and cash equivalents at end of the period	<u>\$ 38,615</u>	<u>\$ 91,917</u>

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. These financial statements should be read in conjunction with the "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Quantitative and Qualitative Disclosures About Market Risk" and the financial statements and notes thereto for the year ended December 31, 2008 and the three months ended March 31, 2009 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008 and the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2009, respectively, filed with the SEC. Certain reclassifications have been made to previously reported amounts to conform to the current period presentation. Further, in connection with preparation of the condensed consolidated financial statements and in accordance with recently issued Statement of Financial Accounting Standards (SFAS) No. 165 "Subsequent Events" (SFAS 165), the Company evaluated subsequent events after the balance sheet date of June 30, 2009 through July 30, 2009.

The terms "Company" and "Neurocrine" are used in this report to refer collectively to Neurocrine Biosciences, Inc. and its subsidiaries.

**2. ORGANIZATION AND SUMMARY OF BUSINESS**

Neurocrine Biosciences, Inc. discovers, develops and intends to commercialize drugs for the treatment of neurological and endocrine-related diseases and disorders. The Company's product candidates address some of the largest pharmaceutical markets in the world, including endometriosis, anxiety, depression, pain, diabetes, benign prostatic hyperplasia, irritable bowel syndrome, and other neurological and endocrine-related diseases and disorders. The Company currently has eight programs in various stages of research and development, including five programs in clinical development. While the Company independently develops many of its own product candidates, Neurocrine is in collaborations with pharmaceutical companies for two of its programs. The Company's lead clinical development program, elagolix, is a drug candidate for the treatment of endometriosis.

**3. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles", a replacement of FASB 162. The FASB Accounting Standards Codification (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect the adoption of SFAS 168 to have a material effect on its consolidated results of operations or financial condition.

In May 2009, the FASB issued SFAS 165 "Subsequent Events". SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material effect on the Company's consolidated results of operations or financial condition.

In April 2009, the FASB issued several pronouncements related to fair value measurement, recording and disclosure in financial reporting.

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FASB Staff Position No. 107-1 and Accounting Principles Board (APB) 28-1, "Interim Disclosures about Fair Value of Financial Instruments," were issued to outline the required financial statement disclosures relating to fair value of financial instruments during interim reporting periods. FASB Staff Position No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," was issued to provide additional guidance in evaluating the fair value of a financial instrument when the volume and level of activity for the asset or liability has significantly decreased. FASB Staff Position No. 115-2 and FASB Staff Position No. 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments," were issued to provide additional guidance on presenting impairment losses on securities.

All of the fair value measurement pronouncements were effective for interim and annual reporting periods ending after June 15, 2009. The adoption of these new pronouncements did not have a material effect on the Company's consolidated results of operations or financial condition.

### 4. 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.

### 5. 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 other 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.

The following is a summary of investments classified as available-for-sale securities (in thousands):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains<sup>(1)</sup></u>	<u>Gross Unrealized Losses<sup>(1)</sup></u>	<u>Aggregate Estimated Fair Value</u>
<b>June 30, 2009</b>				
Certificates of deposit	\$ 14,160	\$ —	\$ (8)	\$ 14,152
Auction rate securities	5,258	1,404	—	6,662
Total available-for-sale securities	<u>\$ 19,418</u>	<u>\$ 1,404</u>	<u>\$ (8)</u>	<u>\$ 20,814</u>
<b>December 31, 2008</b>				
Securities of government-sponsored enterprises	\$ 9,919	\$ 80	\$ —	\$ 9,999
Corporate debt securities	2,039	—	(32)	2,007
Auction rate securities	6,689	—	—	6,689
Total available-for-sale securities	<u>\$ 18,647</u>	<u>\$ 80</u>	<u>\$ (32)</u>	<u>\$ 18,695</u>

(1) Unrealized gains and losses are included in other comprehensive loss.



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The amortized cost and estimated fair value of debt securities classified as available-for-sale by contractual maturity at June 30, 2009 and December 31, 2008 are presented below (in thousands):

	Maturing in less than 12 months		Maturing in more than 12 Months	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
<b>June 30, 2009</b>				
Certificates of deposit	\$ 14,160	\$ 14,152	\$ —	\$ —
Auction rate securities classified as available-for-sale	—	—	5,258	6,662
Total available-for-sale securities	<u>\$ 14,160</u>	<u>\$ 14,152</u>	<u>\$ 5,258</u>	<u>\$ 6,662</u>
<b>December 31, 2008</b>				
Securities of government-sponsored enterprises	\$ 9,919	\$ 9,999	\$ —	\$ —
Corporate debt securities	2,039	2,007	—	—
Auction rate securities classified as available-for-sale	—	—	6,689	6,689
Total available-for-sale securities	<u>\$ 11,958</u>	<u>\$ 12,006</u>	<u>\$ 6,689</u>	<u>\$ 6,689</u>

The following table presents certain information related to sales and maturities of investments (in thousands):

	6 months ended June 30, 2009	6 months Ended June 30, 2008
Proceeds from sales/maturities of available-for-sale securities	\$13,200	\$56,187
Gross realized gains on sales of available-for-sale securities <sup>(1)</sup>	—	9
Gross realized losses on sales of available-for-sale securities <sup>(1)</sup>	—	(10)
Gains reclassified out of accumulated other comprehensive loss into earnings	—	9
Losses reclassified out of accumulated other comprehensive loss into earnings	—	(14)
Net unrealized holding gain(loss) on available-for-sale securities included in accumulated other comprehensive income	1,396	48
Gains from trading securities held	6	—
Gains(losses) included in earnings from transfers of securities from available-for-sale to trading	—	—

(1) The cost basis used in calculating gains and losses on sales of available-for-sale securities is determined using the specific identification method.

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The following table presents information about investments in an unrealized loss position (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
<b>June 30, 2009</b>						
Certificates of deposit <sup>(1)</sup>	\$ 10,800	\$ (10)	\$ —	\$ —	\$ 10,800	\$ (10)
Total	<u>\$ 10,800</u>	<u>\$ (10)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 10,800</u>	<u>\$ (10)</u>
<b>December 31, 2008</b>						
Corporate debt securities	\$ 2,007	\$ (32)	\$ —	\$ —	\$ 2,007	\$ (32)
Total	<u>\$ 2,007</u>	<u>\$ (32)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 2,007</u>	<u>\$ (32)</u>

- (1) The Company holds 45 certificates of deposit (“CDs”) at June 30, 2009 that are in an unrealized loss position due to valuations assigned based on market data. All of the Company’s CD holdings are all fully guaranteed by the Federal Deposit Insurance Corporation. The Company has the ability and intent to hold these CDs until a recovery of fair value, which may be at maturity, and therefore does not consider these investments to be other-than-temporarily impaired at June 30, 2009.

## 6. AUCTION RATE SECURITIES

The Company’s long-term investments at June 30, 2009 included (at par value) \$22.6 million of auction rate securities, \$14.6 million of which are maintained by UBS AG (UBS) and \$8.0 million of which are maintained by Citigroup (Citi). With the liquidity issues experienced in global credit and capital markets, these auction rate securities have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders, and as a result, these affected securities are currently not liquid. However, the Company now earns a higher interest rate according to the terms of these securities. All of the Company’s auction rate securities are secured by student loans, which are backed by the full faith and credit of the federal government (up to approximately 98% of the value of the student loan). All of these securities continue to pay interest according to their stated terms (generally 120 basis points over the ninety-one day United States Treasury bill rate) with interest rates resetting every 7 to 28 days. While it is not the Company’s intent to hold these securities until their stated ultimate maturity dates, these investments are scheduled to ultimately mature between 2030 and 2047.

The valuation of the Company’s auction rate securities investment portfolio is subject to uncertainties that are difficult to predict. The fair values of these securities are estimated utilizing a discounted cash flow analysis as of June 30, 2009. The significant assumptions of this valuation model were discount margins ranging from 191 to 491 basis points which are based on industry recognized student loan sector indices, an additional required rate of return of 150 basis points and an estimated term to liquidity of 5.5 to 7.5 years. Other items this analysis considers are the collateralization underlying the security investments, the creditworthiness of the counterparty, and the timing of expected future cash flows. These securities were also compared, when possible, to other observable market data with similar characteristics as the securities held by the Company. Although the auction rate security investments continue to pay interest according to their stated terms, based on valuation models of the individual securities.

During the fourth quarter of 2008, UBS extended an offer of Auction Rate Securities Rights (ARS Rights) to holders of illiquid auction rate securities that were maintained by UBS as of February 13, 2008. The ARS Rights provide the holder with the ability to sell the auction rate securities, along with the ARS Rights, to UBS at the par value of the auction rate securities, during an applicable exercise period. The ARS Rights grant UBS the sole discretion and right to sell or otherwise dispose of auction rate securities at any time up until July 2, 2012, without any prior notification of the holder, so long as the holder receives a payment of par upon any sale or disposition. The ARS Rights are not transferable, not tradeable, and will not be quoted or listed on any securities exchange or any other trading network. The offer period for the ARS Rights closed on November 14, 2008 and ARS Rights were issued by UBS during the fourth quarter of 2008.

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The Company elected to participate in the ARS Rights program for all of its outstanding auction rate securities maintained by UBS. The Company has \$14.6 million (at par value) of auction rate securities that are maintained by UBS. Under the terms of the ARS Rights offer, the applicable exercise period begins on June 30, 2010 and ends July 2, 2012. Additionally, the Company is eligible for a loan of up to 75% of the market value of the auction rate securities, should a loan be needed. It is the Company's intention to sell the auction rate securities and ARS Rights to UBS on June 30, 2010.

The Company has elected to measure the ARS Rights under the fair value option of SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an amendment to FASB Statement No. 115" (SFAS 159) to mitigate volatility in reported earnings due to their linkage to the auction rate securities. The ARS Rights were valued in a similar fashion to the auction rate securities as described above. Simultaneously, due to the ARS Rights granted by UBS, the Company made a one-time election to transfer the related auction rate security holdings from available-for-sale securities to trading securities. The Company anticipates that any changes in the fair value of the ARS Rights will be offset by the changes in the fair value of the related auction rate securities with no material net impact to the consolidated statement of operations. The ARS Rights will continue to be measured at fair value under SFAS 159 until the earlier of their maturity or exercise. At June 30, 2009, the Company valued these ARS Rights at \$1.9 million.

These ARS Rights together with the auction rate securities held at UBS (fair value of \$12.6 million as of June 30, 2009) are carried as long-term investments on the condensed consolidated balance sheet at June 30, 2009. In addition to the election of the fair value option for the ARS Rights, the Company made a one-time election in the fourth quarter of 2008 to transfer the related auction rate security holdings from available-for-sale securities to trading securities. This enabled the changes in the fair value of the ARS Rights to be offset by the changes in the fair value of the related auction rate securities with no material net impact to the condensed consolidated statement of operations.

The Company's remaining auction rate securities that are maintained by Citi continue to be treated as available-for-sale investments. These auction rate securities have a par value of \$8.0 million. During the first three months of 2009, certain ratings agencies downgraded these auction rate securities and the Company recognized an other-than-temporary impairment of \$1.5 million in the consolidated statement of operations for the three months ended March 31, 2009. During the second quarter of 2009, global credit markets improved and credit spreads narrowed resulting in an increase in the fair value of the investments of approximately \$1.4 million which was recorded as an unrealized gain in other comprehensive income as of June 30, 2009. At June 30, 2009, the Company valued these long-term investments at \$6.7 million.

At present, in the event the Company needs to access the funds that are in an illiquid state, the Company may not be able to do so without the possible loss of principal until a future auction for these investments is successful, another secondary market evolves for these securities, they are redeemed by the issuer or they mature. If the Company is unable to sell these securities in the market or they are not redeemed, the Company could be required to hold them to maturity.

Changes to estimates and assumptions used in estimating the fair value of the auction rate securities and related ARS Rights may provide materially different values. In addition, actual market exchanges, if any, may occur at materially different amounts. For example, a reduction of the expected term to redemption assumption by approximately two years for the auction rate securities and related ARS Rights would yield a net increase in the valuation of these investments of \$0.3 million. Other factors that may impact the valuation of the Company's auction rate securities and related ARS Rights include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

## 7. FAIR VALUE MEASUREMENTS

The Company adopted SFAS No. 157, "Fair Value Measurements" (SFAS 157) on January 1, 2008. SFAS 157, among other things, defines fair value, establishes a consistent framework for measuring fair value and expands disclosure for each major asset and liability category measured at fair value on either a recurring or nonrecurring basis. SFAS 157 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, SFAS 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

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Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets measured at fair value as of June 30, 2009 and December 31, 2008 are classified below based on the three fair value hierarchy tiers described above (in millions):

	Carrying Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>June 30, 2009:</b>				
Cash and money market funds	\$ 45.0	\$ 45.0	\$ —	\$ —
Certificates of Deposit <sup>(1)</sup>	14.2	14.2	—	—
Auction rate securities <sup>(2)</sup>	19.3	—	—	19.3
ARS Rights (Note 6)	1.9	—	—	1.9
Total	<u>\$ 80.4</u>	<u>\$ 59.2</u>	<u>\$ —</u>	<u>\$ 21.2</u>
<b>December 31, 2008:</b>				
Cash and money market funds	\$ 64.9	\$ 64.9	\$ —	\$ —
Commercial Paper <sup>(1)</sup>	10.0	10.0	—	—
Corporate debt securities <sup>(1)</sup>	2.0	2.0	—	—
Securities of government-sponsored enterprises <sup>(1)</sup>	10.0	10.0	—	—
Auction rate securities <sup>(2)</sup>	18.7	—	—	18.7
ARS Rights (Note 6)	2.4	—	—	2.4
Total	<u>\$ 108.0</u>	<u>\$ 86.9</u>	<u>\$ —</u>	<u>\$ 21.1</u>

Activity for assets measured at fair value during the six month period ended June 30, 2009 using significant unobservable inputs. (Level 3) is presented in the table below (in millions):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)
Beginning balance as of December 31, 2008	\$ 21.1
Transfers into Level 3	—
Purchases, sales, issuances, and settlements (net)	—
Total unrealized gains included in other comprehensive income	1.4
Total unrealized losses (net) included in other expense	(1.3)
Ending balance as of June 30, 2009	<u>\$ 21.2</u>

(1) Securities are classified as available-for-sale.

(2) The Company transferred a portion of its auction rate securities from available-for-sale to trading in the fourth quarter of 2008. The fair value of these auction rate securities was estimated based on the following: (i) the underlying structure of each security; (ii) the present value of future principal and interest payments discounted at rates considered to reflect current market conditions; (iii) consideration of the probabilities of default, auction failure, or repurchase at par for each period; (iv) the expected term to liquidity; and (v) its market required rate of return.

## 8. IMPAIRMENT OF LONG-LIVED ASSETS

In accordance with SFAS 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 the carrying amount is not recoverable, the Company measures the amount of any impairment by comparing the carrying value of the asset to the present value of the expected future cash flows associated with the use of the asset. The Company has determined that no impairment exists on its long-lived assets.

## 9. SHARE-BASED COMPENSATION

The Company's net loss for the three months ended June 30, 2009 and 2008 included \$1.0 million and \$2.2 million, respectively, of compensation expense related to the Company's share-based compensation awards. The Company's net loss for the six months ended June 30, 2009 and 2008 included \$2.9 million and \$4.4 million, respectively, of compensation expense related to the Company's share-based compensation awards. As of June 30, 2009, total unrecognized estimated compensation cost related to non-vested stock options and non-vested restricted stock units (RSUs) granted prior to that date was \$1.4 million and \$3.2 million, respectively, which is expected to be recognized over a weighted average period of approximately 1.0 and 1.4 years, respectively. The compensation expense related to the Company's share-based compensation arrangements is recorded as components of general and administrative expense and research and development expense. The following is a summary of the components of the Company's compensation expense related to share-based compensation (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
General and administrative	\$0.7	\$1.2	\$1.6	\$2.5
Research and development	0.3	1.0	1.3	1.9

There were no stock option exercises for the six months ended June 30, 2009. Cash received from stock option exercises for the six months ended June 30, 2008 was \$33,000. The Company issued approximately 0.5 million shares of common stock pursuant to the vesting of RSUs and distributions of stock awards from the Company's deferred compensation plan during the six months ended June 30, 2009.

**Stock Option Assumptions**

The exercise price of all options granted during the six month period ended June 30, 2009 and 2008 was equal to the closing price of the Company's common stock on the date of grant. The estimated fair value of each option award granted was determined on the date of grant using the Black-Scholes option valuation model. The following weighted-average assumptions were used for option grants during the three and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Risk-free interest rate	2.34 %	3.36 %	2.34 %	2.65 %
Expected volatility of common stock	83.26 %	67.99 %	83.26 %	68.60 %
Dividend yield	0.0 %	0.0 %	0.0 %	0.0 %
Expected option term	5.35 years	4.75 years	5.35 years	4.75 years

The Company estimates forfeiture rates for options based on past behavior for similar options with further consideration given to the class of employees to whom the options were granted.

## 10. RESTRUCTURING CHARGES

In May 2009, the Company announced a restructuring program to implement cost containment measures and to focus research and development efforts. As a result, the Company reduced its research and development and general and administrative staff in San Diego by approximately 65 employees and incurred a net restructuring charge of approximately \$2.9 million (of which \$2.2 million was classified as research and development expense and \$0.7 million classified as general and administrative expense), which was comprised of salary continuation, outplacement services, and other miscellaneous costs related to this reduction in force. Substantially all of these expenses were paid in cash during the second quarter of 2009. During the first quarter of 2008, the Company also recorded a net charge of \$2.1 million (primarily all general and administrative expense) for severance related to certain executives and other personnel departing the Company.

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As of June 30, 2009, the Company had a remaining balance of approximately \$1.5 million of accrued restructuring expenses included in the condensed consolidated balance sheet. This liability will be paid over the remaining contractual period of certain severance agreements. The changes to the accrued liability for the first six months of 2009 are as follows (in thousands):

	<b>Six Months Ended June 30, 2009</b>
Accrual balance as of January 1, 2009	\$ 1,578
Charge for 2009 restructuring	2,900
Payments	(3,018)
Adjustments	(8)
Accrual balance as of June 30, 2009	<u>\$ 1,452</u>

## 11. REAL ESTATE

Effective December 10, 2008, the Company entered into a First Amendment to Lease (Lease Amendment) with DMH Campus Investors, LLC (DMH). The Company and DMH are parties to a lease agreement, dated December 4, 2007, pursuant to which the Company leases its corporate headquarters, located at 12790 El Camino Real (Front Building) and 12780 El Camino Real (Rear Building) in San Diego, California (Lease). The Lease Amendment provides for the renovation of the Front Building in a manner that facilitates multiple tenant usage and establishes a mechanism for the Company to terminate its use of the Front Building. The Company will continue to occupy the Rear Building.

During the fourth quarter of 2008, the Company vacated the Front Building. In accordance with SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146), a liability of \$15.7 million was recorded for estimated lease termination costs (cease-use liability). Estimated lease termination costs include future minimum lease payments, taxes, insurance, construction, and maintenance costs from the cease-use date to the end of the remaining lease term net of estimated sublease rental income. During the first six months of 2009, the Company adjusted the liability in response to the declining economic conditions in San Diego, by extending the expected period to lease the Front Building. In addition, certain other period costs such as leasing commissions and legal fees will be borne by the Company in the event of the sublease of the Front Building. If estimated net sublease rental income were to change by 10% in either direction, the Company's estimated lease termination costs would increase or decrease by approximately \$1.7 million. The changes to the accrued liability for the first six months of 2009 are as follows (in millions):

	<b>Six Months Ended June 30, 2009</b>
Accrued lease termination costs at January 1, 2009	\$ 15.4
Lease termination costs accrued during the period	5.8
Cash payments for lease termination costs during the period	(3.0)
Accrued lease termination costs at June 30, 2009	18.2
Less current portion of accrued lease termination costs	15.4
Non-current portion of accrued lease termination costs	<u>\$ 2.8</u>

In accordance with SFAS No. 98, "Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases" (SFAS 98) and SFAS No. 66, "Accounting for Sales of Real Estate" (SFAS 66) the Company initially deferred the gain on the sale of the building and related vacant parcel due to a repurchase right. The Company initially established a long-term liability of \$108.7 million upon the close of the transaction, essentially the gross proceeds from the real estate sale. The lease amendment terminated this repurchase right and the Company removed from its balance sheet the long-term liability of \$108.7 million and the related previously conveyed real estate related assets of \$69.6 million during the fourth quarter of 2008. Additionally, the Company began to recognize the deferred gain of \$39.1 million on the sale of the real estate over the remaining term of the lease. During the first six months of 2009, the Company recognized \$1.4 million of the deferred gain and will recognize the balance of the deferred gain over the remaining lease term.

## 12. LOSS PER COMMON SHARE

The Company computes net loss per share in accordance with SFAS No. 128, "Earnings Per Share" (SFAS 128). Under the provisions of SFAS 128, basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share is computed by dividing the net 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 historical diluted loss per share because of their anti-dilutive effect. Potentially dilutive securities totaled 8,000 and 0.1 million for the

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three months ended June 30, 2009 and 2008, respectively, and 8,000 and 0.1 million for the six months ended June 30, 2009 and 2008, respectively.

### 13. COMPREHENSIVE LOSS

Comprehensive loss is calculated in accordance with SFAS No. 130, "Comprehensive Income" (SFAS 130). SFAS 130 requires the disclosure of all components of comprehensive loss, including net 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 available-for-sale investments. For the three months ended June 30, 2009 and 2008, comprehensive loss was \$12.8 million and \$21.1 million, respectively. For the six months ended June 30, 2009 and 2008, comprehensive loss was \$32.3 million and \$43.3 million, respectively.

### 14. REVENUE RECOGNITION

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, 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. Upfront, nonrefundable payments for license fees, grants, 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 for which achievement of the milestone was not readily assured at the inception of the agreement.

### 15. RESEARCH AND DEVELOPMENT

Research and development (R&D) expenses are recognized as incurred and include related salaries, contractor fees, clinical trial costs, facilities costs, administrative expenses and allocations of certain other costs. These expenses result from the Company's independent R&D efforts as well as efforts associated with collaborations and in-licensing arrangements. In addition, the Company funds R&D at other companies and research institutions under agreements, which are generally cancelable. The Company reviews and accrues clinical trial expenses based on work performed, a method that relies on estimates of total costs incurred based on patient enrollment, completion of patient studies and other events. The Company follows 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.

### 16. INCOME TAXES

On July 13, 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes, an interpretation of FASB No. 109". Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN 48 on January 1, 2007. There were no unrecognized tax benefits as of the date of adoption. As a result of the implementation of FIN 48, the Company did not recognize an increase in the liability for unrecognized tax benefits. There are no unrecognized tax benefits included in the balance sheet that would, if recognized, affect the effective tax rate.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accrual for interest or penalties on the Company's balance sheets at December 31, 2008 and at June 30, 2009, and has not recognized interest and/or penalties in the statement of operations for the first six months of 2009.

The Company is subject to taxation in the United States and various state jurisdictions. The Company's tax years for 1993 and forward are subject to examination by the United States and California tax authorities due to the carryforward of unutilized net operating losses and R&D credits.

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At January 1, 2009, the Company had net deferred tax assets of \$69.3 million. Due to uncertainties surrounding the Company's ability to generate future taxable income to realize these assets, a full valuation allowance has been established to offset the net deferred tax assets. Additionally, the future utilization of the Company's net operating loss and research and development credit carryforwards to offset future taxable income may be subject to a substantial annual limitation, pursuant to Internal Revenue Code Sections 382 and 383, as a result of ownership changes that may have occurred previously or that could occur in the future. Although the Company determined that an ownership change had not occurred through January 31, 2007, it is possible that an ownership change occurred subsequent to that date. The Company has not completed an update of its Section 382 analysis subsequent to January 31, 2007. Until this analysis has been updated, the Company has removed the deferred tax assets for net operating losses of \$227.2 million and research and development credits of \$38.8 million generated through 2008 from its deferred tax asset schedule and has recorded a corresponding decrease to its valuation allowance. Due to the existence of the valuation allowance, future changes in the Company's unrecognized tax benefits will not impact the Company's effective tax rate.

## **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 in Part II, Item 1A 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, 2008 and the three months ended March 31, 2009 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, which are contained in our Annual Report on Form 10-K for the year ended December 31, 2008 and our Quarterly Report on Form 10-Q for the three months ended March 31, 2009, respectively.*

## **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 endometriosis, anxiety, depression, pain, diabetes, irritable bowel syndrome, insomnia, and other neurological and endocrine related diseases and disorders. To date, we have not generated any revenues from the sale of products. 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 certain products with corporate collaborators and intend to rely on existing and future collaborators to meet funding requirements. We expect to generate future net losses due to increases in operating expenses as product candidates are advanced through the various stages of clinical development. As of June 30, 2009, we had an accumulated deficit of \$738.2 million and expect to incur operating losses in the near future, which may be greater than losses in prior years. We currently have eight programs in various stages of research and development, including five programs in clinical development. While we independently develop many of our product candidates, we are in a collaboration for two of our programs.

In May 2009, we announced a restructuring program to implement cost containment measures and to focus research and development efforts. As a result, we reduced our research and development and general and administrative staff in San Diego by approximately 65 employees and incurred a net restructuring charge of approximately \$2.9 million. Restructuring charges are comprised of salary continuation, outplacement services, and other miscellaneous costs related to this reduction in force. Substantially all of these expenses were paid in cash during the second quarter of 2009. We expect this restructuring to save approximately \$12.0 million per annum through a reduction of personnel-related and other research and development costs.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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 (research and development expense), debt, share-based compensation, 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



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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 and development agreements are recognized as 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, 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. Upfront, nonrefundable payments for license fees, grants, 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 requires substantive effort, and for which achievement of the milestone was not readily assured at the inception of the agreement.

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 and clinical trials at other companies and research institutions under agreements, which are generally cancelable. We review and accrue clinical trials expense based on work performed, a method that relies on estimates of total 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. Historically, revisions have not resulted in material changes to R&D costs; however a modification in the protocol of a clinical trial or cancellation of a trial could result in a charge to our results of operations.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144 (SFAS 144), "Accounting for the Impairment or Disposal of Long-Lived Assets," if indicators of impairment exist, we assess 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, we measure the amount of such impairment by comparing the carrying value of the asset to the estimated fair value of the asset, which is generally determined based on the present value of the expected future cash flows. We have determined that no impairment exists on our long-lived assets.

We grant stock options to purchase our common stock to our employees and directors under the 2003 Incentive Stock Plan, as amended (the 2003 Plan) and grant stock options to certain employees pursuant to Employment Commencement Nonstatutory Stock Option Agreements. We also grant certain employees stock bonuses and RSUs under the 2003 Plan. Additionally, we have outstanding options that were granted under option plans from which we no longer make grants. The benefits provided under all of these plans are subject to the provisions of revised SFAS No. 123, "Share-Based Payment" (SFAS 123R). Share-based compensation expense recognized under SFAS 123R for the three months ended June 30, 2009 and 2008 was \$1.0 million and \$2.2 million, respectively. Share-based compensation expense recognized under SFAS 123R for the six months ended June 30, 2009 and 2008 was \$2.9 million and \$4.4 million, respectively.

Stock option awards and RSUs generally vest over a three to four year period and expense is ratably recognized over those same time periods. However, due to certain retirement provisions in our stock plans, share-based compensation expense may be recognized over a shorter period of time, and in some cases the entire share-based compensation expense may be recognized upon grant of the share-based compensation award. Employees who are age 55 or older and have five or more years of service with us are entitled to accelerated vesting of certain unvested share-based compensation awards upon retirement. This retirement provision leads to variability in the quarterly expense amounts recognized under SFAS 123R, and therefore individual share-based compensation awards may impact earnings disproportionately in any individual fiscal quarter.

The determination of fair value of stock-based payment awards on the date of grant using the Black-Scholes model is affected by our stock price, as well as the input of other subjective assumptions. These assumptions include, but are not limited to, the expected term of stock options and our expected stock price volatility over the term of the awards. Our stock options have characteristics significantly different from those of traded options, and changes in the assumptions can materially affect the fair value estimates.

SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If actual forfeitures vary from our estimates, we will recognize the difference in compensation expense in the period the actual forfeitures occur or when options vest.

THREE MONTHS ENDED JUNE 30, 2009 AND 2008

Revenues were \$0.7 million for the three months ended June 30, 2009 compared with \$0.7 million for the respective period last year. During the second quarters of both 2009 and 2008, we recognized \$0.7 million in revenue under our collaboration agreement with Dainippon Sumitomo Pharma Co. Ltd (DSP) from amortization of up-front licensing fees.

Research and development expenses decreased to \$10.8 million for the second quarter of 2009 compared with \$16.2 million for the respective period in 2008. Laboratory costs decreased by \$0.6 million in the second quarter of 2009 compared to the same period in 2008 and external development costs decreased by \$4.5 million compared to the same period last year. External development spending in our elagolix and pro drug programs decreased by \$3.5 million and \$1.1 million, respectively, in the second quarter of 2009 compared with the same period in 2008. Research and development expenses for the second quarter of 2009 also included severance expenses of \$2.2 million, which were offset entirely by other personnel cost reductions during the quarter.

General and administrative expenses were \$4.8 million for the second quarter of 2009 compared with \$4.7 million during the same period last year. General and administrative expenses for the second quarter of 2009 also included severance costs of \$0.7 million which were almost entirely offset by cost savings from related expense management efforts.

During the second quarter of 2009, we recognized additional cease-use expense under SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS 146) of \$0.9 million due to the timing of tenant occupancy for the Front Building. See Note 11, "Real Estate" to the accompanying financial statements.

Other income (expense) was \$(0.9) million during the second quarter of 2008 compared to \$0.6 million for the second quarter of 2009. The change resulted primarily from rental payments made during the second quarter of 2008 under our sale-leaseback agreement which were recorded as interest expense under sale-leaseback accounting rules. These rental payments are components of operating expense during 2009. Additionally, we recognized \$0.7 million in deferred gains on real estate and \$0.2 million in gains on our auction rate securities in the second quarter of 2009.

Our net loss for the second quarter of 2009 was \$15.3 million, or \$0.39 per share, compared to \$21.0 million, or \$0.55 per share, for the same period in 2008. This decrease in net loss primarily resulted from expense management efforts during the second quarter of 2009.

SIX MONTHS ENDED JUNE 30, 2009 AND 2008

Revenues were \$1.5 million for the six months ended June 30, 2009 compared with \$2.5 million for the respective period last year. During the six months ended June 30, 2008, we recognized a \$1.0 million milestone from GSK related to clinical advancements of our CRF program. During both six month periods ended June 30, 2009 and 2008, we recognized \$1.5 million in revenue under our collaboration agreement with DSP from amortization of up-front licensing fees.

Research and development expenses decreased to \$21.7 million for the first half of 2009 compared with \$30.4 million for the respective period in 2008. This decrease in research and development expenses is primarily due to cost savings related to our recent restructurings. The decrease in staff levels reduced personnel costs in the first six months of 2009 which were essentially offset by severance costs of \$2.2 million during the first six months of 2009. Additionally, laboratory costs decreased by \$0.8 million in the first half of 2009 compared to the same period in 2008. External development costs decreased by \$6.6 million to \$4.4 million in the first half of 2009 compared to \$11.0 million in the same period last year. External development spending in our elagolix and pro drug programs decreased by \$5.3 million and \$1.1 million, respectively, in the first six months of 2009 compared to the same period in 2008. Other non-personnel cost management efforts have resulted in approximately \$1.0 million of year to date savings over the prior six month period.

General and administrative expenses were \$9.0 million for the six months ended June 30, 2009 compared with \$13.0 million during the same period last year. We incurred a \$2.2 million restructuring charge in the first half of 2008 compared to a \$0.7 million charge in the first half of 2009. Additionally, other non-personnel cost reductions resulted in savings of approximately \$1.2 million compared with the prior year period.

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During the six months ended June 30, 2009, we recognized additional cease-use expense under SFAS 146 of \$5.8 million due to an estimated increase in construction costs, and a change in assumptions on the timing of tenant occupancy and rental rates for the Front Building. See Note 11, "Real Estate" to the accompanying financial statements.

Other income (expense) was \$(1.2) million during the first six months of 2008 compared to \$22,000 for the first six months of 2009. The change resulted primarily from rental payments made in 2008 under our facilities sale-leaseback agreement that were recorded as interest expense under sale-leaseback accounting rules. The rental payments are components of operating expense during 2009. Additionally, we recognized \$1.4 million in deferred gains on real estate during the first six months of 2009, which was partially offset by a net recognized loss on auction rate securities of \$1.2 million during the same period.

Net loss for the first half of 2009 was \$34.9 million, or \$0.90 per share, compared to \$42.0 million, or \$1.10 per share, for the same period in 2008. This decrease in net loss was primarily due to a reduction in expenses as a result of our restructuring programs implemented in the fourth quarter of 2007 and second quarter of 2009.

To date, our revenues have been derived primarily from funded research and development, achievements of milestones under corporate collaborations, and licensing of product candidates. The nature and amount of these revenues from period to period may lead to substantial fluctuations in our of quarterly revenues and earnings. Accordingly, results and earnings for one period are not predictive of future periods. Collaborations, including grant revenue, accounted for 100% of our revenue for the three and six months ended June 30, 2009 and 2008.

We expect to incur operating losses for the foreseeable future because of the expenses we expect to incur related to progressing programs through our pipeline.

## LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2009, our cash, cash equivalents, and investments totaled \$74.0 million compared with \$101.5 million at December 31, 2008. The decrease in cash and investment balances at June 30, 2009 resulted primarily from our net loss of \$34.9 million, which includes various non-cash expenditures.

Our long-term investments at June 30, 2009 included (at par value) \$22.6 million of auction rate securities. With the liquidity issues experienced in global credit and capital markets, these auction rate securities have experienced multiple failed auctions as the amount of securities submitted for sale has exceeded the amount of purchase orders, and as a result, these affected securities are currently not liquid. All of our auction rate securities are secured by student loans, which are backed by the full faith and credit of the federal government (up to approximately 98% of the value of the student loan). All of these securities continue to pay interest according to their stated terms (generally 120 basis points over the ninety-one day United States Treasury bill rate) with interest rates resetting every 7 to 28 days. While it is not our intent to hold these securities until their stated ultimate maturity dates, these investments are scheduled to ultimately mature between 2030 and 2047.

The valuation of our auction rate securities investment portfolio is subject to uncertainties that are difficult to predict. The fair values of these securities were estimated utilizing a discounted cash flow analysis as of June 30, 2009. The significant assumptions of this valuation model were discount margins ranging from 191 to 491 basis points which are based on industry recognized student loan sector indices, an additional liquidity discount of 150 basis points and an estimated term to liquidity of 5.5 to 7.5 years. Other items this analysis considers are the collateralization underlying the security investments, the creditworthiness of the counterparty, and the timing of expected future cash flows. These securities were also compared, when possible, to other observable market data with similar characteristics as the securities held by us. Although the auction rate security investments continue to pay interest according to their stated terms, based on valuation models of the individual securities, we have recognized in the consolidated statement of operations for the six months ended June 30, 2009 a loss of approximately \$1.3 million in other expense, net for auction rate securities that we have concluded that an other-than-temporary impairment exists.

During the fourth quarter of 2008, UBS AG (UBS) extended an offer of Auction Rate Securities Rights (ARS Rights) to holders of illiquid auction rate securities that were maintained by UBS as of February 13, 2008. The ARS Rights provide the holder with the ability to sell the auction rate securities, along with the ARS Rights, to UBS at the par value of the auction rate securities, during an applicable exercise period. The ARS Rights grant UBS the sole discretion and right to sell or otherwise dispose of auction rate securities at any time up until July 2, 2012, without any prior notification of the holder, so long as the holder receives a payment of par upon any sale or disposition. The ARS Rights are not transferable, not tradeable, and will not be quoted or listed on any securities

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exchange or any other trading network. The offer period for the ARS Rights closed on November 14, 2008 and ARS Rights were issued by UBS during the fourth quarter of 2008.

We have elected to participate in the ARS Rights program for all of our outstanding auction rate securities maintained by UBS. We have \$14.6 million (at par value) of auction rate securities that are maintained by UBS. Under the terms of the ARS Rights offer, our applicable exercise period begins on June 30, 2010 and ends July 2, 2012. Additionally, we are eligible for a loan of up to 75% of the market value of the auction rate securities, should a loan be needed. It is our intention to sell the auction rate securities and ARS Rights to UBS on June 30, 2010.

We elected to measure the ARS Rights under the fair value option of SFAS 159, "The Fair Value Option for Financial Assets and Financial Liabilities — including an amendment of FASB Statement No. 115" (SFAS 159), to mitigate volatility in reported earnings due to their linkage to the auction rate securities. Simultaneously, due to the ARS Rights granted by UBS, we made a one-time election to transfer the related auction rate security holdings from available-for-sale securities to trading securities. We anticipate that any changes in the fair value of the ARS Rights will be offset by the changes in the fair value of the related auction rate securities with no material net impact to the consolidated statement of operations. The ARS Rights will continue to be measured at fair value under SFAS 159 until the earlier of their maturity or exercise. At June 30, 2009, we valued these ARS Rights at \$1.9 million.

These ARS Rights together with the auction rate securities held at UBS (fair value of \$12.6 million as of June 30, 2009) are carried as short-term investments on the condensed consolidated balance sheet at June 30, 2009. In addition to the election of the fair value option for the ARS Rights, we made a one-time election in the fourth quarter of 2008 to transfer the related auction rate security holdings from available-for-sale securities to trading securities. This enabled the changes in the fair value of the ARS Rights to be offset by the changes in the fair value of the related auction rate securities with no material net impact to our condensed consolidated statement of operations.

Our remaining auction rate securities that are not maintained by UBS continue to be treated as available-for-sale investments. These auction rate securities have a par value of \$8.0 million. During the three months ended March 31, 2009, certain ratings agencies downgraded these auction rate securities and we recognized an other-than-temporary impairment of \$1.5 million in the consolidated statement of operations for the three months ended March 31, 2009. During the second quarter of 2009, global credit markets improved and credit spreads narrowed resulting in an increase in the fair value of these investments of approximately \$1.4 million which was recorded as an unrealized gain in other comprehensive income as of June 30, 2009. At June 30, 2009, we valued these investments at \$6.7 million and they are carried as long-term investments on our condensed consolidated balance sheet at June 30, 2009.

Changes to estimates and assumptions used in estimating the fair value of the auction rate securities and related ARS Rights may provide materially different values. In addition, actual market exchanges, if any, may occur at materially different amounts. For example, a reduction of the expected term to redemption assumption by approximately two years for the auction rate securities and related ARS Rights would yield a net increase in the valuation of these investments of \$0.3 million. Other factors that may impact the valuation of our auction rate securities and related ARS Rights include changes to credit ratings of the securities as well as to the underlying assets supporting those securities, rates of default of the underlying assets, underlying collateral value, discount rates, counterparty risk and ongoing strength and quality of market credit and liquidity.

At present, in the event we need to access the funds that are in an illiquid state, we may not be able to do so without the possible loss of principal, until a future auction for these investments is successful, another secondary market evolves for these securities, they are redeemed by the issuer or they mature. If we are unable to sell these securities in the market or they are not redeemed, we could be required to hold them to maturity. We do not currently anticipate a need to access these funds for operational purposes in 2009, nor the outstanding auction rate securities with UBS prior to June 30, 2010, the beginning of the ARS Rights exercise period. We will continue to monitor and evaluate these investments on an ongoing basis for impairment.

Net cash used in operating activities during the first half of 2009 was \$28.0 million compared with \$43.2 million during the same period last year. Net loss for the first six months of 2009 was \$34.9 million compared to \$42.0 million for the same period in 2008. This decrease in net loss was primarily due to a reduction in expenses as a result of our restructuring programs and expense management efforts.

Net cash used in investing activities during the first six months of 2009 was \$1.8 million compared to net cash provided by investing activities of \$36.3 million for the first six months of 2008. The fluctuation in net cash provided by investing activities

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resulted primarily from the timing differences in investment purchases, sales and maturities, and the fluctuation of our portfolio mix between cash equivalents and short-term investment holdings.

No cash was utilized in financing activities during the first six months of 2009 compared to \$0.9 million used in 2008 related to cash payments made on outstanding debt obligations.

The terms of our facility lease agreement require that we maintain \$50.0 million in cash and investments at all times, or increase our security deposit by \$5.0 million.

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 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. Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events have generally made equity and debt financing more difficult to obtain. 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. To the extent that we are unable to obtain third-party funding for such expenses, we expect that increased expenses will result in increased losses from operations. We cannot assure you that we will be successful in the development of our product candidates, or that, if successful, any products marketed will generate sufficient revenues to enable us to earn a profit.

## INTEREST RATE RISK

We are exposed to interest rate risk on our short and long 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 seek to 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 initial average maturity of our investments does not exceed 36 months. If a 10% change in interest rates had occurred on June 30, 2009, 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 and the nature of our investments, we have concluded that we do not have a material financial market interest rate risk exposure.

## NEW ACCOUNTING PRONONCEMENTS

In June 2009, the Financial Accounting Standards Board (FASB) issued SFAS 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles", a replacement of FASB 162. The FASB Accounting Standards Codification (Codification) will become the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the Securities and Exchange Commission (SEC) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. On the effective date of this Statement, the Codification will supersede all then-existing non-SEC accounting and reporting standards. All other non-grandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We do not expect the adoption of SFAS 168 to have a material impact on our consolidated results of operation or financial condition.

In May 2009, the FASB issued SFAS 165, "Subsequent Events" (SFAS 165). SFAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are

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available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material effect on our consolidated results of operations or financial condition.

In April 2009, the FASB issued several pronouncements related to fair value measurement, recording and disclosure in financial reporting.

FASB Staff Position No. 107-1 and Accounting Principles Board (APB) 28-1, "Interim Disclosures about Fair Value of Financial Instruments," were issued to outline the required financial statement disclosures relating to fair value of financial instruments during interim reporting periods. FASB Staff Position No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," was issued to provide additional guidance in evaluating the fair value of a financial instrument when the volume and level of activity for the asset or liability has significantly decreased. FASB Staff Position No. 115-2 and FASB Staff Position No. 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments," were issued to provide additional guidance on presenting impairment losses on securities.

The adoption of these new fair value measurement pronouncements did not have a material effect on our consolidated results of operations or financial condition.

### FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q and the information incorporated herein by reference contain forward-looking statements that involve a number of risks and uncertainties. Although our forward-looking statements reflect the good faith judgment of our management, these statements can only be based on facts and factors currently known by us. Consequently, these forward-looking statements are inherently subject to risks and uncertainties, and actual results and outcomes may differ materially from results and outcomes discussed in the forward-looking statements.

Forward-looking statements can be identified by the use of forward-looking words such as "believes," "expects," "hopes," "may," "will," "plan," "intends," "estimates," "could," "should," "would," "continue," "seeks," "proforma," or "anticipates," or other similar words (including their use in the negative), or by discussions of future matters such as the development or regulatory approval of new products, technology enhancements, possible changes in legislation and other statements that are not historical. These statements include but are not limited to statements under the captions "Risk Factors," and "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as other sections in this report. You should be aware that the occurrence of any of the events discussed under the heading in Part II titled "Item 1A. Risk Factors" and elsewhere in this report could substantially harm our business, results of operations and financial condition and that if any of these events occurs, the trading price of our common stock could decline and you could lose all or a part of the value of your shares of our common stock.

The cautionary statements made in this report are intended to be applicable to all related forward-looking statements wherever they may appear in this report. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. Except as required by law, we assume no obligation to update our forward-looking statements, even if new information becomes available in the future.

### 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 SEC'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 decisions 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,

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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), we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our 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 control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II: OTHER INFORMATION

### ITEM 1A. RISK FACTORS

The following Risk Factors do not reflect any material changes to the Risk Factors set forth in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, other than the revisions to the risk factors set forth below with an asterisk (\*) next to the title. 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 Our Company

*We depend on continuing our current collaborations and developing additional collaborations to develop and commercialize our product candidates.*

Our strategy for fully developing and commercializing our products is dependent upon maintaining our current arrangements and establishing new arrangements with research collaborators, corporate collaborators and others, particularly as it relates to our GnRH and urocortin 2 programs. We have active collaboration agreements with GlaxoSmithKline and Dainippon Sumitomo Pharma Co. Ltd. and previously have had collaborations with Pfizer, Wyeth, Johnson & Johnson, Novartis, Taisho and Eli Lilly and Company. We historically have been dependent upon these corporate collaborators to provide adequate funding for a number of our programs. Under these arrangements, our corporate collaborators are typically 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.

Because we expect to continue to rely heavily on corporate collaborators, the development and commercialization of our programs would be substantially delayed if one or more of our current or future collaborators:

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

These issues and possible disagreements with current or future 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 development and commercialization of drug candidates and, ultimately, our generation of product revenues.



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

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.

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

- the product candidate 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 or similar foreign regulatory authorities may suspend the trials;
- the results may not be statistically significant;
- patient recruitment may be slower than expected;
- patients may drop out of the trials; and
- regulatory requirements may change.

For example, there is uncertainty regarding future development of indiplon as described below under the risk factor entitled *“There is uncertainty regarding future development of our product candidate, indiplon, and we may not be able to meet the requirements to receive regulatory approvals for it.”*

In addition, 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. Any failure or substantial delay in completing clinical trials for our product candidates may severely harm our business.

***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, to conduct preclinical studies and clinical trials, for operating expenses and to pursue regulatory approvals for product candidates, for the costs involved in filing and prosecuting patent application and enforcing or defending patent claims, if any, as well as costs associated with litigation matters, product in-licensing and any possible acquisitions, and we may require additional funding to establish manufacturing and marketing capabilities in the future. We believe that our existing capital resources, together with investment 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;

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- 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. For example, we have an effective shelf registration statement on file with the Securities and Exchange Commission which allows us to issue shares of our common stock from time to time for an aggregate initial offering price of up to \$150 million. In addition, we have previously financed capital purchases and may continue to pursue opportunities to obtain additional debt financing in the future. Recently, the credit markets and the financial services industry have been experiencing a period of unprecedented turmoil and upheaval characterized by the bankruptcy, failure, collapse or sale of various financial institutions and an unprecedented level of intervention from the United States federal government. These events have generally made equity and debt financing more difficult to obtain. Accordingly, additional equity or debt financing might not be available on reasonable terms, if at all. Any additional equity financings will be dilutive to our stockholders and any additional debt financings may involve operating covenants that restrict our business.

### ***\*Our restructuring activities could result in management distractions, operational disruptions and other difficulties.***

In order to focus efforts on our clinical programs, we initiated restructuring activities in an effort to reduce operating costs, including a work force reduction announced in May 2009. Employees whose positions were eliminated in connection with this reduction may seek future employment with our competitors. Although all employees are required to sign a confidentiality agreement with us at the time of hire, we cannot assure you that the confidential nature of our proprietary information will be maintained in the course of such future employment. We cannot assure you that we will not undertake additional restructuring activities, that any of our restructuring efforts will be successful, or that we will be able to realize the cost savings and other anticipated benefits from our previous or future restructuring plans. In addition, if we continue to reduce our workforce, it may adversely impact our ability to respond rapidly to any new growth opportunities.

We also entered into a December 2008 amendment to our facilities lease, under which our landlord will seek to enter into leases with replacement tenants for portions of the front building of our corporate headquarters, thereby reducing our rent under the lease. Our landlord may not be successful in entering into leases with replacement tenants on favorable terms, or at all. Any additional restructuring efforts could divert the attention of our management away from our operations, harm our reputation and increase our expenses. If we are unable to lease our front building, we will continue to incur significant expense which will limit the resources we can devote to our development programs.

### ***There is uncertainty regarding future development of our product candidate, indiplon, and we may not be able to meet the requirements to receive regulatory approvals for it.***

On December 12, 2007 we received an action letter from the FDA stating that indiplon 5mg and 10mg capsules are approvable (2007 FDA Approvable Letter). The 2007 FDA Approvable Letter acknowledged that our resubmitted NDA for indiplon 5mg and 10mg capsules had addressed the issues raised in a previous approvable letter, but set forth new requirements. The new requirements set forth in the 2007 FDA Approvable Letter are the following: (i) an objective/subjective clinical trial in the elderly, (ii) a safety study assessing the rates of adverse events occurring with indiplon when compared to a marketed product and (iii) a preclinical study to evaluate indiplon administration during the third trimester of pregnancy. After receipt of the 2007 FDA Approvable Letter, we ceased all indiplon clinical development activities in the United States as well as all pre-commercialization activities. We met with the FDA in July 2008 to discuss the 2007 FDA Approvable Letter and we are awaiting the finalization of the written minutes of this meeting from the FDA.

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The process of preparing and resubmitting the NDA for indiplon would require significant resources and could be time consuming and subject to unanticipated delays and cost. As a result of the 2007 FDA Approvable Letter, there is a significant amount of uncertainty regarding the future development of indiplon. Should the NDA be refiled, the FDA could again refuse to approve the NDA, or could still require additional data analysis or clinical trials, which would require substantial expenditures by us and would further delay the approval process. Even if our indiplon NDA is approved, the FDA may determine that our data do not support elements of the labeling we have requested. In such a case, the labeling actually granted by the FDA could limit the commercial success of the product. The FDA could 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. The FDA could also require a Risk Evaluation and Mitigation Strategy (REMS) program for indiplon that could limit the commercial success of the product. We face the risk that for any of the reasons described above, as well as other reasons set forth herein, indiplon may never be approved by the FDA or commercialized anywhere in the world.

If we determine that it is impractical or we are unable to refile the NDA, or the FDA refuses to accept or approve the resubmitted NDA for any reason or we experience a further delay in approval and subsequent commercialization of indiplon, our business and reputation may be harmed and our stock price could decline.

***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 \$88.6 million and \$207.3 million for the years ended December 31, 2008 and 2007, respectively. As a result of ongoing operating losses, we had an accumulated deficit of \$703.3 million and \$614.7 million as of December 31, 2008 and 2007, respectively. We do not expect to be profitable for the year ending December 31, 2009 or the foreseeable future.

We have not yet obtained 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 portion of our costs are predetermined on an annual basis, 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 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, Inc. (DOV). In addition, we license some of the core technologies used in our collaborations from third parties, including the CRF receptor we license from The Salk Institute and use in our CRF1 program, and urocortin 2 which we license from Research Development Foundation. Other in-licensed technologies, such as the GnRH receptor we license from Mount Sinai School of Medicine, will be important for future collaborations for our *elagolix* program. If we were to default on our obligations under any of our licenses, we could lose some or all of our rights to develop, market and sell products covered by these licenses. 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, clinical development or in registration with the FDA. 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 to commercialize 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 have limited 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 limited experience in marketing and selling pharmaceutical products. 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 (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 may delay or prevent the approval of our FDA applications and our introduction 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, and will continue to 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 develop or 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; and
- drug manufacturers are subject to ongoing periodic unannounced inspection by the FDA, the DEA, and other 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.

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 a significant number of consultants to assist us in formulating our research and development strategy. All of our consultants 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, effective, superior and/or cost-effective, we may not recover our investment.

***Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.***

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq rules, are creating uncertainty for companies such as ours. These laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and management time related to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting requires the commitment of significant financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. If we fail to comply with these laws, regulations and standards, our reputation may be harmed and we might be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission. Any such action could adversely affect our financial results and the market price of our common stock.

***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 \$2 per share to approximately \$6 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;

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- general economic and market conditions;
- developments in patent or other proprietary rights;
- developments related to the FDA approval process for indiplon;
- future sales of our common stock by existing stockholders;
- comments by securities analysts;
- 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.

### ***\*Negative conditions in the global credit markets may impair the liquidity of a portion of our investment portfolio.***

Our investment securities consist of auction rate securities, corporate debt securities and government agency securities. As of June 30, 2009, our long-term investments included (at par value) \$22.6 million of auction rate securities. All of our auction rate securities are secured by student loans, which are backed by the full faith and credit of the federal government (up to approximately 98% of the value of the student loan). All of these auction rate securities have experienced failed auctions due to lack of liquidity at the time their interest rates were to reset. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate securities. As a result, certain of these types of securities are not fully liquid and we could be required to hold them until they are redeemed by the issuer, a future auction for these securities is successful, another secondary market evolves for these securities, or they mature. In the event we need to access the funds that are in an illiquid state, we may not be able to do so without a potential loss of principal. Although the auction rate securities continue to pay interest according to their stated terms, based on valuation models as of June 30, 2009, the carrying value of all auction rate securities had been reduced by \$3.3 million, from \$22.6 million to \$19.3 million, reflecting an estimated change in fair market value due primarily to a lack of liquidity. If the credit ratings of the security issuers deteriorate or if uncertainties in these markets continue and any decline in market value is determined to be other-than-temporary, we would be required to adjust the carrying value of the investment through an impairment charge, which could negatively affect our financial condition, cash flow and reported earnings.

### **Risks Related to Our Industry**

#### ***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, our recovery of prepaid royalties, and our liquidity and capital resources. All of our products are in research and development, and we have not yet 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.

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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.

***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 endometriosis, anxiety, depression, pain, diabetes, irritable bowel syndrome, insomnia, and other neurological and 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.

***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, through 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 grounds that our patents do not cover its technology. Interference proceedings declared by the United States Patent and Trademark Office (USPTO) 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 collaborators with respect to technologies used in potential products. If a patent infringement suit were brought against us or our collaborators, we or our collaborators 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 collaborators 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 collaborators 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 harm our results of operations and cause us to use a substantial portion of our cash reserves, which would force us to seek additional financing.

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

The Company's Annual Meeting of Stockholders was held on May 29, 2009. As of the close of business on April 1, 2009, the record date for the Annual Meeting, there were 38,677,454 shares of common stock entitled to vote, of which there were 32,681,124 shares present at the Annual Meeting in person or by proxy. At the Annual Meeting, stockholders voted on four matters: (i) the election of three Class I Directors for a term of three years expiring at the 2012 Annual Meeting of Stockholders, (ii) the ratification of the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009, (iii) the approval of an amendment to the Company's 2003 Incentive Stock Plan, as amended, to increase the number of shares of common stock reserved for issuance thereunder from 5,300,000 to 5,800,000 shares, and (iv) the consideration of a stockholder proposal to declassify the Board of Directors. The voting results were as follows:

- Election of three Class I Directors for a term of three years expiring at the 2012 Annual Meeting of Stockholders

Joseph A. Mollica, Ph.D.	For	19,538,745	Withheld	13,142,379
W. Thomas Mitchell	For	19,536,997	Withheld	13,144,127
Wylie W. Vale, Ph.D.	For	19,135,061	Withheld	13,546,063

The three nominees for Class I Director were elected. Our Class II Directors, Corinne H. Lyle, Richard F. Pops, and Stephen A. Sherwin, continue in office until our 2010 Annual Meeting of Stockholders. Our Class III Directors, Gary A. Lyons and Kevin C. Gorman, continue in office until our 2011 Annual Meeting of Stockholders.

- Ratification of the appointment of Ernst & Young LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2009

For	31,927,183	Against 606,937	Abstain 147,003
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The appointment of Ernst & Young LLP was ratified.

- Approval of an amendment to the Company's 2003 Incentive Stock Plan, as amended, which increases the number of shares of common stock reserved for issuance from 5,300,000 to 5,800,000 shares

For	12,348,860	Against 9,429,145	Abstain 314,466
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The amendment to the Company's 2003 Incentive Stock Plan, as amended, was approved.

- Consideration of a stockholder proposal to declassify the Board of Directors

For	15,037,840	Against 6,996,203	Abstain 58,427
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The stockholder proposal was approved.

**ITEM 6. EXHIBITS**

3.1	Restated Certificate of Incorporation (1)
3.2	Certificate of Amendment to Certificate of Incorporation (2)
3.3	Bylaws (1)
3.4	Certificate of Amendment of Bylaws (3)
3.5	Certificate of Amendment of Bylaws (4)
4.1	Form of Common Stock Certificate (1)
10.1	Neurocrine Biosciences, Inc. 2003 Incentive Stock Plan, as amended, and form of stock option agreement and restricted stock unit agreement.
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) 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.

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(1) Incorporated by reference to the Company's Registration Statement on Form S-1 (Registration No. 333-03172)

(2) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 9, 2006

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997 filed on April 10, 1998 (File No.: 000-22705)

(4) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004

\* 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.

**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: July 30, 2009

/s/ Timothy P. Coughlin

Timothy P. Coughlin

Vice President and Chief Financial Officer

(Duly authorized officer and Principal Financial Officer)

## NEUROCRINE BIOSCIENCES, INC.

## 2003 INCENTIVE STOCK PLAN

as amended May 25, 2005, November 7, 2005, January 12, 2006,  
March 2, 2006, May 31, 2007, August 1, 2007, May 28, 2008 and May 29, 2009

**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, Restricted Stock Unit awards and Stock Bonus awards.

**2. Definitions.**

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

(b) "Award Agreement" shall mean any written or electronic agreement, contract, or other instrument or document evidencing an Award.

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

(d) "Change in Control" has the meaning set forth in Section 15(c) of the Plan.

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

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

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

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

(i) "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.

(j) "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.

(k) “Director” means a member of the Board of Directors of the Company.

(l) “Disability” means total and permanent disability (as defined in Section 22(e)(3) of the Code).

(m) “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.

(n) “Holder” shall mean a person who has been granted or awarded an Award pursuant to the Plan.

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

(p) “Nonstatutory Stock Option” shall mean an Option not intended to qualify as an Incentive Stock Option.

(q) “Option” shall mean a stock option granted pursuant to the Plan. An Option may be either an Incentive Stock Option or a Nonstatutory Stock Option.

(r) “Option Agreement” shall mean any written or electronic agreement, contract, or other instrument or document evidencing an Option.

(s) “Optioned Stock” shall mean the Common Stock subject to an Option.

(t) “Optionee” shall mean an Employee or Consultant who receives an Option.

(u) “Outside Director” means a Director who is not an Employee.

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

(w) “Performance Award” shall mean an Award that vests based upon the achievement of performance goals related to one or more Performance Criteria.

(x) “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.

(y) "Plan" shall mean this 2003 Incentive Stock Plan, as amended.

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

(aa) "Restricted Stock Unit" shall mean a right to receive a specified number of shares of Common Stock during specified time periods pursuant to Section 12 of the Plan.

(bb) "Retirement" has the meaning set forth in Section 9(d) of the Plan.

(cc) "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.

(dd) "Share" shall mean a share of the Common Stock, as adjusted in accordance with Section 15 of the Plan.

(ee) "Stock Bonus" shall mean the right to receive a bonus of Common Stock for past services pursuant to Section 13 of the Plan.

(ff) "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 15 of the Plan, the maximum aggregate number of shares available for issuance under the Plan is five million eight hundred thousand (5,800,000) 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 15.

(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 15), the canceled Option shall be counted against the limit set forth in subsection (i) above.

(c) Shares Available. Subject to adjustment as provided in Section 15, the aggregate number of shares of Common Stock with respect to which awards of Restricted Stock, Restricted Stock Units, Stock Bonuses or a combination thereof shall be made under this Plan shall not exceed fifty percent (50%) of the aggregate number of shares of Common Stock available under this Plan, as set forth in Section 3(a).

(d) Limited Exception to Minimum Vesting Restrictions. Up to five percent (5%) of the total number of shares of Common Stock available for issuance under the Plan pursuant to Section 3(a) may in the aggregate be issued as awards of Restricted Stock, Restricted Stock Units, Stock Bonuses or a combination thereof that are not subject to the minimum vesting requirements set forth in Sections 11(d), 12(b) and 13(d) of the Plan.

#### **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) Discretionary Awards to Directors. Except for Options granted automatically at the time and manner set forth in Section 10, any Award granted to a Director shall be administered by a committee consisting solely of Outside Directors and such Outside Directors may administer and grant discretionary Awards to themselves.

(iv) 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.

(v) 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, Restricted Stock Unit 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 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 6 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; and, 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. Except to the extent prohibited by Sections 11(d), 12(b) and 13(d) of the Plan, the Board shall have the power to accelerate the time at which an Award may first be exercised or the time during which an Award or any part thereof will vest in accordance with the Plan, notwithstanding the provisions in the Award stating the time at which it may first be exercised or the time during which it will vest.

(c) Effect of Board's Decision. All decisions, determinations and interpretations of the Board shall be final and binding on all 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, Restricted Stock Unit 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, Restricted Stock Unit 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, Restricted Stock Unit 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, Restricted Stock Unit 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 Holder 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 17 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 21.

**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 closing price per share (or the closing bid, if no sales were reported) 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 Stock Market) or, in the event the Common Stock is listed on another stock exchange, the fair market value per Share shall be the closing price per share (or the closing bid, if no sales were reported) on such exchange on the date of grant, as reported in the Wall Street Journal (or if not so reported, as otherwise reported by such exchange).

(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, 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

Award 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 seven (7) 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 Stockholder.

(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 15 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 9(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 Disability, 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 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) 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 as an Employee or Consultant 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 Employee. Notwithstanding the provisions of Section 9(b) above, in the event of termination of an Employee'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 as an Employee for (5) years or more ("Retirement"), all Awards held by such Employee 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 Award), exercise the Award 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 is 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 thirty thousand (30,000) 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 of the Company shall be automatically granted an annual Option (a "Subsequent Option") to purchase, in the case of an Outside Director, fifteen thousand (15,000) Shares, and in the case of the Chairman of the Board of Directors of the Company, twenty thousand (20,000) 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 seven (7) 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 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 Holder in lieu of cash compensation otherwise payable to the Holder. 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 Holder make adequate provision for any Federal and State withholding obligations of the Company as a condition to the Holder purchasing such Shares.

(d) Vesting. Subject to the following minimum vesting requirements and the requirements of Section 4(d) of the Plan with respect to Restricted Stock awards granted to Section 162(m) Participants, at the time of the grant of a Restricted Stock award, the Board may impose such restrictions or conditions to the vesting of such Restricted Stock award as it, in its sole discretion, deems appropriate. No Restricted Stock award that is not a Performance Award shall vest at a rate more favorable to the Holder than in pro-rata installments over a three (3) year period measured from the date of grant. The vesting of all Restricted Stock Performance Awards shall be subject to the completion of at least one (1) year of Continuous Status as an Employee or Consultant measured from the date of the grant of the Award. Notwithstanding the foregoing minimum vesting requirements, vesting of Restricted Stock awards may occur earlier in the event of (A) death, (B) Disability, (C) Retirement, or (D) a Change in Control. Additionally, Restricted Stock awards granted pursuant to the exception set forth in Section 3(d) of the Plan are not subject to the foregoing minimum vesting requirements.

(e) Unvested Share Repurchase Option. The stock purchase agreement shall grant the Company an unvested share repurchase option exercisable upon the voluntary or involuntary termination of the Holder'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 Holder to the Company.

(f) 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. Restricted Stock Unit Awards.**

(a) Grant of Restricted Stock Units. Any Employee or Consultant selected by the Board may be granted an Award of Restricted Stock Units in the manner determined from time to time by the Board.

(b) Vesting of Restricted Stock Units. Subject to the following minimum vesting requirements and the requirements of Section 4(d) with respect to Restricted Stock Unit awards granted to Section 162(m) Participants, at the time of the grant of a Restricted Stock Unit award, the Board may impose such restrictions or conditions to the vesting of such Restricted Stock Unit award as it, in its sole discretion, deems appropriate. No Restricted Stock Unit award that is not a Performance Award shall vest at a rate more favorable to the Holder than in pro-rata installments over a three (3) year period measured from the date of grant. The vesting of all Restricted Stock Unit Performance Awards shall be subject to the completion of at least one (1) year of Continuous Status as an Employee or Consultant measured from the date of the grant of the Award. Notwithstanding the foregoing minimum vesting requirements, vesting of Restricted Stock Unit awards may occur earlier in the event of (A) death, (B) Disability, (C) Retirement, or (D) a Change in Control. Additionally, Restricted Stock Unit awards granted pursuant to the exception set forth in Section 3(d) of the Plan are not subject to the foregoing minimum vesting requirements. Common Stock underlying a Restricted Stock Unit award will not be issued until the Restricted Stock Unit award has vested, pursuant to a vesting schedule or Performance Criteria set by the Board.

(c) No Rights as a Stockholder. Unless otherwise provided by the Board, a Holder awarded Restricted Stock Units shall have no rights as a Company stockholder with respect to such Restricted Stock Units until such time as the Restricted Stock Units have vested and the Common Stock underlying the Restricted Stock Units has been issued.

(d) Purchase Price. The Board shall establish the purchase price, if any, and form of payment for each Restricted Stock Unit 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 Unit award is granted to the Holder in lieu of cash compensation otherwise payable to the Holder. In all cases, legal consideration shall be required for each issuance of a Restricted Stock Unit award.

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

## **13. 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 Holder in lieu of cash compensation otherwise payable to the Holder.

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

(d) Vesting. Subject to the following minimum vesting requirements and the requirements of Section 4(d) with respect to Stock Bonus awards granted to Section 162(m) Participants, at the time of the grant of a Stock Bonus award, the Board may impose such restrictions or conditions to the vesting of such Stock Bonus award as it, in its sole discretion, deems appropriate. No Stock Bonus award that is not a Performance Award shall vest at a rate more favorable to the Holder than in pro-rata installments over a three (3) year period measured from the date of grant. The vesting of all Stock Bonus Performance Awards shall be subject to the completion of at least one (1) year of Continuous Status as an Employee or Consultant measured from the date of the grant of the Award. Notwithstanding the foregoing minimum vesting requirements, vesting of Stock Bonus awards may occur earlier in the event of (A) death, (B) Disability, (C) Retirement, or (D) a Change in Control. Additionally, Stock Bonus awards granted pursuant to the exception set forth in Section 3(d) of the Plan are not subject to the foregoing minimum vesting requirements.

(e) Unvested Share Repurchase/Reacquisition Option. The Stock Bonus award agreement shall grant the Company an unvested share repurchase/reacquisition option exercisable upon the voluntary or involuntary termination of the Holder's employment with the Company for any reason (including death or Disability). Subject to applicable laws, if the Board so determines, the purchase price (if any) for shares repurchased may be paid by cancellation of any indebtedness of the Holder to the Company. If no purchase price was paid for the shares, the unvested shares may be reacquired by the Company for no consideration.

(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.

**14. 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 Holder, only by the Holder. If the Board makes an Award transferable, such Award shall contain such additional terms and conditions as the Board deems appropriate.

**15. 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 another established stock exchange on which the Company's securities are traded, and subject to Section 15(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 Holder 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. Unless otherwise provided in the Award Agreement, 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 Award shall be assumed or an equivalent award 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 a Holder that is an Employee without Cause (as defined below), such Holder shall fully vest in and, if applicable, have the right to exercise the award assumed or substituted for the Award as to all of the Shares subject to the Award, including Shares as to which it would not otherwise be exercisable. In the event that the successor corporation refuses to assume or substitute the Award, the Holder shall fully vest in and, if applicable, have the right to exercise the Award as to all of the Shares subject to the Award, including Shares as to which it would not otherwise be exercisable. If an Award becomes fully vested and exercisable in lieu of

assumption or substitution in the event of a Change in Control, the Board shall notify the Holder in writing or electronically that the Award shall be fully vested and exercisable for a period of fifteen (15) days from the date of such notice, and the Award shall terminate upon the expiration of such period, if applicable.

For the purposes of this paragraph, the Award shall be considered assumed if, following the Change in Control, the Award confers the same acquisition rights for each Share subject to the Award immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) received in the Change in 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 in 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 pursuant to the Award, for each Share subject to the Award, 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 in 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 Holder shall fully vest in and, if applicable, have the right to exercise all outstanding Awards as to all of the Shares subject to such Award, 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 15 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.

**16. 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.

**17. 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 Holder 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 another 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 Holder, as applicable, and the Board, which agreement must be in writing and signed by the Holder, as applicable, and the Company.

**18. 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 Securities Exchange Act of 1934, as amended, the rules and regulations promulgated thereunder, and the requirements of the NASDAQ Stock Market or any other 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.

**19. 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.

**20. Award Agreements.** Options shall be evidenced by written Option Agreements in such form as the Board shall approve. Restricted Stock awards, Restricted Stock Unit awards, or Stock Bonus awards shall be evidenced by written restricted stock award agreements, a restricted stock unit award agreements, or stock bonus agreements, respectively, in such form as the Board shall approve.

**21. 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 other stock exchange upon which the Common Stock is listed.

**22. Section 409A of the Code.** In the event any provision of the Plan, or the application thereof, is or becomes inconsistent with Section 409A of the Code and any regulations promulgated thereunder, such provision shall be void or unenforceable or in the sole discretion of the Board shall be deemed amended to comply with Section 409A and any regulations promulgated thereunder. The other provisions of the Plan shall remain in full force and effect.

## STOCK OPTION AGREEMENT

Unless otherwise defined herein, the terms defined in the 2003 Stock Option Plan as amended, (the "Plan") shall have the same defined meanings in this Option Agreement.

### I. NOTICE OF STOCK OPTION GRANT

NAME  
ADDRESS  
CITY, STATE ZIP

As part of [your Employment Agreement or the Company's Performance Options Policy] you have been granted an option to purchase Common Stock of the Company, subject to the terms and conditions of the Plan and this Option

Agreement, as follows:

Date of Grant:  
Vesting Commencement Date  
Exercise Price per Share:  
Total Number of Shares Granted:  
Total Exercise Price:  
Type of Option:  
    NQ Nonstatutory Stock Option  
Term/Expiration Date:

Vesting Schedule:

This Option may be exercised, in whole or in part, in accordance with the following schedule:

[25% of the Shares subject to the Option shall vest twelve months after the Vesting Commencement Date, and 1/48 of the Shares subject to the Option shall vest each month thereafter, subject to the Optionee continuing to be an Employee or Consultant on such dates.

or

One third (1/3) of the Shares subject to the Option shall vest annually beginning one year after the Vesting Commencement Date, subject to the Optionee continuing to be an Employee or Consultant on such dates.]

Termination Period:

This Option may be exercised for ninety (90) days (or such other period of time not exceeding six (6) months, as is determined by the Board) after Optionee's Continuous Status as an Employee or Consultant terminates. Upon the death or Disability of the Optionee, this Option may be exercised for six (6) months after Optionee's Continuous Status as an Employee or Consultant. In no event shall this Option be exercised later than the Term/Expiration Date as provided above.

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## II. AGREEMENT

1. Grant of Option. The Plan Administrator of the Company hereby grants to the Optionee named in the Notice of Grant attached as Part I of this Agreement (the "Optionee") an option (the "Option") to purchase the number of Shares, as set forth in the Notice of Grant, at the exercise price per share set forth in the Notice of Grant (the "Exercise Price"), subject to the terms and conditions of the Plan, which is incorporated herein by reference. Subject to Section 13(b) of the Plan, in the event of a conflict between the terms and conditions of the Plan and the terms and conditions of this Option Agreement, the terms and conditions of the Plan shall prevail.

If designated in the Notice of Grant as an Incentive Stock Option ("ISO"), this Option is intended to qualify as an Incentive Stock Option under Section 422 of the Code. However, if this Option is intended to be an Incentive Stock Option, to the extent that it exceeds the \$100,000 rule of Code Section 422(d) it shall be treated as a Nonstatutory Stock Option ("NSO").

### 2. Exercise of Option.

(a) Right to Exercise. This Option is exercisable during its term in accordance with the Vesting Schedule set out in the Notice of Grant and the applicable provisions of the Plan and this Option Agreement.

(b) Method of Exercise. This Option is exercisable by delivery of an exercise notice, in the form attached as Exhibit A (the "Exercise Notice"), which shall state the election to exercise the Option, the number of Shares in respect of which the Option is being exercised (the "Exercised Shares"), and such other representations and agreements as may be required by the Company pursuant to the provisions of the Plan. The Exercise Notice shall be completed by the Optionee and delivered to the President, the Chief Financial Officer or Secretary of the Company. The Exercise Notice shall be accompanied by payment of the aggregate Exercise Price as to all Exercised Shares. This Option shall be deemed to be exercised upon receipt by the Company of such fully executed Exercise Notice accompanied by such aggregate Exercise Price.

No Shares shall be issued pursuant to the exercise of this Option unless such issuance and exercise complies with Applicable Laws. Assuming such compliance, for income tax purposes the Exercised Shares shall be considered transferred to the Optionee on the date the Option is exercised with respect to such Exercised Shares.

3. Method of Payment. Payment of the aggregate Exercise Price shall be by any of the following, or a combination thereof, at the election of the Optionee:

(a) cash; or

(b) check; or

(c) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan; or

(d) surrender of other Shares which (i) in the case of Shares acquired upon exercise of an option, have been owned by the Optionee for more than six (6) months on the date of surrender, and (ii) have a Fair Market Value on the date of surrender equal to the aggregate Exercise Price of the Exercised Shares.

4. Non-Transferability of Option. This Option may not be transferred in any manner otherwise than by will or by the laws of descent or distribution and may be exercised during the lifetime of Optionee only by the

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Optionee. The terms of the Plan and this Option Agreement shall be binding upon the executors, administrators, heirs, successors and assigns of the Optionee.

5. Term of Option. This Option may be exercised only within the term set out in the Notice of Grant, and may be exercised during such term only in accordance with the Plan and the terms of this Option Agreement.

6. Tax Consequences. Some of the federal tax consequences relating to this Option, as of the date of this Option, are set forth below. THIS SUMMARY IS NECESSARILY INCOMPLETE, AND THE TAX LAWS AND REGULATIONS ARE SUBJECT TO CHANGE. THE OPTIONEE SHOULD CONSULT A TAX ADVISER BEFORE EXERCISING THIS OPTION OR DISPOSING OF THE SHARES.

(a) Exercising the Option.

(i) Nonstatutory Stock Option. The Optionee may incur regular federal income tax liability upon exercise of a NSO. The Optionee will be treated as having received compensation income (taxable at ordinary income tax rates) equal to the excess, if any, of the Fair Market Value of the Exercised Shares on the date of exercise over their aggregate Exercise Price. If the Optionee is an Employee or a former Employee, the Company will be required to withhold from his or her compensation or collect from Optionee and pay to the applicable taxing authorities an amount in cash equal to a percentage of this compensation income at the time of exercise, and may refuse to honor the exercise and refuse to deliver Shares if such withholding amounts are not delivered at the time of exercise.

(ii) Incentive Stock Option. If this Option qualifies as an ISO, the Optionee will have no regular federal income tax liability upon its exercise, although the excess, if any, of the Fair Market Value of the Exercised Shares on the date of exercise over their aggregate Exercise Price will be treated as an adjustment to alternative minimum taxable income for federal tax purposes and may subject the Optionee to alternative minimum tax in the year of exercise. In the event that the Optionee ceases to be an Employee but continues to provide services to the Company, any Incentive Stock Option of the Optionee that remains unexercised shall cease to qualify as an Incentive Stock Option and will be treated for tax purposes as a Nonstatutory Stock Option on the date three (3) months and one (1) day following such change of status.

(b) Disposition of Shares.

(i) NSO. If the Optionee holds NSO Shares for at least one year, any gain realized on disposition of the Shares will be treated as long-term capital gain for federal income tax purposes (holding the Shares for more than eighteen (18) months may lower the long-term capital gains rate).

(ii) ISO. If the Optionee holds ISO Shares for at least one year after exercise and two years after the grant date, any gain realized on disposition of the Shares will be treated as long-term capital gain for federal income tax purposes. If the Optionee disposes of ISO Shares within one year after exercise or two years after the grant date, any gain realized on such disposition will be treated as compensation income (taxable at ordinary income rates) to the extent of the excess, if any, of the lesser of (A) the difference between the Fair Market Value of the Shares acquired on the date of exercise and the aggregate Exercise Price, or (B) the difference between the sale price of such Shares and the aggregate Exercise Price. Any additional gain will be taxed as capital gain, short-term or long-term depending on the period that the ISO Shares were held.

(c) Notice of Disqualifying Disposition of ISO Shares. If the Optionee sells or otherwise disposes of any of the Shares acquired pursuant to an ISO on or before the later of (i) two years after the grant date, or (ii) one year after the exercise date, the Optionee shall immediately notify the Company in writing of such disposition. The Optionee agrees that he or she may be subject to income tax withholding by the Company on the compensation

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income recognized from such early disposition of ISO Shares by payment in cash or out of the current earnings paid to the Optionee.

7. Entire Agreement; Governing Law. The Plan is incorporated herein by reference. The Plan and this Option Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and Optionee with respect to the subject matter hereof, and may not be modified adversely to the Optionee's interest except by means of a writing signed by the Company and Optionee. This agreement is governed by the internal substantive laws, but not the choice of law rules, of California.

8. NO GUARANTEE OF CONTINUED SERVICE. OPTIONEE ACKNOWLEDGES AND AGREES THAT THE VESTING OF SHARES PURSUANT TO THE VESTING SCHEDULE HEREOF IS EARNED ONLY BY CONTINUING AS AN EMPLOYEE OR CONSULTANT AT THE WILL OF THE COMPANY (AND NOT THROUGH THE ACT OF BEING HIRED, BEING GRANTED AN OPTION OR PURCHASING SHARES HEREUNDER).

OPTIONEE FURTHER ACKNOWLEDGES AND AGREES THAT THIS AGREEMENT, THE TRANSACTIONS CONTEMPLATED HEREUNDER AND THE VESTING SCHEDULE SET FORTH HEREIN DO NOT CONSTITUTE AN EXPRESS OR IMPLIED PROMISE OF CONTINUED ENGAGEMENT AS AN EMPLOYEE OR CONSULTANT FOR THE VESTING PERIOD, FOR ANY PERIOD, OR AT ALL, AND SHALL NOT INTERFERE WITH OPTIONEE'S RIGHT OR THE COMPANY'S RIGHT TO TERMINATE OPTIONEE'S RELATIONSHIP AS AN EMPLOYEE OR CONSULTANT AT ANY TIME, WITH OR WITHOUT CAUSE.

By your signature and the signature of the Company's representative below, you and the Company agree that this Option is granted under and governed by the terms and conditions of the Plan and this Option Agreement. Optionee has reviewed the Plan and this Option Agreement in their entirety, has had an opportunity to obtain the advice of counsel prior to executing this Option Agreement and fully understands all provisions of the Plan and Option Agreement. Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Administrator upon any questions relating to the Plan and Option Agreement. Optionee further agrees to notify the Company upon any change in the residence address indicated below.

OPTIONEE:

NEUROCRINE BIOSCIENCES, INC.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Signature

Date

Date

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Name:  
NAME  
ADDRESS  
CITY, STATE ZIP

CONSENT OF SPOUSE

The undersigned spouse of Optionee has read and hereby approves the terms and conditions of the Plan and this Option Agreement. In consideration of the Company's granting his or her spouse the right to purchase Shares as set forth in the Plan and this Option Agreement, the undersigned hereby agrees to be irrevocably bound by the terms and conditions of the Plan and this Option Agreement and further agrees that any community property interest shall be similarly bound. The undersigned hereby appoints the undersigned's spouse as attorney-in-fact for the undersigned with respect to any amendment or exercise of rights under the Plan or this Option Agreement.

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Spouse of Optionee

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EXHIBIT A

NEUROCRINE BIOSCIENCES, INC.

2003 Stock Option Plan as amended

EXERCISE NOTICE

Neurocrine Biosciences, Inc.  
12780 El Camino Real  
San Diego, CA 92130

Attention: Secretary

1. Exercise of Option. Effective as of today, \_\_\_\_\_, 20\_\_\_\_, the undersigned (“Purchaser”) hereby elects to purchase \_\_\_\_\_ shares (the “Shares”) of the Common Stock of Neurocrine Biosciences, Inc. (the “Company”) under and pursuant to the 2003 Stock Option Plan as amended (the “Plan”) and the Stock Option Agreement dated \_\_\_\_\_, 20\_\_\_\_ (the “Option Agreement”). The purchase price for the Shares shall be \$\_\_\_\_\_, as required by the Option Agreement.
  2. Delivery of Payment. Purchaser herewith delivers to the Company the full purchase price for the Shares.
  3. Representations of Purchaser. Purchaser acknowledges that Purchaser has received, read and understood the Plan and the Option Agreement and agrees to abide by and be bound by their terms and conditions.
  4. Rights as Shareholder. 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 Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Shares so acquired shall be issued to the Optionee as soon as practicable after exercise of the Option. No adjustment will be made for a dividend or other right for which the record date is prior to the date of issuance, except as provided in Section 11 of the Plan.
  5. Tax Consultation. Purchaser understands that Purchaser may suffer adverse tax consequences as a result of Purchaser’s purchase or disposition of the Shares. Purchaser represents that Purchaser has consulted with any tax consultants Purchaser deems advisable in connection with the purchase or disposition of the Shares and that Purchaser is not relying on the Company for any tax advice.
  6. Entire Agreement; Governing Law. The Plan and Option Agreement are incorporated herein by reference. This Agreement, the Plan and the Option Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and Purchaser with respect to the subject matter hereof, and may not be modified adversely to the Purchaser’s interest except by means of a writing signed by the Company and Purchaser. This agreement is governed by the internal substantive laws, but not the choice of law rules, of California.
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Submitted by:  
PURCHASER:

Accepted by:

NEUROCRINE BIOSCIENCES, INC.

\_\_\_\_\_  
Signature

\_\_\_\_\_  
Print Name

Neurocrine Biosciences, Inc.  
12780 El Camino Real  
San Diego, CA 92130

Date Received

\_\_\_\_\_  
Its

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**NEUROCRINE BIOSCIENCES, INC.**

**2003 INCENTIVE STOCK PLAN**

**Restricted Stock Unit Agreement**

**Grant Notice**

Neurocrine Biosciences, Inc. (the "Company") hereby grants you, [ \_\_\_\_\_ ] (the "Employee"), an award of Restricted Stock Units ("RSUs") under the Company's 2003 Incentive Stock Plan, as amended (the "Plan"), the terms of which are hereby incorporated by reference. The date of this Restricted Stock Unit Agreement, which includes Appendix A attached hereto and incorporated herein (the "Agreement"), is September 26, 2006 (the "Effective Date"). Subject to the remaining terms of this Agreement and of the Plan, the principal features of this award are as follows:

Number of RSUs: \_\_\_\_\_

Vesting of RSUs: The RSUs will vest according to the following schedule:

So long as you remain in Continuous Status as an Employee or Consultant through each such date, 1/3<sup>rd</sup> of the RSUs shall vest on each of the thirteen (13), twenty-four (24) and thirty-six (36) month anniversaries of the Effective Date, so that the RSUs will become fully vested on the thirty-six (36) month anniversary of the Effective Date (the "Vesting Schedule"). The RSUs are also subject to the vesting conditions set forth in paragraph 4 of the attached Appendix A.

Unless otherwise defined herein or in Appendix A, capitalized terms herein or in Appendix A shall have the defined meanings ascribed to them in the Plan.

Your signature below indicates your agreement and understanding that this award is subject to all of the terms and conditions contained in this Agreement (including Appendix A) and the Plan. For example, important additional information on vesting and forfeiture of the RSUs is contained in Paragraphs 4 through 6 of Appendix A. PLEASE BE SURE TO READ ALL OF APPENDIX A, WHICH CONTAINS THE SPECIFIC TERMS AND CONDITIONS OF THIS AGREEMENT.

NEUROCRINE BIOSCIENCES, INC.

EMPLOYEE

\_\_\_\_\_  
**Tim Coughlin**

\_\_\_\_\_  
**[NAME]**

Address: \_\_\_\_\_

**VP and CFO**

Date: \_\_\_\_\_9/26/06\_\_\_\_\_

\_\_\_\_\_  
Date: \_\_\_\_\_

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## APPENDIX A

### TERMS AND CONDITIONS OF RESTRICTED STOCK UNITS

1. **Grant.** The Company hereby grants to the Employee under the Plan an award of that number of RSUs set forth on the first page of this Agreement, subject to all of the terms and conditions in this Agreement and the Plan.
  2. **Plan Governs.** The RSUs are issued pursuant to, and the terms of this Agreement are subject to, all terms and provisions of the Plan, including without limitation Section 15 of the Plan. Except as provided in paragraph 4(b) below, in the event of a conflict between one or more provisions of this Agreement and one or more provisions of the Plan, the provisions of the Plan will govern.
  3. **Company's Obligation to Pay.** Each RSU has a value equal to the fair market value of a share of Common Stock on the date the shares subject thereto are distributed. Unless and until the RSUs will have vested in the manner set forth in paragraphs 4 and 5, the Employee will have no right to payment of any such RSUs. Prior to actual payment of any vested RSUs, such RSUs will represent an unsecured obligation of the Company, payable (if at all) only from the general assets of the Company. Nothing contained in this Agreement, and no action taken pursuant to its provisions, shall create or be construed to create a trust of any kind or fiduciary relationship between Employee and the Company or any other person.
  4. **Vesting.**
    - (a) Subject to paragraph 5, the RSUs awarded by this Agreement will vest in the Employee according to the Vesting Schedule set forth on the first page of this Agreement, subject to the Employee's remaining in Continuous Status as an Employee or Consultant through such vesting periods or dates.
    - (b) Notwithstanding anything to the contrary set forth in the Plan, the vesting of the RSUs awarded by this Agreement shall not accelerate in accordance with Section 9(d) of the Plan in connection with a termination of Employee's Continuous Status as an Employee as a result of Employee's retirement from the Company.
    - (c) In the event of a Change in Control of the Company approved by the majority of the members of the Board on the Board prior to the commencement of such Change in Control, the RSUs shall be assumed or an equivalent award 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 Employee without Cause, the RSUs shall become immediately fully vested. In the event that the successor corporation refuses to assume or substitute the RSUs, the RSUs shall become immediately fully vested and the shares subject to the RSUs shall be issued to Employee immediately prior to the Change in Control, provided that such transaction also qualifies as a change in the ownership or effective control of the Company, or in the ownership of a substantial portion of the assets of the Company, in each case for purposes of Section 409A(a)(2)(A)(v) of the Internal Revenue Code and the regulations and other guidance thereunder ("Section 409A Change of Control").
    - (d) 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, the RSUs shall immediately fully vest. In the event that the successor corporation refuses to assume or substitute the RSUs, the shares subject to the RSUs shall be issued to Employee immediately prior to the Change in Control, provided that such transaction also qualifies as a Section 409A Change of Control.
    - (e) The RSUs shall be considered assumed if, following the Change in Control, the RSUs confer the right to receive, for each Share of Common Stock subject to the RSUs immediately prior to the Change in Control, the consideration (whether stock, cash, or other securities or property) received in the Change in 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 in 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 issued pursuant to the RSUs, for each Share of Common Stock subject to the RSUs, 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 in Control.
  5. **Forfeiture upon Termination as Service Provider.** Notwithstanding any contrary provision of this Agreement, if the Employee terminates Continuous Status as an Employee or Consultant for any or no reason, the then-unvested RSUs awarded by this Agreement will thereupon be forfeited at no cost to the Company and the Employee shall have no further rights thereunder. To the extent not already paid, RSUs that vest in accordance with the Vesting Schedule shall be paid following the Employee's termination of Continuous Status as an Employee or Consultant in accordance with paragraph 6 or 8 below, as applicable.
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6. Issuance after Vesting. If Employee does not elect to defer his or her distribution of the shares subject to the RSUs in accordance with paragraph 8 below, shares of Common Stock subject to any RSUs that vest in accordance with the Vesting Schedule will be issued to the Employee (or in the event of the Employee's death, to his or her estate) in whole shares of Common Stock on each of the thirteen (13), twenty-four (24) and thirty-six (36) month anniversaries of the Effective Date (each a "Vesting Distribution Date"), in each case not later than ten (10) days following each Vesting Distribution Date, with respect to shares of Common Stock subject to those RSUs that have vested on each such date.

7. Tax Withholding. On or before the time Employee receives a distribution of shares of Common Stock pursuant to the RSUs, or at any time thereafter as requested by the Company, the Employee must make adequate provision, as determined by the Company, for any sums required to satisfy the federal, state, local and foreign tax withholding obligations of the Company or a Subsidiary, if any, which arise in connection with the vesting and/or issuance of the shares subject to the RSUs. Unless the tax withholding obligations of the Company and/or any Subsidiary are satisfied, the Company shall have no obligation to issue the shares of Common Stock subject to the RSU. If the Employee does not satisfy the tax withholding obligations of the Company and/or any Subsidiary within thirty (30) days following receipt of notice from the Company, then the RSU will automatically terminate and the Employee will not be issued any shares pursuant to the RSU.

8. Deferral Election.

(a) Election Whether to Defer Distribution of RSU Shares. Each Employee must elect whether to defer his or her distribution of the RSU shares to a date following the Vesting Distribution Date in accordance with paragraph 8(b) or 8(c) below, as applicable. Employees who are not eligible to participate in the Amended and Restated Neurocrine Biosciences, Inc. Nonqualified Deferred Compensation Plan (the "Deferred Compensation Plan"), as amended, must make an election pursuant to paragraph 8(b) below. Employees who are eligible to participate in the Deferred Compensation Plan ("Selected Employees") must make an election pursuant to paragraph 8(c) below. If an Employee does not make a valid, timely election pursuant to paragraph 8(b) or 8(c) below, as applicable, the Employee will be deemed to have affirmatively elected not to defer his or her distribution of the RSU shares, and the shares will be delivered to Employee in accordance with paragraph 6.

(b) Standard Deferral Election. Employees who are not Selected Employees must make an election whether to defer receipt of the RSU shares pursuant to the terms and conditions of the Standard Deferral Election Agreement attached hereto as Exhibit A. Subject to a valid deferral election made within thirty (30) days following the Effective Date, the Employee may elect to defer the timing of the receipt of shares under this Agreement and have such shares issued at a later date pursuant to the terms and conditions of the Standard Deferral Election Agreement. Such deferral elections must also comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and the related Treasury Regulations or other guidance issued thereunder.

(c) Deferral Election Under Deferred Compensation Plan by Selected Employees. Selected Employees must make an election whether to defer receipt of the RSU shares pursuant to the terms and conditions of the Deferred Compensation Plan Deferral Election Agreement attached hereto as Exhibit B. Subject to a valid deferral election made within thirty (30) days following the Effective Date, Selected Employees may elect to defer the timing of the receipt of the shares under this Agreement and have such shares issued at a later date pursuant to the terms and conditions of the Deferred Compensation Plan and the Deferred Compensation Plan Deferral Election Agreement. Such deferral elections must also comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended (the "Code"), and the related Treasury Regulations or other guidance issued thereunder. To make a valid deferral election pursuant to this paragraph 8(c), Employee must also complete a Deferred Compensation Plan Beneficiary Designation form, in substantially the form attached hereto as Exhibit C.

(d) Deferred Distribution Date. The date upon which the shares of Common Stock are scheduled to be delivered pursuant to any deferral election made under this paragraph 8 is the "Deferred Distribution Date." Shares of Common Stock subject to any RSUs that are subject to any deferral election made under this paragraph 8 will be issued to the Employee (or in the event of the Employee's death, to his or her estate) in whole shares of Common Stock in each case not later than ten (10) days following the Deferred Distribution Date

9. Delay in Issuance of Shares. Notwithstanding anything to the contrary set forth herein, if the Company determines that the Employee's sale of shares of Common Stock on the date the shares subject to the RSUs are scheduled to be delivered, whether on the Vesting Distribution Date or a Deferred Distribution Date selected pursuant to paragraph 8 above (in either case, the "Original Distribution Date") would violate its policy regarding insider trading of the Company's stock, as determined by the Company in accordance with such policy, then such shares shall not be delivered on such Original Distribution Date and shall instead be delivered as soon as practicable on or after the earliest date on which the Employee could sell such shares pursuant to such policy; provided, however, that in no event shall the delivery of the shares be delayed pursuant to this provision beyond the later of: (1) December 31st of the same calendar year of the Original Distribution Date, or (2) the 15th day of the third calendar month following the Original Distribution Date.

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10. Rights as Stockholder. Neither the Employee nor any person claiming under or through the Employee will have any of the rights or privileges of a stockholder of the Company in respect of any shares of Common Stock deliverable hereunder unless and until certificates representing such shares of Common Stock will have been issued, recorded on the records of the Company or its transfer agents or registrars, and delivered to the Employee.

11. No Effect on Employment. This Agreement is not an employment contract, and nothing herein shall be deemed to create in any way whatsoever any obligation on the Employee's part to continue in the employ of the Company, or of the Company to continue the Employee's employment with the Company. The Employee's employment with the Company is on an at will basis only. The Company will have the right, which is hereby expressly reserved, to terminate or change the terms of the employment of the Employee at any time for any reason whatsoever, with or without good cause.

12. Address for Notices. Any notice to be given to the Company under the terms of this Agreement will be addressed to the Company at its principal place of business (attention: General Counsel), or at such other address as the Company may hereafter designate in writing. Any notices provided for in this Agreement or the Plan shall be given in writing and shall be deemed effectively given upon receipt or, in the case of notices delivered by the Company to the Employee, five (5) days after deposit in the United States mail, postage prepaid, addressed to the Employee at the address specified on the first page of this Agreement or at such other address as the Employee may hereafter designate by written notice to the Company.

13. Transferability. Unless determined otherwise by the Board, this grant and the rights and privileges conferred hereby, including without limitation the shares of Common Stock issuable following the vesting of the RSUs, will not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner (whether by operation of law or otherwise) and will not be subject to sale under execution, attachment or similar process until, with respect to whole shares of Common Stock issuable following the vesting of the RSUs, such shares are issued pursuant to paragraph 6 or 8 above. Upon any attempt to sell, pledge, assign, hypothecate, transfer, or dispose of this grant, or any right or privilege conferred hereby, or upon any attempted sale under any execution, attachment or similar process, this grant and the rights and privileges conferred hereby immediately will become null and void.

14. Binding Agreement. Subject to the limitations on the transferability of this grant contained herein, this Agreement will be binding upon and inure to the benefit of the heirs, legatees, legal representatives, successors and assigns of the parties hereto.

15. Additional Conditions to Issuance of Stock. If at any time the Company will determine, in its discretion, that the listing, registration or qualification of the shares of Common Stock upon any securities exchange or under any state or federal law, or the consent or approval of any governmental regulatory authority, is necessary or desirable as a condition to the issuance of shares of Common Stock to the Employee (or his or her estate), such issuance will not occur unless and until such listing, registration, qualification, consent or approval will have been effected or obtained free of any conditions not acceptable to the Company. The Company will make all reasonable efforts to meet the requirements of any such state or federal law or securities exchange and to obtain any such consent or approval of any such governmental authority.

16. Committee Authority. The Committee will have the power to interpret the Plan and this Agreement and to adopt such rules for the administration, interpretation and application of the Plan and this Agreement as are consistent therewith and to interpret or revoke any such rules. All actions taken and all interpretations and determinations made by the Committee in good faith will be final and binding upon Employee, the Company and all other interested persons. No member of the Committee will be personally liable for any action, determination or interpretation made in good faith with respect to the Plan or this Agreement.

17. Captions. Captions provided herein are for convenience only and are not to serve as a basis for interpretation or construction of this Agreement.

18. Agreement Severable. In the event that any provision in this Agreement will be held invalid or unenforceable, such provision will be severable from, and such invalidity or unenforceability will not be construed to have any effect on, the remaining provisions of this Agreement.

19. Amendment. The Committee may amend, terminate or revoke this Agreement in any respect to the extent determined necessary or desirable by the Committee in its discretion to comply with the requirements of Section 409A of the Code and the Treasury Regulations or other guidance issued thereunder. Employee expressly understands and agrees that no additional consent of Employee shall be required in connection with such amendment, termination or revocation.

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## EXHIBIT A

### STANDARD DEFERRAL ELECTION AGREEMENT

Please complete this Standard Deferral Election Agreement (“Election Agreement”) and return a signed copy to Steve Zug no later than the thirtieth (30<sup>th</sup>) day following the Effective Date as indicated on your Restricted Stock Unit Agreement.

#### I. Deferral Election (check one)

Election to Defer:

Employee hereby irrevocably elects to defer receipt of the shares of Common Stock associated with the RSUs provided for in the Grant Notice and Appendix A thereto, to which this Exhibit A is attached, until the fifth anniversary of the Effective Date.

Decline:

Employee hereby irrevocably elects not to defer receipt of the shares of Common Stock associated with the RSUs provided for in the Grant Notice and Appendix A thereto, to which this Exhibit A is attached (shares will be issued to Employee as the RSU award vests in accordance with the Restricted Stock Unit Agreement).

#### II. Terms and Conditions of Deferral Election

If Employee elects to defer receipt of the shares subject to the RSU pursuant to this Election Agreement, by signing this Election Agreement, Employee hereby acknowledges his or her understanding and acceptance of each of the following:

1. Acceleration of Issuance of Shares Upon Termination of Continuous Status as an Employee or Consultant. In the event of Employee’s termination of Continuous Status as an Employee or Consultant prior to the fifth anniversary of the Effective Date that qualifies as a “separation from service” within the meaning of Code Section 409A(a)(2)(A)(i) and the regulations and other guidance promulgated thereunder, then any vested shares of Common Stock subject to the RSUs shall instead be delivered to Employee on the date of his or her termination of Continuous Status as an Employee or Consultant.
  2. Acceleration of Issuance of Shares Upon Change in Control. Notwithstanding Employee’s deferral election pursuant to this Election Agreement, in the event that a successor corporation refuses to assume or substitute the RSUs in connection with a Change in Control, the shares subject to the RSUs shall instead be issued to Employee immediately prior to the Change in Control to the extent provided in paragraph 4 of the Appendix.
  3. Delay in Distribution for Specified Employees. Notwithstanding anything to the contrary set forth herein, if at the time the shares of Common Stock would otherwise be issued to Employee as a result of termination of Continuous Status as an Employee or Consultant, Employee is subject to the distribution limitations contained in Section 409A of the Code applicable to “specified employees,” share issuances resulting from a termination of Continuous Status as an Employee or Consultant shall not be made before the date which is six (6) months following the date of termination of Continuous Status as an Employee or Consultant, or, if earlier, the date of Employee’s death that occurs within such six (6) month period.
  4. Delay in Distribution for Insiders. Notwithstanding the foregoing election, as described in paragraph 9 of the Appendix to the RSU Agreement, the distribution of shares may be delayed if the Company determines that Employee’s sale of the shares on such date would violate the Company’s policy regarding insider trading of the Company’s stock, as determined by the Company in accordance with such policy.
  5. Effective Election. In order for the foregoing deferral election to become effective, this Election Agreement must be submitted by Employee to Steve Zug on or before thirty (30) days following the Effective Date of the RSUs.
  6. Withholding. The Company shall require that Employee make adequate provision for any federal, state, or local tax required by law to be withheld prior to the issuance of the shares of Common Stock.
  7. Nonassignable. Employee’s rights and interests under this Election Agreement may not be assigned, pledged, or transferred.
  8. Termination of this Election Agreement. The Company reserves the right to terminate this Election Agreement at any time. In such case, any vested shares of Common Stock granted to Employee pursuant to the Restricted Stock Unit Agreement may be issued to Employee immediately, to the extent permitted by Section 409A of the Code and the regulations and other guidance promulgated thereunder.
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9. Bookkeeping Account. The Company will establish a bookkeeping account to reflect the number of shares of Common Stock that Employee may acquire pursuant to the RSUs and the fair market value of such shares of Common Stock that are subject to this Election Agreement.
10. Governing Law. This Election Agreement shall be construed and administered according to the internal laws of the State of California, without regard to its conflicts of laws principles.

III. Authorization and Signature

By completing and executing this Election Agreement, Employee authorizes the Company to defer or not defer, as applicable, the issuance of the shares subject to the RSU award. Employee acknowledges that the Company has not made any representations concerning future performance of the Company's Common Stock. Further, Employee has not relied upon advice from the Company in making Employee's election. By executing this Election Agreement, the Employee hereby acknowledges his or her understanding of and agreement with all the terms and provisions set forth herein.

EMPLOYEE

NEUROCRINE BIOSCIENCES, INC.

\_\_\_\_\_

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

Date: \_\_\_\_\_

Date: \_\_\_\_\_

---

## EXHIBIT B

### DEFERRED COMPENSATION PLAN DEFERRAL ELECTION AGREEMENT (RSU AWARDS)

Please complete this Deferred Compensation Plan Deferral Election Agreement ("Election Agreement") and return a signed copy to Steve Zug no later than the thirtieth (30<sup>th</sup>) day following the Effective Date as indicated on your Restricted Stock Unit Agreement ("RSU Agreement").

Defined terms not explicitly defined in this Election Agreement but defined in the Company's 2003 Incentive Stock Plan ("Plan"), the Company's Amended and Restated Nonqualified Deferred Compensation Plan ("Deferred Compensation Plan"), or your RSU Agreement shall have the same definitions as in such documents.

I. Deferral Election (check one)

Election to Defer:

Employee hereby irrevocably elects to defer receipt of the shares of Common Stock associated with the RSUs provided for in the Grant Notice and Appendix A thereto, to which this Exhibit B is attached, in accordance with the terms of the Deferred Compensation Plan.

Decline:

Employee hereby irrevocably elects not to defer receipt of the shares of Common Stock associated with the RSUs provided for in the Grant Notice and Appendix A thereto, to which this Exhibit B is attached (shares will be issued to Employee as the RSU award vests in accordance with the RSU Agreement).

If Employee elects above to defer receipt of the shares subject to the RSUs, Employee must complete Deferral Alternative #1 (Termination of Service). Selecting Deferral Alternative #2 is optional. If Employee selects Deferral Alternative #2, Employee must also complete the applicable portion that follows such selection.

**ALL EMPLOYEES WHO ELECT TO DEFER RECEIPT OF THEIR RSUs MUST COMPLETE THIS SECTION**

DEFERRAL ALTERNATIVE #1 (TERMINATION OF SERVICE):

Employee elects to receive the vested shares of Common Stock associated with the RSUs upon his or her termination of service.

PLEASE NOTE: The above election will apply in the event of Employee's termination of service for any reason, including due to Employee's Death, Disability or Retirement. The shares subject to the RSUs will be issued in a single lump sum upon termination of service. However, for termination of service distributions Employee may (but is not required to) instead elect annual installment distribution of the shares, as follows:

- Employee elects to receive the vested shares of Common Stock associated with the RSUs upon his or her termination of service in substantially equal annual installments as follows:
  - \_\_\_\_\_ annual installments (elect 2-15)

PLEASE NOTE: The above election to receive a distribution of shares in annual installments instead of a lump sum will only apply if the number of shares subject to each annual installment is at least 2,500 shares. If the number of shares to be distributed pursuant to any annual installment would be less than 2,500 shares, the shares subject to the RSUs will be issued in a single lump sum upon termination of service.

**COMPLETION OF THIS SECTION IS OPTIONAL**

DEFERRAL ALTERNATIVE #2: (SPECIFIED DATE(S) — CHECK BOXES THAT APPLY)

- o Employee elects to receive the vested shares of Common Stock associated with the RSUs on the following specified dates (must be year 2013 or later) for the following number of shares:

A.	<input type="checkbox"/>	_____	_____	_____	_____
		Number of shares	Month	Day	Year
B.	<input type="checkbox"/>	_____	_____	_____	_____
		Number of shares	Month	Day	Year
C.	<input type="checkbox"/>	_____	_____	_____	_____
		Number of shares	Month	Day	Year
D.	<input type="checkbox"/>	_____	_____	_____	_____
		Number of shares	Month	Day	Year

PLEASE NOTE: If Employee's Retirement, Death, Disability, or Termination of Employment occurs before the elected specified date(s), the shares will not be issued to Employee on the specified date(s) elected above, but will instead be issued to Employee in accordance with Employee's deferral election under Alternative #1 (Termination of Service). Employee may elect up to four separate specified dates, and may not elect that fewer than 5,000 shares be issued to Employee on any specified date.

**II. Election Conditions**

The following conditions apply to the foregoing deferral election:

1. Employee may elect a Deferred Distribution Date that occurs after the date of vesting of the RSUs. The "Deferred Distribution Date" is the date as of which Employee will receive the shares of vested Common Stock associated with the RSUs that Employee elects to defer. Unless Employee timely elects otherwise on this Election Agreement, such shares will be issued to Employee on or about the date or dates upon which they vest as indicated in the RSU Agreement. Notwithstanding the foregoing, as described in paragraph 9 of the Appendix to the RSU Agreement, the distribution of such shares may be delayed if the Company determines that Employee's sale of the shares on such date would violate the Company's policy regarding insider trading of the Company's stock, as determined by the Company in accordance with such policy.
2. Employee may elect as the Deferred Distribution Date a termination of Employee's service that qualifies as a "separation from service" for purposes of Section 409A of the Code.
3. As an alternative to 2 above, Employee may elect up to four different specified dates as Deferred Distribution Dates. However, if prior to such Deferred Distribution Date, there is a termination of Employee's service with the Company that is a "separation from service" for purposes of Section 409A of the Code, Employee will receive all shares of vested Common Stock associated with the RSUs in accordance with Employee's election under Deferral Alternative #1, notwithstanding any deferral election Employee makes on this Election Agreement under Alternative #2 to receive shares on a specified date.
4. If no Deferred Distribution Date is elected, then the issuance of vested Common Stock will occur upon or about the vesting date(s) as indicated in the RSU Agreement.
5. Notwithstanding anything to the contrary set forth herein, if at the time the shares of Common Stock would otherwise be issued to Employee as a result of termination of service, Employee is subject to the distribution limitations contained in Section 409A of the Code applicable to "specified employees," share issuances resulting from a termination of service shall not be made before the date which is six (6) months following the date of termination of Employee's service, or, if earlier, the date of Employee's death that occurs within such six (6) month period.

6. Notwithstanding anything to the contrary that may be set forth in Section 4.6 of the Deferred Compensation Plan, and notwithstanding Employee's deferral election pursuant to this Election Agreement, in the event that a successor corporation refuses to assume or substitute the RSUs in connection with a Change in Control (as defined in the 2003 Incentive Stock Plan), the shares subject to the RSUs shall instead be issued to Employee immediately prior to the Change in Control to the extent provided in paragraph 4 of the Appendix.

### III. Acknowledgement

Employee further acknowledges and agrees as follows:

1. In order for the foregoing deferral election to become effective, this Election Agreement must be submitted by Employee to Steve Zug on or before thirty (30) days following the Effective Date of the RSUs.
2. The Company shall require that Employee make adequate provision for any federal, state, or local tax required by law to be withheld prior to the issuance of the shares of Common Stock.
3. Employee's rights and interests under this Election Agreement may not be assigned, pledged, or transferred.
4. The Company reserves the right to terminate this Election Agreement at any time. In such case, any vested shares of Common Stock granted to Employee pursuant to the RSU Agreement may be issued to Employee immediately, to the extent permitted by Section 409A of the Code and the regulations and other guidance promulgated thereunder.
5. The Company will establish a bookkeeping account to reflect the number of shares of Common Stock that Employee may acquire pursuant to the RSUs and the fair market value of such shares of Common Stock that are subject to this Election Agreement.
6. This Election Agreement shall be construed and administered according to the internal laws of the State of California, without regard to its conflicts of laws principles.

### IV. Authorization and Signature

By completing and executing this Election Agreement, Employee authorizes the Company to defer or not defer, as applicable, the issuance of the shares subject to the RSU award. Employee acknowledges that the Company has not made any representations concerning future performance of the Company's Common Stock. Further, Employee has not relied upon advice from the Company in making Employee's election. Additionally, Employee acknowledges that the terms of the Deferred Compensation Plan document, as reasonably interpreted by the Company, governs all aspects of this election. By executing this Election Agreement, the Employee hereby acknowledges his or her understanding of and agreement with all the terms and provisions set forth herein.

• \_\_\_\_\_  
Signature of Employee

\_\_\_\_\_  
Date

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EXHIBIT C

BENEFICIARY DESIGNATION

**Personal Information**

Last	First	Middle Initial	Social Security Number
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I hereby designate the following Beneficiary(ies) to receive any benefit payable under the Plan by reason of my death, as provided in the Plan document.

**Primary Beneficiary(ies)**

Beneficiary	Percentage
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Relationship to Participant	Social Security Number
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Beneficiary	Percentage
-------------	------------

Relationship to Participant	Social Security Number
-----------------------------	------------------------

Beneficiary	Percentage
-------------	------------

Relationship to Participant	Social Security Number
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Beneficiary	Percentage
-------------	------------

Relationship to Participant	Social Security Number
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**Contingent Beneficiary(ies)**

Beneficiary	Percentage
-------------	------------

Relationship to Participant	Social Security Number
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Beneficiary	Percentage
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Relationship to Participant	Social Security Number
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**Please Sign Below**

If no percentage is indicated, all beneficiaries will be deemed to have an equal interest in the benefits payable under the Plan.

• \_\_\_\_\_  
Signature of Employee

\_\_\_\_\_  
Date

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

I, Kevin C. Gorman, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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
  - d) 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 internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - 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: July 30, 2009

/s/ Kevin C. Gorman  
\_\_\_\_\_  
Kevin C. Gorman  
President and Chief Executive Officer

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

I, Timothy P. Coughlin, 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)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), 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) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) 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
  - d) 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 internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - 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: July 30, 2009

/s/ Timothy P. Coughlin  
\_\_\_\_\_  
Timothy P. Coughlin  
Vice President and Chief Financial Officer



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. (Company) on Form 10-Q for the period ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (Report), I, Kevin C. Gorman, 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.

July 30, 2009

By: /s/ Kevin C. Gorman  
Name: Kevin C. Gorman  
Title: President and Chief Executive Officer

In connection with the Quarterly Report of Neurocrine Biosciences, Inc. (Company) on Form 10-Q for the period ended June 30, 2009 as filed with the Securities and Exchange Commission on the date hereof (Report), I, Timothy P. Coughlin, 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:

- (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.

July 30, 2009

By: /s/ Timothy P. Coughlin  
Name: Timothy P. Coughlin  
Title: Vice President and Chief Financial Officer