SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTIONS 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

For the fiscal year ended December 31, 2005

OR

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

For the transition period from _____ to _____

Commission file number: 0-22705

NEUROCRINE BIOSCIENCES, INC.
(Exact name of registrant as specified in its charter)

Delaware	**33-0525145**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
12790 El Camino Real, San Diego, CA	**92130**
(Address of principal executive office)	(Zip Code)

Registrant's telephone number, including area code: **(858) 617-7600**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
None	

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.001 par value
(Title of Class)

Preferred Share Purchase Rights
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☑ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ☑

Note- checking the box above will not relieve any registrant required to file reports pursuant to Section 13 of 15(d) of the Exchange Act from their obligations under those Sections.

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 report), and (2) has been subject to such filing requirements for the past 90 days. Yes ☑ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer ☑ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the common equity held by non-affiliates of the Registrant as of June 30, 2005 totaled approximately $1,117,161,759 based on the closing stock price as reported by the Nasdaq National Market.

As of January 26, 2006, there were 37,208,611 shares of the Registrant's Common Stock, $0.001 par value per share, outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document Description	10-K Part
Portions of the Registrant's notice of annual meeting of stockholders and proxy statement to be filed pursuant to Regulation 14A within 120 days after Registrant's fiscal year end of December 31, 2005 are incorporated by reference into Part III of this report.	III, ITEMS 10, 11, 12, 13, 14

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PART I

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K 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, 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,” “pro forma,” or “anticipates,” or other similar words (including their use in the negative), or by discussions of future matters such as the development 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,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Business” as well as other sections in this report. You should be aware that the occurrence of any of the events discussed under the heading “Item 1.A. 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.

ITEM 1. BUSINESS

We discover, develop and intend to commercialize drugs for the treatment of neurological and endocrine-related diseases and disorders. Our product candidates address some of the largest pharmaceutical markets in the world, including insomnia, anxiety, depression, various female and male health disorders, multiple sclerosis, diabetes and other neurological and endocrine related diseases and disorders. We currently have nine programs in various stages of research and development, including seven programs in clinical development. While we independently develop many of our product candidates, we have entered into collaborations for three of our programs. Our lead clinical development program, indiplon, is a drug for the treatment of insomnia. We have submitted two New Drug Applications (NDAs) to the United States Food and Drug Administration (FDA) with respect to indiplon.

Our Product Pipeline

The following table summarizes our most advanced product candidates currently in clinical development and those currently in research, and is followed by detailed descriptions of each program:

Program	Target Indication	Status	Commercial Rights
Products under clinical development:			
Indiplon	Insomnia	Registration	Pfizer/Neurocrine
GnRH Antagonist	Endometriosis	Phase II	Neurocrine
Altered Peptide Ligand	Multiple Sclerosis	Phase II	Neurocrine
Altered Peptide Ligand	Type 1 Diabetes	Phase II	Neurocrine
CRF R_2 Peptide Agonist — Urocortin 2	Cardiovascular/Endocrine	Phase II	Neurocrine
CRF R_1 Antagonist	Anxiety and Depression	Phase I	GlaxoSmithKline/ Neurocrine
GnRH Antagonist	Benign Prostatic Hyperplasia	Phase I	Neurocrine

Program	Target Indication	Status	Commercial Rights
Research:			
CRF R_1 Antagonist	Anxiety, Depression, Gastrointestinal Disorders	Research	GlaxoSmithKline/ Neurocrine
GnRH Antagonist	Endometriosis, Benign Prostatic Hyperplasia	Research	Neurocrine
Adenosine 2A Receptor Antagonists	Parkinson's Disease	Research	Neurocrine/Almirall
H1 Antagonist	Insomnia	Research	Neurocrine

"Registration" indicates that we or our collaborators have submitted an NDA to the FDA for regulatory approval of the drug candidate.

"Phase III" indicates that we or our collaborators are conducting large-scale, comparative clinical trials on groups of patients afflicted with a specific disease in order to determine safety and efficacy as primary support for regulatory approval by the FDA to market a product for a specific disease or condition.

"Phase II" indicates that we or our collaborators are conducting clinical trials on groups of patients afflicted with a specific disease in order to determine preliminary efficacy, optimal dosages and expanded evidence of safety.

"Phase I" indicates that we or our collaborators are conducting clinical trials with a smaller number of patients to determine early safety profile, maximally tolerated dose and pharmacological properties of the product in human volunteers.

"Research" indicates identification and evaluation of compound(s) in laboratory and preclinical models.

"R_1 and R_2" refer to two CRF receptor subtypes.

Products Under Clinical Development

Indiplon

Insomnia is a neurological disorder with approximately 85 million adults in the United States reporting trouble sleeping a few nights per week or more, according to a 2005 report from Mattson Jack (an epidemiological database used to determine the prevalence of a disease or disorder). Mattson Jack also reports that approximately 22 million adults in the United States experience chronic insomnia, having trouble sleeping every night or almost every night. In addition, according to the National Sleep Foundation (2003), frequent sleep problems in individuals that are 55 to 84 years old, if ignored, can complicate the treatment of other medical conditions, including arthritis, diabetes, heart and lung disease and depression. According to a 2005 report from IMS Health, the United States insomnia pharmaceutical market was $2.2 billion in 2004 and was expected to exceed $2.7 billion in 2005.

Researchers have found that insomnia can be treated by drugs that interact with the site of action of a natural brain chemical involved in promoting and maintaining sleep. This chemical is called gamma amino-butyric acid, or GABA, and the site of action is called the GABA-A receptor. During the 1980s, drugs that non-selectively target the GABA-A receptor, known as benzodiazepines, were used as sedatives to treat insomnia. This class of drugs produces several undesirable side effects, including negative interactions with other central nervous system depressants, such as alcohol, the development of tolerance upon repeat dosing, and rebound insomnia, or the worsening of insomnia following discontinuation of dosing. Additional side effects, due to the long half-life, or the duration of action of a compound associated with this class of drugs include next-day residual sedation effects and impairment of coordination and memory. Memory impairment, which can include amnesia for events occurring prior to and after drug administration, is of particular concern in the elderly who comprise approximately 18% of the total insomnia population according to Mattson Jack (2005).

During the late 1980s, a class of drugs known as non-benzodiazepines was developed to target a specific site on the GABA-A receptor. The non-benzodiazepines have a reduced incidence of side effects that are believed to be

attributable to binding more selectively on a GABA-A receptor subtype than the benzodiazepines. The most commonly prescribed of the non-benzodiazepines in the United States are Ambien®, Sonata® and Lunesta ®. Ambien® is the current market leader, with approximately $1.8 billion in worldwide sales in 2005, according to Sanofi-Synthelabo.

We obtained the rights to indiplon for the treatment of insomnia through an exclusive worldwide sublicense agreement that we entered into with DOV Pharmaceutical, Inc. in June 1998. Indiplon is a non-benzodiazepine GABA-A receptor agonist which acts via the same mechanism as the currently marketed non-benzodiazepine therapeutics. However, preclinical studies suggest that indiplon has fewer side effects than currently marketed non-benzodiazepines, including Ambien®, and Sonata®. In our Phase II and III clinical studies, indiplon demonstrated efficacy with no significant next-day residual sedation effects at clinically relevant doses.

We are developing indiplon in both a short acting capsule formulation and a longer acting tablet formulation to address the different needs of the insomnia patient population. To develop these two different formulations, we have capitalized on important features of indiplon, its rapid absorption and its short half-life in the body. Based on our clinical studies, we have determined that the concentration of indiplon in the bloodstream reaches levels high enough to induce sedation approximately 15 minutes after the patient takes the pill. Indiplon is then rapidly metabolized and eliminated. This results in rapid sleep onset followed by rapid elimination of the drug from the body, reducing the risk of next-day residual sedation effects.

We believe that together, these two formulations of indiplon will address the most prevalent forms of insomnia — difficulty falling asleep; difficulty staying asleep; and middle of the night awakenings, with difficulty getting back to sleep. The capsule can be used by patients who have trouble falling asleep or who wake up during the night and cannot get back to sleep. The tablet can be used by patients to rapidly induce sleep and maintain sleep through the night. Both forms are intended to improve sleep quality without creating drug induced impairment upon awakening. Our indiplon program is one of the most comprehensive clinical programs addressing the multiple needs of both younger and older adult patients with various forms of insomnia such as sleep initiation, sleep maintenance, middle of the night awakening, and long term administration.

On April 14, 2005 we submitted an NDA to the FDA seeking clearance to market indiplon capsules for the treatment of insomnia. On May 26, 2005, we submitted an NDA to the FDA seeking clearance to market indiplon tablets for the treatment of insomnia. The FDA accepted both of these NDA submissions and established the Prescription Drug User Fee Act (PDUFA) dates as February 15, 2006 for the capsule NDA filing and March 27, 2006 for the tablet NDA filing. The PDUFA action date is the date by which the FDA is expect to have completed its review of the submissions and will document its assessment through the issuance of an action letter. In January 2006, the FDA requested submission of results from the driving study we completed in late 2005. We submitted the final report of this study to the agency as requested. Based on feedback from the FDA, we anticipate labeling that includes data from this study, which showed no impairment in next-day driving performance. In addition, the FDA has stated its intent to issue a combined package insert in lieu of individual package inserts for the capsule and tablet NDAs. To complete review of the driving study and the combined package insert, the FDA has advised us that the PDUFA dates for the capsule and tablet NDAs have been moved to May 15, 2006 and June 27, 2006, respectively. However, the FDA has committed to an action by May 15, 2006 for both NDAs. The NDAs contain data from a total of 74 clinical trials which included approximately 8,000 adult and elderly subjects, over 350,000 patient exposures and more than 80 preclinical studies. The data reported from these trials consistently has met both primary and secondary endpoints demonstrating the efficacy and safety of indiplon.

GnRH Antagonist

Gonadotropin-releasing hormone, or GnRH, is a brain peptide that stimulates the secretion of the pituitary hormones that are responsible for sex steroid production and normal reproductive function. Researchers have found that chronic administration of GnRH agonists reversibly shuts down this transmitter pathway and is clinically useful in treating hormone-dependent diseases such as endometriosis, uterine fibroids and benign prostatic hyperplasia. Other companies have developed several peptide drugs on this principle, such as Lupron® and Zoladex®, and according to manufacturers of these products, the annual worldwide sales in 2005 for these drugs were approximately $2.0 billion. However, since these drugs are peptides, they must be injected rather than taken orally. In addition, these types of agonists take up to several weeks to exert their effect, a factor not seen with direct GnRH antagonists, and until these drugs exert their effects, they have shown a tendency to exacerbate the condition. We believe that there is a large potential market for an orally delivered GnRH antagonist.

Our current GnRH antagonist clinical efforts are focused on providing new treatments for endometriosis and benign prostatic hyperplasia (BPH). Mattson Jack (2005) estimates that there are more than 5.9 million women in the United States who are clinically recognized as having chronic endometriosis. Of those afflicted, approximately 200,000 patients are treated in an inpatient setting, and approximately 250,000 are treated in an outpatient setting, according to a 1998 National Patient Profile audit. According to the American Academy of Family Physicians, endometriosis is believed to account for a significant proportion of infertility and greater than 90 percent of cases of chronic pelvic pain. The direct medical costs of endometriosis are estimated at $2.8 billion annually. We believe that the availability of an oral treatment, lacking the side effect profile of the currently available peptide agonists, may be an alternative to current therapies and ultimately encourage a higher treatment rate.

A Phase I clinical trial of our GnRH candidate for endometriosis was completed during 2005. This trial assessed a daily dosing of 50mg and 150mg of GnRH over a six week period in 60 healthy pre-menopausal women to assess the safety, pharmacokinetics, and pharmacodynamics of the compound. Immediately following the six week period, there were reductions of 40% (50mg) and 79% (150mg) in mean estradiol concentrations compared to placebo. This study demonstrated that our GnRH antagonist was safe and well tolerated, and a dose-dependent suppression of estradiol with once a day dosing was observed throughout the study. The effects of reduction in estradiol have been correlated with a reduction in pain and other symptoms of endometriosis. Based on the results of this trial, we initiated and fully enrolled a three-month Phase II trial in 76 endometriosis patients to establish efficacy and tolerability of our lead endometriosis drug candidate during 2005. Efficacy in this Phase II study is being assessed through the Composite Pelvic Sign and Symptoms Score (CPSSS) and results are expected in 2006.

A second Phase II study in patients with endometriosis was initiated in December 2005 to more fully explore dose responses. The study will include 72 patients and is designed to assess safety and efficacy over a three-month period with a safety extension for three-months. The primary endpoint is reduction in endometriotic pain as measured by CPSSS. Preliminary results are expected in the third quarter of 2006. Additionally, two previous Phase I studies showed our GnRH antagonist to be safe and well tolerated, resulting in suppression of estradiol in women and testosterone in men.

BPH is an enlargement of the prostate gland and affects approximately 33% of men over age 60 according to Mattson Jack (2005). Scientists have determined that dihydrotestosterone (DHT), a derivative of testosterone, is the primary cause of prostate enlargement. Scientists also have noted that men who do not generate DHT do not develop BPH. Although BPH affects an estimated 31 million men in the United States, only 5 million have been diagnosed and less than 1 million actually receive treatment (Mattson Jack 2004). United States sales of current treatments for BPH are approximately $1.4 billion in 2005 (IMS Health). During 2004, we conducted a Phase I single dose study to assess the safety, tolerability, pharmacokinetics and pharmacodynamics of our GnRH antagonist in healthy males. The results of this trial demonstrated that our GnRH antagonist effectively reduced testosterone production when compared to placebo. In 2005, we filed an Investigational New Drug application to initiate multiple dose Phase I studies in males as a basis for a Phase II study in 2006.

Altered Peptide Ligand

The American Autoimmune Related Diseases Association estimates that approximately 50 million people in the United States suffer from autoimmune diseases such as multiple sclerosis, rheumatoid arthritis and type 1 diabetes. The immune system typically protects an individual from disease agents, such as viruses, by recognizing and destroying those foreign substances using specialized blood cells, called lymphocytes. Occasionally, however, some lymphocytes arise that inappropriately recognize the body's own tissues as an invader and begin to attack normal healthy tissue, resulting in an autoimmune disease. While the mechanism through which the lymphocyte initiates the autoimmune disease is still unknown, the development of drugs that specifically suppress the action of self-reactive lymphocytes or restore the function of regulatory cells may prove advantageous for the prevention, cure or treatment of autoimmune disease.

One type of lymphocyte involved in the immune response to self or foreign substances is the T cell. T cells detect antigens, which are foreign substances, such as viruses or bacteria, and destroy them. Our scientists have determined based on a series of experiments that specific amino acid residues within a peptide sequence of an antigen are required for T cell recognition and subsequent cellular activation. The structure of such a peptide fragment can be specifically altered so that it will not properly activate the T cell. This altered peptide ligand can thus prevent the T cell from destroying its target, or in the case of an autoimmune reaction, prevent the T cell from destroying the healthy tissue.

Multiple Sclerosis. Multiple sclerosis is a chronic autoimmune disease characterized by recurrent attacks of neurological dysfunction due to damage in the central nervous system. The classic clinical features of multiple sclerosis include impaired vision and weakness or paralysis of one or more limbs. According to the National Multiple Sclerosis Society, there are approximately 400,000 cases of multiple sclerosis in the United States, with approximately 2.5 million cases worldwide. The National Multiple Sclerosis Society also estimates that most multiple sclerosis patients are diagnosed between the ages of 20 and 25 and that two to three times more women are affected than men. Currently available treatments for multiple sclerosis offer limited efficacy and steroids are often prescribed to reduce the severity of acute flare-ups and speed recovery. Experimental therapy with other immune-suppressive agents has shown limited success. Nevertheless, the two leading therapies for Multiple Sclerosis are projected to reach $4.9 billion in worldwide sales in 2005.

We have designed a novel altered peptide ligand based on myelin basic protein that would target the autoreactive T cells that cause neurological damage in multiple sclerosis. We have completed Phase I clinical trials and two Phase II clinical trials of our altered peptide ligand for the treatment of multiple sclerosis. One of the Phase II placebo-controlled studies showed a reduction in the total volume of new enhancing lesions (a marker for multiple sclerosis) in the central nervous system for 57% of the patients in the lowest dose group compared to 25% in the control group. However, allergic reactions were seen in approximately 10% of patients in these trials, suggesting that optimal dosing may be at lower levels than those selected for the trials.

In July 2003, we initiated a third Phase II clinical trial for our altered peptide ligand for the treatment of relapsing multiple sclerosis to further define safety and efficacy. This multicenter, randomized, double-blind, placebo-controlled trial is designed to evaluate safety and tolerability of our compound vs. placebo in approximately 150 patients. Enrollment in this study was completed in 2005, with data expected in early 2006.

Type 1 Diabetes. Utilizing our experience in the development of altered peptide ligands for multiple sclerosis, we have extended this approach to type 1 or insulin dependent diabetes mellitus, which is a metabolic disease in which the body does not produce enough insulin. Like multiple sclerosis, in type 1 diabetes the immune system erroneously targets healthy tissue, in this case the pancreatic cells responsible for the production of insulin. According to the International Diabetes Federation, type 1 diabetes is one of the most prevalent chronic childhood conditions worldwide, afflicting approximately 4.9 million patients. Diabetics often suffer from a number of complications of the disease, including heart disease, circulatory problems, kidney failure, neurological disorders and blindness. Current therapy for type 1 diabetes consists of daily insulin injections to regulate blood glucose levels, which does not cure, nor prevent, the disease. Spending on all diabetic therapies in the United States was approximately $10 billion in 2005 according to the IMS Health.

We believe that an altered peptide ligand specific for autoimmune T cells involved in diabetes may stop the destruction of the insulin-secreting cells in early onset type 1 diabetic patients, thus allowing patients to delay or avoid chronic insulin therapy. In preclinical studies, our altered peptide ligand was capable of eliciting a protective immune response and reducing the incidence of diabetes. In addition, experiments using immune cells derived from the blood of type 1 diabetes patients indicate that patients' immune cells recognize our altered peptide ligand. This suggests that this compound may have the potential to intervene in the disease process in humans.

We have completed four Phase I/IIa safety and dose escalating clinical trials in approximately 120 diabetic patients. Data from these trials indicates that the compound is safe and well tolerated. A double blind, placebo-controlled, multi-center, Phase IIb clinical study in adolescent and adult patients with new onset type 1 diabetes is currently underway. This study is a 188 patient dose response, efficacy and safety trial which will involve dosing over a two-year period at approximately 20 medical sites in Canada, Europe and South Africa. Enrollment was completed in the first quarter of 2004. Final results are expected in mid-2006.

Corticotropin-Releasing Factor

According to Mattson Jack, in 2005 over 22 million people in the United States suffered from major depression, and another 12 million suffered from less severe forms of depression. The National Institute of Mental Health also indicated that in 2005 over 19 million Americans suffer from a debilitating anxiety disorder. In 2005, the United States market for depression therapeutics was in excess of $13 billion according to IMS Health. However, significant unmet medical needs remain. The leading drug class, known as the selective serotonin reuptake inhibitors, is ineffective or intolerable in one-third of patients. These drugs frequently require as long as three weeks to take effect and have significant adverse side effects such as sexual dysfunction. Therefore, a rapid acting antidepressant with fewer side effects would represent a major advance in the treatment of depression.

Depression. Depression is one of a group of neuropsychiatric disorders that is characterized by extreme feelings of elation and despair, loss of body weight, decreased aggressiveness and sexual behavior, and loss of sleep. Researchers believe that depression results from a combination of environmental factors, including stress, as well as an individual's biochemical vulnerability, which is genetically predetermined. The most frequently prescribed antidepressant therapies are selective serotonin reuptake inhibitors such as Zoloft®, Paxil®, Lexapro® and Prozac®, as well as certain generic equivalents, that act to increase the levels of serotonin and several other chemicals in the brain. However, because these drugs affect a wide range of neurotransmitters, they have been associated with a number of adverse side effects. While newer, more selective drugs offer some safety improvement, side effects remain problematic. In addition, one of the biggest limitations of most existing antidepressant therapies is their slow onset of action.

Anxiety. Anxiety is among the most commonly observed group of central nervous system disorders, which includes phobias or irrational fears, panic attacks, obsessive-compulsive disorders and other fear and tension syndromes. Of the pharmaceutical agents that other companies currently market for the treatment of anxiety disorders, benzodiazepines, such as Valium® and Xanax®, and the anxiolytics BuSpar® and Effexor® as well as certain generic equivalents are the most frequently prescribed. Several side effects, however, limit the utility of these anti-anxiety drugs. Most problematic among these are drowsiness, the inability to stand up, amnesia, drug dependency and withdrawal reactions following the termination of therapy.

Researchers have identified what they believe to be the central mediator of the body's stress responses or stress-induced disorders (including depression and anxiety). This mediator is a brain chemical known as corticotropin-releasing factor, or CRF. CRF is overproduced in clinically depressed patients and individuals with anxiety disorders. Current research indicates that clinically depressed patients and patients with anxiety experience dysfunction of the hypothalamic-pituitary-adrenal axis, the system that manages the body's overall response to stress. This amplifies production of CRF, and induces the physical effects that are associated with stress that can lead to depression or anxiety. The novelty and specificity of the CRF mechanism of action and the prospect of improving upon selective serotonin reuptake inhibitor therapy represents a market opportunity both to better serve patients and expand overall treatment of depression. We also believe that CRF offers a novel mechanism of action that may offer the advantage of being more selective, thereby providing increased efficacy with reduced side effects in anxiety as compared to benzodiazepines.

We have a strategic position in the CRF field through our intellectual property portfolio and relationship with experts in the neuropsychiatric field. We have further characterized the CRF receptor system and have identified additional members of the CRF receptor family. We have patent rights on two receptor subtypes called CRF R_1 and CRF R_2, and we have pending patent applications on small molecule organic compounds modulating the CRF receptors.

The first clinical trial to offer evidence of proof of concept of CRF antagonists in addressing depression (and anxiety as a co-examined variable) was a Phase IIa open label trial we conducted in 1999 pursuant to collaborations with Janssen in the field of CRF antagonists. Results from this trial indicated that the drug candidate was safe and well tolerated and demonstrated anti-depressant activity as measured by a widely-accepted depression scale known as the Hamilton Depression Scores. In this trial, the drug candidate was administered to 20 patients with major depressive disorders. Results from the trial, as reported in the Journal of Psychiatric Research, showed that treatment response, as defined by more than a 50% reduction in Hamilton Depression Scores, occurred in 50% of the patients in the low dose group and 80% of the patients in the higher dose group. Additionally, the drug candidate demonstrated a reduction in Hamilton Anxiety Scores from baseline in both treatment groups at all times after dosing. While development of our first generation CRF antagonist was discontinued for safety reasons by our collaborator Janssen, we were encouraged by these results which we believe support the hypothesized mechanism of action. Our CRF antagonist research collaboration with Janssen was terminated in March 2002.

In July 2001, we announced our second CRF antagonist collaboration, a worldwide collaboration with GlaxoSmithKline (GSK), to develop and commercialize CRF antagonists for psychiatric, neurological and gastrointestinal diseases. Under the terms of this agreement, GSK sponsored and we jointly conducted a collaborative research program and collaborated in the development of our current lead compounds, as well as novel back-up candidates and second generation compounds identified through the collaborative research. The sponsored research portion of the collaboration was completed in 2005.

During 2004, GSK advanced one of the lead CRF R_1 receptor antagonists drug candidates arising out of our collaboration into Phase I clinical trials. The trial was a double-blind, placebo controlled, single dose study to evaluate safety and pharmacokinetics of a range of escalating doses. In late 2005, a placebo-controlled double blind multiple dose Phase I study was initiated and is currently ongoing. Following the completion of this Phase I trial, further evaluation of this lead CRF R_1 drug candidate in extended Phase I and Phase II proof of concept trials is scheduled to begin in the second half of 2006.

Irritable Bowel Syndrome. Research has also suggested that CRF plays a role in the control or modulation of the gastrointestinal system. Studies have demonstrated that central administration of CRF acts in the brain to inhibit emptying of the stomach while stimulating bowel activity, and suggest that overproduction of CRF in the brain may be a main contributor to stress-related gastrointestinal disorders.

Irritable bowel syndrome is a gastrointestinal inflammatory disease that affects approximately 30 million people in the United States, accounting for over $25 billion in direct and indirect costs each year, according to the International Foundation for Functional Gastrointestinal Disorders. Irritable bowel syndrome can be a lifelong, intermittent disease, involving chronic or recurrent abdominal pain and frequent diarrhea or constipation. Some patients with irritable bowel syndrome report the onset of symptoms of the disease following a major life stress event, such as death in the family, which suggests that the causes of irritable bowel syndrome may be related to stress. In addition, most irritable bowel syndrome sufferers also experience anxiety and depression. GSK plans on advancing a CRF antagonist, targeting irritable bowel syndrome, into a Phase II proof of concept clinical trial in late 2006, in parallel with the anxiety and depression trials.

CRF R_2 Peptide Agonist — Urocortin 2

Urocortin 2 is a recently discovered endogenous peptide ligand of the CRF R_2 receptor present in the cardiovascular system, notably the heart and cerebral arterial system. Urocortin 2 plays a role in the control of the hormonal, cardiovascular, gastrointestinal, and behavioral responses to stress, and has an array of effects on the cardiovascular system and metabolism. Based on preclinical efficacy and safety data, together with its known role in human physiology, we believe that urocortin 2 may have positive hemodynamic effects on cardiac output and blood

pressure which may benefit patients with acute congestive heart failure (CHF). There are an estimated one million hospitalizations each year in the United States for CHF (Mattson Jack, 2005).

CHF is a condition where the heart cannot pump enough blood to supply all of the body's organs. It is a result of narrowing of the arteries combined with high blood pressure, which results in increased respiration as well as edema from water retention. In the case of acute symptomology, CHF patients will eventually experience a rapid deterioration and require urgent treatment in the hospital. According to 2005 data from the American Heart Association, nearly 5 million people experience CHF and about 550,000 new cases are diagnosed each year in the United States. CHF becomes more prevalent with age and the number of cases is expected to grow as the overall age of the population increases. Current treatment options include a cocktail of drugs consisting of diuretics to remove excess water, beta blockers and digitalis to improve heart muscle contraction, and/or ACE inhibitors and vasodilators to expand blood vessels.

During 2005, we completed a Phase II placebo controlled dose-escalation study to evaluate the safety, pharmacokinetics and pharmacodynamics of two dose levels of urocortin 2 in patients with stable CHF. Results of this study demonstrated a dose-related increase in cardiac output of up to 50% with only a modest increase (6%) in heart rate. We expect to complete an additional Phase II study evaluating dose and duration of infusion in patients with stable CHF in the first half of 2006 followed by a Phase II study in patients with acute decompensated heart failure during the second half of 2006.

Research

Our research focus is on addressing diseases and disorders of the central nervous system and endocrine system, which includes stress-related disorders and neurodegenerative diseases. Central nervous system drug therapies represent the second largest sector of the worldwide drug market, accounting for over $65 billion in worldwide drug sales in 2004 according to Espicom Business Intelligence.

CRF R_1 Antagonist

As mentioned previously, the CRF R_1 antagonist has been identified by researchers to be the central mediator of the body's stress responses or stress related disorders. Through our collaboration with GSK, development and evaluation of compounds for stress-related disorders continues.

GnRH Antagonists

As previously mentioned, GnRH antagonists may be useful in treating certain hormone dependent diseases. Our discovery work in GnRH antagonists continues to focus on endometriosis and benign prostatic hyperplasia as we continue to search for additional candidates for preclinical and clinical trials.

Adenosine 2A Receptor Antagonists

In October, 2004, we entered into a licensing agreement with Almirall Prodesfarma, S.A. for the development of adenosine 2A receptor antagonists for Parkinson's disease. Adenosine 2A receptor antagonists have been shown to be effective in both pre-clinical models of Parkinson's disease and in clinical trials with Parkinson's disease patients. This subtype of receptors for the neuromodulator adenosine is selectively localized on neurons in the brain that also express dopamine D2 receptors. The function of these neurons is impaired due to dopamine depletion that occurs in Parkinson's disease and antagonism of adenosine 2A receptors appears to help restore normal function. We are in the process of identifying a lead development candidate.

H1 Antagonist

Insomnia has several dimensions and numerous co-morbidities. We are developing the non-benzodiazepine GABA-A agonist, indiplon for the treatment of insomnia in most of its forms. There are however other central nervous system pathways that are involved in sleep regulation in addition to the GABA-A channel. Histamine is a brain chemical that controls arousal and wakefulness by binding and activating neuronal H1 receptors. Our scientists have discovered and developed a novel series of potent and highly selective small molecule H1 antagonists for the

treatment of chronic insomnia. By virtue of their selectivity and mechanism of action, we believe that this program is complementary to our indiplon program. We plan to file an Investigational New Drug Application with the FDA in early 2006 and to initiate single-dose and multi-dose Phase I studies to assess the safety, pharmacokinetic and pharmacodynamic characteristics of our H1 antagonist.

Our Discovery Technology

We utilize a proprietary approach to small molecule drug design that we refer to as multi-channel technology.

Multi-Channel Discovery™. The advent of molecular biology, culminating in the cloning of the human genome, has opened up a vast array of receptors as potential targets for drug discovery. Numerous new technologies have been developed to try to speed the identification of small molecule drugs. These technologies have mainly relied on the creation of large chemical libraries utilizing combinatorial chemistry, automated synthesis of compounds and ultra-high throughput screening machines to test hundreds of thousands of compounds against a particular receptor. While we utilize all of these technologies, we have taken the science to the next step, which we call Multi-Channel Discovery, or MCD™.

MCD is driven by the power of traditional medicinal chemistry accelerated by a suite of computational methodologies that guide the synthesis of highly active small molecules. At the core of MCD is our development of a virtual library containing over 100 million molecules. Utilizing this “universe” of compounds our chemists sequentially apply computer generated molecular screens to filter compounds that will bind to the desired receptor. The unique feature of MCD is that chemists are no longer constrained by the physical properties of a particular compound but rather are free to work with thousands of shapes and charges to design compounds that will fit onto the receptor target.

The power of MCD, however, lies not in its application to a single receptor as a drug target but in the database of compounds that are characterized and isolated for the next target from the same class of receptors. Our current focus is on G-protein-coupled receptors. MCD is not a static process, but one that becomes more powerful, more predictive, and more efficient with each subsequent use. It is an artificial intelligence system applied to drug design. More recent enhancements using commercially available software now allow us to “grow” new molecules from an initial seed template that satisfy predetermined arrays of features often 2-D or 3-D pharmacophore. This generates new ideas that the medicinal chemist may not have originally considered and therefore offers another option when engaged in “lead-hopping” activities.

In connection with our multi-channel technology, we utilize other advanced technologies to enhance our drug discovery capabilities and to accelerate the drug development process. These technologies include:

High-Throughput Screening. We have assembled a chemical library of diverse, low molecular weight organic molecules for lead compound identification and we have implemented robotics screening capabilities linked to our library of compounds that facilitate the rapid identification of new drug candidates for multiple drug targets. We believe that our utilization of high-throughput screening and medicinal and peptide chemistry will enable us to rapidly identify and optimize lead molecules. Our chemical library is enhanced annually by computational selection of commercially available chemical libraries and further diversity is obtained through strategic collaborations such as that currently underway with Pharmacopeia.

Molecular Biology. Our scientists utilize novel techniques to examine gene expression in a variety of cellular systems. We have developed a sophisticated technique to evaluate the type and quantity of genes in various cellular systems prior to the isolation of genes. We have also developed unique expression vectors and cell lines that allow for the highly efficient protein expression of specific genes.

Our drug discovery program creates a significant amount of genetic sequence information. We have developed a bioinformatics system, which we believe will allow us to identify novel genes involved in neurodegeneration. We collect data with automated instruments, and we store and analyze the data using customized computational tools.

Gene Sequencing. We apply integrated automated DNA sequencing and gene identification technology in our drug discovery program, enabling us to perform extended gene analysis in a rapid, high-throughput format with

independent linkage into a sequence identification database. We have optimized gene sequencing instrumentation for differential display, a technique that may facilitate the rapid identification of novel genes.

Our Business Strategy

Our goal is to become the leading biopharmaceutical company focused on neurological and endocrine-related diseases and disorders. The following are the key elements of our business strategy:

Completing the Development and Commercialization of Our Lead Product Candidate, indiplon. We are working with our collaboration partner, Pfizer, to gain FDA marketing approval for indiplon. On April 14, 2005, we submitted an NDA to the FDA seeking clearance to market indiplon capsules for the treatment of insomnia. On May 26, 2005, we submitted an NDA to the FDA seeking clearance to market indiplon tablets for the treatment of insomnia. The FDA accepted both of these NDA submissions and established the PDUFA dates as February 15, 2006 for the capsule NDA filing and March 27, 2006 for the tablet NDA filing. The PDUFA action date is the date by which the FDA is expect to have completed its review of the submissions and will document its assessment through the issuance of an action letter. In January 2006, the FDA requested that we submit the results from the driving study we completed in late 2005. We submitted the final report of this study to the agency as requested. Based on feedback from the FDA, we anticipate labeling that includes data from this study, which showed no impairment in next-day driving performance. In addition, the FDA has stated its intent to issue a combined package insert in lieu of individual package inserts for the capsule and tablet NDAs. To complete review of the driving study and the combined package insert, the FDA has advised us that the PDUFA dates for the capsule and tablet NDAs have been moved to May 15, 2006 and June 27, 2006, respectively. However, the FDA has committed to an action by May 15, 2006 for both NDAs.

During 2005, we completed the hiring, training and deployment of our 200-person sales force that is paid for and supported by Pfizer. Our salesforce is currently detailing Pfizer's antidepressant Zoloft® to psychiatrists in preparation for launching the promotion of indiplon to those same prescribers. In addition, we have implemented a sales support structure, business intelligence systems and increased our marketing staff to provide resources for brand management, a managed care strategy, consumer plans and market research.

Continuing to Advance and Build Our Product Portfolio Focused on Neurological and Endocrine-Related Diseases and Disorders. We believe that by continuing to advance and build our product pipeline, we can mitigate some of the clinical development risks associated with drug development. We currently have nine programs in various stages of research and development, with seven programs in clinical development. We take a portfolio approach to managing our pipeline that balances the size of the market opportunities with clear and defined clinical and regulatory paths to approval. We do this to ensure that we focus our internal development resources on innovative therapies with improved probabilities of technical and commercial success.

Identifying Novel Drug Targets to Address Large Unmet Market Opportunities. We seek to identify and validate novel drug targets for internal development or collaboration. For example, the novel drug candidates we have identified to regulate CRF, which is believed to be the central mediator of the body's stress response, may represent the first new breakthrough for anxiety and depression in over 25 years. GnRH antagonists, compounds designed to reduce the secretions of sex steroids, may represent the first novel non-injectible means of treatment of endometriosis. The creativity and productivity of our discovery research group will continue to be a critical component for our continued success. Our team of approximately 230 biologists and chemists has a goal of delivering three innovative clinical compounds over the next five years to fuel our research and development pipeline. Research and development costs were $106.6 million, $115.1 million, and $177.3 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Selectively Establishing Corporate Collaborations with Global Pharmaceutical Companies to Assist in the Development of Our Products and Mitigate Financial Risk while Retaining Significant Commercial Upside. We leverage the development, regulatory and commercialization expertise of our corporate collaborators to accelerate the development of our potential products, while typically retaining co-promotional rights, and at times commercial rights, in North America. We have active collaborations with:

- Pfizer, for indiplon for the treatment of insomnia;
- GlaxoSmithKline, for second generation corticotropin-releasing factor receptor antagonists to treat anxiety and depression and irritable bowel syndrome; and
- Almirall, for adenosine 2A receptor antagonists for the treatment of Parkinson's disease.

We intend to further leverage our resources by selectively entering into additional strategic alliances to enhance our internal development and commercialization capabilities by licensing our technology.

Acquiring Rights to Complementary Drug Candidates and Technologies. We plan to continue to selectively acquire rights to products in various stages of development to take advantage of our drug development capabilities. For example, in June 1998, we licensed exclusive worldwide commercial rights for indiplon from DOV Pharmaceutical (DOV). Additionally, during 2003, we licensed our urocortin 2 product candidate from the Research Development Foundation, and in 2004 we licensed adenosine 2A receptor antagonist technology from Almirall Prodesfarma, S.A.

Our Corporate Collaborations and Strategic Alliances

One of our business strategies is to utilize strategic alliances to enhance our development and commercialization capabilities. The following is a summary of our significant collaborations/alliances:

Pfizer. In December 2002, we announced an exclusive worldwide collaboration with Pfizer to develop and commercialize indiplon. Pfizer made an upfront payment to us of $100 million and agreed to make additional pre-commercialization milestone payments of up to $300 million. Under the terms of the agreement, Pfizer is also responsible for all future third-party development, marketing and commercialization costs, with the exception of $30 million for specified development costs that we contributed towards development of indiplon during 2003 and 2004. During 2005, Pfizer began to pay for and support a 200-person Neurocrine sales force that is currently promoting Pfizer's leading antidepressant drug, Zoloft®, to psychiatrists in the United States and, upon approval of the indiplon NDA, will co-promote indiplon in the United States to those same prescribers. We will be entitled to a percentage of worldwide sales of indiplon for the longer of 10 years or the life of the indiplon patent rights as well as co-promotion payments on sales of indiplon and Zoloft® in the United States. In addition, subject to FDA approval of indiplon and various other conditions, Pfizer has committed to loan us up to $175 million, at commercial terms, pursuant to a secured credit facility. We have granted Pfizer an exclusive license to develop and market indiplon in all markets outside the United States. Pfizer may terminate the collaboration at its discretion upon 180-days written notice to us. In such event, we would be entitled to specified payments for ongoing clinical development and related activities and all indiplon product rights would revert to us. As of December 31, 2005, we had recorded revenues of $93.5 million in license fees, $90.5 million in milestones and $121.3 million in sponsored development, over the life of the agreement. In addition, at December 31, 2005 we had $6.5 million of deferred revenue, which is being amortized over the estimated date of commercialization of indiplon.

We obtained rights to indiplon pursuant to a 1998 Sublicense and Development Agreement with DOV Pharmaceutical. Wyeth licensed the indiplon technology to DOV in 1998 in exchange for milestone payments and royalties on future sales of indiplon. On February 26, 2004, we entered into several agreements with Wyeth and DOV pursuant to which, we acquired Wyeth's financial interest in indiplon for approximately $95 million, consisting of $50 million in cash and $45 million of the Company's common stock. The agreements among us, Wyeth and DOV provide that we will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that we will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth, decreasing our royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction was recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based primarily upon indiplon sales.

GlaxoSmithKline. In July 2001, we announced a worldwide collaboration with an affiliate of GlaxoSmithKline to develop and commercialize CRF antagonists for psychiatric, neurological and gastrointestinal diseases. Under the terms of this agreement, we and GlaxoSmithKline will conduct a collaborative research program and collaborate in the development of our current lead compounds, as well as novel back-up candidates and second generation compounds identified through the collaborative research. In addition, we will be eligible to receive milestone payments as compounds progress through the research and development process, royalties on future product sales

and co-promotion rights in the U.S. in some circumstances. GlaxoSmithKline may terminate the agreement at its discretion upon 90-days prior written notice to us. In such event, we may be entitled to specified payments and all product rights would revert to us. As of December 31, 2005, we had recorded revenues of $4.5 million in license fees, $19.8 million in milestone payments, $19.5 million in sponsored research and $1.2 million in reimbursement of development costs, over the life of the agreement. The sponsored research portion of this collaboration agreement concluded in 2005.

Intellectual Property

We seek to protect our lead compounds, compound libraries, expressed proteins, synthetic organic processes, formulations, assays, cloned targets, screening technology and other technologies by filing, or by causing to be filed on our behalf, patent applications in the United States and abroad. These applications have resulted in the issuance of approximately 53 United States patents. Additionally, we have licensed from institutions such as The Salk Institute, Stanford University, DOV Pharmaceutical, Almirall Prodesfarma, Research Development Foundation and others the rights to issued United States patents, pending United States patent applications, and issued and pending foreign filings. We face the risk that one or more of the above patent applications may be denied. We also face the risk that issued patents that we own or license may be challenged or circumvented or may otherwise not provide protection for any commercially viable products we develop.

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. If this occurs, we may be required to obtain licenses to patents or proprietary rights of others in order to continue with the commercialization of our products. We are aware of a patent application controlled by another company, which if granted in its broadest scope and held to be valid, could impact the commercialization of our tablet insomnia formulation in the United States unless we obtain a license, which may not be available to us. Based on information available from the United States Patent and Trademark Office (USPTO), we have learned that the USPTO has examined the pending claims of this application two times and that both times it has rejected all the pending claims. We are also aware that the corresponding patent application in Europe has issued as a patent, and we have filed an opposition against the issued European patent.

Indiplon is covered in an issued United States patent, which we sublicensed from DOV Pharmaceutical. The term of the United States patent is due to expire in 2020. Additional United States patents covering synthesis, formulations and forms of indiplon have been issued with expirations ranging from 2020 to 2023. We intend to seek additional protection of this compound through United States and foreign patent applications directed to the synthesis, formulations and various forms of indiplon. We face the risk that these patents may not issue, or may subsequently be challenged successfully. In addition to the granted and potential patent protection, the United States, the European Union and Japan all provide data protection for new medicinal compounds. If this protection is available, no competitor may use the original applicant’s data as the basis of a generic marketing application during the period of data protection. This period of exclusivity is five years in the United States, six years in Japan and six to ten years in the European Union, measured from the date of FDA, or corresponding foreign, approval.

In-Licensed Technology

We have in-licensed the following technologies to complement our ongoing clinical and research programs. Most of these licenses extend for the term of the related patent and contain customary royalty, termination and other provisions.

- In October 2004, we licensed non-exclusive rights to Almirall Prodesfarma’s small molecule adenosine 2A receptor antagonists for the treatment of Parkinson’s Disease.
- In October 2003, we licensed non-exclusive rights to corticotropin releasing factor receptor 2 deficient mice from Research Development Foundation.
- In September 2003, we entered into a collaboration and license agreement with Pharmacopeia, Inc. relating to screening compounds against certain targets.

- In June 2003, we licensed a non-exclusive rights to Cav3.1 human cDNA expressing cell line from University of Virginia Patent Foundation.
- In May 2003, we entered into a collaboration and license agreement with Bicoll GmbH relating to GPCR targets.
- In March 2003, we licensed a non-exclusive right to certain green fluorescent proteins.
- In January 2003, we licensed exclusive rights to urocortin 2 from Research Development Foundation.
- In December 2002, we entered into a collaboration and license agreement with Biosite Incorporated relating to high affinity antibodies.
- In December 2002, we licensed knock-out mice to certain target genes from Deltagen, Inc.
- In March 2001, we licensed non-exclusive rights to a saoS-2 cell line from The Sloan-Kettering Institute for Cancer Research.
- In March 2001, we licensed a HERG cell line from Wisconsin Alumni Research Foundation.
- In August 2000, we licensed non-exclusive rights to CRF R_1 deficient mice from the Research Development Foundation.
- In August 1999, we licensed non-exclusive rights to the human gonadotropin-releasing hormone receptor from Mount Sinai School of Medicine.
- In June 1998, we licensed exclusive worldwide rights to our sedative compound, indiplon, from DOV Pharmaceutical, Inc.

Manufacturing and Distribution

We currently rely on contract manufacturers, and will continue to rely on contract manufacturers for at least the next few years, to produce sufficient quantities of our product candidates for use in our preclinical and anticipated clinical trials. We have established an internal pharmaceutical development group to develop manufacturing methods for our products, to optimize manufacturing processes, and to select and transfer these manufacturing technologies to our suppliers. We continue to contract with multiple manufacturers to ensure adequate product supply and to mitigate risk.

There currently are a limited number of these manufacturers. Furthermore, some of the contract manufacturers that we have identified to date only have limited experience at manufacturing, formulating, analyzing and packaging our product candidates in quantities sufficient for conducting clinical trials or for commercialization.

We currently have no distribution capabilities. In order to commercialize any of our product candidates, we must either internally develop distribution capabilities or make arrangements with third parties to perform these services.

Marketing and Sales

We currently have limited experience in marketing or selling pharmaceutical products. We have initiated sales and marketing activities for indiplon by hiring staff with experience in pharmaceutical sales, marketing and distribution.

As part of our collaboration agreement with Pfizer, we receive funding from Pfizer for a 200-person United States sales force. During 2005, we completed the hiring, training and deployment of our 200-person sales force which is currently detailing Pfizer’s antidepressant Zoloft® to psychiatrists and is preparing to launch the promotion of indiplon to those same prescribers. Pfizer currently manages all aspects of distribution for Zoloft® and will manage all aspects of distribution for indiplon.

Additionally, under our collaboration agreement with GlaxoSmithKline we may have the opportunity to co-promote any collaboration products in the United States. To market any of our other products directly, we must develop a sales force with technical expertise and develop supporting distribution capabilities none of which we currently have.

Government Regulation

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. All of our products will require regulatory approval by government agencies prior to commercialization. In particular, human therapeutic products are subject to rigorous preclinical studies and clinical trials and other approval procedures of the FDA and similar regulatory authorities in foreign countries. Various federal and state statutes and regulations also govern or influence testing, manufacturing, safety, labeling, storage and record-keeping related to such products and their marketing. The process of obtaining these approvals and the subsequent compliance with appropriate federal and state statutes and regulations require the expenditure of substantial time and financial resources.

Preclinical studies generally are conducted in laboratory animals to evaluate the potential safety and the efficacy of a product. Drug developers submit the results of preclinical studies to the FDA as a part of an IND application that must be approved before clinical trials can begin in humans. Typically, clinical evaluation involves a time consuming and costly three-phase process.

Phase I	Clinical trials are conducted with a small number of patients to determine the early safety profile, maximum tolerated dose and pharmacological properties of the product in human volunteers.
Phase II	Clinical trials are conducted with groups of patients afflicted with a specific disease in order to determine preliminary efficacy, optimal dosages and expanded evidence of safety.
Phase III	Large-scale, multi-center, comparative clinical trials are conducted with patients afflicted with a specific disease in order to determine safety and efficacy as primary support for regulatory approval by the FDA to market a product candidate for a specific disease.

The FDA closely monitors the progress of each of the three phases of clinical trials that are conducted in the United States and may, at its discretion, reevaluate, alter, suspend or terminate the testing based upon the data accumulated to that point and the FDA's assessment of the risk/benefit ratio to the patient. To date, we have also conducted some of our clinical trials in Europe, Oceania, and South Africa.

Once Phase III trials are completed, drug developers submit the results of preclinical studies and clinical trials to the FDA in the form of an NDA or a biologics licensing application for approval to commence commercial sales. In response, the FDA may grant marketing approval, request additional information or deny the application if the FDA determines that the application does not meet regulatory approval criteria. FDA approvals may not be granted on a timely basis, or at all. Furthermore, the FDA may prevent a drug developer from marketing a product under a label for its desired indications, which may impair commercialization of the product.

If the FDA approves the NDA, the drug becomes available for physicians to prescribe in the United States. After approval, the drug developer must submit periodic reports to the FDA, including descriptions of any adverse reactions reported. The FDA may request additional studies, known as Phase IV, to evaluate long-term effects.

In addition to studies requested by the FDA after approval, a drug developer may conduct other trials and studies to explore use of the approved compound for treatment of new indications. The purpose of these trials and studies and related publications is to broaden the application and use of the drug and its acceptance in the medical community.

We will also have to complete an approval process similar to that in the United States in virtually every foreign target market for our products in order to commercialize our product candidates in those countries. The approval procedure and the time required for approval vary from country to country and may involve additional testing. Foreign approvals may not be granted on a timely basis, or at all. In addition, regulatory approval of prices is required in most countries other than the United States. We face the risk that the resulting prices would be insufficient to generate an acceptable return to us or our corporate collaborators.

Competition

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 biotechnology and pharmaceutical companies, research institutions, government agencies and academic institutions. Competition may also arise from, among other things:

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

Developments by others may render our product candidates or technologies obsolete or noncompetitive. We are performing research on or developing products for the treatment of several disorders including insomnia, anxiety, depression, diabetes mellitus, multiple sclerosis, irritable bowel syndrome and various female and male health disorders.

We are developing indiplon for the treatment of insomnia. Ambien®, Sonata®, Lunesta®, and Rozerem® are already marketed for the treatment of insomnia by Sanofi-Synthelabo, King Pharmaceuticals, Inc., Sepracor, Inc., and Takeda Pharmaceutical Company, respectively. Sanofi-Synthelabo has also recently marketed a controlled-release formulation of Ambien®. H. Lundbeck A/S and Merck & Co. are developing gaboxadol, a GABA A agonist, for sleep disorders, which is currently in Phase III clinical trials.

Products that may compete with our altered peptide ligand for multiple sclerosis, include Betaseron® and Avonex®, which are similar forms of beta-interferon marketed by Berlex BioSciences and Biogen Idec, respectively, Copaxone®, a peptide polymer marketed by Teva, and Rebif® marketed by Serono and Pfizer.

In the area of anxiety disorders, our product candidates will compete with well-established products such as Valium®, marketed by Hoffman-La Roche, Xanax®, marketed by Pfizer, BuSpar®, marketed by Bristol-Myers Squibb, Zoloft® marketed by Pfizer, Wellbutrin® marketed by GlaxoSmithKline and Effexor® marketed by Wyeth, among others, as well as any generic alternatives for each of these products.

We are also developing products for depression, which will compete with well-established products in the antidepressant class, including Prozac®, marketed by Eli Lilly as well as its generic alternatives, Zoloft®, marketed by Pfizer, Paxil®, marketed by GlaxoSmithKline, Effexor®, marketed by Wyeth, and Lexapro®, marketed by Forest Laboratories, among others. Some technologies under development by other pharmaceutical companies could result in additional commercial treatments for depression and anxiety. In addition, a number of companies also are conducting research on molecules to block CRF, which is the same mechanism of action employed by our compounds.

There are a number of competitors to products in our pipeline. Lupron Depot®, marketed by Takeda-Abbott Pharmaceuticals, and Synarel®, marketed by Pfizer, are gonadotropin-releasing hormone peptide agonists that have been approved for the treatment of endometriosis, infertility, and central precocious puberty. Additionally, Proscar®, an enzyme inhibitor marketed by Merck, and Flomax®, an alpha blocker marketed by Boehringer Ingelheim Pharmaceuticals, are both used in the treatment of benign prostatic hyperplasia. These drugs may compete with any small molecule gonadotropin-releasing hormone antagonists we develop for these indications. If one or more of these products or programs are successful, it may reduce or eliminate the market for our products.

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

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

Any of these competitive factors could harm our business, prospects, financial condition and results of operations, which could negatively affect our stock price.

Employees

As of December 31, 2005, we had 588 employees, consisting of 564 full-time and 24 part-time employees. Of the full-time employees, approximately 124 hold Ph.D., M.D. or equivalent degrees. None of our employees are represented by a collective bargaining arrangement, and we believe our relationship with our employees is good. Furthermore, recruiting and retaining qualified scientific personnel to perform research and development work in the future will also be critical to our success. We face the risk that we may not be able 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 number of consultants to assist us in formulating our research and development strategies.

Insurance

We maintain product liability insurance for our clinical trials. We intend to expand our insurance coverage to include the sale of commercial products if marketing approval is obtained for products in development. However, insurance coverage is becoming increasingly expensive, and no assurance can be given that we will be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. There can also be no assurance that we will be able to obtain commercially reasonable product liability insurance for any products approved for marketing.

Available Information

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Section 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended, are available on our website at *www.neurocrine.com*, when such reports are available on the Securities and Exchange Commission website.

Additionally, copies of the Company’s annual report will be made available, free of charge, upon written request.

ITEM 1A. RISK FACTORS

Risks Relating to the Company

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

Regulation by government authorities in the United States and foreign countries is a significant factor in the development, manufacture and marketing of our proposed products and in our ongoing research and product development activities. Any failure to receive the regulatory approvals necessary to commercialize our product candidates would harm our business. The process of obtaining these approvals and the subsequent compliance with federal and state statutes and regulations require spending substantial time and financial resources. If we fail or our collaborators or licensees fail to obtain or maintain, or encounter delays in obtaining or maintaining, regulatory approvals, it could adversely affect the marketing of any products we develop, our ability to receive product or royalty revenues, 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.

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

Based on the results of the Phase III clinical trials on indiplon, we assembled and filed with the FDA New Drug Applications (NDAs) for both the immediate release capsule and the modified release tablet formulations of indiplon. If the FDA finds either or both of our NDAs incomplete or insufficient, delays approval, or refuses to approve the NDAs for any reason, our business and reputation may be harmed and our stock price may decrease. In addition, even if our indiplon NDAs are approved, the labeling granted by the FDA may limit the commercial success of the product. The FDA could also require Phase IV, or post-marketing, trials to study the long-term effects of indiplon and could withdraw its approval based on the results of those trials.

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

Pfizer has agreed to:

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

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

Decisions within the collaboration are made within a series of joint committees comprised of Neurocrine and Pfizer representatives. In the event of disagreement at the committee level, the agreement provides for elevation of the issue to a joint steering committee and thereafter to senior executives at both companies. The agreement provides that certain decisions are Neurocrine decisions, certain decisions are Pfizer decisions and certain decisions require consensus among both parties before any action can be taken. We face the risk that decisions may be delayed as a result of this resolution process. Our agreement further provides that upon occurrence of certain events, some decisions designated as Neurocrine decisions may become Pfizer decisions.

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

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

Any failure or substantial delay in completing clinical trials for our product candidates may severely harm our business. Before obtaining regulatory approval for the sale of any of our potential products, we must subject these product candidates to extensive preclinical and clinical testing to demonstrate their safety and efficacy for humans. Clinical trials are expensive, time-consuming and may take years to complete. We have submitted NDAs based on the results of our clinical trials in our indiplon development program for insomnia. This is our most advanced clinical program and represents a significant portion of our total clinical development activities and expenditures, to date. If the FDA determines that we have failed to demonstrate that indiplon is safe and efficacious for the targeted patient populations or if the FDA does not approve the proposed indiplon product labeling, our business and reputation would be harmed and our stock price would be negatively affected.

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

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

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

We 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 $22.2 million and $45.8 million for the years ended December 31, 2005 and 2004, respectively. As a result of ongoing operating losses, we had an accumulated deficit of $300.1 million and $278.0 million as of December 31, 2005 and 2004, respectively. We were not profitable for the year ended December 31, 2005. Profitability in 2006 is contingent upon the timing of the approval of our NDA filings for indiplon by the FDA, and acceptance of indiplon by prescribers and consumers. 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 depend on continuing our current strategic alliances and developing additional strategic alliances to develop and commercialize our product candidates.

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

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

Our strategy for developing and commercializing our products is dependent upon maintaining our current arrangements and establishing new arrangements with research collaborators, corporate collaborators and others. We

have active collaboration agreements with Pfizer and GlaxoSmithKline. Because we rely heavily on our corporate collaborators, the development of our projects would be substantially delayed if our collaborators:

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

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

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

We are dependent on licenses from third parties for some of our key technologies. These licenses typically subject us to various commercialization, reporting and other obligations. If we fail to comply with these obligations, we could lose important rights. For example, we have licensed indiplon from DOV Pharmaceutical. In addition, we license some of the core technologies used in our collaborations from third parties, including the CRF receptor we license from The Salk Institute and use in our CRF program collaboration with GlaxoSmithKline and the adenosine 2A receptor antagonist we license from Almirall Prodesfarma, S.A. 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 GnRH program. If we were to default on our obligations under any of our product licenses, such as our license to indiplon, we could lose some or all of our rights to develop, market and sell the product. Likewise, if we were to lose our rights under a license to use proprietary research tools, it could adversely affect our existing collaborations or adversely affect our ability to form new collaborations. We also face the risk that our licensors could, for a number of reasons, lose patent protection or lose their rights to the technologies we have licensed, thereby impairing or extinguishing our rights under our licenses with them.

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

All of our product candidates are in research, clinical development, or in registration with the FDA and, while we expect indiplon to be commercially available in 2006, there is the possibility that it will not be commercially available at all. Only a small number of research and development programs ultimately result in commercially successful drugs. Potential products that appear to be promising at early stages of development may not reach the market for a number of reasons. These reasons include the possibilities that the potential products may:

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

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

Since indiplon is our most advanced product program, our business and reputation would be particularly harmed, and our stock price likely would be harmed, if we fail to receive necessary regulatory approvals on a timely basis or achieve market acceptance.

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. In preparation for marketing indiplon upon approval by the FDA, we have hired staff with experience in pharmaceutical sales and marketing. We will rely on Pfizer to co-promote indiplon with us in the United States and rely exclusively on Pfizer to market indiplon outside of the United States. We will also rely on Pfizer to provide distribution, customer service, order entry, shipping, billing, customer reimbursement assistance and managed care sales support related to indiplon.

If we fail to establish successful marketing and sales capabilities or fail to enter into successful marketing arrangements with third parties, our product revenues will suffer. If Pfizer's sales force or our sales force do not successfully promote indiplon to prescribers, sales of indiplon and our royalty revenues will suffer. Further, if Pfizer does not provide the other services it has agreed to provide in a satisfactory manner, sales of indiplon will be harmed and our reputation may be damaged.

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

We depend on independent clinical investigators and contract research organizations, or CROs, to conduct our clinical trials under their agreements with us. The investigators are not our employees, and we cannot control the amount or timing of resources that they devote to our programs. If independent investigators fail to devote sufficient time and resources to our drug development programs, or if their performance is substandard, it will delay the approval of our FDA applications and our 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 several contract manufacturers for all production of products for development and commercial purposes. If we are unable to obtain or retain third-party manufacturers, we will not be able to commercialize our products. The manufacture of our products for clinical trials and commercial purposes is

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

- contract manufacturers may encounter difficulties in achieving volume production, quality control and quality assurance, and also may experience shortages in qualified personnel. As a result, our contract manufacturers might not be able to meet our clinical schedules or adequately manufacture our products in commercial quantities when required;
- switching manufacturers may be difficult because the number of potential manufacturers is limited. It may be difficult or impossible for us to find a replacement manufacturer quickly on acceptable terms, or at all;
- our contract manufacturers may not perform as agreed or may not remain in the contract manufacturing business for the time required to successfully produce, store or distribute our products;
- drug manufacturers are subject to ongoing periodic unannounced inspection by the FDA, the Drug Enforcement Agency, and corresponding state agencies to ensure strict compliance with good manufacturing practices and other government regulations and corresponding foreign standards. We do not have control over third-party manufacturers' compliance with these regulations and standards; and
- if the primary contract manufacturer for indiplon should be unable to manufacture indiplon for any reason, or should fail to receive FDA approval or Drug Enforcement Agency approval, commercialization of indiplon could be delayed, which would delay indiplon sales and negatively impact our business.

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

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

We are highly dependent on the principal members of our management and scientific staff. The loss of any of these people could impede the achievement of our development objectives. Furthermore, recruiting and retaining qualified scientific personnel to perform research and development work in the future is critical to our success. We may be unable to attract and retain personnel on acceptable terms given the competition among biotechnology, pharmaceutical and health care companies, universities and non-profit research institutions for experienced scientists. In addition, we rely on 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 and effective, we may not recover our investment.

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

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

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

- continued scientific progress in our research and development programs;
- the magnitude of our research and development programs;
- progress with preclinical testing and clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in filing and pursuing patent applications and enforcing patent claims;
- competing technological and market developments;
- the establishment of additional strategic alliances;
- the cost of commercialization activities and arrangements, including manufacturing of our product candidates; and
- the cost of product in-licensing and any possible acquisitions.

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

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 National Market rules, are creating uncertainty for companies such as ours. These new or changed 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 and our external auditors' audit of that assessment has required 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 new or changed 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 $34 per share to approximately $66 per share. The market price of our common stock may fluctuate in response to many factors, including:

- developments related to the FDA approval process for indiplon;
- the results of our clinical trials;
- developments concerning our strategic alliance agreements;
- announcements of technological innovations or new therapeutic products by us or others;
- developments in patent or other proprietary rights;
- future sales of our common stock by existing stockholders;
- comments by securities analysts;
- general market conditions;
- fluctuations in our operating results;
- government regulation;
- health care reimbursement;

- failure of any of our product candidates, if approved, to achieve commercial success; and
- public concern as to the safety of our drugs.

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

Risks Related to Our Industry

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

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

Competition may also arise from, among other things:

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

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

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

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

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

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

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

- obtain patent protection for our products;
- preserve our trade secrets;

- prevent third parties from infringing upon our proprietary rights; and
- operate without infringing upon the proprietary rights of others, both in the United States and internationally.

Because of the substantial length of time and expense associated with bringing new products through the development and regulatory approval processes in order to reach the marketplace, the pharmaceutical industry places considerable importance on obtaining patent and trade secret protection for new technologies, products and processes. Accordingly, we intend to seek patent protection for our proprietary technology and compounds. However, we face the risk that we may not obtain any of these patents and that the breadth of claims we obtain, if any, may not provide adequate protection of our proprietary technology or compounds.

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

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

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

We cannot assure you that third parties will not assert patent or other intellectual property infringement claims against us or our collaboration partners with respect to technologies used in potential products. We are aware of a patent application controlled by another company, which if granted in its broadest scope and held to be valid, could impact the commercialization of our modified release insomnia formulation in the United States unless we obtain a license, which may not be available to us. Based on information available from the United States Patent and Trademark Office (USPTO), we have learned that the USPTO has examined the pending claims of this application two times and that both times it has rejected all the pending claims. We are also aware that the corresponding patent application in Europe has issued as a patent, and we have filed an opposition against the issued European patent. Even if we were to prevail, any litigation could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. Furthermore, if a patent infringement suit were brought against us or our collaboration partners, we or our collaboration partners could be forced to stop or delay developing, manufacturing or selling potential products that are claimed to infringe a third party's intellectual property unless that party grants us or our collaboration partners rights to use its intellectual property. In such cases, we could be required to obtain licenses to patents or proprietary rights of others in order to continue to commercialize our products. However, we may not be able to obtain any licenses required under any patents or proprietary rights of third parties on acceptable terms, or at all. Even if our collaboration partners or we were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our

potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

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

The use of any of our potential products in clinical trials, and the sale of any approved products, may expose us to liability claims. These claims might be made directly by consumers, health care providers, pharmaceutical companies or others selling our products. We have obtained limited product liability insurance coverage for our clinical trials in the amount of $10 million per occurrence and $10 million in the aggregate. However, our insurance may not reimburse us or may not be sufficient to reimburse us for any expenses or losses we may suffer. Moreover, insurance coverage is becoming increasingly expensive, and we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. We intend to expand our insurance coverage to include the sale of commercial products if we obtain marketing approval for product candidates in development, but we may be unable to obtain commercially reasonable product liability insurance for any products approved for marketing. On occasion, juries have awarded large judgments in class action lawsuits based on drugs that had unanticipated side effects. A successful product liability claim or series of claims brought against us would decrease our cash reserves and could cause our stock price to fall.

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

Our research activities involve the controlled use of hazardous materials. We cannot eliminate the risk of accidental contamination or injury from these materials. If an accident occurs, a court may hold us liable for any resulting damages, which may 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 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own our facility which has approximately 200,000 square feet of laboratory and office space in San Diego, California, of which approximately 85% is allocated to research and development activities. There is currently a mortgage loan outstanding on the facility of approximately $48.8 million. We believe that our property and equipment are generally well maintained and in good operating condition.

ITEM 3. LEGAL PROCEEDINGS

We are not currently a party to any material legal proceedings, though we are currently participating in other litigation in the ordinary course of business.

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

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the Nasdaq National Market System under the symbol "NBIX." The following table sets forth for the periods indicated the high and low sale price for the common stock as reported by the Nasdaq National Market. These prices do not include retail markups, markdowns or commissions.

	High	Low
Year Ended December 31, 2004		
1st Quarter	$62.25	$50.54
2nd Quarter	69.90	47.90
3rd Quarter	54.37	40.67
4th Quarter	51.10	42.87
Year Ended December 31, 2005		
1st Quarter	$50.10	$36.58
2nd Quarter	44.09	33.86
3rd Quarter	52.90	41.20
4th Quarter	65.70	43.31

As of January 26, 2006, there were approximately 80 stockholders of record of our common stock. We have not paid any cash dividends on our common stock since inception and do not anticipate paying cash dividends in the foreseeable future.

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data have been derived from our audited financial statements. The information set forth below is not necessarily indicative of the results of future operations and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the financial statements and notes thereto appearing elsewhere in this Form 10-K.

	2005	2004	2003	2002	2001
	(in thousands, except for loss per share data)				
STATEMENT OF OPERATIONS DATA					
Revenues:					
Sponsored research and development	$ 9,187	$ 27,156	$ 96,699	$ 12,364	$ 16,880
Milestones and license fees	92,702	57,612	41,126	3,516	22,937
Sales force allowance	22,000	—	—	—	—
Grant income and other revenues	—	408	1,253	2,165	1,425
Total revenues	123,889	85,176	139,078	18,045	41,242
Operating expenses:					
Research and development	106,628	115,066	177,271	108,939	74,267
Sales, general and administrative	42,333	22,444	20,594	12,721	10,857
Total operating expenses	148,961	137,510	197,865	121,660	85,124
Loss from operations	(25,072)	(52,334)	(58,787)	(103,615)	(43,882)
Other income:					
Gain on sale of property	—	—	17,946	—	—
Interest income, net	2,881	6,640	10,743	9,079	7,092
Total other income	2,881	6,640	28,689	9,079	7,092
Loss before income taxes	(22,191)	(45,694)	(30,098)	(94,536)	(36,790)
Income taxes	—	79	158	—	120
Net loss	$ (22,191)	$ (45,773)	$ (30,256)	$ (94,536)	$ (36,910)
Net loss per common share:					
Basic and diluted	$ (0.60)	$ (1.26)	$ (0.93)	$ (3.10)	$ (1.42)
Shares used in calculation of net loss per common share:					
Basic and diluted	36,763	36,201	32,374	30,488	26,028
BALANCE SHEET DATA					
Cash, cash equivalents and short-term investments	$ 273,068	$ 301,129	$ 453,168	$ 244,710	$ 319,982
Working capital	245,617	254,230	361,797	215,615	306,754
Total assets	483,123	519,217	554,955	266,539	346,350
Long-term debt	53,590	59,452	32,473	5,277	3,600
Accumulated deficit	(300,146)	(277,955)	(232,182)	(201,926)	(107,390)
Total stockholders' equity	390,104	393,827	391,120	224,254	310,393

ITEM 7. 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 pertaining to, among other things, the expected continuation of our collaborative agreements, the receipt of research and development payments thereunder, the future achievement of various milestones in product development and the receipt of payments related thereto, the potential receipt of royalty payments, pre-clinical testing and clinical trials of potential products, the period of time that our existing capital resources will meet our funding requirements, and our financial results of operations. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various risks and uncertainties, including those set forth in this Annual Report on Form 10-K under the heading "Item 1.A. Risk Factors."

Overview

We discover, develop and intend to commercialize drugs for the treatment of neurological and endocrine-related diseases and disorders. Our product candidates address some of the largest pharmaceutical markets in the world, including insomnia, anxiety, depression, various female and male health disorders, multiple sclerosis, diabetes and other neurological and endocrine related diseases and disorders. To date, we have not generated any revenues from the sale of products, and we do not expect to generate any revenues from product sales until indiplon is commercialized. We have funded our operations primarily through private and public offerings of our common stock and payments received under research and development agreements. We are developing a number of products with corporate collaborators and will rely on existing and future collaborators to meet funding requirements. We expect to generate future net losses due to increases in operating expenses as product candidates are advanced through the various stages of clinical development. As of December 31, 2005, we have incurred a cumulative deficit of $300.1 million and expect to incur operating losses in the near future, which may be greater than losses in prior years.

Critical Accounting Policies

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

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

Clinical Trial Costs

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, which 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.

Results of Operations for Years Ended December 31, 2005, 2004 and 2003

The following table summarizes our primary sources of revenue:

	Year Ended December 31,		
	2005	2004	2003
		(in thousands)	
Revenues under collaboration agreements:			
Pfizer	$121,397	$76,939	$128,894
GlaxoSmithKline (GSK)	2,492	7,829	7,779
Taisho	—	—	1,144
Wyeth	—	—	8
Total revenue under collaboration agreements	123,889	84,768	137,825
Grant income	—	408	1,253
Total revenues	$123,889	$85,176	$139,078

Our revenues for the year ended December 31, 2005 were $123.9 million compared with $85.2 million in 2004. This increase in revenues is primarily due to milestones recognized under our collaboration agreement with Pfizer. Milestones received under the Pfizer collaboration agreement totaled $70.0 million in 2005 related to the FDA's accepting for review our NDA for indiplon capsules and tablets, compared to $20.5 million in milestones earned in 2004 under the Pfizer collaboration agreement for the successful completion of Phase III studies for long-term administration and sleep maintenance of indiplon during 2004. License fees recognized under our Pfizer agreement were $20.7 million in 2005 compared to $34.8 million in 2004. Sponsored development revenue decreased to $8.7 million in 2005 compared to $21.7 million in 2004, due to the continued winding down of our indiplon Phase III clinical program. During 2005 we also recognized $22.0 million from Pfizer as a sales force allowance for the building and operation of our 200-person sales force. Additionally, during 2005 we received $2.0 million in milestones under our GlaxoSmithKline (GSK) collaboration agreement, related to successful completion of the research portion of the agreement and selection of two drug candidates for clinical development. During 2004, we recognized $5.5 million from GSK for sponsored research in our CRF program. The sponsored research portion of our collaboration agreement with GSK ended in 2005. We also earned $1.5 million during 2004 from GSK related to milestones for selection and progress of development candidates.

Our revenues for the year ended December 31, 2004 were $85.2 million compared with $139.1 million in 2003. The $53.9 million decrease in revenues from 2003 to 2004 is due to lower sponsored development revenue associated with the winding down of the Phase III clinical program for indiplon ($69.2 million less in 2004 than 2003). Additionally, license fees recognized under our collaboration agreements were $5.0 million less in 2004 when compared to 2003. This is primarily due to the timing of the license fee recognition under the Pfizer agreement and the ending of the Taisho collaboration during 2003. These decreases were offset by the above-mentioned $20.5 million in milestones earned under the Pfizer collaboration agreement for the successful completion of Phase III studies of indiplon during 2004.

Research and development expenses decreased to $106.6 million during 2005 compared to $115.1 million in 2004. The $8.5 million decrease from 2004 to 2005 relates primarily to the winding down of our Phase III program for indiplon. External development costs incurred related to indiplon were $12.8 million in 2005 compared to $26.5 million in 2004, primarily due to the tapering of our indiplon clinical program during 2005. This decrease was offset by an increase in external development expense under other clinical programs of approximately $5.4 million. External development costs related to our GnRH program increased to $10.1 million in 2005 from $9.5 million in 2004, costs related to our multiple sclerosis program increased to $4.7 million in 2005, from $3.7 million in 2004, and costs in our H1 antagonist program increased to $3.8 million in 2005, from $1.7 million in 2004. Additionally, scientific personnel costs have increased to $36.0 million in 2005 compared to $32.9 million in 2004, and laboratory costs were $2.1 million higher in 2005 than 2004. The increase in personnel costs and laboratory costs are related to efforts on advancing our research and development candidates. Costs related to in-licensing, scientific consultants, and milestone expenses were $3.3 million in 2005 compared to $8.9 million in 2004. This decrease is primarily due to milestone expenses and consultant expenses during 2004, related to the indiplon NDA filings.

Research and development expenses decreased to $115.1 million during 2004 compared to $177.3 million in 2003. The $62.2 million decrease from 2003 to 2004 relates primarily to the winding down of our Phase III program for indiplon. External development costs incurred related to indiplon were $26.5 million in 2004 compared to $111.4 million in 2003. This $84.9 million decrease is due primarily to the tapering of our indiplon clinical program during 2004. This decrease was offset by an increase in external development expense under other clinical programs of approximately $5.9 million. Additionally, personnel costs have increased by $5.0 million from $27.9 million in 2003 to $32.9 million in 2004, collaboration costs related to in-licensing and milestone expenses were $4.0 million higher in 2004 compared to 2003, and laboratory costs were $3.6 million higher in 2004 than 2003.

We expect research and development expenses to increase modestly during 2006, primarily due to increases in costs related to non-indiplon development and research programs offset by the wind down of the Phase III indiplon development program. We expect research and development costs will continue to increase in 2007 as clinical trials progress for other compounds in our pipeline.

Sales, general and administrative expenses increased to $42.3 million in 2005 compared to $22.4 million during 2004 and $20.6 million during 2003. The $19.9 million increase in expenses from 2004 to 2005 resulted primarily from the implementation of our commercialization strategy, including the hiring, training and deployment of our 200-person sales force. This increase in sales costs is offset by revenue recognized under our sales force allowance from Pfizer, who is obligated to pay for and support a 200-person sales force. The $1.8 million increase in expenses from 2003 to 2004 resulted primarily from additional administrative personnel needed to support research and development activities and the implementation of our commercialization strategy.

Other income decreased to $2.9 million in 2005 compared with $6.6 million during 2004 and $28.7 million during 2003. The decrease in other income from 2004 to 2005 is due to increased interest expense and lower interest income. Interest expense increased from $2.0 million in 2004 to $4.2 million in 2005, primarily due to capitalization, in 2004, of approximately $1.3 million in interest expense related to the construction of our corporate facility, and higher average debt balances in 2005. Our debt balance increased during 2004 as we incurred debt as needed to fund construction of our facility which was completed in 2004. The decrease in interest income from 2004 to 2005 is a result of lower average cash and investment balances, primarily due to operating losses. The decrease in other income from 2004 to 2003 is a primarily a result of a one-time gain on the sale of our former corporate headquarters of approximately $18.0 million in the fourth quarter of 2003. Additionally, lower cash and investment balances due to operating losses, and a $50 million payment for the Wyeth royalty stream during the first quarter of 2004 led to lower interest income in 2004 compared to 2003.

Our net loss for 2005 was $22.2 million, or $0.60 per share, compared to $45.8 million, or $1.26 per share, in 2004 and $30.3 million, or $0.93 per share, in 2003. The decrease in net loss from 2004 to 2005 was primarily the result of $70.0 million in milestones earned under the Pfizer collaboration agreement, offset by higher non-indiplon related research and development costs. The increase in net loss from 2003 to 2004 is a result of higher non-indiplon related development costs and increased employee and laboratory costs related to research and development. These costs were offset by $22.0 million in milestones achieved under the Pfizer and GSK collaborations during 2004, and a lower contribution by us to the indiplon development program. During 2003, we contributed $22.5 million to the external development costs for indiplon, this amount was reduced to $7.5 million in 2004.

During 2006, we will continue to recognize revenue from the amortization of the Pfizer $100 million upfront license fee through the estimated commercialization date of indiplon. Additionally, we will continue to recognize revenue under our collaboration agreement with Pfizer as we incur external development costs for indiplon. As of December 31, 2005, the majority of the external development costs related to indiplon have been incurred. We also expect to achieve certain milestones in 2006 under our collaboration agreement with Pfizer upon FDA approval of our NDAs for indiplon. Costs associated with research and development are expected to modestly increase in 2006 as the Phase III indiplon costs are replaced with increased research and development costs on other products in our pipeline. Additionally, during 2006 we will incur additional expense concurrent with our adoption of Statement of Financial Accounting Standards 123R (SFAS 123R) which requires us to expense employee stock options. In anticipation of the adoption of SFAS 123R, we accelerated vesting of approximately 472,000 outstanding unvested employee options with exercise prices at $50.00 and greater on November 7, 2005 to eliminate approximately $10.5 million in expense that would have been reported, beginning in 2006, over the remaining vesting period of the relative options, primarily four years.

On April 14, 2005, we submitted an NDA to the FDA seeking clearance to market indiplon capsules for the treatment of insomnia. On May 26, 2005, we submitted an NDA to the FDA seeking clearance to market indiplon tablets for the treatment of insomnia. The FDA accepted both of these NDA submissions and established the Prescription Drug User Fee Act (PDUFA) dates as February 15, 2006 for the capsule NDA filing and March 27, 2006 for the tablet NDA filing. The PDUFA action date is the date by which the FDA is expect to have completed its review of the submissions and will document its assessment through the issuance of an action letter. In January 2006, the FDA requested submission of results from the driving study we completed in late 2005. We submitted the final report of this study to the agency as requested. Based on feedback from the FDA, we anticipate labeling that includes data from this study, which showed no impairment in next-day driving performance. In addition, the FDA has stated its intent to issue a combined package insert in lieu of individual package inserts for the capsule and tablet NDA. To complete review of the driving study and the combined package insert, the FDA has advised us that the PDUFA dates for the capsule and tablet NDAs have been moved to May 15, 2006 and June 27, 2006, respectively. However, the FDA has committed to an action by May 15, 2006 for both NDAs.

During 2005, we completed the hiring, training and deployment of our 200-person sales force that is paid for and supported by Pfizer. Our sales force is currently detailing Pfizer’s antidepressant Zoloft® to psychiatrists and is preparing to launch its promotion of indiplon to those same psychiatrists. Upon approval of indiplon by the FDA, we will then begin to receive royalties from Pfizer based on sales of indiplon. Sales related costs will increase during 2006 as we begin to market indiplon. This increase in cost will primarily be offset by revenue from Pfizer as it continues to fund our sales force in 2006.

Prior to indiplon royalty revenue and recognition of expense from adoption of FAS 123R, we anticipate 2006 to be a break-even year. We will adopt FAS 123R in 2006 which will add expense to our statement of operations, however, profitability for 2006 is dependent upon the approval of our NDA for indiplon by the FDA, and upon acceptance of indiplon by prescribers and consumers.

Liquidity and Capital Resources

At December 31, 2005, our cash, cash equivalents, and short-term investments totaled $273.1 million compared with $301.1 million at December 31, 2004. This $28.0 million decrease is primarily a result of our operating loss of $22.2 million for the year ended December 31, 2005, and payments on long-term debt of $6.7 million. At December 31, 2004, our cash, cash equivalents, and short-term investments totaled $301.1 million compared to $453.2 million at December 31, 2003. This $152.1 million decrease is primarily a result of a $50.0 million payment to Wyeth for its portion of the indiplon royalty stream, a $32.8 million decrease in payables related to clinical trials and our net loss of $45.8 million.

Net cash (used in) provided by operating activities during 2005 was ($30.8) million compared to ($100.0) million in 2004 and $37.1 million in 2003. The fluctuation between 2004 and 2005 is due to a loss of $22.2 million in 2005 compared to a loss of $45.8 million in 2004, and a reduction in payables of $31.1 million in 2004, primarily due to paying accrued clinical trial costs for indiplon. The fluctuation in cash provided by (used in) operations from 2003 to 2004 is due to an increase in the clinical trials payable by $32.8 million during 2003 compared to a decrese in payables of $31.1 million in 2004, and the receipt of a $100.0 million up front payment from Pfizer in 2003.

Net cash provided by (used in) investing activities during 2005 was $9.4 million compared to $18.5 million in 2004 and ($186.6) million in 2003. These fluctuations resulted primarily from timing differences in investment purchases, sales and maturities and the fluctuations in our portfolio mix between cash equivalents and short-term investment holdings. We expect similar fluctuations to continue in future periods. During 2004, net cash provided by investing activities included construction costs of $31.7 million. Additionally, we used $50.0 million to purchase the Wyeth indiplon royalty stream. During 2003, net cash used in investing activities included construction and land acquisition costs related to our new corporate headquarters totaling approximately $43.0 million, which was partially offset by the sale of our current headquarters for $40.0 million. Capital equipment purchases for 2005, 2004, and 2003 were $7.2 million, $13.7 million, and $7.2 million, respectively. Capital equipment purchases for 2006 are expected to be approximately $7.5 million.

During 2003, we sold our former research and administrative facility and an undeveloped parcel of land adjacent to the facility for $40.0 million and recognized a gain on the sale of these properties of approximately $18.0 million. Additionally, during 2003, we acquired undeveloped real property in San Diego, California for approximately $17.0 million to construct a new corporate facility. In January 2004, we purchased an additional parcel of land adjacent to the property for $7.7 million. Construction of the new facility commenced in June 2003 and was completed in mid-2004.

The costs we incurred in connection with these two properties included design and construction costs as well as site improvements, equipment and construction financing costs for these facilities. These costs were approximately $57.1 million. The land acquisition and construction costs were financed through the net proceeds of the sale of the former facility and a construction loan. The construction loan agreement was for an amount up to $60.6 million and required us to place a $17.5 million guaranty deposit with the lender for the term of the loan. The loan bore interest at the prime rate plus .75 percentage points. In October 2004, we repaid the outstanding amount under the construction loan of $60.3 million, and our guaranty deposit was released by the lender. The construction loan was replaced with a $49.5 million loan secured by a first mortgage on the property. The new loan bears interest at a rate of 6.48% per annum, and is being amortized over a period of thirty years, with a principal balloon payment of $42.0 million due on the tenth anniversary of the loan. Additionally, we are required by the lender to maintain a $5.0 million letter of credit with a local bank as security for the first mortgage loan. The letter of credit is secured by a $5.2 million deposit with the same bank.

During 2005, concurrent with the deployment of our sales force, we were required to place an irrevocable letter of credit in the amount of $0.5 million related to the leasing of our fleet of vehicles under an operating lease. Under that letter of credit we are required to maintain a security deposit of $0.5 million with a local bank.

Net cash provided by financing activities during 2005 was $10.3 million compared with $36.7 million in 2004 and $211.1 million in 2003. In addition to the above-mentioned fiscal 2004 debt transactions, during 2003 we obtained financing for $31.5 million of capital purchases, primarily under the construction loan discussed above, and paid off the outstanding debt related to our former corporate headquarters of approximately $14.0 million. Additionally, we sold 3.75 million shares of our common stock in an underwritten public offering yielding net cash proceeds of $187.4 million during 2003. Cash proceeds from the issuance of common stock upon exercise of outstanding stock options and employee stock purchase plans was $17.0 million, $6.8 million, and $9.2 million in 2005, 2004, and 2003, respectively. We expect similar fluctuations to occur in the future, as the amount and frequency of stock-related transactions are dependent upon the market performance of our common stock.

On February 26, 2004, we entered into several agreements with Wyeth and DOV pursuant to which we acquired Wyeth’s financial interest in indiplon for approximately $95.0 million, consisting of $50.0 million in cash and $45.0 million in our common stock. Wyeth’s financial interest in indiplon arose from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the indiplon technology to DOV in exchange for milestone payments and royalties on future sales of indiplon. We subsequently licensed the indiplon technology from DOV in exchange for milestones and royalties. The February 2004 agreements among us, Wyeth and DOV provide that we will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that we will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth. This decreases our overall royalty obligation on sales of indiplon from six percent

to three and one-half percent. This transaction has been recorded as a long-term asset (prepaid royalty), and this asset will be amortized over the commercialization period of indiplon, based primarily upon indiplon sales.

Factors That May Affect Future Financial Condition and Liquidity

We anticipate significant increases in expenditures as we continue to expand our research and development activities. Because of our limited financial resources, our strategies to develop some of our programs include collaborative agreements with major pharmaceutical companies and sales of our common stock in both public and private offerings. Our collaborative agreements typically include a partial recovery of our research costs through license fees, contract research funding and milestone revenues. Our collaborators are also financially and managerially responsible for clinical development and commercialization. In these cases, the estimated completion date would largely be under the control of the collaborator. We cannot forecast, with any degree of certainty, which proprietary products or indications, if any, will be subject to future collaborative arrangements, in whole or in part, and how such arrangements would affect our capital requirements.

The following table summarizes our contractual obligations at December 31, 2005 and the effect such obligations are expected to have on our liquidity and cash flow in future periods. Our license, research and clinical development agreements are generally cancelable with written notice in 0-180 days. In addition to the minimum payments due under our license and research agreements, we may be required to pay up to $44.6 million in milestone payments, plus sales royalties, in the event that all scientific research under these agreements is successful. Some of our clinical development agreements contain incentives for time-sensitive activities.

Contractual Obligations	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
			(in thousands)		
Debt	$59,404	$ 5,762	$ 6,653	$ 1,494	$ 45,495
Operating lease	1,248	879	333	36	—
License & research agreements	3,574	3,259	165	150	—
Clinical development agreements	10,996	10,335	661	—	—
Total contractual obligations	$75,222	$ 20,235	$ 7,812	$ 1,680	$ 45,495

The funding necessary to execute our business strategies is subject to numerous uncertainties, which may adversely affect our liquidity and capital resources. Completion of clinical trials may take several years or more, but the length of time generally varies substantially according to the type, complexity, novelty and intended use of a product candidate. It is also important to note that if a clinical candidate is identified, the further development of that candidate can be halted or abandoned at any time due to a number of factors. These factors include, but are not limited to, funding constraints, safety or a change in market demand.

An important element of our business strategy is to pursue the research and development of a diverse range of product candidates for a variety of disease indications. We pursue this goal through proprietary research and development as well as searching for new technologies for licensing opportunities. This allows us to diversify against risks associated with our research and development spending. To the extent we are unable to maintain a diverse and broad range of product candidates, our dependence on the success of one or a few product candidates would increase.

The nature and efforts required to develop our product candidates into commercially viable products include research to identify a clinical candidate, preclinical development, clinical testing, FDA approval and commercialization. This process may cost in excess of $500 million and can take in excess of 10 years to complete for each product candidate.

We test our potential product candidates in numerous pre-clinical studies to identify disease indications for which our product candidates may show efficacy. We may conduct multiple clinical trials to cover a variety of indications for each product candidate. As we obtain results from trials, we may elect to discontinue clinical trials for certain product candidates or for certain indications in order to focus our resources on more promising product candidates or indications. The duration and the cost of clinical trials may vary significantly over the life of a project as a result of differences arising during the clinical trial protocol, including, among others, the following:

- we or the FDA may suspend the trials;
- we may discover that a product candidate may cause harmful side effects;
- patient recruitment may be slower than expected; and
- patients may drop out of the trials.

For each of our programs, we periodically assess the scientific progress and merits of the programs to determine if continued research and development is economically viable. Certain of our programs have been terminated due to the lack of scientific progress and lack of prospects for ultimate commercialization. Because of the uncertainties associated with research and development of these programs, we may not be successful in achieving commercialization. As such, the ultimate timeline and costs to commercialize a product cannot be accurately estimated.

Our product candidates have not yet achieved FDA regulatory approval, which is required before we can market them as therapeutic products. In order to proceed to subsequent clinical trial stages and to ultimately achieve regulatory approval, the FDA must conclude that our clinical data establish safety and efficacy. The results from preclinical testing and early clinical trials may not be predictive of results in later clinical trials. It is possible for a candidate to show promising results in clinical trials, but subsequently fail to establish sufficient safety and efficacy data necessary to obtain regulatory approvals.

As a result of the uncertainties discussed above, among others, the duration and completion costs of our research and development projects are difficult to estimate and are subject to considerable variation. Our inability to complete our research and development projects in a timely manner or our failure to enter into collaborative agreements, when appropriate, could significantly increase our capital requirements and could adversely impact our liquidity. These uncertainties could force us to seek additional, external sources of financing from time to time in order to continue with our business strategy. Our inability to raise additional capital, or to do so on terms reasonably acceptable to us, would jeopardize the future success of our business.

We also may be required to make further substantial expenditures if unforeseen difficulties arise in other areas of our business. In particular, our future capital requirements will depend on many factors, including:

- continued scientific progress in our research and development programs;
- the magnitude of our research and development programs;
- progress with preclinical testing and clinical trials;
- the time and costs involved in obtaining regulatory approvals;
- the costs involved in filing and pursuing patent applications and enforcing patent claims;
- competing technological and market developments;
- the establishment of additional collaborations and strategic alliances;
- the cost of manufacturing facilities and of commercialization activities and arrangements; and
- the cost of product in-licensing and any possible acquisitions.

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 our existing capital resources and anticipated revenues will be sufficient to conduct and complete all of our research and development programs as planned.

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, for the cost of product in-licensing and for any possible acquisitions, and we may require additional funding to establish manufacturing and marketing capabilities in the future. We may seek to access the public or private equity markets whenever conditions are favorable. We may also seek additional funding through strategic alliances and other financing mechanisms. We cannot assure you that adequate funding will be available on terms acceptable to us, if at all. If adequate funds are not available, we may be required to curtail significantly one or more of our research or development programs or obtain funds through arrangements with collaborators or others. This may require us to relinquish rights to certain of our technologies or product candidates. 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 successfully develop our products under development or that our products, if successfully developed, will generate revenues sufficient to enable us to earn a profit.

Interest Rate Risk

We are exposed to interest rate risk on our short-term investments. The primary objective of our investment activities is to preserve principal while at the same time maximizing yields without significantly increasing risk. To achieve this objective, we invest in highly liquid and high quality government and other debt securities. To minimize our exposure due to adverse shifts in interest rates, we invest in short-term securities and ensure that the maximum average maturity of our investments does not exceed 40 months. If a 10% change in interest rates were to have occurred on December 31, 2005, this change would not have had a material effect on the fair value of our investment portfolio as of that date. Due to the short holding period of our investments, we have concluded that we do not have a material financial market risk exposure.

Cautionary Note on Forward-Looking Statements

Our business is subject to significant risks, including but not limited to, the risks inherent in our research and development activities, including the successful continuation of our strategic collaborations, the successful completion of clinical trials, the lengthy, expensive and uncertain process of seeking regulatory approvals, uncertainties associated both with the potential infringement of patents and other intellectual property rights of third parties, and with obtaining and enforcing our own patents and patent rights, uncertainties regarding government reforms and of product pricing and reimbursement levels, technological change, competition, manufacturing uncertainties and dependence on third parties. Even if our product candidates appear promising at an early stage of development, they may not reach the market for numerous reasons. Such reasons include the possibilities that the product will be ineffective or unsafe during clinical trials, will fail to receive necessary regulatory approvals, will be difficult to manufacture on a large scale, will be uneconomical to market or will be precluded from commercialization by proprietary rights of third parties. For more information about the risks we face, see “Item 1.A. Risk Factors” included in this report.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123R “Share Based Payment.” This statement is a revision to SFAS 123 and supersedes Accounting Principles Board (APB) Opinion No. 25, “Accounting for Stock Issued to Employees,” and amends FASB Statement No. 95, “Statement of Cash Flows.” This statement requires a public entity to expense the cost of employee services received in exchange for an award of equity instruments. This statement also provides guidance on valuing and expensing these awards, as well as disclosure requirements of these equity arrangements. This statement is effective for the first interim reporting period that begins after December 15, 2005.

SFAS 123R permits public companies to choose between the following two adoption methods:

1. A “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, or

2. A “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, we currently account for share-based payments to employees using APB Opinion 25’s intrinsic value method and, as such, we generally recognize no compensation cost for employee stock options. The impact of the adoption of SFAS 123R cannot be predicted at this time because it will be depend on levels of share-based payments granted in the future. However, valuation of employee stock options under SFAS 123R is similar to SFAS 123, with minor exceptions. For information about what our reported results of operations and earnings per share would have been had we adopted SFAS 123, please see the discussion under the heading “Stock Based Compensation” in Note 1 to our Consolidated Financial Statements. Accordingly, the adoption of SFAS 123R’s fair value method will have a significant impact on our results of operations, although it will have no impact on our overall financial position. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. We have not yet completed the analysis of the ultimate impact that this new pronouncement will have on the results of operations, nor the method of adoption for this new standard.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Quantitative and Qualitative Disclosures about Market Risk is contained in “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations — Interest Rate Risk.”

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See the list of the Company’s Financial Statements filed with this Form 10-K under Item 15 below.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the timelines specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely 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, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer and the Company’s Chief Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures as of the end of the year 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.

Management's Report on Internal Control Over Financial Reporting

Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of directors, management and other personnel, 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, and includes those policies and procedures that:

(1) Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;

(2) Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorization of our management and directors; and

(3) Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk. Management is responsible for establishing and maintaining adequate internal control over financial reporting for the company.

Management has used the framework set forth in the report entitled *Internal Control-Integrated Framework* published by the Committee of Sponsoring Organizations of the Treadway Commission, known as COSO, to evaluate the effectiveness of the Company's internal control over financial reporting. Based on this assessment, management has concluded that our internal control over financial reporting was effective as of December 31, 2005. Ernst & Young LLP, the independent registered public accounting firm that audited the consolidated financial statements included in the Annual Report on Form 10-K, has issued an attestation report on management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2005. This report which expresses an unqualified opinion on management's assessment of and the effectiveness of our internal controls over financial reporting as of December 31, 2005 is included herein.

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

Report of Independent Registered Public Accounting Firm
on Internal Control Over Financial Reporting

The Board of Directors and Stockholders
Neurocrine Biosciences, Inc.

We have audited management's assessment, included in the accompanying "Management's Report on Internal Control Over Financial Reporting," that Neurocrine Biosciences, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Neurocrine Biosciences' management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Neurocrine Biosciences, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Neurocrine Biosciences, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005 of Neurocrine Biosciences, Inc. and our report dated January 20, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, California
January 20, 2006

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. EXECUTIVE OFFICERS AND DIRECTORS OF THE REGISTRANT

Information required by this item will be contained in our Definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2005. Such information is incorporated herein by reference.

The Company has adopted a code of ethics that applies to its Chief Executive Officer, Chief Financial Officer, and to all of its other officers, directors, employees and agents. The code of ethics is available at the Corporate Governance section of the Investor Relations page on the Company's website at *www.neurocrine.com*. The Company intends to disclose future amendments to, or waivers from, certain provision of its code of ethics on the above website within five business days following the date of such amendment or waiver.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item will be contained in our Definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2005. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information required by this item will be contained in our Definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2005. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information required by this item will be contained in our Definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2005. Such information is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this item will be contained in our Definitive Proxy Statement for our 2006 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2005. Such information is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) *Documents filed as part of this report.*

1. List of Financial Statements. The following financial statements of Neurocrine Biosciences, Inc. and Report of Independent Registered Public Accounting Firm, are included in this report:

   Report of Independent Registered Public Accounting Firm

   Consolidated Balance Sheets as of December 31, 2005 and 2004

   Consolidated Statements of Operations for the years ended December 31, 2005, 2004 and 2003

   Consolidated Statements of Stockholders' Equity for the years ended December 31, 2005, 2004 and 2003

   Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003

   Notes to the Consolidated Financial Statements (includes unaudited Selected Quarterly Financial Data)

2. List of all Financial Statement schedules. All schedules are omitted because they are not applicable or the required information is shown in the Financial Statements or notes thereto.

3. List of Exhibits required by Item 601 of Regulation S-K. See part (c) below.

(b) *Reports on Form 8-K.*

1. On October 24, 2005 the Company filed a report on Form 8-K which reported under Items 1.01 and 9.01 the amendment to Dr. Henry Pan's employment agreement.

2. On November 1, 2005 the Company filed a report on Form 8-K which reported under Items 1.01 and 9.01 the granting of an employment commencement nonstatutory stock option to Dr. Christopher O'Brien.

3. On November 14, 2005 the Company filed a report on Form 8-K which reported under Item 1.01 the acceleration of vesting of certain unvested options, and approval of amendments to the stock option plan and employee stock purchase plan.

4. On December 7, 2005 the Company filed a report on Form 8-K which reported under Item 5.02 the appointment of Adrian Adams to the board of directors.

(c) *Exhibits.* The following exhibits are filed as part of, or incorporated by reference into, this report:

Exhibit Number	Description
3.1	Restated Certificate of Incorporation (1)
3.2	Bylaws (1) (11)
3.3	Certificate of Amendment of Bylaws (1) (19)
4.1	Form of Common Stock Certificate (1)
4.2	Amended and Restated Preferred Shares Rights Agreement by and between the Registrant and American Stock Transfer & Trust Company, as Rights Agent, dated as of January 11, 2002 (10)
10.1	1992 Incentive Stock Plan, as amended (7)
10.2	1996 Director Stock Option Plan, as amended, and form of stock option agreement (1)
10.3	1996 Employee Stock Purchase Plan, as amended
10.4	Form of Director and Officer Indemnification Agreement (1)
10.5	Employment Agreement dated March 1, 1997, between the Registrant and Gary A. Lyons, as amended May 24, 2000 (6)
10.6	Employment Agreement dated March 1, 1997, between the Registrant and Paul W. Hawran, as amended May 24, 2000 (6)
10.7*	Research and License Agreement dated October 15, 1996, between the Registrant and Eli Lilly and Company (2)
10.8	Form of incentive stock option agreement and nonstatutory stock option agreement for use in connection with 1992 Incentive Stock Plan (1)
10.9*	Sub-License and Development Agreement dated June 30, 1998, by and between DOV Pharmaceutical, Inc. and the Registrant (4)
10.10*	Collaboration and License Agreement dated January 1, 1999, by and between American Home Products Corporation acting through its Wyeth Laboratories Division and the Registrant (5)
10.11	Employment Agreement dated October 1, 1998, between the Registrant and Margaret Valeur-Jensen, as amended May 24, 2000 (6)
10.12*	Collaboration and License Agreement between the Registrant and Glaxo Group Limited dated July 20, 2001(8)
10.13	Employment Agreement dated November 1, 2005 between the Registrant and Henry Pan, MD, PhD. (9)
10.14	2001 Stock Option Plan, as amended August 6, 2002 and October 15, 2002 (12)
10.15*	License Agreement between the Registrant and Pfizer dated December 18, 2002 (11)
10.16*	Collaboration Agreement between the Registrant and Pfizer dated December 18, 2002 (11)
10.17*	Loan Agreement between the Registrant and Pfizer dated December 18, 2002 (11)
10.18	Employment Agreement dated June 16, 2003 between the Registrant and Robert Little (14)
10.19	Neurocrine Biosciences, Inc. Nonqualified Deferred Compensation Plan, as amended (24)
10.20	Neurocrine Biosciences, Inc. 2003 Incentive Stock Plan, as amended and form of stock option agreement (13) (24)
10.21	Employment Agreement dated as of September 1, 2003 between the Registrant and Wendell Wierenga (15)
10.22	Employment Commencement Nonstatutory Stock Option Agreement between the Registrant and Wendell Wierenga (20)
10.23	Tax Indemnity Agreement between the Registrant and Gary Lyons (16)
10.24	Tax Indemnity Agreement between the Registrant and Paul W. Hawran (16)
10.25	Tax Indemnity Agreement between the Registrant and Margaret Valeur-Jensen (16)

Exhibit Number	Description
10.26	Tax Indemnity Agreement between the Registrant and Kevin Gorman (16)
10.27	Tax Indemnity Agreement between the Registrant and Paul Conlon (16)
10.28	Employment Agreement dated October 27, 2003 between the Registrant and Kevin C. Gorman (18)
10.29	Promissory Note between Science Park Center LLC and Teachers Insurance and Annuity Association of America (21)
10.30	Deed of Trust, Assignment of Leases and Rents, Security Agreement and Fixture Filing by and between Science Park Center LLC, and Stewart Title Guaranty Company, as Trustee for the benefit of Teachers Insurance and Annuity Association of America (21)
10.31	Letter of Credit (21)
10.32	Assignment and License Agreement dated February 26, 2004 by and among Wyeth Holdings Corporation and Neurocrine Biosciences, Inc. (17)
10.33	Stock Purchase Agreement dated March 15, 2004 by and among Wyeth Holdings Corporation and Neurocrine Biosciences, Inc. (17)
10.34	Consent Agreement and Amendment dated March 15, 2004 by and among Wyeth Holdings Corporation, Neurocrine Biosciences, Inc. and DOV Pharmaceutical, Inc. (17)
10.35	License Agreement dated March 15, 2004 by and among Wyeth Holdings Corporation and DOV Pharmaceutical, Inc. (17)
10.36	Consulting Agreement dated November 15, 2004 between the Registrant and Wylie Vale (19)
10.37	Consulting Agreement dated November 15, 2004 between the Registrant and Lawrence Steinman (19)
10.38	Employment Agreement dated June 20, 2005 between the Registrant and Richard Ranieri (22)
10.39	Employment Commencement Nonstatutory Stock Option Agreement between the Registrant and Richard Ranieri (22)
10.40	Employment Commencement Nonstatutory Stock Option Agreement between the Registrant and Christopher O'Brien (23)
21.1	Subsidiaries of the Company
23.1	Consent of Independent Registered Public Accounting Firm
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14 and 15d-14 promulgated under the Securities Exchange Act of 1934
32**	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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

(2) Incorporated by reference to the Company's Report on Form 10-K for the fiscal year ended December 31, 1996 filed on March 31, 1997

(3) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 14, 1997

(4) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 14, 1998

(5) Incorporated by reference to the Company's Report on Form 10-K for the fiscal year ended December 31, 1998 filed on March 31, 1999

(6) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 11, 2000

(7) Incorporated by reference to the Company's Report on Form S-8 filed on July 16, 2001

(8) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 14, 2001

(9) Incorporated by reference to the Company's Quarterly Report on Form 8-K filed on October 24, 2005

(10) Incorporated by reference to the Company's Current Report on Form 8-K filed on January 14, 2002

(11) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 20, 2002

(12) Incorporated by reference to the Company's Report on Form 10-K for the fiscal year ended December 31, 2002 filed on March 4, 2003

(13) Incorporated by reference to the Company's Registration Statement on Form S-8 filed on June 6, 2003

(14) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 8, 2003

(15) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on November 7, 2003

(16) Incorporated by reference to the Company's Report on Form 10-K for the fiscal year ended December 31, 2003 filed on March 15, 2004

(17) Incorporated by reference to the Company's Report on Form 8-K filed on March 17, 2004

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

(19) Incorporated by reference to the Company's Report on Form 10-K filed on February 16, 2005

(20) Incorporated by reference to the Company's Report on Form S-8 filed on September 2, 2004

(21) Incorporated by reference to the Company's Report on Form 8-K filed on October 29, 2004

(22) Incorporated by reference to the Company's Report on Form 8-K filed on June 24, 2005

(23) Incorporated by reference to the Company's Report on Form 8-K filed on November 1, 2005

(24) Incorporated by reference to the Company's Report on Form 8-K filed on January 19, 2006

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* Confidential treatment has been granted with respect to certain portions of the exhibit.

** 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.

(d) *Financial Statement Schedules.* See Item 15(a)(2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEUROCRINE BIOSCIENCES, INC.
A Delaware Corporation

Date: February 1, 2006

By: /s/ Gary A. Lyons
Gary A. Lyons
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Gary A. Lyons Gary A. Lyons	President, Chief Executive Officer and Director (Principal Executive Officer)	February 1, 2006
/s/ Paul W. Hawran Paul W. Hawran	Executive Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)	February 1, 2006
/s/ Joseph A. Mollica Joseph A. Mollica	Chairman of the Board of Directors	February 1, 2006
/s/ Adrian Adams Adrian Adams	Director	February 1, 2006
/s/ Corinne H. Lyle Corinne H. Lyle	Director	February 1, 2006
/s/ W. Thomas Mitchell W. Thomas Mitchell	Director	February 1, 2006
/s/ Richard F. Pops Richard F. Pops	Director	February 1, 2006
/s/ Stephen A. Sherwin Stephen A. Sherwin	Director	February 1, 2006
/s/ Wylie W. Vale Wylie W. Vale	Director	February 1, 2006

NEUROCRINE BIOSCIENCES, INC.

INDEX TO THE FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON FINANCIAL STATEMENTS

The Board of Directors and Stockholders
Neurocrine Biosciences, Inc.

We have audited the accompanying consolidated balance sheets of Neurocrine Biosciences, Inc. as of December 31, 2005 and 2004, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Neurocrine Biosciences, Inc. at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with generally accepted accounting principles in the United States.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Neurocrine Biosciences Inc.'s internal control over financial reporting as of December 31, 2005, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 20, 2006, expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, California
January 20, 2006

NEUROCRINE BIOSCIENCES, INC.
Consolidated Balance Sheets
(in thousands, except for par value and share totals)

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 49,948	$ 61,027
Short-term investments, available-for-sale	223,120	240,102
Receivables under collaborative agreements	858	8,213
Other current assets	5,384	4,473
Total current assets	279,310	313,815
Property and equipment, net	99,307	102,166
Restricted cash	5,775	5,250
Prepaid royalty	94,000	94,000
Other non-current assets	4,731	3,986
Total assets	$ 483,123	$ 519,217
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 3,447	$ 5,391
Accrued liabilities	17,895	19,846
Deferred revenues	6,537	27,674
Current portion of long-term debt	5,814	6,674
Total current liabilities	33,693	59,585
Long-term debt	53,590	59,452
Deferred revenues	—	2,000
Other liabilities	5,736	4,353
Total liabilities	93,019	125,390
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; 50,000,000 shares authorized; issued and outstanding shares were 37,132,478 in 2005 and 36,532,767 in 2004	37	37
Additional paid-in capital	691,717	674,034
Deferred compensation	—	(312)
Notes receivable from stockholders	—	(69)
Accumulated other comprehensive loss	(1,504)	(1,908)
Accumulated deficit	(300,146)	(277,955)
Total stockholders' equity	390,104	393,827
Total liabilities and stockholders' equity	$ 483,123	$ 519,217

See accompanying notes.

NEUROCRINE BIOSCIENCES, INC.
Consolidated Statements of Operations
(in thousands, except loss per share data)

	Years Ended December 31,		
	2005	2004	2003
Revenues:			
Sponsored research and development	$ 9,187	$ 27,156	$ 96,699
Milestones and license fees	92,702	57,612	41,126
Sales force allowance	22,000	—	—
Grant income	—	408	1,253
Total revenues	123,889	85,176	139,078
Operating expenses:			
Research and development	106,628	115,066	177,271
Sales, general and administrative	42,333	22,444	20,594
Total operating expenses	148,961	137,510	197,865
Loss from operations	(25,072)	(52,334)	(58,787)
Other income and (expenses):			
Gain on sale of property	—	—	17,946
Interest income	7,039	8,601	11,259
Interest expense	(4,158)	(1,961)	(516)
Total other income	2,881	6,640	28,689
Loss before taxes	(22,191)	(45,694)	(30,098)
Income taxes	—	79	158
Net loss	$ (22,191)	$ (45,773)	$ (30,256)
Net loss per common share:			
Basic and diluted	$ (0.60)	$ (1.26)	$ (0.93)
Shares used in the calculation of net loss per common share:			
Basic and diluted	36,763	36,201	32,374

See accompanying notes.

NEUROCRINE BIOSCIENCES, INC.
Consolidated Statements of Stockholders' Equity
(in thousands)

	Common stock Shares	Common stock Amount	Additional Paid-in Capital	Deferred Compensation	Notes Receivable from Stockholders	Accumulated Other Comprehensive Income (loss)	Accumulated Deficit	Total Stockholders' Equity
BALANCE AT DECEMBER 31, 2002	30,662	$ 31	$ 424,084	$ (1,240)	$ (208)	$ 3,513	$ (201,926)	$ 224,254
Net loss	—	—	—	—	—	—	(30,256)	(30,256)
Unrealized loss on short-term investments	—	—	—	—	—	(1,849)	—	(1,849)
Comprehensive loss	—	—	—	—	—	—	—	(32,105)
Issuance of common stock for option exercises	820	1	7,486	—	—	—	—	7,487
Issuance of common stock pursuant to the Employee Stock Purchase Plan	55	—	1,725	—	—	—	—	1,725
Issuance of common stock, net of offering costs	3,750	3	187,398	—	—	—	—	187,401
Amortization of deferred compensation, net	—	—	387	456	—	—	—	843
Science Park Center LLC consolidation	—	—	600	—	—	—	—	600
Common shares issued as a stock bonus	13	—	653	—	—	—	—	653
Issuance of warrants	—	—	193	—	—	—	—	193
Issuance of common stock for exercise of warrants	12	—	—	—	—	—	—	—
Stockholder note forgiveness	—	—	—	—	69	—	—	69
BALANCE AT DECEMBER 31, 2003	35,312	35	622,526	(784)	(139)	1,664	(232,182)	391,120
Net loss	—	—	—	—	—	—	(45,773)	(45,773)
Unrealized loss on short-term investments	—	—	—	—	—	(3,572)	—	(3,572)
Comprehensive loss	—	—	—	—	—	—	—	(49,345)
Issuance of common stock for option exercises	268	1	4,763	—	—	—	—	4,764
Tax benefit of stock options	—	—	236	—	—	—	—	236
Issuance of common stock pursuant to the Employee Stock Purchase Plan	47	—	1,999	—	—	—	—	1,999
Issuance of common stock, related to royalty stream purchase	803	1	44,999	—	—	—	—	45,000
Reversal of offering expenses	—	—	50	—	—	—	—	50
Amortization of deferred compensation, net	—	—	61	472	—	—	—	533
Buyout of minority interest in Science Park LLC	—	—	(600)	—	—	—	—	(600)
Issuance of common stock for exercise of warrants	103	—	—	—	—	—	—	—
Stockholder note forgiveness	—	—	—	—	70	—	—	70
BALANCE AT DECEMBER 31, 2004	36,533	37	674,034	(312)	(69)	(1,908)	(277,955)	393,827
Net loss	—	—	—	—	—	—	(22,191)	(22,191)
Unrealized gain on short-term investments	—	—	—	—	—	404	—	404
Comprehensive loss	—	—	—	—	—	—	—	(21,787)
Issuance of common stock for option exercises	529	—	14,457	—	—	—	—	14,457
Issuance of common stock pursuant to the	70	—	2,514	—	—	—	—	2,514

Employee Stock Purchase Plan								
Amortization of deferred compensation, net	—	—	98	312	—	—	—	410
Vesting acceleration of unvested options (Note 6)	—	—	614	—	—	—	—	614
Stockholder note forgiveness	—	—	—	—	69	—	—	69
BALANCE AT DECEMBER 31, 2005	37,132	$ 37	$ 691,717	$ —	$ —	$ (1,504)	$ (300,146)	$ 390,104

See accompanying notes.

NEUROCRINE BIOSCIENCES, INC.
Consolidated Statements of Cash Flows
(in thousands)

	Years Ended December 31,		
	2005	2004	2003
CASH FLOW FROM OPERATING ACTIVITIES			
Net loss	$ (22,191)	$ (45,773)	$ (30,256)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:			
Depreciation and amortization	10,094	7,081	3,692
Loss (gain) on sale/abandonment of assets	—	136	(17,946)
Deferred revenues	(23,137)	(38,233)	61,375
Deferred expenses	—	1,000	1,380
Loan forgiveness on notes receivable	119	200	134
Non-cash compensation expense	1,025	533	1,689
Change in operating assets and liabilities:			
Accounts receivable and other current assets	6,444	5,955	(15,207)
Other non-current assets	(636)	(982)	81
Other non-current liabilities	1,383	1,244	—
Accounts payable and accrued liabilities	(3,895)	(31,149)	32,186
Net cash (used in) provided by operating activities	(30,794)	(99,988)	37,128
CASH FLOW FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(382,829)	(543,722)	(448,294)
Sales/maturities of short-term investments	399,971	645,049	300,490
Deposits and restricted cash	(525)	20,289	(25,039)
Purchase of prepaid royalty stream	—	(50,000)	—
Proceeds from sale of property and building, net	—	—	36,636
Purchases of property and equipment, net	(7,235)	(53,147)	(50,439)
Net cash provided by (used in) investing activities	9,382	18,469	(186,646)
CASH FLOW FROM FINANCING ACTIVITIES			
Issuance of common stock	16,970	6,763	196,613
Proceeds received from debt	—	94,570	31,524
Principal payments on debt	(6,722)	(64,877)	(17,078)
Tax benefit from exercise of stock options	—	236	—
Payments received on notes receivable from employees	85	—	—
Net cash provided by financing activities	10,333	36,692	211,059
Net (decrease) increase in cash and cash equivalents	(11,079)	(44,827)	61,541
Cash and cash equivalents at beginning of the year	61,027	105,854	44,313
Cash and cash equivalents at end of the year	$ 49,948	$ 61,027	$ 105,854
SUPPLEMENTAL DISCLOSURES			
Supplemental disclosures of cash flow information:			
Interest paid	$ 4,454	$ 1,331	$ 566
Taxes paid	$ —	$ —	$ 158
Stock issued for prepaid royalty	$ —	$ 45,000	$ —

See accompanying notes.

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Activities. Neurocrine Biosciences, Inc. (the Company or Neurocrine) incorporated in California in 1992 and reincorporated in Delaware in 1996. The Company 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 insomnia, anxiety, depression, various female and male health disorders, multiple sclerosis, diabetes and other neurological and endocrine related diseases and disorders.

In May 1997, the Company along with two unrelated parties formed Science Park Center LLC (Science Park) in order to construct an office and laboratory facility which was subsequently leased by the Company. Science Park is a California limited liability company, of which the Company, prior to April 2003, owned only a nominal minority interest. The Company became the majority owner of Science Park effective April 1, 2003, and acquired the remaining interest in Science Park during 2004.

Other subsidiaries of the Company include Neurocrine Continental, Inc. (formerly Neurocrine Commercial Operations, Inc.) a Delaware corporation and wholly owned subsidiary of the Company, established to support the sales operations beginning in 2005; Neurocrine International LLC, a Delaware limited liability company in which the Company holds a 99% ownership interest and Science Park holds a 1% interest, and Neurocrine HQ Inc., a Delaware corporation and wholly owned subsidiary of the Company, both of which are primarily inactive.

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.

Cash Equivalents. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Short-Term Investments Available-for-Sale. In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Debt and Equity Securities," short-term investments are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in other comprehensive income (loss). 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.

Concentration of Credit Risk. Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents and short-term investments. The Company has established guidelines to limit its exposure to credit expense by placing investments with high credit quality financial institutions, diversifying its investment portfolio and placing investments with maturities that maintain safety and liquidity.

Collaboration Agreements. During the years ended December 31, 2005, 2004 and 2003, collaborative research and development agreements accounted for substantially all of the Company's revenue.

Property and Equipment. Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets using the straight-line method. Building costs are depreciated over an average estimated useful life of 25 years and equipment is over three to seven years.

Industry Segment and Geographic Information. The Company operates in a single industry segment - - the discovery and development of therapeutics for the treatment of neurological and endocrine related diseases and disorders. The Company had no foreign operations for the years ended December 31, 2005, 2004 and 2003.

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Other Non-Current Assets. Includes $4.2 million and $3.4 million, respectively, of mutual fund investments related to the Company's nonqualified deferred compensation plan for certain employees as of December 31, 2005 and 2004, respectively. Net unrealized gains related to these mutual funds were approximately $478,000 and $229,000 as of December 31, 2005 and December 31, 2004, respectively. Additionally, the Company has recorded a liability for these deferred compensation investments in other liabilities.

The participants in the deferred compensation plan may select from a variety of investment options and have the ability to make investment changes on a daily basis. A participant may elect to receive all or a portion of his or her deferred compensation on a fixed payment date of his or her choosing and may delay that fixed date, subject to plan limitations. The Board of Directors may, at its sole discretion, suspend or terminate the plan.

Other non-current assets also includes $483,000 and $621,000 of notes receivable from employees as of December 31, 2005 and 2004, respectively. The notes are secured by real property.

Impairment of Long-Lived Assets. In accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets," if indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If 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. While the Company's current and historical operating and cash flow losses are indicators of impairment, the Company believes the future cash flows to be received from the long-lived assets will exceed the assets' carrying value, and accordingly the Company has not recognized any impairment losses through December 31, 2005.

Fair Value of Financial Instruments. Financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities, are carried at cost, which management believes approximates fair value because of the short-term maturity of these instruments.

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

License fees are received in exchange for a grant to use the Company's proprietary technologies on an as-is basis for the term of the collaborative agreement. Milestones are received for specific scientific achievements determined at the beginning of the collaboration. These achievements are substantive and are based on the success of scientific efforts.

Comprehensive Income. Comprehensive income is calculated in accordance with SFAS No. 130, "Comprehensive Income." SFAS No. 130 requires the disclosure of all components of comprehensive income, including net income and changes in equity during a period from transactions and other events and circumstances generated from non-owner sources. The Company's other comprehensive income/loss consisted of unrealized gains and losses on short-term investments and is reported in the statements of stockholders' equity.

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Research and Development Expenses. Research and development (R&D) expenses include related salaries, contractor fees, clinical trial costs, 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 and in-licensing arrangements. In addition, we fund R&D at other companies and research institutions under agreements, which are generally cancelable. We review and accrue clinical trials expenses based on work performed, which relies on estimates of total costs incurred based on completion of patient 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.

Stock-Based Compensation. As permitted by SFAS No. 123, "Accounting for Stock-Based Compensation," the Company has elected to follow Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for stock-based employee compensation. Deferred compensation is recorded for employee options only in the event that the fair market value of the stock on the date of the option grant exceeds the exercise price of the options. The deferred compensation is amortized over the vesting period of the options. The following table illustrates the effect on net income and earnings per share if the company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	2005	2004	2003
Net loss as reported	$(22,191)	$(45,773)	$(30,256)
Stock option expense	(38,472)	(24,368)	(23,067)
Pro forma net loss	$(60,663)	$(70,141)	$(53,323)
Loss per share (basic and diluted)	$ (0.60)	$ (1.26)	$ (0.93)
Pro forma loss per share (basic and diluted)	$ (1.65)	$ (1.94)	$ (1.65)

The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model using the following weighted average assumptions for 2005, 2004 and 2003, respectively: risk-free interest rates of 4.2%, 3.6% and 3.3%; a dividend yield of 0.0% (for all years); volatility factors of the expected market price of the Company's common stock of .34, .40 and .40; and a weighted average expected life of the option of 5.8 years for 2005 and 5 years for 2004 and 2003. The pro forma effect on net losses for 2005, 2004 and 2003 is not likely to be representative of the effects on reported income or loss in future years.

Compensation charges for options granted to non-employees have been determined in accordance with SFAS No. 123 and Emerging Issues Task Force (EITF) 96-18, "Accounting for Equity Instruments that Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," as the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured. Compensation for options granted to non-employees is periodically re-measured as the underlying options vest. For the years ended December 31, 2005, 2004 and 2003 compensation expense relating to non-employee stock options was $98,000, $61,000, and $384,000, respectively.

During 2005, the Company accelerated vesting of approximately 472,000 unvested options which resulted in approximately $10.5 million of stock option expense included in the 2005 pro forma net loss (Note 6).

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Net Loss Per Share. The Company computes net loss per share in accordance with SFAS No. 128, "Earnings Per Share." Under the provisions of SFAS No. 128, basic net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and common equivalent shares outstanding during the period. Potentially dilutive securities comprised of incremental common shares issuable upon the exercise of stock options and warrants, were excluded from historical diluted loss per share because of their anti-dilutive effect. Dilutive common stock equivalents would include the dilutive effects of common stock options and warrants for common stock. Potentially dilutive securities totaled 1.5 million, 2.0 million and 2.0 million for the years ended December 31, 2005, 2004 and 2003, respectively, and were excluded from the diluted earnings per share because of their anti-dilutive effect.

Impact of Recently Issued Accounting Standards. In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R "Share Based Payment." This statement is a revision to SFAS 123 and supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and amends FASB Statement No. 95, "Statement of Cash Flows". This statement requires a public entity to expense the cost of employee services received in exchange for an award of equity instruments. This statement also provides guidance on valuing and expensing these awards, as well as disclosure requirements of these equity arrangements. This statement is effective for the first interim reporting period of the first fiscal year beginning after June 15, 2005.

SFAS 123R permits public companies to choose between the following two adoption methods:

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, or

2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, the Company generally recognizes no compensation cost for employee stock options. The impact of the adoption of SFAS 123R cannot be predicted at this time because it will be depend on levels of share-based payments granted in the future. However, valuation of employee stock options under SFAS 123R is similar to SFAS 123, with minor exceptions. The impact on the results of operations and earnings per share had the Company adopted SFAS 123, is described in the Stock Based Compensation section of Note 1 above. Accordingly, the adoption of SFAS 123R's fair value method will have a significant impact on the Company's results of operations, although it will have no impact on the Company's overall financial position. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Due to timing of the release of SFAS 123R, the Company has not yet completed the analysis of the ultimate impact that this new pronouncement will have on the results of operations, nor the method of adoption for this new standard.

NEUROCRINE BIOSCIENCES, INC.
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NOTE 2. SHORT-TERM INVESTMENTS

Cash, cash equivalents, and short-term investments totaled $273.1 million and $301.1 million as of December 31, 2005 and 2004, respectively. The following is a summary of short-term investments classified as available-for-sale securities (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
December 31, 2005				
U.S. Government securities	$ 72,446	$ —	$ (1,150)	$ 71,296
Corporate debt securities	141,725	1	(732)	140,994
Short-term municipals	4,489	—	—	4,489
Other debt securities	6,442	—	(101)	6,341
Total investments	$225,102	$ 1	$ (1,983)	$223,120
December 31, 2004				
U.S. Government securities	$127,395	$ —	$ (1,090)	$126,305
Corporate debt securities	92,461	—	(932)	91,529
Other debt securities	22,383	4	(119)	22,268
Total investments	$242,239	$ 4	$ (2,141)	$240,102

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2005 are shown below (in thousands):

	Amortized Cost	Estimated Fair Value
Due in 12 months or less	$132,102	$131,329
Due between 12 months and 36 months	93,000	91,791
	$225,102	$223,120

The following table presents certain information related to sales of available-for-sale securities (in thousands):

	Years Ended December 31,		
	2005	2004	2003
Proceeds from sales	$399,971	$645,049	$300,490
Gross realized gains on sales	$ —	$ 1,110	$ 725
Gross realized losses on sales	$ (975)	$ (139)	$ (121)

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 3. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2005 and 2004 consist of the following (in thousands):

	2005	2004
Land	$ 25,370	$ 25,370
Buildings	56,765	57,080
Furniture and fixtures	3,166	3,110
Equipment	41,376	35,120
	126,677	120,680
Less accumulated depreciation	(27,370)	(18,514)
Property and equipment, net	$ 99,307	$102,166

For the years ended December 31, 2005, 2004 and 2003, depreciation expense was $10.1 million, $7.1 million and $3.7 million, respectively.

During 2004, the Company completed construction of its new facility in San Diego, California, which has approximately 200,000 square feet of space, of which approximately 85% is allocated to research and development. The former facility was sold in the fourth quarter of 2003 for $40.0 million and was leased-back until August 2004, when construction of the new facility was completed. In accordance with SFAS No. 98 “Accounting for Leases: Sales-Leaseback Transactions Involving Real Estate,” the Company recognized a financial statement gain on the sale of the property during 2003 of approximately $18.0 million.

In May 2003, the Company acquired undeveloped real property in San Diego, California for approximately $17.0 million to construct the new corporate facility. During 2003, the Company also had a deposit of $3.5 million, which was included in deposits and restricted cash at December 31, 2003, and a $4.4 million irrevocable standby letter of credit for an adjacent parcel of land, secured by a $4.4 million deposit, which amount was also included in deposits and restricted cash at December 31, 2003. The adjacent land parcel was purchased in January 2004 for $7.7 million, through the release of both of the deposits. Additionally, the letter of credit was canceled upon purchase of the land.

To finance the construction of the new facility, the Company secured a loan from a commercial bank for up to $60.6 million. The loan bore interest at the prime rate plus .75 percentage points. In accordance with SFAS No. 34, applicable interest cost was capitalized during the construction period. For the year ended December 31, 2004 and 2003, the Company recorded $1,262,000 and $659,000 of capitalized interest, respectively. The loan was repaid in 2004.

NOTE 4. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2005 and 2004 consist of the following (in thousands):

	2005	2004
Accrued employee benefits	$ 6,362	$ 5,202
Accrued development costs	6,599	11,062
Other accrued liabilities	4,934	3,582
	$17,895	$19,846

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 5. COMMITMENTS AND CONTINGENCIES

Debt. In October 2004, the Company repaid the outstanding amount under the construction loan which was replaced with a $49.5 million loan secured by a first mortgage on the corporate facility. The mortgage bears interest at a rate of 6.48% per annum, and principal is being amortized over a period of thirty years, with a balloon principal payment of $42.0 million due on the tenth anniversary of the loan. Monthly principal and interest payments total $312,000. At December 31, 2005, $48.8 million was outstanding under this loan agreement. Additionally, the Company is required by the lender to maintain a $5.0 million letter of credit with a local bank as security for the loan. This letter of credit is further secured by a mandatory deposit of $5.2 million with the bank providing the letter of credit. This deposit is recorded in restricted cash in the consolidated balance sheet at December 31, 2005.

The Company has also entered into equipment financing arrangements with lenders to finance equipment purchases, which expire on various dates through the year 2008 and bear interest at rates between 6.3% and 7.7%. The debt obligations are repayable in monthly installments. Amounts outstanding under these loans at December 31, 2005 and 2004 totaled $10.6 million and $16.7 million respectively.

Operating Leases. The Company has entered into an operating lease agreement with a vendor to provide vehicles to its sales force. As part of this agreement, the Company is required to maintain a $500,000 letter of credit with a local bank as security for the vehicles. This letter of credit is secured by a deposit of $525,000 and is recorded as restricted cash in the consolidated balance sheet at December 31, 2005

Rent Expense. Rent expense was $1.0 million $2.7 million and $2.6 million for the years ended December 31, 2005, 2004 and 2003, respectively. Sublease income was $77,000 for the year ended December 31, 2003.

Licensing and Research Agreements. The Company has entered into licensing agreements with various universities and research organizations, which are cancelable at the option of the Company with terms ranging from 0-180 days written notice. Under the terms of these agreements, the Company has received licenses to research tools, know-how and technology claimed, in certain patents or patent applications. The Company is required to pay fees, milestones and/or royalties on future sales of products employing the technology or falling under claims of a patent, and some of the agreements require minimum royalty payments. Some of the agreements also require the Company to pay expenses arising from the prosecution and maintenance of the patents covering the licensed technology. The Company continually reassesses the value of the license agreements and cancels them when research efforts are discontinued on these programs. If all licensed and research candidates are successfully developed, the Company may be required to pay milestone payments of approximately $44.6 million over the lives of these agreements, in addition to sales royalties ranging up to 5%. Due to the uncertainties of the development process, the timing and probability of the milestone and royalty payments cannot be accurately estimated.

Related Party Transactions. The Company has entered into agreements with a vendor to provide research support. An officer of this vendor also serves as a director of the Company. During 2005, 2004 and 2003, the Company paid approximately $950,000, $950,000 and $800,000, respectively, to the vendor for these research support services. Several of the Company's officers have entered into agreements for estate tax planning. All of these officers have agreed to indemnify the Company for any payroll withholding taxes and related costs and expenses that may result from these estate tax planning initiatives.

Clinical Development Agreements. The Company has entered into agreements with various vendors for the pre-clinical and clinical development of its product candidates, which are cancelable at the option of the Company for convenience or performance, with terms ranging from 0-180 days written notice. Under the terms of these agreements, the vendors provide a variety of services including conducting pre-clinical development research, manufacturing clinical compounds, enrolling patients, recruiting patients, monitoring studies, data analysis and regulatory filing assistance. Payments under these agreements typically include fees for services and reimbursement of expenses. Some agreements also may include incentive bonuses for time-sensitive activities. The timing of payments due under these agreements were estimated based on current schedules of clinical studies in progress.

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005

NOTE 5. COMMITMENTS AND CONTINGENCIES (continued)

Payment schedules for commitments and contractual obligations at December 31, 2005 are as follows (in thousands):

Fiscal Year	Mortgage Debt	Equipment Debt	Operating Leases	Licenses & Research Agreements	Clinical Development Agreements
2006	$ 547	$ 5,215	$ 879	$ 3,259	$ 10,335
2007	635	3,854	201	70	372
2008	678	1,486	132	95	289
2009	723	—	36	75	—
2010	771	—	—	75	—
Thereafter	45,495	—	—	—	—
Total minimum payments	$48,849	$10,555	$ 1,248	$ 3,574	$ 10,996

NOTE 6. STOCKHOLDERS' EQUITY

Stock Incentive Plans. The Company has authorized 12.7 million shares of common stock for issuance upon exercise of options or stock purchase rights granted under the 1992 Incentive Stock Plan, 1996 Director Option Plan, 1997 Northwest Neurologic, Inc. Restated Incentive Stock Plan, 2001 Stock Option Plan, several Employment Commencement Nonstatutory Stock Option Agreements and the 2003 Stock Option Plan (collectively, the Option Plans). The Option Plans provide for the grant of stock options, restricted stock units, and stock bonuses to officers, directors, and employees of, and consultants and advisors to, the Company. Options under the Option Plans have terms of up to 10 years from the date of grant, and generally vest over a four year period. Options under the 1992 Incentive Stock Plan, the Northwest Neurologic, Inc. Restated 1997 Incentive Stock Plan, and the 2003 Stock Option Plan may be designated as incentive stock options or nonstatutory stock options. Options under the 2001 Stock Option Plan are nonstatutory stock options. Of the shares available for future issuance under the Option Plans, 6.5 million are outstanding grants and 268,000 remain available for future grant at December 31, 2005.

On November 7, 2005, the Company accelerated vesting of all unvested options to purchase shares of common stock that are held by current employees which have an exercise price per share equal to or greater than $50.00. Options to purchase approximately 472,000 shares of common stock were subject to this acceleration. The exercise prices and number of shares subject to the accelerated options were unchanged. The acceleration was effective November 7, 2005. The acceleration of these options was undertaken to eliminate the future compensation expense of approximately $10.5 million that the Company would have otherwise recognized under SFAS 123R in its future consolidated statements of operations. By accelerating vesting, the $10.5 million is included in the pro-forma disclosure of stock-based compensation (Note 1).

On November 7, 2005, the closing price of the Company's common stock on the Nasdaq stock market was $55.42. Approximately 231,000 of the employee stock options for which vesting has been accelerated had exercise prices between $50.00 and $55.41 on November 7, 2005. Under the intrinsic value provision of APB No. 25, the Company recorded expense of approximately $614,000 as a result of this acceleration during 2005.

A summary of the Company's stock option activity and related information for the years ended December 31 follows (in thousands, except for weighted average exercise price data):

	2005		2004		2003	
	Options (in thousands)	Weighted Average Exercise Price	Options (in thousands)	Weighted Average Exercise Price	Options (in thousands)	Weighted Average Exercise Price
Outstanding at January 1	5,987	$ 36.40	5,220	$ 32.25	4,875	$ 24.23
Granted	1,321	43.14	1,138	52.66	1,298	47.97
Exercised	(560)	27.19	(269)	20.55	(837)	9.13
Canceled	(204)	45.38	(102)	47.44	(116)	37.90
Outstanding at December 31	6,544	$ 38.32	5,987	$ 36.40	5,220	$ 32.25

NEUROCRINE BIOSCIENCES, INC.
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December 31, 2005

NOTE 6. STOCKHOLDERS' EQUITY (continued)

A summary of options outstanding as of December 31, 2005 follows (in thousands, except for weighted average remaining contractual life and weighted average exercise price data):

Options Outstanding				Options Exercisable	
Range of Exercise Prices	Outstanding as of 12/31/05	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of 12/31/05	Weighted Average Exercise Price
$ 1.51 to $20.00	754	2.6	$ 7.97	754	$ 7.97
$20.01 to $35.00	993	4.9	28.95	977	28.93
$35.01 to $38.00	1,346	6.9	36.50	896	36.22
$38.01 to $43.00	920	7.9	40.74	395	39.98
$43.01 to $48.50	908	8.3	46.18	375	45.95
$48.51 to $55.50	952	7.6	50.70	787	51.08
$55.51 to $68.04	671	8.4	58.30	576	57.85
$ 1.51 to $68.04	6,544	6.7	$38.23	4,760	$36.40

The weighted average fair values (computed using Black-Scholes) of the options granted during 2005, 2004 and 2003 were $17.22, $21.25 and $19.50, respectively.

Effective January 1, 2006, the Board has approved prospectively changing the overall option life by reducing the term of future option grants from a maximum of ten years to a maximum of seven years.

Employee Stock Purchase Plan. The Company has reserved 625,000 shares of common stock for issuance under the 1996 Employee Stock Purchase Plan, as amended (the Purchase Plan). The Purchase Plan previously permitted eligible employees to purchase common stock through payroll deductions at a purchase price equal to 85% of the lesser of the fair market value per share of common stock on the enrollment date or on the date on which the shares are purchased. Effective January 1, 2006, the Purchase Plan was amended such that the purchase price of common stock would be at 85% of the fair market value per share of common stock on the date on which the shares are purchased regardless of the price on the enrollment date.

The Company has two purchase dates each year, June 30 and December 31. As of December 31, 2005, 592,000 shares have been issued pursuant to the Purchase Plan.

Warrants. The Company has outstanding warrants to purchase 239,031 shares of common stock at the following exercise prices. At December 31, 2005, all outstanding warrants were exercisable.

Exercise Prices	Warrants Outstanding at December 31, 2005	Expiration
$10.50	174,244	03/2006
$41.23	60,000	11/2006
$52.05	4,787	12/2012
	239,031	

The following shares of common stock are reserved for future issuance at December 31, 2005 (in thousands):

Stock option plans	6,836
Employee stock purchase plan	33
Warrants	239
Total	7,108

In September 2003, the Company sold 3.75 million shares of its common stock at $53.00 per share in a public offering. The net proceeds from this transaction were $187.4 million.

NEUROCRINE BIOSCIENCES, INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2005

NOTE 7. SIGNIFICANT COLLABORATIVE RESEARCH AND DEVELOPMENT AGREEMENTS

Pfizer. In December 2002, the Company entered into an exclusive worldwide collaboration with Pfizer, Inc. (Pfizer) to complete the clinical development of, and to commercialize, indiplon for the treatment of insomnia. Under the terms of the agreement, Pfizer and Neurocrine collaborated in the completion of the indiplon Phase III clinical program. During 2005, 2004 and 2003, the Company was responsible for $5.5 million, $7.5 million and $22.5 million, respectively, in development costs, and all other external collaboration costs were borne by Pfizer. During 2005, Pfizer supported the creation and operation of a 200-person Neurocrine sales force. The Company's sales force will detail Pfizer's antidepressant drug Zoloft® to psychiatrists in the United States. Upon approval of the indiplon NDA, the Company's sales force will also co-promote indiplon to psychiatrists and sleep specialists in the United States. Pfizer will continue to support the sales force through an annual sales force allowance. During 2003, the Company received an upfront payment of $100 million. The Company has since received $90.5 million of the remaining $300 million in additional pre-commercialization milestone payments the Company is eligible to receive as indiplon moves to commercialization. Further, upon commercialization of indiplon, the Company will be entitled to a percentage of worldwide sales of indiplon for the longer of 10 years or the life of the indiplon patent rights as well as co-promotion payments on sales of Zoloft® and indiplon in the United States. In addition, Pfizer has committed to loan the Company up to $175 million, at commercial terms, pursuant to a secured short-term credit facility, subject to prior U.S. launch of indiplon and various other conditions. Pfizer may terminate the collaboration at its discretion upon 180-days written notice to the Company. In such event, the Company would be entitled to certain payments for ongoing clinical development and related activities and all indiplon product rights would revert to the Company.

The Company obtained rights to indiplon pursuant to a 1998 Sublicense and Development Agreement with DOV Pharmaceutical, Inc. (DOV) and is responsible for specified milestone payments and royalties to DOV on net sales under the license agreement. Wyeth licensed the indiplon technology to DOV in 1998 in exchange for milestone payments and royalties on future sales of indiplon. On February 26, 2004, the Company entered into several agreements with Wyeth and DOV pursuant to which the Company acquired Wyeth's financial interest in indiplon for approximately $95.0 million, consisting of $50.0 million in cash and $45.0 million of the Company's common stock. The agreements among the Company, Wyeth and DOV provide that the Company will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that the Company will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth, effectively decreasing the Company's royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction was recorded as a prepaid royalty and will be amortized over the commercialization period of indiplon, based primarily upon total estimated indiplon sales. Additionally, the Company is responsible for specified milestone payments up to $3.5 million to DOV Pharmaceutical under the license agreement, of which $2.0 million was paid during 2004 and the balance will be payable upon commercialization of indiplon.

For the years ended December 31, 2005, 2004 and 2003, the Company recognized revenue of $8.7 million, $21.7 million and $90.9 million, respectively, from the reimbursement of clinical development expenses under the Pfizer agreement. The Company also amortized into revenue $20.7 million, $34.8 million and $38.0 million of the upfront license fee for the years ended December 31, 2005, 2004 and 2003, respectively. During 2005, the Company received a $70.0 million milestone payment from Pfizer related to the FDA's accepting for review the NDA filings for the indiplon capsules and tablets. During 2004, the Company received $20.5 million from Pfizer for certain clinical development milestones related to successful completion of Phase III studies for long-term administration and sleep maintenance of indiplon. The Company also recognized $22.0 million from Pfizer during 2005 as a sales force allowance for the building and operation of our 200-person sales force. At December 31, 2005, the Company has $6.5 million of deferred upfront fees that will be amortized over the time period until commercialization of the Company's indiplon product.

NEUROCRINE BIOSCIENCES, INC.
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NOTE 7. SIGNIFICANT COLLABORATIVE RESEARCH AND DEVELOPMENT AGREEMENTS (continued)

GlaxoSmithKline. In July 2001, the Company announced a worldwide collaboration with GlaxoSmithKline (GSK) to develop and commercialize CRF antagonists for psychiatric, neurological and gastrointestinal diseases. Under the terms of this agreement, the Company and GSK will conduct a collaborative research program for up to five years and collaborate in the development of Neurocrine's current lead CRF compounds, as well as novel back-up candidates and second generation compounds identified through the collaborative research. In addition, the Company will be eligible to receive milestone payments as compounds progress through the research and development process, royalties on future product sales and co-promotion rights in the U.S. under some conditions. GSK may terminate the agreement at its discretion upon prior written notice to the Company. In such event, the Company may be entitled to certain payments and all product rights would revert to Neurocrine. For each of the years ended December 31, 2005, 2004 and 2003, the Company recognized $2.5 million, $7.8 million and $7.8 million, respectively, in revenue under the GSK agreement. The sponsored research portion of this collaboration agreement ended in 2005.

Taisho Pharmaceutical Co., Ltd. In December 1999, the Company entered into an agreement with Taisho Pharmaceutical Co., Ltd. (Taisho), providing to Taisho an exclusive option to obtain European, Asian and North American development and commercialization rights for Neurocrine's altered peptide ligand product for Type 1 diabetes in exchange for a $2.0 million option fee. On March 31, 2003, the Company reacquired the worldwide rights to its diabetes drug candidate. For the year ended December 31, 2003, the Company recognized $1.1 million in revenue under the Taisho agreement.

NOTE 8. INCOME TAXES

At December 31, 2005, the Company had Federal and California income tax net operating loss carry-forwards of approximately $371.2 million and $248.5 million, respectively. The Federal and California tax loss carry-forwards will begin to expire in 2010 and 2006, respectively, unless previously utilized. In addition, the Company has Federal and California research and development tax credit carry-forwards of $19.6 million and $10.8 million, respectively. The Federal research and development credit carry-forwards will begin to expire in 2007 unless previously utilized. The California research and development credit carry-forwards carry forward indefinitely. The Company also has Federal Alternative Minimum Tax credit carry-forwards of approximately $256,000, which will carry-forward indefinitely. At December 31, 2005, approximately $74.8 million of the net operating loss carry-forwards relate to stock option exercises, which will result in an increase to additional paid-in capital and a decrease in income taxes payable at the time when the tax loss carry-forwards are utilized.

Pursuant to Internal Revenue Code Sections 382 and 383, annual use of the Company's net operating loss and credit carry-forwards may be limited because of cumulative changes in ownership of more than 50%. However, the Company does not believe such changes will have a material impact upon the utilization of these carry-forwards.

NEUROCRINE BIOSCIENCES, INC.
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NOTE 8. INCOME TAXES (continued)

Significant components of the Company's deferred tax assets as of December 31, 2005 and 2004 relate primarily to its net operating loss and tax credit carry-forwards. A valuation allowance of $165.1 million and $143.4 million at December 31, 2005 and 2004, respectively, have been recognized to offset the net deferred tax assets as realization of such assets is uncertain. Amounts are shown in thousands as of December 31, of the respective years:

	2005	2004
Deferred tax assets:		
Net operating loss carry-forwards	$ 144,200	$ 107,200
Tax credit carry-forwards	26,600	28,000
Capitalized research and development	5,400	7,300
Deferred compensation	2,800	1,800
Accrued expenses	900	600
Unrealized losses on investments	600	800
Deferred revenue	2,600	12,100
Other	300	200
Total deferred tax assets	183,400	158,000
Deferred tax liabilities:		
Investment in LLC	10,000	10,400
Intangibles	4,600	—
Fixed assets	3,700	4,200
Total deferred tax liabilities	18,300	14,600
Net deferred tax asset	165,100	143,400
Valuation allowance	(165,100)	(143,400)
Net deferred tax assets	$ —	$ —

The provision for income taxes on earnings subject to income taxes differs from the statutory Federal rate at December 31, 2005, 2004 and 2003, due to the following (in thousands):

	2005	2004	2003
Federal income taxes at 35%	$(7,767)	$(16,020)	$(10,537)
State income tax, net of Federal benefit	(1,077)	(4,151)	(1,730)
Tax effect on non-deductible expenses and credits	(112)	(2,676)	(5,470)
Increase in valuation allowance	8,956	22,926	17,895
	$ —	$ 79	$ 158

The provision for income taxes for the year ended December 31, 2004 was for current federal taxes, for the year ended December 31, 2003 consisted of $150,000 current federal taxes and $8,000 current state taxes.

NOTE 9. RETIREMENT PLAN

The Company has a 401(k) defined contribution savings plan (the "401(k) Plan"). The 401(k) Plan is for the benefit of all qualifying employees and permits voluntary contributions by employees up to 60% of base salary limited by the IRS-imposed maximum. The Company matches 50% of employee contributions up to 6% of eligible compensation, with cliff vesting over four years. Employer contributions were $1,069,000, $750,000 and $576,000 for the years ended December 31, 2005, 2004, and 2003, respectively.

NEUROCRINE BIOSCIENCES, INC.
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NOTE 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following is a summary of the quarterly results of operations for the years ended December 31, 2005 and 2004 (unaudited, in thousands, except for earnings (loss) per share data):

	Quarters Ended				Year Ended
	Mar 31	Jun 30	Sep 30	Dec 31	Dec 31
2005					
Revenues	$ 11,864	$ 33,169	$ 64,745	$ 14,111	$ 123,889
Operating expenses	31,211	39,421	39,624	38,705	148,961
Net (loss) income	(18,830)	(5,604)	26,151	(23,908)	(22,191)
Net (loss) income per share:					
Basic	$ (0.51)	$ (0.15)	$ 0.71	$ (0.65)	$ (0.60)
Diluted	$ (0.51)	$ (0.15)	$ 0.68	$ (0.65)	$ (0.60)
Shares used in the calculation of net (loss) income per share:					
Basic	36,598	36,647	36,707	36,992	36,763
Diluted	36,598	36,647	38,406	36,992	36,763
2004					
Revenues	$ 16,941	$ 15,049	$ 34,701	$ 18,485	$ 85,176
Operating expenses	31,671	28,438	37,732	39,669	137,510
Net loss	(12,380)	(11,131)	(1,647)	(20,615)	(45,773)
Net loss per share:					
Basic and diluted	$ (0.35)	$ (0.31)	$ (0.05)	$ (0.57)	$ (1.26)
Shares used in the calculation of net loss per share:					
Basic and diluted	35,527	36,368	36,427	36,477	36,201

EXHIBIT 10.3

NEUROCRINE BIOSCIENCES, INC.

1996 EMPLOYEE STOCK PURCHASE PLAN

(AS AMENDED MAY 24, 2001, JUNE 15, 2001 AND NOVEMBER 7, 2005)

The following constitute the provisions of the 1996 Employee Stock Purchase Plan of Neurocrine Biosciences, Inc.

1. Purpose. The purpose of the Plan is to provide employees of the Company and its Designated Subsidiaries with an opportunity to purchase Common Stock of the Company through accumulated payroll deductions. It is the intention of the Company to have the Plan qualify as an "Employee Stock Purchase Plan" under Section 423 of the Internal Revenue Code of 1986, as amended. The provisions of the Plan, accordingly, shall be construed so as to extend and limit participation in a manner consistent with the requirements of that section of the Code.

2. Definitions.

(a) "Board" shall mean the Board of Directors of the Company.

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

(c) "Common Stock" shall mean the Common Stock of the Company.

(d) "Company" shall mean Neurocrine Biosciences, Inc. and any Designated Subsidiary of the Company.

(e) "Compensation" shall mean all regular straight time gross earnings but shall exclude variable compensation for field sales personnel, incentive bonuses, overtime, shift premium, lead pay and automobile allowances and other compensation.

(f) "Designated Subsidiaries" shall mean the Subsidiaries which have been designated by the Board from time to time in its sole discretion as eligible to participate in the Plan.

(g) "Employee" shall mean any individual who is an Employee of the Company for tax purposes whose customary employment with the Company is at least twenty (20) hours per week and more than five (5) consecutive months in any calendar year. For purposes of the Plan, the employment relationship shall be treated as continuing intact while the individual is on sick leave or other leave of absence approved by the Company. Where the period of leave exceeds 90 days and the individual's right to reemployment is not guaranteed either by statute or by contract, the employment relationship will be deemed to have terminated on the 91st day of such leave.

(h) "Enrollment Date" shall mean the first day of each Offering Period.

(i) "Exercise Date" shall mean the last Trading Day of each Purchase Period. The first Exercise Date shall be the last Trading Day on or before December 31, 1996.

(j) "Fair Market Value" shall mean, as of any date, the value of Common Stock determined as follows:

(1) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market of the National Association of Securities Dealers, Inc. Automated Quotation ("NASDAQ") System, its Fair Market Value shall be the closing sale price for the Common Stock (or the mean of the closing bid and asked prices, if no sales were reported), as quoted on such exchange (or the exchange with the greatest volume of trading in Common Stock) or system on the date of such determination, as reported in The Wall Street Journal or such other source as the Board deems reliable; or

(2) If the Common Stock is quoted on the NASDAQ System (but not on the National Market thereof) or is regularly quoted by a recognized securities dealer but selling prices are not reported, its Fair Market Value shall be the mean of the closing bid and asked prices for the Common Stock on the date of such determination, as reported in The Wall Street Journal or such other source as the Board deems reliable; or

(3) In the absence of an established market for the Common Stock, the Fair Market Value thereof shall be determined in good faith by the Board.

(4) For purposes of the Enrollment Date of the first Offering Period, the Fair Market Value of the Common Stock shall be the Price to Public as set forth in the final prospectus filed with the Securities and Exchange Commission pursuant to Rule 424 under the Securities Act of 1933, as amended.

(k) "Offering Period" shall mean the period of approximately twelve (12) months during which an option granted pursuant to the Plan may be exercised, commencing on the first Trading Day on or after January 1 and July 1 of each year and terminating on the last Trading Day in the periods ending up to one-year later (provided, however, that any employee with an Offering Period beginning before January 1, 2001, shall have an initial Offering Period of up to two-years). The first day of the first Offering Period shall be the effective date of the Company's initial public offering of its Common Stock that is registered with the Securities and Exchange Commission. The duration and timing of Offering Periods may be changed pursuant to Section 4 of this Plan.

(l) "Plan" shall mean this Neurocrine Biosciences, Inc. 1996 Employee Stock Purchase Plan as amended hereby.

(m) "Purchase Price" shall mean an amount equal to 85% of the Fair Market Value of a share of Common Stock on the Enrollment Date or on the Exercise Date, whichever is lower. For purposes of Offering Periods commencing on or after January 1, 2006, "Purchase Price" shall mean an amount equal to 85% of the Fair Market Value of a share of Common Stock on the Exercise Date.

(n) "Purchase Period" shall mean the approximately six-month period commencing after one Exercise Date and ending with the next Exercise Date, except that the first Purchase Period

of any Offering Period shall begin on the Enrollment Date and end with the next Exercise Date. The first Purchase Period of the first Offering Period shall begin on the first day of the first Offering Period and shall end on the first Exercise Date.

(o) "Reserves" shall mean the number of shares of Common Stock covered by each option under the Plan which have not yet been exercised and the number of shares of Common Stock which have been authorized for issuance under the Plan but not yet placed under option.

(p) "Subsidiary" shall mean a corporation, domestic or foreign, of which not less than 50% of the voting shares are held by the Company or a Subsidiary, whether or not such corporation now exists or is hereafter organized or acquired by the Company or a Subsidiary.

(q) "Trading Day" shall mean a day on which national stock exchanges and the National Association of Securities Dealers Automated Quotation (NASDAQ) System are open for trading.

3. Eligibility.

(a) Any Employee (as defined in Section 2(g)), who shall be employed by the Company on a given Enrollment Date shall be eligible to participate in the Plan.

(b) Any provisions of the Plan to the contrary notwithstanding, no Employee shall be granted an option under the Plan (i) if, immediately after the grant, such Employee (or any other person whose stock would be attributed to such Employee pursuant to Section 424(d) of the Code) would own capital stock of the Company and/or hold outstanding options to purchase such stock possessing five percent (5%) or more of the total combined voting power or value of all classes of the capital stock of the Company or of any Subsidiary, or (ii) if such option permits his or her rights to purchase stock under all employee stock purchase plans of the Company and its Subsidiaries to accrue at a rate which exceeds twenty-five thousand dollars ($25,000) worth of stock (determined at the fair market value of the shares at the time such option is granted) for each calendar year in which such option is outstanding at any time.

4. Offering Periods. The Plan shall be implemented by consecutive, overlapping Offering Periods with a new Offering Period beginning on the first Trading Day on or after July 1 and January 1 each year, or on such other date as the Board shall determine, and continuing thereafter until terminated in accordance with Section 19 hereof. The first day of the first Offering Period shall be the effective date of the Company's initial public offering of its Common Stock that is registered with the Securities and Exchange Commission. The Board shall have the power to change the duration of Offering Periods (including the commencement dates thereof) with respect to future offerings without stockholder approval if such change is announced at least five (5) days prior to the scheduled beginning of the first Offering Period to be affected thereafter.

5. Participation.

(a) An eligible Employee may become a participant in the Plan by completing a subscription agreement authorizing payroll deductions in the form of Exhibit A to this Plan and filing it with the Company's payroll office prior to the applicable Enrollment Date.

(b) Payroll deductions for a participant shall commence on the first payroll date following the Enrollment Date and shall end on the last payroll date in the Offering Period to which such authorization is applicable, unless sooner terminated by the participant as provided in Section 10 hereof.

6. Payroll Deductions.

(a) At the time a participant files his or her subscription agreement, he or she shall elect to have payroll deductions made on each pay day during the Offering Period in an amount not exceeding fifteen percent (15%) of the Compensation which he or she receives on each pay day during the Offering Period, and the aggregate of such payroll deductions during the Offering Period shall not exceed fifteen percent (15%) of the participant's Compensation during said Offering Period.

(b) All payroll deductions made for a participant shall be credited to his or her account under the Plan and will be withheld in whole percentages only. A participant may not make any additional payments into such account.

(c) A participant may discontinue his or her participation in the Plan as provided in Section 10 hereof, or may increase or decrease the rate of his or her payroll deductions during the Offering Period by completing or filing with the Company a new subscription agreement authorizing a change in payroll deduction rate. The Board may, in its discretion, limit the number of participation rate changes during any Offering Period. The change in rate shall be effective with the first full payroll period following five (5) business days after the Company's receipt of the new subscription agreement unless the Company elects to process a given change in participation more quickly. A participant's subscription agreement shall remain in effect for successive Offering Periods unless terminated as provided in Section 10 hereof.

(d) Notwithstanding the foregoing, to the extent necessary to comply with Section 423(b)(8) of the Code and Section 3(b) hereof, a participant's payroll deductions may be decreased to 0% at such time during any Purchase Period which is scheduled to end during the current calendar year (the "Current Purchase Period") that the aggregate of all payroll deductions which were previously used to purchase stock under the Plan in a prior Purchase Period which ended during that calendar year plus all payroll deductions accumulated with respect to the Current Purchase Period equal $21,250. Payroll deductions shall recommence at the rate provided in such participant's subscription agreement at the beginning of the first Purchase Period which is scheduled to end in the following calendar year, unless terminated by the participant as provided in Section 10 hereof.

(e) At the time the option is exercised, in whole or in part, or at the time some or all of the Company's Common Stock issued under the Plan is disposed of, the participant must make adequate provision for the Company's federal, state, or other tax withholding obligations, if any,

which arise upon the exercise of the option or the disposition of the Common Stock. At any time, the Company may, but will not be obligated to, withhold from the participant's compensation the amount necessary for the Company to meet applicable withholding obligations, including any withholding required to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by the Employee.

7. Grant of Option. On the Enrollment Date of each Offering Period, each eligible Employee participating in such Offering Period shall be granted an option to purchase on each Exercise Date during such Offering Period (at the Purchase Price) up to a number of shares of the Company's Common Stock determined by dividing such Employee's payroll deductions accumulated prior to such Exercise Date and retained in the Participant's account as of the Exercise Date by the Purchase Price; provided, that in no event shall an Employee be permitted to purchase during each Purchase Period more than a number of Shares determined by dividing $12,500 by the Fair Market Value of a share of the Company's Common Stock on the Enrollment Date; and provided, further, that such purchase shall be subject to the limitations set forth in Sections 3(b) and 12 hereof. Exercise of the option shall occur as provided in Section 8 hereof, unless the participant has withdrawn pursuant to Section 10 hereof, and shall expire on the last day of the Offering Period.

8. Exercise of Option. Unless a participant withdraws from the Plan as provided in Section 10 hereof, his or her option for the purchase of shares will be exercised automatically on the Exercise Date, and the maximum number of full shares subject to the option shall be purchased for such participant at the Purchase Price with the accumulated payroll deductions in his or her account. No fractional shares will be purchased; any payroll deductions accumulated in a participant's account which are not sufficient to purchase a full share shall be retained in the participant's account for the subsequent Purchase Period or Offering Period, subject to earlier withdrawal by the participant as provided in Section 10 hereof. Any other monies left over in a participant's account after the Exercise Date shall be returned to the participant. During a participant's lifetime, a participant's option to purchase shares hereunder is exercisable only by him or her.

9. Delivery. As promptly as practicable after each Exercise Date on which a purchase of shares occurs, the Company shall arrange the delivery to each participant, as appropriate, of a certificate representing the shares purchased upon exercise of his or her option.

10. Withdrawal; Termination of Employment.

(a) A participant may withdraw all but not less than all the payroll deductions credited to his or her account and not yet used to exercise his or her option under the Plan at any time by giving written notice to the Company in the form of Exhibit B to this Plan. All of the participant's payroll deductions credited to his or her account will be paid to such participant promptly after receipt of notice of withdrawal and such participant's option for the Offering Period will be automatically terminated, and no further payroll deductions for the purchase of shares will be made for such Offering Period. If a participant withdraws from an Offering Period, payroll deductions will not resume at the beginning of the succeeding Offering Period unless the participant delivers to the Company a new subscription agreement.

(b) Upon a participant's ceasing to be an Employee (as defined in Section 2(g) hereof), for any reason, he or she will be deemed to have elected to withdraw from the Plan and the payroll deductions credited to such participant's account during the Offering Period but not yet used to exercise the option will be returned to such participant or, in the case of his or her death, to the person or persons entitled thereto under Section 14 hereof, and such participant's option will be automatically terminated. The preceding sentence notwithstanding, a participant who receives payment in lieu of notice of termination of employment shall be treated as continuing to be an Employee for the participant's customary number of hours per week of employment during the period in which the participant is subject to such payment in lieu of notice.

11. Interest. No interest shall accrue on the payroll deductions of a participant in the Plan.

12. Stock.

(a) The maximum number of shares of the Company's Common Stock which shall be made available for sale under the Plan shall be six hundred and twenty five thousand (625,000), subject to adjustment upon changes in capitalization of the Company as provided in Section 18 hereof. If, on a given Exercise Date, the number of shares with respect to which options are to be exercised exceeds the number of shares then available under the Plan, the Company shall make a pro rata allocation of the shares remaining available for purchase in as uniform a manner as shall be practicable and as it shall determine to be equitable.

(b) The participant will have no interest or voting right in shares covered by his option until such option has been exercised.

(c) Shares to be delivered to a participant under the Plan will be registered in the name of the participant or in the name of the participant and his or her spouse.

13. Administration.

(a) Administrative Body. The Plan shall be administered by the Board or a committee of members of the Board appointed by the Board. The Board or its committee shall have full and exclusive discretionary authority to construe, interpret and apply the terms of the Plan, to determine eligibility and to adjudicate all disputed claims filed under the Plan. Every finding, decision and determination made by the Board or its committee shall, to the full extent permitted by law, be final and binding upon all parties.

(b) Rule 16b-3 Limitations. Notwithstanding the provisions of Subsection (a) of this Section 13, in the event that Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or any successor provision ("Rule 16b-3") provides specific requirements for the administrators of plans of this type, the Plan shall be only administered by such a body and in such a manner as shall comply with the applicable requirements of Rule 16b-3. Unless permitted by Rule 16b-3, no discretion concerning decisions regarding the Plan shall be afforded to any committee or person that is not "disinterested" as that term is used in Rule 16b-3.

14. Designation of Beneficiary.

(a) A participant may file a written designation of a beneficiary who is to receive any shares and cash, if any, from the participant's account under the Plan in the event of such participant's death subsequent to an Exercise Date on which the option is exercised but prior to delivery to such participant of such shares and cash. In addition, a participant may file a written designation of a beneficiary who is to receive any cash from the participant's account under the Plan in the event of such participant's death prior to exercise of the option. If a participant is married and the designated beneficiary is not the spouse, spousal consent shall be required for such designation to be effective.

(b) Such designation of beneficiary may be changed by the participant at any time by written notice. In the event of the death of a participant and in the absence of a beneficiary validly designated under the Plan who is living at the time of such participant's death, the Company shall deliver such shares and/or cash to the executor or administrator of the estate of the participant, or if no such executor or administrator has been appointed (to the knowledge of the Company), the Company, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the participant, or if no spouse, dependent or relative is known to the Company, then to such other person as the Company may designate.

15. Transferability. Neither payroll deductions credited to a participant's account nor any rights with regard to the exercise of an option or to receive shares under the Plan may be assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution or as provided in Section 14 hereof) by the participant. Any such attempt at assignment, transfer, pledge or other disposition shall be without effect, except that the Company may treat such act as an election to withdraw funds from an Offering Period in accordance with Section 10 hereof.

16. Use of Funds. All payroll deductions received or held by the Company under the Plan may be used by the Company for any corporate purpose, and the Company shall not be obligated to segregate such payroll deductions.

17. Reports. Individual accounts will be maintained for each participant in the Plan. Statements of account will be given to participating Employees at least annually, which statements will set forth the amounts of payroll deductions, the Purchase Price, the number of shares purchased and the remaining cash balance, if any.

18. Adjustments Upon Changes in Capitalization, Dissolution, Liquidation, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the stockholders of the Company, the Reserves as well as the price per share of Common Stock covered by each option under the Plan which has not yet been exercised shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration". 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 option.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Offering Periods will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Board.

(c) Merger or Asset Sale. In the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each option under the Plan shall be assumed or an equivalent option shall be substituted by such successor corporation or a parent or subsidiary of such successor corporation, unless the Board determines, in the exercise of its sole discretion and in lieu of such assumption or substitution, to shorten the Offering Periods then in progress by setting a new Exercise Date (the "New Exercise Date"). If the Board shortens the Offering Periods then in progress in lieu of assumption or substitution in the event of a merger or sale of assets, the Board shall notify each participant in writing, at least ten (10) business days prior to the New Exercise Date, that the Exercise Date for his option has been changed to the New Exercise Date and that his option will be exercised automatically on the New Exercise Date, unless prior to such date he has withdrawn from the Offering Period as provided in Section 10 hereof. For purposes of this paragraph, an option granted under the Plan shall be deemed to be assumed if, following the sale of assets or merger, the option confers the right to purchase, for each share of option stock subject to the option immediately prior to the sale of assets or merger, the consideration (whether stock, cash or other securities or property) received in the sale of assets or merger by holders of Common Stock for each share of Common Stock held on the effective date of the transaction (and if such holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding shares of Common Stock); provided, however, that if such consideration received in the sale of assets or merger was not solely common stock of the successor corporation or its parent (as defined in Section 424(e) of the Code), the Board may, with the consent of the successor corporation, provide for the consideration to be received upon exercise of the option to be solely common stock of the successor corporation or its parent equal in fair market value to the per share consideration received by holders of Common Stock and the sale of assets or merger.

19. Amendment or Termination.

(a) The Board may at any time and for any reason terminate or amend the Plan. Except as provided in Section 18 hereof, no such termination can affect options previously granted; provided, that an Offering Period may be terminated by the Board on any Exercise Date if the Board determines that the termination of the Plan is in the best interests of the Company and its stockholders. Except as provided in Section 18 hereof, no amendment may make any change in any option theretofore granted which adversely affects the rights of any participant. To the extent necessary to comply with Rule 16b-3 or under Section 423 of the Code (or any successor rule or provision or any other applicable law or regulation), the Company shall obtain stockholder approval in such a manner and to such a degree as required.

(b) Without stockholder consent and without regard to whether any participant rights may be considered to have been "adversely affected," the Board (or its committee) shall be entitled to change the Offering Periods, limit the frequency and/or number of changes in the amount withheld during an Offering Period, establish the exchange ratio applicable to amounts withheld in a currency other than U.S. dollars, permit payroll withholding in excess of the amount designated by a participant in order to adjust for delays or mistakes in the Company's processing of properly completed withholding elections, establish reasonable waiting and adjustment periods and/or accounting and crediting procedures to ensure that amounts applied toward the purchase of Common Stock for each participant properly correspond with amounts withheld from the participant's Compensation, and establish such other limitations or procedures as the Board (or its committee) determines in its sole discretion advisable which are consistent with the Plan.

20. Notices. All notices or other communications by a participant to the Company under or in connection with the Plan shall be deemed to have been duly given when received in the form specified by the Company at the location, or by the person, designated by the Company for the receipt thereof.

21. Conditions Upon Issuance of Shares. Shares shall not be issued with respect to an option unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all applicable provisions of law, domestic or foreign, including, without limitation, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange upon which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

As a condition to the exercise of an option, the Company may require the person exercising such option 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 applicable provisions of law.

22. Term of Plan. The Plan shall become effective upon the earlier to occur of its adoption by the Board or its approval by the stockholders of the Company. It shall continue in effect for a term of ten (10) years unless sooner terminated under Section 19 hereof.

23. Automatic Transfer to Low Price Offering Period. To the extent permitted by Rule 16b-3 of the Exchange Act, if the Fair Market Value of the Common Stock on any Exercise Date in an Offering Period is lower than the Fair Market Value of the Common Stock on the Enrollment Date of such Offering Period, then all participants in such Offering Period shall be automatically withdrawn from such Offering Period immediately after the exercise of their option on such Exercise Date and automatically re-enrolled in the immediately following Offering Period as of the first day thereof.

24. 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 state and federal law.

25. Financial Reports. The Company shall provide to each Optionee, not less frequently than annually during the period such Optionee has one or more Options outstanding, copies of annual financial statements. The Company shall not be required to provide such statements to key employees whose duties in connection with the Company assure their access to equivalent information.

EXHIBIT A

NEUROCRINE BIOSCIENCES, INC.

1996 EMPLOYEE STOCK PURCHASE PLAN

SUBSCRIPTION AGREEMENT

_____ Original Application Enrollment Date: _____
_____ Change in Payroll Deduction Rate
_____ Change of Beneficiary(ies)

1. _____ hereby elects to participate in the Neurocrine Biosciences, Inc. 1996 Employee Stock Purchase Plan (the "Employee Stock Purchase Plan") and subscribes to purchase shares of the Company's Common Stock in accordance with this Subscription Agreement and the Employee Stock Purchase Plan.

2. I hereby authorize payroll deductions from each paycheck in the amount of ____% of my Compensation on each payday (1-15%) during the Offering Period in accordance with the Employee Stock Purchase Plan. (Please note that no fractional percentages are permitted.)

3. I understand that said payroll deductions shall be accumulated for the purchase of shares of Common Stock at the Purchase Price determined in accordance with the Employee Stock Purchase Plan. I understand that if I do not withdraw from an Offering Period, any accumulated payroll deductions will be used to automatically exercise my option.

4. I have received a copy of the complete "Neurocrine Biosciences, Inc. 1996 Employee Stock Purchase Plan." I understand that my participation in the Employee Stock Purchase Plan is in all respects subject to the terms of the Employee Stock Purchase Plan. I understand that my ability to exercise the option under this Subscription Agreement is subject to obtaining stockholder approval of the Employee Stock Purchase Plan.

5. Shares purchased for me under the Employee Stock Purchase Plan should be issued in the name(s) of (Employee or Employee and spouse only): _____.

6. I understand that if I dispose of any shares received by me pursuant to the Plan within 2 years after the Enrollment Date (the first day of the Offering Period during which I purchased such shares) or one year after the Exercise Date, I will be treated for federal income tax purposes as having received ordinary income at the time of such disposition in an amount equal to the excess of the fair market value of the shares at the time such shares were purchased over the price which I paid for the shares. I HEREBY AGREE TO NOTIFY THE COMPANY IN WRITING WITHIN 30 DAYS AFTER THE DATE OF ANY DISPOSITION OF MY SHARES AND I WILL MAKE ADEQUATE

PROVISION FOR FEDERAL, STATE OR OTHER TAX WITHHOLDING OBLIGATIONS, IF ANY, WHICH ARISE UPON THE DISPOSITION OF THE COMMON STOCK. The Company may, but will not be obligated to, withhold from my compensation the amount necessary to meet any applicable withholding obligation including any withholding necessary to make available to the Company any tax deductions or benefits attributable to sale or early disposition of Common Stock by me. If I dispose of such shares at any time after the expiration of the 2-year and 1-year holding periods, I understand that I will be treated for federal income tax purposes as having received income only at the time of such disposition, and that such income will be taxed as ordinary income only to the extent of an amount equal to the lesser of (1) the excess of the fair market value of the shares at the time of such disposition over the purchase price which I paid for the shares, or (2) 15% of the fair market value of the shares on the first day of the Offering Period. The remainder of the gain, if any, recognized on such disposition will be taxed as capital gain.

7. I hereby agree to be bound by the terms of the Employee Stock Purchase Plan. The effectiveness of this Subscription Agreement is dependent upon my eligibility to participate in the Employee Stock Purchase Plan.

8. In the event of my death, I hereby designate the following as my beneficiary(ies) to receive all payments and shares due me under the Employee Stock Purchase Plan:

NAME: (Please print) _____

(First) (Middle) (Last)

_____

Relationship

_____

_____

(Address)

Employee's Social Security Number: _____

Employee's Address: _____

_____

_____

I UNDERSTAND THAT THIS SUBSCRIPTION AGREEMENT SHALL REMAIN IN EFFECT THROUGHOUT SUCCESSIVE OFFERING PERIODS UNLESS TERMINATED BY ME.

Dated: _____ _____

Signature of Employee

_____

Spouse's Signature (If beneficiary other than spouse)

EXHIBIT B

NEUROCRINE BIOSCIENCES, INC.

1996 EMPLOYEE STOCK PURCHASE PLAN

NOTICE OF WITHDRAWAL

The undersigned participant in the Offering Period of the Neurocrine Biosciences, Inc. 1996 Employee Stock Purchase Plan which began on _____, 19____ (the "Enrollment Date") hereby notifies the Company that he or she hereby withdraws from the Offering Period. He or she hereby directs the Company to pay to the undersigned as promptly as practicable all the payroll deductions credited to his or her account with respect to such Offering Period. The undersigned understands and agrees that his or her option for such Offering Period will be automatically terminated. The undersigned understands further that no further payroll deductions will be made for the purchase of shares in the current Offering Period and the undersigned shall be eligible to participate in succeeding Offering Periods only by delivering to the Company a new Subscription Agreement.

Name and Address of Participant:

_____

_____

_____

Signature:

_____

Date: _____

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EXHIBIT 21.1

NEUROCRINE BIOSCIENCES INC. SUBSIDIARIES

NAME OF SUBSIDIARY	STATE OF INCORPORATION
Neurocrine Commercial Operations, Inc. (renamed Neurocrine Continental, Inc. effective 1/1/06)	Delaware
Neurocrine HQ, Inc.	Delaware
Neurocrine International LLC	Delaware
Science Park Center LLC	California

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-108726, 333-105917 and 333-73216) and Form S-8 (Nos. 333-127214, 333-118773, 333-105907, 333-101756, 333-92328, 333-65198, 333-57096, 333-44012, 333-87127 and 333-57875) of our reports dated January 20, 2006, with respect to (1) the consolidated financial statements of Neurocrine Biosciences, Inc., and (2) management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting of Neurocrine Biosciences, Inc., included in its Annual Report (Form 10-K) for the year ended December 31, 2005.

/s/ ERNST & YOUNG LLP
San Diego, California
February 2, 2006

EXHIBIT 31.1

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

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

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

2. Based on my knowledge, this annual 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 annual 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 annual 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 the 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 annual report based on such evaluation; and

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

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

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

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

Dated: February 1, 2006

/s/ Gary A. Lyons

Gary A. Lyons
President and Chief Executive Officer

EXHIBIT 31.2

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

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

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

2. Based on my knowledge, this annual 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 annual report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual 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 annual 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 the 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 annual report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this annual 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 the internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

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

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

Dated: February 1, 2006

/s/ Paul W. Hawran

Paul W. Hawran
Executive Vice President and
Chief Financial Officer

EXHIBIT 32

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

In connection with the Annual Report on Form 10-K of Neurocrine Biosciences, Inc. (the "Company") for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gary A. Lyons, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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

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

February 1, 2006

By: /s/ Gary A. Lyons

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

In connection with the Annual Report on Form 10-K of Neurocrine Biosciences, Inc. (the "Company") for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Paul W. Hawran, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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

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

February 1, 2006

By: /s/ Paul W. Hawran

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