# 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)

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

For the fiscal year ended December 31, 2003

OR

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

For the transition period from _____ to _____

Commission file number: 0-28150

# 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) |
| **10555 Science Center Drive, San Diego, CA** | **92121** |
| (Address of principal executive office) | (Zip Code) |

Registrant's telephone number, including area code: **(858) 658-7600**

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)

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 [X] No [ ]

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. [X]

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

The aggregate market value of the common equity held by non-affiliates of the Registrant as of June 30, 2003 totaled approximately $1,288,637,000 based on the closing stock price as reported by the Nasdaq National Market.

As of February 27, 2004, there were 35,334,440 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, 2003 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. Business-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 13 programs in various stages of research and development, including eight programs in clinical development. While we independently develop many of our product candidates, we have entered into collaborations for four of our programs. Our lead clinical development program, indiplon, is a drug for the treatment of insomnia and is currently being evaluated in Phase III clinical trials in collaboration with Pfizer. We anticipate filing a new drug application, or NDA, for indiplon in mid-2004.

### 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 | Targeted Indication | Status | Commercial Rights |
|---|---|---|---|
| ***Products under clinical development:*** | | | |
| Indiplon | Insomnia | Phase III | Pfizer/Neurocrine |
| GnRH Antagonist | Endometriosis, Fibroids | Phase I | Neurocrine |
| Altered Peptide Ligand | Multiple Sclerosis | Phase II | Neurocrine |
| Altered Peptide Ligand | Type 1 Diabetes | Phase II | Neurocrine |
| $D_2$ Receptor Agonist | Male and Female Sexual Dysfunction | Phase II | Neurocrine |
| CRF $R_1$ Antagonist | Anxiety, Depression, Gastrointestinal Disorders | Development | GlaxoSmithKline/ Neurocrine |
| CRF $R_2$ Peptide Agonist — Urocortin II | Cardiovascular | Development | Neurocrine |
| IL-4 Fusion Toxin | Solid Tumors, Malignant Glioma | Phase I &II | Neurocrine |

| Program | Targeted Indication | Status | Commercial Rights |
|---|---|---|---|
| ***Research:*** | | | |
| CRF $R_1$ Antagonist | Anxiety, Depression, Gastrointestinal Disorders | Research | GlaxoSmithKline/ Neurocrine |
| CRF $R_2$ Antagonist | Psychiatric Disorders, Eating Disorders | Research | GlaxoSmithKline/ Neurocrine |
| GnRH Antagonist | Endometriosis, Fibroids, Prostate Cancer | Research | Neurocrine |
| CRF $R_2$ Agonist | Obesity | Research | Eli Lilly/ Neurocrine |
| Melanocortin Receptor Agonist/ Antagonist | Obesity/Cachexia | Research | Neurocrine |
| Melanin Concentrating Hormone Antagonist | Depression, Obesity, Anxiety | Research | Neurocrine |
| Excitatory Amino Acid Transporters | Neurodegenerative Diseases, Schizophrenia | Research | Wyeth/ Neurocrine |
| Chemokines | Pain | Research | Neurocrine |
| Sleep Disorders | Insomnia | Research | Neurocrine |

"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.

"Development" indicates lead compound(s) have been selected and are undergoing good laboratory practices toxicology studies to prepare for Phase I clinical trials.

"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 82 million adults in the United States reporting trouble sleeping a few nights per week or more, according to Mattson Jack (an epidemiological database used to determine the prevalence of a disease or disorder). Mattson Jack also states that approximately 25 million adults in the United States experience chronic insomnia, having trouble sleeping every night or almost every night. Studies have indicated that an estimated 80% of affected individuals have insomnia for more than a year and an estimated 40% have the condition for more than five years. Despite this widespread prevalence, insomnia remains a disorder without a satisfactory therapeutic option. There is currently no approved therapy that induces and maintains sleep throughout the night without next-day residual effects. According to IMS Health, the United States insomnia market was $1.7 billion in 2002. However, insomnia remains significantly undertreated as only an estimated one-third of insomnia sufferers are diagnosed, and only one-half of those diagnosed receive prescription drug treatment. In addition, according to the National Sleep Foundation, 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.

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 20% of the total insomnia population according to Mattson Jack.

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 popular of the non-benzodiazepines are marketed in the United States as Ambien® and Sonata®. Ambien® is the current market leader, with approximately $1.5 billion in worldwide sales in 2003, according to Sanofi-Synthelabo, with sales growing in excess of 10% per year.

We obtained the rights to indiplon for the treatment of insomnia through an exclusive worldwide sublicense that we entered into with DOV Pharmaceutical, Inc. in June 1998. Indiplon, a non-benzodiazepine GABA-A receptor agonist, acts via the same mechanism as the currently marketed non-benzodiazepine therapeutics. However, preclinical studies suggest that indiplon has fewer side effects than the 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 both an immediate release, or short acting, formulation and a modified release, or longer acting, formulation of indiplon 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 tablet. 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 both 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 immediate release formulation can be used by patients who have trouble falling asleep or who wake up in the middle of the night and cannot get back to sleep. The modified release formulation can be used by patients to rapidly induce sleep and maintain sleep through the night. There are currently no non-benzodiazepine GABA-A receptor agonists approved for maintaining, rather than simply inducing, sleep.

During 2003, we completed the enrollment of our Phase III registration program with indiplon for multiple insomnia indications. With several Phase III trials now completed, data analyzed and reported, indiplon has been demonstrated to be safe, well tolerated and effective in achieving rapid sleep induction and sleep maintenance without evidence of next-day residual effects. In December of 2003, we reported the results of a Phase III trial using the modified release formulation of indiplon for patients with chronic sleep maintenance insomnia. In this study, patients receiving nightly administration of 30 mg of indiplon over a two-week period demonstrated statistically significant improvements in the primary endpoint of patient reported Total Sleep Time relative to placebo for both week one and week two. Secondary endpoints also demonstrated statistically significant results in additional measures of sleep maintenance and patient reported Latency to Sleep Onset. Patients exhibited no evidence of next day impairment or drowsiness. Overall, the data confirmed patients with chronic insomnia fell asleep more rapidly and stayed asleep longer with the effect being sustained over the full two-week period. Our entire Phase III program will consist of 13 studies with approximately 4,600 subjects, all of which are underway or completed.

We have also completed 47 Phase I and Phase II clinical trials of indiplon for efficacy and safety involving approximately 2,000 subjects. In our Phase II clinical studies, indiplon was also shown to be safe and effective in helping both younger and older adult subjects with both chronic and transient insomnia to fall asleep rapidly without adverse side effects as compared to a placebo.

We are now approaching completion of 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. Upon completion of the data analysis for the full clinical program for both the immediate and modified release formulations of indiplon, we will include data for the NDA package filing from 62 clinical trials and approximately 7,000 subjects making this one of the largest, most robust clinical programs in the sleep class. To date, we have completed 58 clinical trials with indiplon immediate and modified release formulations, and have enrolled nearly 6,700 patients with chronic or transient insomnia. The data reported from these trials has consistently met both primary and secondary endpoints demonstrating the efficacy and safety of indiplon. The results from the remaining ongoing clinical trials for both the immediate and modified release formulations of indiplon will be announced during 2004 and continuing into the first half of 2005. We plan to file the NDA for both formulations of indiplon mid-year 2004 for multiple insomnia indications.

***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 prostate cancer. Other companies have developed several peptide drugs on this principle, such as Lupron® and Zoladex®, and according to annual reports of company's that market these types of drugs and Med Ad News, the annual worldwide sales in 2002 for these drugs were approximately $2.6 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 gonadotropin-releasing hormone 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 gonadotropin-releasing hormone antagonist.

Our GnRH clinical efforts are focused on providing new treatments for endometriosis, uterine fibroids and prostate cancer. According to Mattson Jack, there are more than 5.7 million women in the United States who are clinically recognized as having chronic endometriosis. Of those afflicted, approximately 200,000 patients are treated in a hospital setting, and approximately 250,000 are treated in an outpatient setting, according to a 1998 National Patient Profile audit. 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 surgery and encourage a higher treatment rate. Additionally, approximately 2.8 million women are symptomatic for uterine fibroids, according to the article "Medical Treatment of Uterine Fibroids" published in 2001 in the journal *Clinical Obstetrics and Gynecology.* We also believe our drug will have utility on the treatment of prostate cancer, of which there are expected to be approximately 230,000 new cases in 2004 in the United States, according to the American Cancer Society.

We selected a clinical candidate, in early 2001 and initiated our Phase I clinical program in November 2001 for the treatment of endometriosis. The results of the first Phase I clinical trial demonstrated that GnRH reduced gonadotropin production, which is a surrogate parameter for efficacy. In June 2003, the results of the second Phase I clinical trial demonstrated that the product candidate was safe and well tolerated. Enrollment in a Phase I with a second generation GnRH candidate for endometriosis and uterine fibroids was initiated in September 2003. This trial is a combination single dose, followed by multiple escalating doses in approximately 50 pre-menopausal women. The study is assessing the safety, pharmacokinetics, and pharmcodynamics of the compound. Enrollment is expected to be completed in the first half of 2004.

***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, Type 1 diabetes, systemic lupus erythematosus and thyroiditis. Scientists believe that the body's immune system causes these diseases. The immune system 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 like Type 1 diabetes. 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. Experiments conducted by our scientists determined that specific amino acid residues within a peptide sequence of an antigen are required for T cell recognition and subsequent cellular activation. Scientists can specifically alter the structure of such a peptide fragment 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 neurologic 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. In a recent study of multiple sclerosis patients, the peak age of onset was between the ages of 20 and 25 with approximately 10% of these patients experiencing their first symptoms after the age of 50. According to the National Multiple Sclerosis Society, there are approximately 400,000 cases of multiple sclerosis in the United States. Currently available treatments for multiple sclerosis offer only limited efficacy. Doctors often prescribe steroids to reduce the severity of acute flare-ups and speed recovery. Experimental therapy with other immune-suppressive agents has shown limited success. Nevertheless, worldwide sales of multiple sclerosis therapies reached $2.9 billion in 2002.

We 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. Together with Novartis Pharmaceuticals Corporation, our former collaborative partner for this program, we filed an investigational new drug, or IND, application with the FDA and received approval in 1996 to commence clinical trials. We subsequently 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 trials was a multi-center, placebo-controlled, randomized, parallel design study in which patients received one of three doses, and the other Phase II trial was an open label, unblinded, non-placebo-controlled study in eight patients conducted in collaboration with the NIH. While 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, of the patients completing the placebo-controlled study, the total volume of enhancing lesions was reduced in the lowest dose group compared to the placebo control. Moreover, in this study 57% of the patients in the lowest dose group experienced reductions in the volume of new enhancing lesions compared to 25% in the placebo group. In the open label study, a higher incidence of new brain lesions was found in two patients who received the highest dose and the one patient who received the low dose. As a result, the trial was stopped.

In July 2003 we initiated a Phase II clinical trial for the treatment of relapsing multiple sclerosis. This multicenter, randomized, double-blind, placebo-controlled trial will evaluate optimal dose and frequency of administration. Enrollment is expected to be completed during 2004 and results are expected in 2005. Our aim for future trials will be to further establish the benefit of altered peptide ligand therapy in patients with multiple sclerosis.

*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 at least 17 million patients. Diabetics often suffer from a number of complications of the disease including heart disease, circulatory problems, kidney failure, neurologic disorders and blindness. Current therapy for Type 1 diabetes consists of daily insulin injections to regulate blood glucose levels. This therapy does not cure nor does it prevent the disease. Worldwide sales of diabetes therapies reached $11 billion in 2002 according to ABN AMRO and company annual reports.

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 them 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 Phase IIb clinical trial was initiated consisting of a randomized, double blind, placebo-controlled, multi-center, multi-national study in adolescent and adult patients with new onset Type 1 diabetes. This study will involve approximately 20 medical sites in Canada, Europe and South America and approximately 200 patients. Enrollment is expected to be completed in the first quarter of 2004. Preliminary results from this trial are expected in early 2006.

In 2000, we entered into agreements with Taisho providing them with worldwide rights to our altered peptide ligand for diabetes. On March 31, 2003, we reacquired the worldwide rights to our diabetes drug candidate.

***$D_2$ Receptor Agonist***

In the first quarter of 2003, we acquired the rights from Pharmacia to develop a selective dopamine $D_2$ receptor agonist for the treatment of male and female sexual dysfunction. As a condition to the closing of the Pharmacia-Pfizer merger, the Federal Trade Commission required Pharmacia to divest this product candidate, to enhance competition in the market for human sexual dysfunction. Dopamine receptors in the brain are involved in sexual motivation, performance, and motor activity in rodents and monkeys. Neuroleptic dopamine receptor antagonists suppress both male and female sexual behavior in human patients while L-DOPA exerts pro-sexual effects in both sexes. Based on the results of animal studies, dopamine does not appear to elicit sexual behavior directly, but rather allows sexual stimuli to more readily activate neural circuits that have been primed by sex hormones. Our product candidate has demonstrated high intrinsic activity in animal models of sexual dysfunction and has been tested in Phase I clinical studies. Pursuant to our agreement with Pharmacia (now Pfizer), we were provided funding to conduct a Phase II proof of concept clinical study in the area of erectile dysfunction, or ED, to determine the product candidate's potential efficacy. Pfizer is currently transferring to us the technology and manufacturing know-how to support such a study.

According to Mattson Jack, ED affects approximately 85 million men in the seven major pharmaceutical markets. However, less than 20% of the prevalent population is diagnosed with the condition according to a Decision Resources July 2002 study. Over the next decade, as the number of men 55 and older increases considerably, the number of ED sufferers in the United States is projected to increase by nearly one million or 14% according to a 2001 Gallup study of ED. This far outpaces the population growth rate of men which is likely to increase by only 9% by the year 2010. Currently, PDE-5 inhibitors such as Viagra are the only effective oral treatment. We believe that our approach to ED may have significantly fewer side effects than the currently marketed PDE-5 inhibitors. We also believe that the mechanism of action of our product candidate would enable it to be used in combination with existing therapies for the treatment of ED.

***Corticotropin-Releasing Factor***

According to Mattson Jack, in 2003 over 45 million people in the United States had symptoms of depression. The National Institute of Mental Health has also indicated that over 16% of the United States population has an anxiety disorder. In 2003, the market for depression therapeutics is expected to be approximately $14 billion according to Datamonitor. However, there remain significant unmet medical needs, 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.

Researchers have identified what they believe to be the central mediator of the body's stress responses or stress-induced disorders. 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, which is the system that manages the body's overall response to stress. When the body detects a threat to physical or psychological well-being, the region of the brain called the hypothalamus amplifies production of CRF, which induces the physical effects that are associated with stress which 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 is a topic of interest throughout the psychiatric community and pharmaceutical industry, representing a market opportunity both to better serve patients and expand overall treatment for this life threatening disease.

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.

*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. Researchers believe that the biochemical basis of depression involves elevated secretion of CRF and abnormally low levels of other neurotransmitters in the brain such as serotonin. The most frequently prescribed antidepressant therapies are selective serotonin reuptake inhibitors such as Zoloft®, Paxil®, Lexapro® and Prozac® which 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.

The first clinical trial to offer evidence of proof of concept of CRF antagonists in addressing depression was a Phase IIa open label trial conducted in 1999 pursuant to two 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. 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. In March 2002, Janssen notified us that it had elected to terminate the 1995 and 1999 agreements with us. As a result, exclusive rights to these first generation CRF antagonist compounds have reverted to us.

In 1998, we initiated a proprietary CRF $R_1$ antagonist program independent of Janssen. This program led to the discovery of a novel class of second generation CRF $R_1$ antagonist compounds of a chemical class distinct from the class of compounds that were subject to the Janssen collaboration. In July 2001, we announced our second CRF antagonist collaboration, a worldwide collaboration with GlaxoSmithKline, to develop and commercialize CRF antagonists for psychiatric, neurological and gastrointestinal diseases. Under the terms of this agreement, GlaxoSmithKline will sponsor and 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. It is likely that the sponsored research portion of the collaboration will be completed in 2005.

*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 anxiolytic BuSpar® and their 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. In view of significant evidence implicating CRF in anxiety-related disorders, we are developing small molecule CRF $R_1$ receptor antagonists as anti-anxiety agents that block the effects of overproduction of CRF. We believe that these compounds utilize a novel mechanism of action

that may offer the advantage of being more selective, thereby providing increased efficacy with reduced side effects as compared to benzodiazepines.

As a co-examined variable in the open label Phase IIa clinical trial for depression described above, the anti-anxiety effects of the CRF $R_1$ receptor antagonist showed a reduction in Hamilton Anxiety Scores from baseline in both treatment groups at all times after dosing. In addition, in preclinical studies used to evaluate anti-anxiety drugs, our scientists have demonstrated with statistical significance that clinical compound candidates from our independent CRF $R_1$ antagonist program are effective following oral administration. We did not observe any evidence of clinically relevant side effects. These results are encouraging because they suggest that compounds blocking the CRF $R_1$ receptor may be effective in treating anxiety-related disorders.

*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 110 million people worldwide. 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.

***CRF $R_2$ Peptide Agonist—Urocortin II***

Urocortin II 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. We licensed Urocortin II from the Research Development Foundation to further expand our franchise in CRF. We will continue to study the utility of this compound in endocrine, metabolic, and cardiovascular disorders and expect Urocortin II to enter Phase I trials during 2004.

***IL-4 Fusion Toxin***

Interleukin 4, or IL-4, is a natural chemical that modulates cell growth. Proteins that bind to IL-4, known as IL-4 receptors, are highly concentrated on the cells of malignant brain tumors as well as many other cancers, including some types of kidney and lung cancer. Targeted toxins are a novel form of anticancer therapy under investigation in a variety of clinical settings. Targeted toxin therapeutics carry a toxin to a target site on the cancer cell and subsequently kill the cancer cell. Many scientists believe that targeted toxins have several potential advantages over conventional chemotherapy in that they are more selective and effective in the treatment of chemotherapy-resistant cancer cells.

Our IL-4 product candidate has completed a Phase I trial for solid tumor cancers and a Phase II trial for malignant glioma. In October 1999, the FDA granted us fast track designation for our IL-4 product candidate. We currently plan to outsource the development and commercialization of this product candidate to allow us to focus on neurological and endocrine-related diseases and disorders.

**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, as well as prostate cancer, eating disorders and cardiovascular diseases. Central nervous system drug therapies represent the second largest sector of the worldwide drug market, accounting for over $55 billion in worldwide drug sales in 2002 according to Datamonitor. Additionally, central nervous system drug therapies experienced a growth rate of approximately 10% during 2002 according to Datamonitor.

***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. Since researchers believe that CRF is the primary mediator of stress, they have suggested that CRF $R_1$ antagonists may provide a treatment for irritable bowel syndrome. Researchers have demonstrated the CRF $R_1$ antagonists demonstrate dose dependent effect with in vivo preclinical models of irritable bowel syndrome. Together with GlaxoSmithKline, we are evaluating our proprietary CRF $R_1$ antagonists for treatment of stress, anxiety, depression, and irritable bowel syndrome.

***CRF $R_2$ Antagonist***

Our scientists were the first to isolate a second CRF receptor, called CRF $R_2$. We believe the distribution of CRF $R_2$ in the brain suggests that CRF $R_2$ could play a role in some forms of anxiety and some eating disorders. Our researchers have demonstrated that administration of a CRF $R_2$ antagonist reduces measures of anxiety in studies of obsessive compulsive disorder and conditioned fear. We are also working with GlaxoSmithKline in evaluating our proprietary CRF $R_2$ antagonist for treatment of a variety of psychiatric and eating disorders. We have screened our small molecule library and conducted exploratory chemistry to identify a new series of compounds to undergo further study.

***GnRH Antagonists***

As previously mentioned, GnRH may be useful in treating some hormone dependent diseases. Our discovery work in GnRH has allowed us to select a backup compound to move into preclinical studies during 2003. This compound is expected to complete preclinical studies in mid-2004 and if successful, will advance to Phase I clinical trials. We continue to search for innovative formulations of GnRH that may lead to additional candidates for clinical trials.

***CRF $R_2$ Agonist***

CRF $R_2$ agonists may also represent a therapeutic strategy for diseases and disorders of the central nervous system. Preliminary data indicates that CRF may act as a central regulator of both appetite and metabolism and may play a role in neurodegenerative diseases. In 1996, we initiated a three-year research collaboration with Eli Lilly to screen and optimize CRF $R_2$ agonists. In October 1999, the funded research portion of the program was completed as scheduled, and Eli Lilly has retained control of the program and exclusive rights to the compounds.

***Melanocortin Receptor Agonist/Antagonist***

Melanocortin receptors are proteins on the surface of cells which help regulate some body functions such as eating and skin color. Researchers discovered that one of the melanocortin receptor subtypes, subtype 4, plays an important role in the mechanism regulating appetite and body weight. The subtype 4 receptor is activated by melanocyte stimulating hormone. When melanocyte stimulating hormone is injected into the brain, it reduces food intake and body weight. Responses have included the apparent increase in basal metabolic rate and lowering of serum insulin levels. We believe that an orally active subtype 4 agonist may produce the same effects and, thus, may provide a novel approach to the treatment of obesity. Conversely, the endogenous peptide antagonist of the central melanocortin subtype 4 receptor has been shown to have the reverse effect, increasing food intake over a sustained period of time after a single brain injection, and this observation has prompted significant interest in diseases such as cancer- and AIDS-related cachexia. For these reasons, we are also studying melanocortin subtype 4 receptor antagonists and have discovered novel, potent and selective compounds that are now being evaluated in relevant animal models. Additionally, researchers have recently suggested that melanocortin receptor subtype 4 agonists may also have a role in sexual dysfunction, and studies are underway to explore this further. We have screened our small molecule library and identified highly potent, selective orally active melanocortin subtype 4 receptor antagonist compounds. Optimization of these compounds, to improve their biopharmaceutical properties, has yielded several potential development candidates.

***Melanin Concentrating Hormone Antagonist***

Recent studies suggest that melanin concentrating hormone, or MCH, plays a role in the regulation of eating behavior. Based on these findings, we believe that blocking the effect of MCH with a small molecule antagonist may represent a novel approach to the treatment of obesity. Additional indications include anxiety and depression. Through our research efforts, we have identified and screened small-molecule, orally-active compounds which will block the activity of MCH at its receptor. We believe that these compounds may provide a novel therapeutic strategy for treating obesity and related disorders.

***Excitatory Amino Acid Transporters***

Some of the most successful central nervous system drugs, including selective serotonin reuptake inhibitors such as Prozac®, selectively target transporters of neurotransmitters in the brain. Similarly, we are targeting a set of proteins, called excitatory amino acid transporters, generally located in the brain, which transport glutamate in and out of cells, to selectively control the levels of this neurotransmitter. Drugs which alter the activity of these transporters are expected to produce a therapeutic benefit in disorders where glutamate levels are abnormal such as head trauma, schizophrenia, Lou Gehrig's Disease and other neurodegenerative and psychiatric disorders.

In 1999 we initiated a collaboration with Wyeth to investigate controlling the glutamate transporter function as a novel strategy for the treatment of neurodegenerative and psychiatric disorders that include basic research to understand the function and regulation of the transporters, along with the identification and characterization of chemical and biological leads. Our agreement with Wyeth provided for three years of funded research, which was extended for a fourth year and completed in 2002. Wyeth has retained control of the program and exclusive rights to the compounds.

***Chemokines***

Chemokines are inflammatory molecules that are highly expressed by neurons in the brain. Recent evidence suggests that blockade of certain chemokine receptors may be beneficial in the prevention of chronic pain and other inflammatory disorders. We have initiated a research effort to identify small-molecule, orally-active chemokine receptor antagonists. We believe that these compounds may provide a novel therapeutic strategy for treating pain and related disorders.

***Sleep Disorders***

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 dimensions. There are other CNS pathways that are involved in sleep regulation in addition to the GABA-A channel, and we have generated potent, orally active small molecule modulators of another pathway to regulate sleep and treatment of insomnia. We believe this approach would be complementary to our indiplon program.

**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 recently in the cloning of the human genome, has opened up a vast array of receptors as potential targets for drug discovery. Over the past ten years 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, one 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 the most attractive receptor class in the pharmaceutical industry, 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.

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. In addition, we have designed a 175,000-compound library focused on some of our molecular 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.

*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 complete our Phase III clinical trials for indiplon as promptly as practicable. Our entire Phase III program will consist of 13 studies with approximately 4,600 patients, all of which are currently underway or completed. We anticipate filing an NDA for indiplon in mid-2004.

*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 13 programs in various stages of research and development, with eight projects 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 20 years. GnRH antagonists, compounds designed to reduce the secretions of sex steroids, may represent the first novel non-injectible means of treatment of endometriosis, uterine fibroids and prostate cancer. Additionally, melanocortin and MCH modulators are compounds that affect proteins in the brain believed to be involved in many activities of the body. The creativity and productivity of our discovery research group will continue to be a critical component for our continued success. Our team of approximately 170 biologists and chemists has a goal of delivering three innovative clinical compounds over the next five years to fuel our research and development pipeline.

*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 intend to further leverage our resources by selectively entering into additional strategic alliances to enhance our internal development and commercialization capabilities. We currently have strategic alliances 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;
- Wyeth, for compounds to treat neurodegenerative and psychiatric diseases; and
- Eli Lilly, for treatments of central nervous system disorders, including obesity.

*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. Additionally, during 2003, we have inlicensed our D2 Receptor Agonist product candidate from Pharmacia (now Pfizer), and our Urocortin II product candidate from the Research Development Foundation.

**Our Strategic Alliances**

One of our business strategies is to utilize strategic alliances to enhance our development and commercialization capabilities. To date, we have formed the following 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 which we will bear. Following the filing of an NDA, Pfizer is obligated to pay for and support the creation of a 200-person Neurocrine sales force that will initially promote 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. 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, 2003, we had recorded revenues of $38.0 million in license fees and $90.9 million in sponsored development. In addition, at December 31, 2003 we had $62.0 million of deferred revenue, which is being amortized over the estimated period to 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 (a portion of which is payable by DOV to Wyeth) and royalties (a portion of which is payable by DOV to Wyeth) on future sales of indiplon. On February 26, 2004, we entered into several agreements with Wyeth and DOV pursuant to which, we will acquire Wyeth's financial interest in indiplon for approximately $95 million, consisting of $50 million payable in cash and $45 million payable in 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 will be recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based upon indiplon sales. Additionally, we are responsible for specified milestone payments up to $3.5 million to DOV Pharmaceutical under the license agreement. The closing of this transaction is conditioned upon the approval of the Wyeth Board of Directors and termination of waiting periods under the Hart Scott Rodino Act. Both of these conditions have been met and the transaction is scheduled to close on March 15, 2004.

*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 for up to five years 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, 2003, we had recorded revenues of $3.7 million in license fees, $16.3 million in milestone payments, $13.7 million in sponsored research and $973,000 in reimbursement of development costs. In addition, at December 31, 2003 we had $833,000 of deferred license fees that will be amortized over the remaining life of the agreement. GlaxoSmithKline also sponsors a portion of our research efforts related to CRF through annual payments, of which $3.1 million is deferred and will be amortized over the remaining sponsored research period.

*Wyeth.* Effective in January 1999, we entered into a collaboration and license agreement with Wyeth relating to the research, development and commercialization of compounds that control excitatory amino acid transporters for the treatment of neurodegenerative and psychiatric diseases. We have granted Wyeth exclusive and non-exclusive rights to our excitatory amino acid transporters technology as well as exclusive rights to any products developed during the collaboration. These licenses are for the term of the patents licensed. We will receive royalties on net product sales for the terms of the patents covering the collaboration products, subject to adjustments for royalties payable to other parties and for competition. We will also receive royalties for products that are not the subject of issued patents. Under specified conditions, we have the option to co-promote collaboration products in Canada and the United States. Wyeth may terminate the agreement if it decides that the research is not successful upon six months prior written notice to us. In addition, Wyeth may terminate the agreement if it decides to stop the program upon written notice to us. Wyeth may also terminate the agreement in certain circumstances if we are acquired by another company. The three-year sponsored research portion of the Wyeth agreement was completed on schedule in December 2001 and was subsequently extended on a smaller scale through December 2002. As of December 31, 2003, we had recognized a total of $13.9 million under the Wyeth agreement consisting of $10.5 million in sponsored research and $3.4 million in milestone payments.

*Eli Lilly.* In October 1996, we entered into a research and license agreement with Eli Lilly to collaborate in the discovery, development and commercialization of CRF binding protein ligand inhibitors for the treatment of central nervous system disorders including obesity and dementias, such as Alzheimer's disease, and CRF $R_2$ agonists for central nervous system diseases and disorders. Under the agreement, we are entitled to milestone payments for specified development and regulatory accomplishments. We will have the option to receive co-promotion rights and share profits from commercial sales of select products that result from the collaboration in the United States or receive royalties on United States net sales. We will receive royalties on net sales for the rest of the world.

In October 1999, the funded portion of the research program concluded as scheduled and, to our knowledge, Eli Lilly is not planning any specific future development efforts, and we do not expect to receive any additional payments under this agreement. During the funded portion of the research program, we received payments totaling $17.2 million.

**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. We have licensed, from institutions such as The Salk Institute, Stanford University, Oregon Health Sciences University, DOV Pharmaceutical and others the rights to approximately 40 issued United States patents, 10 pending United States patent applications, and 55 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 our issued patents 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 modified release insomnia formulation unless we obtain a license, which may not be available to us. We are also aware of pending and issued patent claims to melanin concentrating hormone ligand and receptor, and some uses of melanocortin subtype 4 agonists. We are conducting research in all of those areas and may ultimately need to license those patents in order to proceed. In addition, we are aware of two United States patents relating to IL-4 proteins that are controlled by other entities which, if construed very broadly, and if valid as so construed, could prevent us from commercializing our IL-4 fusion toxin products in the United States unless we obtain a license, which may not be available to us on commercially reasonable terms, or at all. We do not believe that our research and development activities as currently conducted infringe any valid issued patents.

Indiplon, our leading gamma amino-butyric acid agonist compound for the treatment of insomnia, 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 were issued in 2002 and do not expire until 2020. Indiplon is not currently covered by any foreign patents of which we are aware. We intend to seek additional protection of this compound through nine United States and foreign patent applications directed to the synthesis, formulations and various forms of indiplon, which could extend some patent protection to the year 2020. 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**

During the last four years, 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 2003, we licensed a 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 March 2003, we licensed exclusive rights to Pharmacia’s selective agonist for the dopamine $D_2$ receptor.
- In January 2003, we licensed exclusive rights to Urocortin II.
- In December 2002, we entered into a collaboration and license agreement with Biosite Incorporated relating to high affinity antibodies.
- In December 2002, we licensed library development software from Deltagen Research Laboratories, Inc.
- In December 2002, we licensed knock-out mice to certain target genes from Deltagen, Inc.
- In May 2002, we licensed a SK-MEL-37 cell line from the Sloan-Kettering Institute for Cancer Research.

- In June 2001, we licensed nonexclusive rights to the BON cell line from the University of Texas Medical Branch.
- In May 2001, we licensed nonexclusive rights to a murine CCR7 expressing cell line from Public Health Service.
- In March 2001, we licensed nonexclusive 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 October 2000, we licensed nonexclusive rights to several GT1-cell lines from The Salk Institute.
- In August 2000, we licensed nonexclusive rights to CRF $R_1$ deficient mice from the Research Development Foundation.
- In July 2000, we licensed exclusive rights to melanocortin subtype 3 receptor knock-out mice from Oregon Health Sciences University.
- In August 1999, we licensed nonexclusive rights to the human gonadotropin-releasing hormone receptor from Mount Sinai School of Medicine.
- In January 1999, we licensed exclusive worldwide rights to patents relating to excitatory amino acid transporters and melanocortin 1-5 from Oregon Health Sciences University.
- In December 1998, we licensed nonexclusive rights to technology covering melanocortin subtype 4 from the University of Michigan.
- In June 1998, we licensed exclusive worldwide rights to our sedative compound, indiplon, from DOV Pharmaceutical, Inc.
- In May 1998, we licensed exclusive worldwide rights to patents covering NBI-3001, our IL-4 fusion toxin, from the National Institutes of Health and inventors Ira Pastan and David Fitzgerald.

**Manufacturing**

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 pre-clinical 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 is currently 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.

**Marketing and Sales**

We currently have no sales or distribution capabilities. In order to commercialize any of our product candidates, we must either internally develop sales and distribution capabilities or make arrangements with third parties to perform these services. Additionally, we currently have no experience in marketing or selling pharmaceutical products. We are currently initiating marketing activities for indiplon by hiring staff with experience in pharmaceutical sales, marketing and distribution.

As part of our collaboration agreement with Pfizer, we will receive funding from Pfizer for a 200 person United States sales force. This funding will commence upon our filing of an NDA for indiplon and the sales force will immediately focus on detailing Pfizer's antidepressant drug Zoloft® to psychiatrists. Upon approval of the indiplon NDA, the sales force will also co-promote indiplon to psychiatrists and sleep specialists. Pfizer will manage all aspects of distribution for both Zoloft® and indiplon.

Additionally, under our collaboration agreements with GlaxoSmithKline, Wyeth, and Eli Lilly, we may have the opportunity to co-promote some of our other products in the United States. To market any of our other products directly, we must develop a sales force with technical expertise and with supporting distributions 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.

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| 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 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, eating disorders, pain, irritable bowel syndrome, autoimmunity and various female and male health disorders.

We are developing indiplon for the treatment of insomnia. Ambien® and Sonata® are already marketed for the treatment of insomnia by Sanofi-Synthelabo and King Pharmaceuticals, Inc., respectively. Additionally, in early 2003, Sepracor filed an NDA for Estorra™ (eszopiclone) for the treatment of insomnia. Takeda Pharmaceuticals is developing TAK-375, a melatonin agonist, for insomnia, which is currently in Phase III clinical trials. 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. Sanofi-Synthelabo has also begun clinical trials for a controlled release version of Ambien® (Ambien CR) to maintain sleep.

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

We are developing a drug candidate for the treatment of sexual dysfunction. There are many approved products for this indication and we believe that this market will become increasingly competitive. These products include, Viagra®, marketed by Pfizer, Cialis®, marketed by Eli Lilly, and Levitra®, marketed by both GlaxoSmithKline and Bayer. We are aware that a number of companies are conducting research on molecules that act through the same mechanism of action as our product candidate.

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, and Wellbutrin® marketed by GlaxoSmithKline among others, as well as 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 research pipeline. Lupron Depot®, marketed by Takeda-Abbott Pharmaceuticals, Zoladex®, marketed by AstraZeneca, and Synarel®, marketed by Pfizer, are gonadotropin-releasing hormone peptide agonists that have been approved for the treatment of prostate cancer, endometriosis, infertility, and central precocious puberty. These drugs may compete with any small molecule gonadotropin-releasing hormone antagonists we develop for these indications. Anti-obesity therapeutics currently available include Xenical® from Roche Laboratories and Meridia® from Abbott Laboratories. 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, 2003, we had 345 employees, consisting of 316 full-time and 29 part-time employees. Of the full-time employees, approximately 115 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 members of our Scientific Advisory Board and a significant 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.

**RISK FACTORS**

***Risks Relating to the Company***

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

Any failure or substantial delay in completing clinical trials for our product candidates may severely harm our business. Before obtaining regulatory approval for the sale of any of our potential products, we must subject these product candidates to extensive preclinical and clinical testing to demonstrate their safety and efficacy for humans. Clinical trials are expensive, time-consuming and may take years to complete. We are currently conducting Phase III

clinical trials in our indiplon development program for insomnia. This is our most advanced clinical program and represents a significant portion of our total clinical development activities and expenditures. If our Phase III indiplon program is significantly delayed or fails to demonstrate that indiplon is safe and efficacious for the targeted patient populations or if the FDA does not approve the proposed indiplon product labeling, our business and reputation would be harmed and our stock price would be negatively affected.

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

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

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

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

Pfizer has agreed to:

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

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

Pfizer may terminate the collaboration at any time upon 180-days written notice, subject to payment of specified amounts related to ongoing clinical development activities. If Pfizer elects to terminate the collaboration prior to FDA approval, we will be responsible for Phase III indiplon development expenses while we seek another partner to assist us in the worldwide development and commercialization of indiplon. This could cause delays in obtaining marketing approvals and sales, and negatively impact our business. If Pfizer elects to terminate the collaboration after receipt of FDA approval, we would be forced to fund the Neurocrine sales force and/or seek new marketing partners for indiplon. This could lead to loss of sales and negatively impact our business. In the event the

collaboration is terminated by Pfizer, we may not be successful in finding another collaboration partner on favorable terms, or at all, and any failure to obtain a new partner on favorable terms could adversely affect indiplon development and commercialization and our business.

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

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

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

We plan to file an NDA for indiplon in mid-2004. We face the risk that the FDA could force us to delay our filing, reject our NDA filing, find it incomplete or find it insufficient for marketing approval for indiplon, which may cause our business and reputation to be harmed and likely would cause our stock price to decrease. In addition, even if our indiplon NDA is approved, the labeling granted by the FDA may limit the commercial success of the product. The FDA could also require Phase IV, or post-marketing, trials to study the long-term effects of indiplon and could withdraw its approval based on the results of those trials.

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

Since our inception, we have incurred significant net losses, including net losses of $30.3 million and $94.5 million for the years ended December 31, 2003 and 2002, respectively. As a result of ongoing operating losses, we had an accumulated deficit of $232.2 million and $201.9 million as of December 31, 2003 and 2002, respectively. We were not profitable for the year ended December 31, 2003, and we do not expect to be profitable in 2004. We have not yet completed the development, including obtaining regulatory approvals, of any products and, consequently, have not generated revenues from the sale of products. Even if we succeed in developing and commercializing one or more of our drugs, we may not be profitable. We also expect to continue to incur significant operating and capital expenditures as we:

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

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

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

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

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

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

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

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

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

These issues and possible disagreements with our corporate collaborators could lead to delays in the collaborative research, development or commercialization of many of our product candidates. Furthermore,

disagreements with these parties could require or result in litigation or arbitration, which would be time-consuming and expensive. If any of these issues arise, it may delay the filing of our NDAs and, ultimately, our generation of product revenues.

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

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

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

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

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

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

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

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

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

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

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

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

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

We have in the past utilized, and intend to continue to utilize, third-party manufacturers to produce the drug compounds we use in our clinical trials and for the potential commercialization of our future products. We have no experience in manufacturing products for commercial purposes and do not currently have any manufacturing facilities. Consequently, we depend on several contract manufacturers for all production of products for development and commercial purposes. If we are unable to obtain or retain third-party manufacturers, we will not be able to commercialize our products. The manufacture of our products for clinical trials and commercial purposes is subject to specific FDA regulations. Our third-party manufacturers might not comply with FDA regulations relating to manufacturing our products for clinical trials and commercial purposes or other regulatory requirements now or in the future. Our reliance on contract manufacturers also exposes us to the following risks:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We may require additional funding to continue our research and product development programs, including preclinical testing and clinical trials of our product candidates, for operating expenses and to pursue regulatory approvals for product candidates. We also may require additional funding to establish manufacturing and marketing

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

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

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

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

*The price of our common stock is volatile.*

The market prices for securities of biotechnology and pharmaceutical companies historically have been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. Over the course of the last 12 months, the price of our common stock has ranged from approximately $37 per share to approximately $60 per share. The market price of our common stock may fluctuate in response to many factors, including:

- the results of our clinical trials;
- developments concerning our strategic alliance agreements;
- announcements of technological innovations or new therapeutic products by us or others;
- developments in patent or other proprietary rights;
- future sales of our common stock by existing stockholders;
- comments by securities analysts;
- general market conditions;

- fluctuations in our operating results;
- government regulation;
- health care reimbursement;
- failure of any of our product candidates, if approved, to achieve commercial success; and
- public concern as to the safety of our drugs.

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

***Risks Related to Our Industry***

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

all. Even if our collaboration partners or we were able to obtain rights to the third party's intellectual property, these rights may be non-exclusive, thereby giving our competitors access to the same intellectual property. Ultimately, we may be unable to commercialize some of our potential products or may have to cease some of our business operations as a result of patent infringement claims, which could severely harm our business.

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

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

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

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

**ITEM 2. PROPERTIES**

We currently lease approximately 110,000 square feet of laboratory and office space in San Diego, California, of which approximately 65% is laboratory space dedicated to research and development. The lease payments are approximately $350,000 per month through the third quarter of 2004. We are in the process of constructing our new headquarters in San Diego, California, which is expected to be completed in July 2004. Our former headquarters was sold in the fourth quarter of 2003, and are now leased-back until the construction of the new headquarters is complete. We believe that our property and equipment are generally well maintained and in good operating condition.

**ITEM 3. LEGAL PROCEEDINGS**

The Salk Institute has notified us that it is Salk's belief that we have not complied with certain milestone payments for our CRF antagonists under the 1993 license agreement between Salk and us. On June 27, 2003, Salk filed a demand for arbitration with the American Arbitration Association seeking information and additional milestone payments from us. We believe that we have complied with the terms of the license agreement and that no additional milestone payments are owed to Salk. We intend to vigorously defend our interests in this matter. We expect that the resolution of this matter will not have a material adverse effect on our business, financial condition or results of operations. However, due to the uncertainties inherent in these types of matters, no assurance can be given as to the outcome of these proceedings.

Other than the above, 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 has been traded on the Nasdaq National Market System under the symbol NBIX since our initial public offering on May 23, 1996. Prior to that time there was no established public trading market for our common stock. 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, 2002** | | |
| 1st Quarter | $52.21 | $32.15 |
| 2nd Quarter | 43.88 | 23.25 |
| 3rd Quarter | 42.65 | 24.04 |
| 4th Quarter | 50.00 | 37.92 |
| **Year Ended December 31, 2003** | | |
| 1st Quarter | $48.53 | $37.38 |
| 2nd Quarter | 60.27 | 41.45 |
| 3rd Quarter | 57.50 | 47.24 |
| 4th Quarter | 56.14 | 44.61 |

As of February 27, 2004, there were approximately 94 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.

| | 2003 | 2002 | 2001 | 2000 | 1999(1) |
|---|---|---|---|---|---|
| | (in thousands, except for loss per share data) | | | | |
| **STATEMENT OF OPERATIONS DATA** | | | | | |
| Revenues: | | | | | |
| Sponsored research and development | $ 96,699 | $ 12,364 | $ 16,880 | $ 6,881 | $ 12,662 |
| Milestones and license fees | 41,126 | 3,516 | 22,937 | 6,345 | 3,000 |
| Grant income and other revenues | 1,253 | 2,165 | 1,425 | 1,362 | 1,129 |
| Total revenues | 139,078 | 18,045 | 41,242 | 14,588 | 16,791 |
| Operating expenses: | | | | | |
| Research and development | 177,271 | 108,939 | 74,267 | 40,227 | 29,169 |
| General and administrative | 20,594 | 12,721 | 10,857 | 9,962 | 7,476 |
| Total operating expenses | 197,865 | 121,660 | 85,124 | 50,189 | 36,645 |
| Loss from operations | (58,787) | (103,615) | (43,882) | (35,601) | (19,854) |
| Other income and (expense): | | | | | |
| Gain on sale of property | 17,946 | — | — | — | — |
| Interest income and expense, net | 10,601 | 8,864 | 6,662 | 6,048 | 2,851 |
| Other income and expense, net | 142 | 215 | 430 | 1,047 | 1,066 |
| Equity in NPI losses and other adjustments, net | — | — | — | — | (885) |
| Total other income | 28,689 | 9,079 | 7,092 | 7,095 | 3,032 |
| Loss before income taxes | (30,098) | (94,536) | (36,790) | (28,506) | (16,822) |
| Income taxes | 158 | — | 120 | 302 | — |
| Net loss | $ (30,256) | $ (94,536) | $ (36,910) | $ (28,808) | $ (16,822) |
| Loss per common share: | | | | | |
| Basic and diluted | $ (0.93) | $ (3.10) | $ (1.42) | $ (1.30) | $ (0.88) |
| Shares used in calculation of loss per common share: | | | | | |
| Basic and diluted | 32,374 | 30,488 | 26,028 | 22,124 | 19,072 |
| **BALANCE SHEET DATA** | | | | | |
| Cash, cash equivalents and short-term investments | $ 453,168 | $ 244,710 | $ 319,982 | $164,670 | $ 91,098 |
| Working capital | 361,797 | 215,615 | 306,754 | 157,446 | 86,168 |
| Total assets | 554,955 | 266,539 | 346,350 | 185,962 | 109,222 |
| Long-term debt | 32,473 | 5,277 | 3,600 | 2,283 | 2,139 |
| Accumulated deficit | (232,182) | (201,926) | (107,390) | (70,480) | (41,672) |
| Total stockholders' equity | 391,120 | 224,254 | 310,393 | 163,208 | 96,354 |

(1) Sponsored research and development includes $491 in revenues from a related party for the year ended December 31, 1999.

## 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 the expected continuation of our collaborative agreements, the receipt of research 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. Business-Risk Factors."*

### Overview

We incorporated in California in 1992 and reincorporated in Delaware in 1996. 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 2005. 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 significant increases in operating expenses as product candidates are advanced through the various stages of clinical development. As of December 31, 2003, we have incurred a cumulative deficit of $232.2 million and expect to incur operating losses in the 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), facility lease, investments, and fixed assets. Estimates are based on historical experience, information received from third parties and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The items in our financial statements requiring significant estimates and judgments are as follows:

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

Research and development (R&D) expenses include related salaries, contractor fees, facilities costs, administrative expenses and allocations of corporate costs. All such costs are charged to R&D expense as incurred. These expenses result from our independent R&D efforts as well as efforts associated with collaborations, grants and in-licensing arrangements. In addition, we fund R&D at other companies and research institutions under

agreements, which are generally cancelable. We review and accrue clinical trials expenses based on work performed, which relies on estimates of total costs incurred based on patient enrollment, completion of studies and other events. We follow this method since reasonably dependable estimates of the costs applicable to various stages of a research agreement or clinical trial can be made. Accrued clinical costs are subject to revisions as trials progress to completion. Revisions are charged to expense in the period in which the facts that give rise to the revision become known.

**Results of Operations for Years Ended December 31, 2003, 2002 and 2001**

The following table summarizes our primary sources of revenue:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| | | (in thousands) | |
| Revenues under collaboration agreements: | | | |
| Pfizer | $128,894 | $ — | $ — |
| GlaxoSmithKline | 7,779 | 7,600 | 19,230 |
| Taisho | 1,144 | 6,770 | 16,575 |
| Wyeth | 8 | 1,510 | 3,408 |
| Other | — | — | 604 |
| Total revenue under collaboration agreements | 137,825 | 15,880 | 39,817 |
| Grant income and other revenue | 1,253 | 2,165 | 1,425 |
| Total revenues | $139,078 | $18,045 | $41,242 |

Our revenues for the year ended December 31, 2003 were $139.1 million compared with $18.0 million in 2002. The $121.1 million increase in revenues from 2002 to 2003 resulted primarily from $90.9 million of sponsored development reimbursements and $38.0 million in amortized upfront fees under the Pfizer collaboration. Our revenues for the year ended December 31, 2002 were $18.0 million compared with $41.2 million in 2001. The $23.2 million decrease in revenues from 2001 to 2002 resulted primarily from $21.0 million of milestones achieved in 2001 under the Taisho and GSK collaborations.

Research and development expenses increased to $177.3 million during 2003 compared with $108.9 million during 2002 and $74.3 million in 2001. Increased expenses over the three years primarily reflect advancement of our drug candidates through progressive clinical development phases and the higher costs associated with expanding development activities and increased enrollment in clinical trials. External development costs increased by $55.4 million from 2002 to 2003 and $32.0 million from 2001 to 2002 primarily related to the indiplon Phase III program. Additionally, personnel and laboratory costs related to the expansion of research and development activities have increased by $11.1 million from 2002 to 2003 and by $2.0 million form 2001 to 2002. We expect research and development expenses to decrease during 2004, primarily due to the completion of the Phase III indiplon development program during 2004. Research and development costs will increase in 2005 as clinical trials progress for other compounds in our pipeline.

General and administrative expenses increased to $20.6 million during 2003 compared with $12.7 million during 2002 and $10.9 million during 2001. The increase in expenses from 2002 to 2003 resulted primarily from increased professional fees related to business development ($1.7 million) and the addition of administrative personnel ($4.8 million) needed to support expanding research and development activities and the implementation of our commercialization strategy. The increase in general and administrative expenses from 2001 to 2002 resulted primarily from increased marketing research and marketing related costs ($.3 million), increased recruiting and relocation costs for new employees ($.8 million), and increased insurance costs ($.6 million).

Interest income increased to $11.1 million during 2003 compared with $9.3 million during 2002 and $7.0 million during 2001. The increase in 2003, compared with 2002 and 2001, resulted primarily from higher investment balances achieved through public offerings of our common stock offset by lower investment yields. In September 2003, we sold 3.75 million shares of our common stock in a public offering resulting in net proceeds of $187.4 million. In December 2001, we sold 4.0 million shares of our common stock in a public offering resulting in net proceeds of $175.6 million.

During the fourth quarter of 2003, we sold our corporate headquarters to Pfizer. As a result of this transaction we recognized a one-time gain on the sale of the property of approximately $18.0 million.

Our net loss for 2003 was $30.3 million, or $0.93 per share, compared with $94.5 million, or $3.10 per share, in 2002 and $36.9 million, or $1.42 per share, in 2001. The decrease in net loss from 2002 to 2003 resulted primarily from increased revenue under the Pfizer collaboration agreement, offset partially by increased external development costs, and the gain on the sale of our corporate headquarters. The increase in net loss from 2001 to 2002 resulted primarily from an increase in scientific personnel and expanded clinical development activities, related primarily to the indiplon program.

We expect to incur a net loss in 2004 as our research, development, pre-clinical studies and clinical trial activities continue. 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, net of $7.5 million that we will contribute to external indiplon development costs during 2004. We also expect to achieve certain milestones under our collaboration agreement with Pfizer upon filing of our NDA for indiplon. We will also recognize revenue in 2004 under our research collaboration agreement with GlaxoSmithKline. Additionally, in mid-2004 we will begin to build our 200 person sales force, with the routine costs of this sales force to be funded by Pfizer. Costs associated with research and development are expected to decrease in 2004 as the Phase III indiplon program ends, however this decrease will be partially offset by increased research and development costs on other products in our pipeline.

Upon approval of indiplon by the FDA, expected in 2005, we will then begin to receive royalties from Pfizer based on sales of indiplon. We also expect to achieve milestones based on FDA approval of indiplon and the labeling received by indiplon. Additionally, Pfizer will continue to fund our sales force in 2005. Research and development costs will increase from 2004 levels as we progress compounds through our pipeline. Sales costs will increase as well during 2005 as we begin to market indiplon. However, we expect to cross over into profitability during 2005.

**Liquidity and Capital Resources**

At December 31, 2003, our cash, cash equivalents, and short-term investments totaled $453.2 million compared with $244.7 million at December 31, 2002. This increase from December 31, 2002 to December 31, 2003 is primarily from the receipt of the initial license and collaboration payments from Pfizer totaling $100.0 million and the sale of 3.75 million shares of our common stock in a public offering which generated net cash proceeds of $187.4 million, offset by capital acquisitions and operating losses. At December 31, 2002, our cash, cash equivalents, and short-term investments totaled $244.7 million compared to $320.0 million at December 31, 2001. This decrease from December 31, 2001 to December 31, 2002 is a result of increased research and clinical development costs, primarily related to the indiplon Phase III program.

Net cash provided by (used in) operating activities during fiscal year 2003 was $37.1 million compared with ($79.9) million in 2002 and ($21.9) million during 2001. The increase in cash provided by operations from 2002 to 2003 is a result of the receipt of the initial payment of $100.0 million under the collaboration agreement with Pfizer, and an increase in accrued liabilities related to accrued clinical trial costs, offset by an increase in accounts receivable from collaborators due to increased reimbursable external development costs. The increase in cash used in operations form 2001 to 2002 is a result of expanded research efforts and an increase in clinical development activities, primarily our indiplon program.

Net cash used in investing activities during fiscal year 2003 was $186.6 million compared to $45.5 million during 2002 and $16.6 million in 2001. 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. Additionally, net cash used in investing activities includes construction in progress 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 2003, 2002 and 2001 were $7.2 million, $5.3 million and $3.8

million, respectively, and were financed primarily through debt arrangements. Capital equipment purchases for 2004 also will be financed primarily through debt agreements and are expected to be approximately $11.3 million.

During 2003, our subsidiary Science Park Center LLC sold our 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. We have negotiated a leaseback provision, as part of the sale agreements to allow us to remain in our current location pending completion of the construction of our new facility.

In May 2003, Science Park Center LLC entered into an agreement to acquire undeveloped real property in San Diego, California for approximately $17.0 million to construct a new corporate facility. We also placed a deposit of $3.5 million and a $4.4 million irrevocable standby letter of credit for an adjacent parcel of land, which we purchased in January 2004. The letter of credit was secured by a $4.4 million cash deposit with the issuer. The letter of credit expired upon closing on the parcel of land in January 2004.

Additional costs we expect to incur in connection with these two properties include design and construction costs as well as the purchase and installation of equipment and furnishings for these facilities. We estimate these costs at $45.0 million and expect to finance these costs through the net proceeds of the sale of the existing facility, a construction loan and a subsequent permanent financing. The construction loan agreement was completed in September 2003 for an amount up to $60.6 million and requires us to place a $17.5 million guaranty deposit with the lender for the term of the loan. The loan bears interest at the prime rate plus .75 percentage points and interest is payable monthly. Construction of the new facility commenced in June 2003 and is expected to be completed in July 2004.

Net cash provided by financing activities during fiscal year 2003 was $211.1 million compared with $5.8 million in 2002 and $181.3 million during 2001. The increase in cash provided from financing activities from 2002 to 2003 resulted primarily from the issuance of 3.75 million shares of our common stock in September 2003 yielding net cash proceeds of $187.4 million. Cash proceeds from the issuance of common stock upon exercise of outstanding stock options and employee stock purchase plans increased by $5.9 million during 2003 compared to the same period last year. We expect similar fluctuations to occur throughout the year, as the amount and frequency of stock-related transactions are dependent upon the market performance of our common stock. Additionally 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 corporate headquarters of approximately $14.0 million. Net cash provided by financing activities during 2001 includes $175.6 million of net proceeds from offerings of our common stock.

On February 26, 2004, we entered into several agreements with Wyeth and DOV pursuant to which, we will acquire Wyeth’s financial interest in indiplon for approximately $95 million, consisting of $50 million payable in cash and $45 million payable in our common stock. Wyeth’s financial interest in indiplon arises from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the indiplon technology to DOV in exchange for milestone payments and royalties on future sales of indiplon. We subsequently licensed the indiplon technology from DOV in exchange for milestones (a portion of which is payable by DOV to Wyeth) and royalties (a portion of which is payable by DOV to Wyeth). The agreements among us, Wyeth and DOV provide that we will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that we will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth. This decreases our overall royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction will be recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based upon indiplon sales. The closing of this transaction is conditioned upon the approval of the Wyeth Board of Directors and termination of waiting periods under the Hart Scott Rodino Act. Both of these conditions have been met and the transaction is scheduled to close on March 15, 2004.

**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, 2003 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 $73.2 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 | $36,433 | $ 3,960 | $31,564 | $ 909 | $ — |
| Operating lease | 2,578 | 2,578 | — | — | — |
| License & research agreements | 765 | 765 | — | — | — |
| Clinical development agreements | 39,695 | 26,587 | 12,826 | 282 | — |
| Total contractual obligations | $79,471 | $33,890 | $44,390 | $1,191 | $ — |

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 the 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, pre-clinical development, clinical testing, FDA approval and commercialization. This process may cost in excess of $100 million and can take as long as 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

pre-clinical 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 pre-clinical 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 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 these capital resources and payments will be sufficient to conduct all of our research and development programs as planned. The amount and timing of expenditures will vary depending upon a number of factors, including progress of our research and development programs.

We will require additional funding to continue our research and product development programs, to conduct pre-clinical 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, 2003, 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. Business – Risk Factors” included in this report.

**New Accounting Pronouncements**

In May 2003, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standard (“SFAS”) No. 150, “Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.” This statement clarifies the definition of a liability, as currently defined under FASB Concepts Statement No. 6 “Elements of Financial Statements”, as well as other items. The statement requires that financial instruments that embody an obligation of an issuer be classified as a liability. Furthermore, the standard provides guidance for the initial and subsequent measurement as well as disclosure requirements of these financial instruments. This statement is effective for financial instruments entered into after May 31, 2003. The adoption of this statement has not had a material impact on our results of operations or financial condition.

In January 2003, the FASB issued FASB Interpretation No. 46 (“FIN 46”), “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51.” FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN 46R, a revision to FIN 46. FIN 46R provides a broad deferral of the latest date by which all public entities must apply FIN 46 to certain variable interest entities to the first reporting period ending after March 15, 2004. We do not expect the adoption of FIN 46 or FIN 46R to have a material impact upon our financial position, cash flows or results of operations.

**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 decision regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving the desired control objectives, and in reaching a reasonable level of assurance, management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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

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

## PART 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 2004 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2003. 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 2004 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2003. 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 2004 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A with the Securities and Exchange Commission within 120 days of December 31, 2003. 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 2004 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2003. 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 2004 Annual Meeting of Stockholders, to be filed pursuant to Regulation 14A, with the Securities and Exchange Commission within 120 days of December 31, 2003. 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 Ernst & Young LLP, Independent Auditors, are included in this report:

   Report of Ernst & Young LLP, Independent Auditors

   Consolidated Balance Sheets as of December 31, 2003 and 2002

   Consolidated Statements of Operations for the years ended December 31, 2003, 2002 and 2001

   Consolidated Statements of Stockholders' Equity for the years ended December 31, 2003, 2002 and 2001

   Consolidated Statements of Cash Flows for the years ended December 31, 2003, 2002 and 2001

   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.*

There were no current reports on Forms 8-K filed for the quarter ended December 31, 2003.

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

| Exhibit Number | Description |
|---|---|
| 2.1 | Agreement and Plan of Reorganization dated May 1, 1998, between Northwest NeuroLogic, Inc., NBI Acquisition Corporation and the Registrant (6) |
| 2.2 | Form of Milestone Warrant pursuant to the Agreement and Plan of Reorganization dated May 1, 1998 (6) |
| 3.1 | Restated Certificate of Incorporation (1) |
| 3.2 | Bylaws (1) |
| 3.3 | Certificate of Amendment of Bylaws (1) |
| 4.1 | Form of Common Stock Certificate (1) |
| 4.2 | Form of warrant issued to existing warrant holders (1) |
| 4.3 | Information and Registration Rights Agreement dated September 15, 1992, as amended (1) |
| 4.4* | Registration Rights Agreement dated May 28, 1998, between certain investors and the Registrant (6) |
| 4.5 | 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 (19) |
| 4.6 | Stock Purchase Agreement dated December 20 through 23, 1999, between Neurocrine Biosciences, Inc. and each of the Purchasers named therein (10) |
| 10.1 | Purchase and Sale Agreement and Escrow Instructions between MS Vickers II, LLC and the Registrant dated February 13, 1997 (3) |
| 10.2 | 1992 Incentive Stock Plan, as amended (16) |
| 10.3 | 1996 Employee Stock Purchase Plan, as amended (16) |
| 10.4 | 1996 Director Stock Option Plan, as amended, and form of stock option agreement (1) |
| 10.5 | Form of Director and Officer Indemnification Agreement (1) |
| 10.6 | Employment Agreement dated March 1, 1997, between the Registrant and Gary A. Lyons, as amended May 24, 2000 (4) (11) |

10.7 Employment Agreement dated March 1, 1997, between the Registrant and Paul W. Hawran, as

| Exhibit Number | Description |
|---|---|
| | amended May 24, 2000 (4) (11) |
| 10.8 | Consulting Agreement dated September 25, 1992, between the Registrant and Wylie A. Vale, Ph.D. (1) |
| 10.9 | Consulting Agreement effective January 1, 1992, between the Registrant and Lawrence J. Steinman, MD (1) |
| 10.10 | License Agreement dated July 17, 1992, by and between The Salk Institute for Biological Studies and the Registrant (1) |
| 10.11 | License Agreement dated November 16, 1993, by and between The Salk Institute for Biological Studies and the Registrant (1) |
| 10.12 | License Agreement dated October 19, 1992, by and between the Board of Trustees of the Leland Stanford Junior University and the Registrant (1) |
| 10.13 | Agreement dated January 1, 1995, by and between the Registrant and Janssen Pharmaceutica, N.V. (1) |
| 10.14* | Research and License Agreement dated October 15, 1996, between the Registrant and Eli Lilly and Company (2) |
| 10.15* | Lease between Science Park Center LLC and the Registrant dated July 31, 1997 (5) |
| 10.16* | Option Agreement between Science Park Center LLC (Optionor) and the Registrant dated July 31, 1997 (Optionee) (5) |
| 10.17* | Construction Loan Agreement Science Park Center LLC and the Registrant dated July 31, 1997 (5) |
| 10.18 | Secured Promissory Note Science Park Center LLC and the Registrant dated July 31, 1997 (5) |
| 10.19* | Operating Agreement for Science Park Center LLC between Nexus Properties, Inc. and the Registrant dated July 31, 1997 (5) |
| 10.20 | Form of incentive stock option agreement and nonstatutory stock option agreement for use in connection with 1992 Incentive Stock Plan (1) |
| 10.21* | Patent License Agreement dated May 7, 1998, between the US Public Health Service and the Registrant (6) |
| 10.22* | Patent License Agreement dated April 28, 1998, between and among Ira Pastan, David Fitzgerald and the Registrant (6) |
| 10.23* | Sub-License and Development Agreement dated June 30, 1998, by and between DOV Pharmaceutical, Inc. and the Registrant (6) |
| 10.24* | Warrant Agreement dated June 30, 1998, between DOV Pharmaceutical, Inc. and the Registrant (6) |
| 10.25* | Warrant Agreement dated June 30, 1998, between Jeff Margolis and the Registrant (6) |
| 10.26* | Warrant Agreement dated June 30, 1998, between Stephen Ross and the Registrant (6) |
| 10.27* | Collaboration and License Agreement dated January 1, 1999, by and between American Home Products Corporation acting through its Wyeth Laboratories Division and the Registrant (7) |
| 10.28 | Employment Agreement dated October 1, 1998, between the Registrant and Margaret Valeur-Jensen, as amended May 24, 2000 (7) (11) |
| 10.29 | Employment Agreement dated January 1, 1998, between the Registrant and Bruce Campbell, as amended May 24, 2000 (7) (11) |
| 10.30* | Agreement by and among Dupont Pharmaceuticals Company, Janssen Pharmaceutica, N.V. and Neurocrine Biosciences, Inc. dated September 28, 1999 (9) |
| 10.31* | Amendment Number One to the Agreement between Neurocrine Biosciences, Inc. and Janssen Pharmaceutica, N.V. dated September 24, 1999 (9) |
| 10.32* | License Agreement between the Registrant and Taisho Pharmaceutical Co., Ltd. dated July 21, 2000 (11) |
| 10.33* | Amendment No. 1 dated November 30, 2000 to the License Agreement between the Registrant and Taisho Pharmaceutical Co., Ltd. dated July 21, 2000 (13) (15) |
| 10.34* | 2001 Stock Option Plan (14) |
| 10.35* | Collaboration and License Agreement between the Registrant and Glaxo Group Limited dated July 20, 2001(17) |
| 10.36 | Employment Agreement dated October 17, 2001, between the Registrant and Henry Pan, MD, PhD. (18) |

| Exhibit Number | Description |
|---|---|
| 10.37 | 2001 Stock Option Plan, as amended August 6, 2002 and October 15, 2002 (22) |
| 10.38* | License Agreement between the Registrant and Pfizer dated December 18, 2002 (20) |
| 10.39* | Collaboration Agreement between the Registrant and Pfizer dated December 18, 2002 (20) |
| 10.40* | Loan Agreement between the Registrant and Pfizer dated December 18, 2002 (20) |
| 10.41* | Restructuring Agreement between the Registrant and Taisho Pharmaceutical Co., Ltd. dated September 30, 2002 (21) |
| 10.42 | Nonqualified Deferred Compensation Plan, as amended and restated February 22, 2000 (22) |
| 10.43 | Employment Agreement dated June 16, 2003 between the Registrant and Robert Little (24) |
| 10.44 | Agreement between the Registrant and Pardee Homes for Purchase and Sale of Real Property (24) |
| 10.45 | First Amendment to Agreement for Purchase and Sale of Real Property and Escrow Instructions between the Registrant and Pardee Homes (24) |
| 10.46 | Second Amendment to Agreement for Purchase and Sale of Real Property and Escrow Instructions between the Registrant and Pardee Homes (24) |
| 10.47 | Third Amendment to Agreement for Purchase and Sale of Real Property and Escrow Instructions between the Registrant and Pardee Homes (24) |
| 10.48 | Agreement between the Registrant and Pfizer, Inc. for Purchase and Sale of Real Property (24) |
| 10.49 | Agreement between Science Park Center LLC and Pfizer for Purchase and Sale of Real Property (24) |
| 10.50 | Fourth Amendment to Operating Agreement for Science Park Center LLC (24) |
| 10.51 | Neurocrine Biosciences, Inc. Nonqualified Deferred Compensation Plan, dated August 5, 2003 (24) |
| 10.52 | Neurocrine Biosciences, Inc. 2003 Incentive Stock Plan (23) |
| 10.53 | Employment Agreement dated as of September 1, 2003 between the Registrant and Wendell Wierenga (25) |
| 10.54 | Construction Loan Agreement dated September 25, 2003 between San Diego National Bank and Science Park Center LLC (25) |
| 10.55 | Loan Guaranty dated September 25, 2003 made by Neurocrine Biosciences, Inc in favor of San Diego National Bank (25) |
| 10.56 | Lien Free Completion Guaranty dated September 25, 2003 made by Neurocrine Biosciences, Inc in favor of San Diego National Bank (25) |
| 10.57 | Promissory Note dated September 25, 2003 by Science Park Center, LLC in favor of San Diego National Bank (25) |
| 10.58 | Construction Agreement (25) |
| 10.59 | Tax Indemnity Agreement between the Registrant and Gary Lyons |
| 10.60 | Tax Indemnity Agreement between the Registrant and Paul W. Hawran |
| 10.61 | Tax Indemnity Agreement between the Registrant and Margaret Valeur-Jensen |
| 10.62 | Tax Indemnity Agreement between the Registrant and Kevin Gorman |
| 10.63 | Tax Indemnity Agreement between the Registrant and Paul Conlon |
| 21.1 | Subsidiaries of the Company |
| 23.1 | Consent of Ernst & Young LLP, Independent Auditors |
| 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 |

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

(2) Incorporated by reference to the Company's 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 amended Quarterly Report on Form 10-Q filed on August 15, 1997

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

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

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

(7) 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

(8) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on August 11, 1999

(9) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on November 12, 1999

(10) Incorporated by reference to the Company's Report on Form S-3 filed on January 20, 2000

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

(12) Incorporated by reference to the Company's Report on Form S-8 filed on August 17, 2000

(13) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 15, 2000

(14) Incorporated by reference to the Company's Registration Statement on Form S-8 filed March 15, 2001

(15) Incorporated by reference to the Company's Report on Form 10-K for the fiscal year ended December 31, 2000 filed on March 30, 2001

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

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

(18) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on November 13, 2001

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

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

(21) Incorporated by reference to the Company's Quarterly Report on Form 10-Q filed on November 13, 2002

(22) 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

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

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

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

* 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: March 12, 2004

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<br>Gary A. Lyons | President, Chief Executive Officer and Director (Principal Executive Officer) | March 12, 2004 |
| /s/ Paul W. Hawran<br>Paul W. Hawran | Chief Financial Officer (Principal Financial and Accounting Officer) | March 12, 2004 |
| /s/ Joseph A. Mollica<br>Joseph A. Mollica | Chairman of the Board of Directors | March 12, 2004 |
| /s/ W. Thomas Mitchell<br>W. Thomas Mitchell | Director | March 12, 2004 |
| /s/ Richard F. Pops<br>Richard F. Pops | Director | March 12, 2004 |
| /s/ Stephen A. Sherwin<br>Stephen A. Sherwin | Director | March 12, 2004 |
| /s/ Lawrence Steinman<br>Lawrence Steinman | Director | March 12, 2004 |
| /s/ Wylie W. Vale<br>Wylie W. Vale | Director | March 12, 2004 |

**NEUROCRINE BIOSCIENCES, INC.**
**INDEX TO THE FINANCIAL STATEMENTS**

## REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

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, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2003. 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 auditing standards generally accepted in the 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, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

San Diego, California
January 23, 2004,
except for Note 11 as to which the date is
February 26, 2004

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

| | December 31, | |
|---|---|---|
| | 2003 | 2002 |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 105,854 | $ 44,313 |
| Short-term investments, available-for-sale | 347,314 | 200,397 |
| Receivables under collaborative agreements | 13,659 | 247 |
| Other current assets | 4,982 | 3,137 |
| Total current assets | 471,809 | 248,094 |
| Property and equipment, net | 56,236 | 14,102 |
| Deposits and restricted cash | 25,539 | 500 |
| Other non-current assets | 1,371 | 3,843 |
| Total assets | $ 554,955 | $ 266,539 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 1,295 | $ 1,959 |
| Accrued liabilities | 55,091 | 22,163 |
| Deferred revenues | 49,666 | 5,699 |
| Current portion of long-term debt | 3,960 | 2,658 |
| Total current liabilities | 110,012 | 32,479 |
| Long-term debt | 32,473 | 5,277 |
| Deferred rent | — | 2,645 |
| Deferred revenues | 18,241 | 833 |
| Other liabilities | 3,109 | 1,051 |
| Total liabilities | 163,835 | 42,285 |
| 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 35,311,893 in 2003 and 30,662,273 in 2002 | 35 | 31 |
| Additional paid-in capital | 622,526 | 424,084 |
| Deferred compensation | (784) | (1,240) |
| Notes receivable from stockholders | (139) | (208) |
| Accumulated other comprehensive income | 1,664 | 3,513 |
| Accumulated deficit | (232,182) | (201,926) |
| Total stockholders' equity | 391,120 | 224,254 |
| Total liabilities and stockholders' equity | $ 554,955 | $ 266,539 |

See accompanying notes.

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| Revenues: | | | |
| Sponsored research and development | $ 96,699 | $ 12,364 | $ 16,880 |
| Milestones and license fees | 41,126 | 3,516 | 22,937 |
| Grant income and other revenues | 1,253 | 2,165 | 1,425 |
| Total revenues | 139,078 | 18,045 | 41,242 |
| Operating expenses: | | | |
| Research and development | 177,271 | 108,939 | 74,267 |
| General and administrative | 20,594 | 12,721 | 10,857 |
| Total operating expenses | 197,865 | 121,660 | 85,124 |
| Loss from operations | (58,787) | (103,615) | (43,882) |
| Other income and (expenses): | | | |
| Gain on sale of property | 17,946 | — | — |
| Interest income | 11,117 | 9,349 | 6,978 |
| Interest expense | (516) | (485) | (316) |
| Other income | 142 | 215 | 430 |
| Total other income | 28,689 | 9,079 | 7,092 |
| Loss before taxes | (30,098) | (94,536) | (36,790) |
| Income taxes | 158 | — | 120 |
| Net loss | $ (30,256) | $ (94,536) | $ (36,910) |
| Loss per common share: | | | |
| Basic and diluted | $ (0.93) | $ (3.10) | $ (1.42) |
| Shares used in the calculation of loss per common share: | | | |
| Basic and diluted | 32,374 | 30,488 | 26,028 |

See accompanying notes.

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

| | Common stock | | Additional | | Notes receivable | Accumulated other | | Total |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | paid-in capital | Deferred compensation | from stockholders | comprehensive income (loss) | Accumulated deficit | stockholders' equity |
| BALANCE AT DECEMBER 31, 2000 | 25,314 | 25 | 233,565 | (59) | (104) | 261 | (70,480) | 163,208 |
| Net loss | — | — | — | — | — | — | (36,910) | (36,910) |
| Unrealized loss on short-term investments | — | — | — | — | — | (330) | — | (330) |
| Comprehensive loss | — | — | — | — | — | — | — | (37,240) |
| Issuance of common stock from exercise of warrants | 43 | — | 1,902 | — | — | — | — | 1,902 |
| Issuance of common stock for notes | 7 | — | 277 | — | (277) | — | — | — |
| Issuance of common stock from option exercises | 781 | 1 | 2,436 | — | — | — | — | 2,437 |
| Issuance of common stock pursuant to the Employee Stock Purchase Plan | 178 | — | 3,382 | — | — | — | — | 3,382 |
| Issuance of common stock, net of offering costs | 4,025 | 4 | 175,558 | — | — | — | — | 175,562 |
| Amortization of deferred compensation, net | — | — | 2,898 | (1,756) | — | — | — | 1,142 |
| BALANCE AT DECEMBER 31, 2001 | 30,348 | 30 | 420,018 | (1,815) | (381) | (69) | (107,390) | 310,393 |
| Net loss | — | — | — | — | — | — | (94,536) | (94,536) |
| Unrealized gain on short-term investments | — | — | — | — | — | 3,582 | — | 3,582 |
| Comprehensive loss | — | — | — | — | — | — | — | (90,954) |
| Issuance of common stock for option exercises | 264 | 1 | 2,195 | — | — | — | — | 2,196 |
| Issuance of common stock pursuant to the Employee Stock Purchase Plan | 50 | — | 1,175 | — | — | — | — | 1,175 |
| Reversal of offering expenses | — | — | 88 | — | — | — | — | 88 |
| Amortization of deferred compensation, net | — | — | 447 | 575 | — | — | — | 1,022 |
| Issuance of warrants | — | — | 161 | — | — | — | — | 161 |
| Stockholder note repayment | — | — | — | — | 104 | — | — | 104 |
| Stockholder note forgiveness | — | — | — | — | 69 | — | — | 69 |
| 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 |

See accompanying notes.

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2003** | **2002** | **2001** |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| Net loss | $ (30,256) | $ (94,536) | $ (36,910) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Depreciation and amortization | 3,692 | 3,098 | 2,651 |
| (Gain) loss on sale/abandonment of assets | (17,946) | 5 | 198 |
| Deferred revenues | 61,375 | (3,267) | 5,737 |
| Deferred expenses | 1,380 | 577 | 597 |
| Loan forgiveness on notes receivable | 134 | 69 | — |
| Non-cash compensation expense | 1,689 | 1,183 | 4,024 |
| Change in operating assets and liabilities: | | | |
| Accounts receivable and other current assets | (15,207) | 8,149 | (3,798) |
| Other non-current assets | 81 | (1,913) | (322) |
| Accounts payable and accrued liabilities | 32,186 | 6,770 | 5,967 |
| Net cash provided by (used in) operating activities | 37,128 | (79,865) | (21,856) |
| CASH FLOW FROM INVESTING ACTIVITIES | | | |
| Purchases of short-term investments | (448,294) | (401,589) | (175,886) |
| Sales/maturities of short-term investments | 300,490 | 360,868 | 163,054 |
| Deposits and restricted cash | (25,039) | 500 | — |
| Proceeds from sale of property and building, net | 36,636 | — | — |
| Purchases of property and equipment, net | (50,439) | (5,300) | (3,805) |
| Net cash used in investing activities | (186,646) | (45,521) | (16,637) |
| CASH FLOW FROM FINANCING ACTIVITIES | | | |
| Issuance of common stock | 196,613 | 3,459 | 179,486 |
| Proceeds received from debt | 31,524 | 4,561 | 3,483 |
| Principal payments on debt | (17,078) | (2,313) | (1,666) |
| Payments received on notes receivable from stockholders | — | 104 | — |
| Net cash provided by financing activities | 211,059 | 5,811 | 181,303 |
| Net increase (decrease) in cash and cash equivalents | 61,541 | (119,575) | 142,810 |
| Cash and cash equivalents at beginning of the year | 44,313 | 163,888 | 21,078 |
| Cash and cash equivalents at end of the year | $ 105,854 | $ 44,313 | $ 163,888 |
| SUPPLEMENTAL DISCLOSURES | | | |
| Supplemental disclosures of cash flow information: | | | |
| Interest paid | $ 566 | $ 410 | $ 312 |
| Taxes paid | $ 158 | $ — | $ 120 |

See accompanying notes.

**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. 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.

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 accordingly the Company now consolidates Science Park in the Company's financial statements. The net effect of the transaction on the Company's consolidated financial statements was to increase property and equipment and long-term debt on the Company's consolidated balance sheet by approximately $14.0 million each at June 30, 2003. In August 2003, the Company repaid the outstanding long-term debt of approximately $14.0 million through a cash payment.

The Company also recently formed Neurocrine International LLC, a Delaware limited liability company in which the Company holds a 99% ownership interest and Science Park holds a 1% interest.

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

***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, 2003, 2002 and 2001, the Company's collaborative research and development agreements accounted for 99%, 88% and 97%, respectively, of total revenue.

***Property and Equipment.*** Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets (generally three to seven years) using the straight-line method. Amortization of leasehold improvements is computed over the shorter of the lease term or the estimated useful life of the related assets.

***Other Non-Current Assets.*** Includes notes receivable from employees of $1.0 million and $1.1 million as of December 31, 2003 and 2002, respectively.

**Licensed Technology and Patent Application Costs.** Licensed technology consists of worldwide licenses to patents related to the Company's platform technology, which are capitalized at cost and amortized over periods of 7

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to 11 years. These costs are regularly reviewed to determine that they include costs for patent applications the Company is pursuing. Costs related to applications that are not being actively pursued are generally written-off. All costs were fully amortized as of December 31, 2002.

***Impairment of Long-Lived Assets.*** In accordance with SFAS No. 144 "Accounting for the Impairment or Disposal of Ling-Lived Assets" if indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the amount of such impairment by comparing the carrying value of the asset to the 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, 2003.

***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.

***Industry Segment and Geographic Information.*** The Company operates in a single industry segment – the discovery and development of therapeutics for the treatment of neurologic and endocrine diseases and disorders. The Company had no foreign operations for the years ended December 31, 2003, 2002 and 2001.

***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 require substantive effort, and achievement of the milestones 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.

Up-front payments have been received for program cost reimbursements incurred during a negotiation period. 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.

***Research and Development Expenses***. Research and development (R&D) expenses include related salaries, contractor fees, facilities costs, administrative expenses and allocations of corporate costs. All such costs are charged to R&D expense as incurred. These expenses result from our independent R&D efforts as well as efforts associated with collaborations, grants and in-licensing arrangements. In addition, we fund R&D at other companies and research institutions under agreements, which are generally cancelable. We review and accrue clinical trials expenses based on work performed, which relies on estimates of total 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," as amended by SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure," 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.

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Net loss as reported | $(30,256) | $ (94,536) | $(36,910) |
| Loss per share (basic and diluted) | (0.93) | (3.10) | (1.42) |
| Pro forma net loss | $(53,323) | $(109,358) | $(44,188) |
| Pro forma loss per share (basic and diluted) | (1.65) | (3.59) | (1.70) |

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 2003, 2002 and 2001, respectively: risk-free interest rates of 3.3%, 2.8% and 4.4%; a dividend yield of 0.0% (for all years); volatility factors of the expected market price of the Company's common stock of .40, .78 and .80; and a weighted average expected life of the option of 5 years (for all years presented). The pro forma effect on net losses for 2003, 2002 and 2001 is not likely to be representative of the effects on reported income or loss in future years because these amounts reflect less than full vesting for options granted during these periods.

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 measured as the underlying options vest. For the years ended December 31, 2003, 2002 and 2001 deferred compensation expense relating to non-employee stock options was $384,000, $610,000, and $1.1 million, respectively

***Earnings (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 2.0 million, 2.1 million and 2.0 million for the years ended December 31, 2003, 2002 and 2001, respectively, and were excluded from the diluted earnings per share because of their anti-dilutive effect.

***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 consisted of gains and losses on short-term investments and is reported in the statements of stockholders' equity.

***Impact of Recently Issued Accounting Standards.*** In May 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." This statement clarifies the definition of a liability, as currently defined under FASB Concepts Statement No. 6 "Elements of Financial Statements", as well as other items. The statement requires that financial instruments that embody an obligation of an issuer be classified as a liability. Furthermore, the standard provides guidance for the initial and subsequent measurement as well as disclosure requirements of these financial

instruments. This statement is effective for financial instruments entered into after May 31, 2003. The adoption of this statement has not had a material impact on the results of operations or financial condition of the Company.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51." FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. In December 2003, the FASB issued FIN 46R, a revision to FIN 46. FIN 46R provides a broad deferral of the latest date by which all public entities must apply FIN 46 to certain variable interest entities to the first reporting period ending after March 15, 2004. We do not expect the adoption of FIN 46 or FIN 46R to have a material impact upon our financial position, cash flows or results of operations.

**NOTE 2. SHORT-TERM INVESTMENTS**

Cash, cash equivalents, and short-term investments totaled $453.2 million and $244.7 million as of December 31, 2003 and 2002, 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, 2003** | | | | |
| U.S. Government securities | $ 82,264 | $ 71 | $(138) | $ 82,197 |
| Corporate debt securities | 129,620 | 1,898 | (205) | 131,313 |
| Short-term municipals | 83,900 | — | — | 83,900 |
| Other debt securities | 46,848 | 55 | (101) | 46,802 |
| Total debt securities | 342,632 | 2,024 | (444) | 344,212 |
| Other investments | 3,018 | 84 | — | 3,102 |
| Total investments | $345,650 | $2,108 | $(444) | $347,314 |
| **December 31, 2002** | | | | |
| U.S. Government securities | $ 82,688 | $ 141 | $ (33) | $ 82,796 |
| Corporate debt securities | 103,861 | 2,293 | (23) | 106,131 |
| Other debt securities | 10,335 | 39 | (1) | 10,373 |
| Total debt securities | 196,884 | 2,473 | (57) | 199,300 |
| Other investments | — | 1,097 | — | 1,097 |
| Total investments | $196,884 | $3,570 | $ (57) | $200,397 |

All gross unrealized losses as of December 31, 2003 have been in an unrealized loss position for less than twelve months. Other investments at December 31, 2003 primarily consists of mutual fund investments.

The amortized cost and estimated fair value of debt securities by contractual maturity at December 31, 2003 are shown below (in thousands):

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Due in 12 months or less | $146,104 | $146,259 |
| Due between 12 months and 36 months | 196,528 | 197,953 |
| | $342,632 | $344,212 |

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

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2003 | 2002 | 2001 |
| Proceeds from sales | $300,490 | $360,868 | $163,054 |
| Gross realized gains on sales | $ 725 | $ 869 | $ 583 |
| Gross realized losses on sales | $ (121) | $ (25) | $ (870) |

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## NOTE 3. PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2003 and 2002 consist of the following (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Land | $ 17,387 | $ 4,290 |
| Furniture and fixtures | 1,860 | 1,761 |
| Equipment | 24,199 | 17,249 |
| Leasehold improvements | 1,386 | 1,386 |
| Construction in progress | 25,640 | 160 |
| | 70,472 | 24,846 |
| Less accumulated depreciation | (14,236) | (10,744) |
| Property and equipment, net | $ 56,236 | $ 14,102 |

For the years ended December 31, 2003, 2002 and 2001, depreciation expense was $3.7 million, $3.1 million and $2.7 million, respectively.

The Company currently has approximately 110,000 square feet of space in San Diego, California, of which approximately 65% is laboratory space dedicated to research and development. Our former headquarters was sold in the fourth quarter of 2003 for $40 million. The former headquarters is being leased-back until the construction of the new headquarters is complete, which is expected in mid-2004. 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 in 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 a new corporate facility. The Company has also placed a deposit of $3.5 million, which amount is included in restricted cash and other non-current assets on the Company’s consolidated balance sheet, and a $4.4 million irrevocable standby letter of credit for an adjacent parcel of land, which was purchased in January 2004. At December 31, 2003, the letter of credit was secured by a $4.4 million cash deposit with the issuer, which amount is included in restricted cash and other non-current assets.

The Company has structured the sale of the existing campus and the acquisition and construction of the new campus to qualify as “like-kind” exchanges within the meaning of Internal Revenue Code Section 1031.

Additional costs the Company expects to incur in connection with these two properties include design and construction costs as well as the purchase and installation of equipment and furnishings for these facilities. The Company estimates these costs at $45 million and expects to finance these costs through the net proceeds of the sale of the existing facility, a construction loan and a subsequent permanent financing. Construction of the new facility commenced in June 2003 and is expected to be completed in July 2004. Capitalized construction costs totaled $25.6 million at December 31, 2003.

The Company has secured a construction loan from a commercial bank for up to $60.6 million to finance the construction of the new facility. The loan requires a guaranty deposit of $17.5 million, which amount is included in restricted cash and other non-current assets, to be maintained at the bank for the duration of the loan. The loan bears interest at the prime rate plus .75 percentage points, and interest is payable monthly. In accordance with SFAS No. 34, applicable interest cost will be capitalized during the construction period. As of December 31, 2003, the Company has recorded $659,000 of capitalized interest.

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## NOTE 4. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2003 and 2002 consist of the following (in thousands):

| | 2003 | 2002 |
|---|---|---|
| Accrued employee benefits | $ 4,727 | $ 2,406 |
| Accrued development costs | 43,901 | 18,499 |
| Accrued construction in progress | 4,580 | — |
| Other accrued liabilities | 1,883 | 1,258 |
| | $55,091 | $22,163 |

## NOTE 5. COMMITMENTS AND CONTINGENCIES

***Debt.*** The Company has entered into equipment financing arrangements with lenders to finance equipment purchases, which expire on various dates through the year 2007 and bear interest at rates between 6.0% and 9.6%. The debt obligations are repayable in monthly installments. Additionally, the Company has secured a construction loan from a commercial bank for up to $60.6 million to finance the construction of the new facility, as mentioned above.

***Operating Leases.*** Rent expense was $2.6 million, $1.6 million and $1.7 million for the years ended December 31, 2003, 2002 and 2001, respectively. Sublease income was $77,000, $190,000 and $698,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

***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. Due to the uncertainty of the pharmaceutical development process, the Company continually reassesses the value of the license agreements and cancels them as 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 $73.2 million over the lives of these agreements, in addition to sales royalties ranging from 1% – 7%. 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 2003, the Company paid approximately $800,000 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 conduct of pre-clinical development research, manufacture of clinical compounds, enrollment of patients, recruiting of patients, monitoring of studies, data analysis and regulatory filing assistance. Payments under these agreements typically include fees for services and reimbursement of expenses. Some agreements may also 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.

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Repayment schedules for commitments and contractual obligations at December 31, 2003 are as follows (in thousands):

| Fiscal Year: | Debt | Operating Leases | Licenses & Research Agreements | Development Agreements |
|---|---|---|---|---|
| 2004 | $ 3,960 | $2,578 | $765 | $26,587 |
| 2005 | 29,347 | — | — | 9,978 |
| 2006 | 2,217 | — | — | 2,848 |
| 2007 | 909 | — | — | 146 |
| 2008 | — | — | — | 136 |
| Thereafter | — | — | — | — |
| Total minimum payments | $36,433 | $2,578 | $765 | $39,695 |

## NOTE 6. STOCKHOLDERS' EQUITY

***Common Stock Issuances.*** From inception through 2003, the Company has issued common stock in various private and public offerings, as well as to corporate collaborators, at prices between $5.00 and $53.00 per share resulting in aggregate net proceeds of approximately $571.5 million. This total includes a September 2003 public offering, in which the Company sold 3.75 million shares of its common stock at $53.00 per share. The net proceeds generated from this transaction were $187.4 million.

***Options.*** The Company has authorized 10.3 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, and 2003 Stock Option Plan (collectively, the Option Plans). The Option Plans provide for the grant of stock options and stock purchase rights 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. 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, 5.2 million are outstanding grants and 218,000 remain available for future grant.

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):

| | 2003 | | 2002 | | 2001 | |
|---|---|---|---|---|---|---|
| | 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 | 4,875 | $24.23 | 3,883 | $18.59 | 3,911 | $12.75 |
| Granted | 1,298 | 47.97 | 1,375 | 37.54 | 980 | 31.17 |
| Exercised | (837) | 9.13 | (268) | 8.90 | (850) | 6.14 |
| Canceled | (116) | 37.90 | (115) | 28.70 | (158) | 19.09 |
| Outstanding at December 31 | 5,220 | $32.25 | 4,875 | $24.23 | 3,883 | $18.59 |

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A summary of options outstanding as of December 31, 2003 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 12/31/03 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Exercisable As of 12/31/03 | Weighted Average Exercise Price |
| $ 0.02 to $11.53 | 945 | 4.4 | $ 6.25 | 930 | $ 6.25 |
| $11.54 to $34.58 | 1,301 | 6.9 | 27.62 | 927 | 27.67 |
| $34.59 to $40.35 | 1,470 | 7.8 | 36.75 | 698 | 36.84 |
| $40.36 to $57.64 | 1,504 | 9.2 | 48.20 | 209 | 46.25 |
| $ 0.02 to $57.64 | 5,220 | 7.3 | $32.25 | 2,764 | $24.18 |

The weighted average fair values (computed using Black-Scholes) of the options granted during 2003, 2002 and 2001 were $25.16, $24.51 and $20.54, respectively.

***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 permits 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. As of December 31, 2003, 475,000 shares have been issued pursuant to the Purchase Plan.

***Warrants.*** The Company has outstanding warrants to purchase 376,021 shares of common stock at the following exercise prices. At December 31, 2003, all outstanding warrants were exercisable. In 2003, the Company issued 10,000 warrants with for services related to business development. The warrants were valued using Black-Scholes and had a fair value of $19.26 each.

| Exercise Prices | Warrants Outstanding at December 31, 2003 | Expiration |
|---|---|---|
| $10.50 | 301,234 | 03/2006 |
| $41.23 | 60,000 | 11/2006 |
| $43.65 | 10,000 | 04/2005 |
| $52.05 | 4,787 | 12/2012 |
| | 376,021 | |

The following shares of common stock are reserved for future issuance at December 31, 2003 (in thousands):

| | |
|---|---|
| Stock option plans | 5,438 |
| Employee stock purchase plan | 150 |
| Warrants | 376 |
| Total | 5,964 |

## 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 will collaborate in the completion of the indiplon Phase III clinical program. During 2003, the Company was responsible for $22.5 million in external development costs , and all other external collaboration costs were borne by Pfizer. During 2004, the Company will be responsible for $7.5 million in development costs, and all other external collaboration costs will be borne by Pfizer. Following the filing of a New Drug Application (NDA) with the Food and Drug Administration regarding indiplon, Pfizer will support the creation 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, our sales force will also co-promote indiplon to psychiatrists and sleep specialists in the United States. During the first quarter of 2003, the Company received an upfront payment of $100 million and will also be eligible to receive up to $300 million in

additional pre-commercialization milestone payments 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 Neurocrine. 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 Neurocrine. The Company has 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 on net sales to DOV under the license agreement. For the year ended December 31, 2003, the Company recognized revenue of $128.9 million, which is primarily from the reimbursement of clinical development expenses under the Pfizer agreement. At December 31, 2003, the Company had $62.0 million of deferred upfront fees that will be amortized over the time period until commercialization of the Company's indiplon product.

***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 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 the year ended December 31, 2003, the Company recognized $7.8 million in revenue under the GSK agreement. At December 31, 2003, the Company had $833,000 of deferred license fees that will be amortized over the remaining life of the agreement. In addition, at December 31, 2003, the Company had $3.1 million of deferred sponsored research that will be amortized over the remaining sponsored research period.

***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 our diabetes drug candidate. For the years ended December 31, 2003, 2002 and 2001, the Company recognized $1.1 million, $6.8 million and $16.6 million, respectively, in revenue under the Taisho agreement.

***Wyeth***. Effective January 1999, the Company entered into a collaboration and license agreement with Wyeth relating to the research, development and commercialization of compounds that control excitatory amino acid transporters for the treatment of neurodegenerative and psychiatric diseases. The Company has granted Wyeth exclusive and non-exclusive rights to the Company's excitatory amino acid transporters technology as well as exclusive rights to any products developed during the collaboration. These licenses are for the term of the patents licensed. The Company will receive royalties on product sales for the terms of the patents covering the collaboration products, subject to adjustments for royalties payable to other parties and for competition. The Company will also receive royalties for products that are not the subject of issued patents. The Company also has the option to co-promote collaboration products in Canada and the United States under some conditions. Wyeth may terminate the agreement if it decides that the research is not successful, if it decides to stop the program or if Neurocrine is acquired by another company. The agreement may also be terminated by either party for the other party's failure to meet its obligations under the agreement or bankruptcy. The three-year sponsored research portion of the Wyeth agreement was completed on schedule in December 2001 and was subsequently extended on a smaller scale through December 2002.

For the years ended December 31, 2003, 2002 and 2001, the Company recognized $8,000, $1.5 million and $3.4 million, respectively, in revenues under the Wyeth agreement.

**NEUROCRINE BIOSCIENCES, INC.**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2003**

***Janssen Pharmaceutica, N.V.*** In January 1995, the Company entered into the first of two research and development agreements with Janssen Pharmaceutica, N.V. (Janssen) to collaborate in the discovery, development and commercialization of small molecule CRF R1 antagonists for the treatment of anxiety, depression and substance abuse. Under the January 1995 agreement, Janssen funded three years of research at Neurocrine and received exclusive licenses to all CRF R1 antagonist compounds developed during the term of the funded research or during the year thereafter. The terms of the licenses are for the term of the patents licensed under the agreement. The collaborative research portion of the first Janssen agreement was completed as scheduled in 1997. In September 1999, together with Janssen, the Company entered into an amended agreement to expand the collaborative research and development efforts to identify additional small molecule CRF antagonists for the treatment of psychiatric disorders. In connection with the amended Janssen agreement, the Company received an initial payment and two years of additional research funding for our scientists working in collaboration with Janssen. This additional research was completed in February 2001.

In March 2002, Janssen notified the Company that it had discontinued development of the backup compound and elected to terminate both the 1995 and 1999 agreements. As a result, exclusive rights to all of the first generation CRF R1 antagonist compounds developed thereunder reverted to Neurocrine. We do not expect additional payments of any kind under the Janssen agreement. For the year ended December 31, 2001, the Company recognized $525,000 in revenues under terms of the Janssen agreements.

## NOTE 8. INCOME TAXES

At December 31, 2003, the Company had Federal and California income tax net operating loss carry-forwards of approximately $166.3 million and $47.4 million, respectively. The Federal and California tax loss carry-forwards will begin to expire in 2010 and 2005, respectively, unless previously utilized. In addition, the Company has Federal and California research and development tax credit carry-forwards of $16.9 million and $9.5 million, respectively. The Federal research and development credit carryforwards will begin to expire in 2007 unless previously utilized. The California research and development credit carryforwards will begin to expire in 2007 unless previously utilized. The Company also has Federal Alternative Minimum Tax credit carry-forwards of approximately $341,000, which will carry-forward indefinitely.

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.

Significant components of the Company's deferred tax assets as of December 31, 2003 and 2002 relate primarily to its net operating loss and tax credit carryforwards. A valuation allowance of $112.7 million and $91.1 million at December 31, 2003 and 2002, 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:

| | 2003 | 2002 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss carry-forwards | $ 60,953 | $ 65,400 |
| Tax credit carry-forwards | 23,487 | 18,688 |
| Capitalized research and development | 7,314 | 4,014 |
| Deferred revenue | 27,669 | — |
| Other, net | (6,717) | 3,036 |
| Total deferred tax assets | 112,706 | 91,138 |
| Valuation allowance | (112,706) | (91,138) |
| Net deferred tax assets | $ — | $ — |

**NEUROCRINE BIOSCIENCES, INC.**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
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The provision for income taxes on earnings subject to income taxes differs from the statutory Federal rate at December 31, 2003, 2002 and 2001, due to the following:

| | 2003 | 2002 | 2001 |
|---|---|---|---|
| Federal income taxes at 34% | $(10,537) | $(32,142) | $(12,582) |
| State income tax, net of Federal benefit | (1,730) | (5,295) | (1,736) |
| Tax effect on non-deductible expenses | (5,470) | (7,981) | (4,202) |
| Increase in valuation allowance | 17,895 | 45,418 | 18,520 |
| | $ 158 | $ — | $ — |

The provision for income taxes for the year ended December 31, 2003 consists 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. On January 1, 2001, the Company began matching 50% of employee contributions up to 6% of eligible compensation, with cliff vesting over four years. Employer contributions were $576,000, $432,000 and $359,000 for the years ended December 31, 2003, 2002, and 2001, respectively.

**NOTE 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

The following is a summary of the quarterly results of operations for the years ended December 31, 2003 and 2002 (unaudited, in thousands, except for earnings (loss) per share data):

| | Quarters Ended | | | | |
|---|---|---|---|---|---|
| | Mar 31 | Jun 30 | Sep 30 | Dec 31 | Year End Dec 31 |
| Fiscal Year End 2003 | | | | | |
| Revenues | $ 37,716 | $ 44,968 | $29,259 | $27,135 | $139,078 |
| Operating expenses | 53,068 | 57,458 | 42,833 | 44,506 | 197,865 |
| Net (loss) income | (13,390) | (10,225) | (9,834) | 3,193 | (30,256) |
| Net (loss) income per share: | | | | | |
| Basic and diluted | $ (0.43) | $ (0.33) | $ (0.31) | $ 0.09 | $ (0.93) |
| Shares used in the calculation of net (loss) income per share: | | | | | |
| Basic | 30,789 | 31,334 | 32,053 | 35,273 | 32,374 |
| Diluted | 30,789 | 31,334 | 32,053 | 37,459 | 32,374 |

| | Quarters Ended | | | | |
|---|---|---|---|---|---|
| | Mar 31 | Jun 30 | Sep 30 | Dec 31 | Year End Dec 31 |
| Fiscal Year End 2002 | | | | | |
| Revenues | $ 4,957 | $ 4,227 | $ 4,983 | $ 3,878 | $ 18,045 |
| Operating expenses | 22,778 | 26,247 | 27,484 | 45,151 | 121,660 |
| Net loss | (15,764) | (19,751) | (20,234) | (38,787) | (94,536) |
| Net loss per share: | | | | | |
| Basic and diluted | $ (0.52) | $ (0.65) | $ (0.66) | $ (1.27) | $ (3.10) |
| Shares used in the calculation of net loss per share: | | | | | |
| Basic and diluted | 30,384 | 30,433 | 30,522 | 30,611 | 30,488 |

**NEUROCRINE BIOSCIENCES, INC.**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**
**December 31, 2003**

## NOTE 11. SUBSEQUENT EVENT

On February 26, 2004, the Company entered into several agreements with Wyeth and DOV pursuant to which the Company will acquire Wyeth's financial interest in indiplon for approximately $95 million, consisting of $50 million payable in cash and $45 million payable in the Company's common stock based on a 15 day average stock price prior to the date of the agreement. Wyeth's financial interest in indiplon arises from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the indiplon technology to DOV in exchange for milestone payments and royalties on future sales of indiplon. The Company subsequently licensed the indiplon technology from DOV in exchange for milestones (a portion of which is payable by DOV to Wyeth) and royalties (a portion of which is payable by DOV to Wyeth). The agreements among the Company, Wyeth and DOV provide that the Company will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that the Company will retain all milestone, royalty and other payments on indiplon commercialization that would have otherwise been payable to Wyeth. This decreases the Company's overall royalty obligation on sales of indiplon from six percent to three and one-half percent. This transaction will be recorded as a long-term asset, and the asset will be amortized over the commercialization period of indiplon, based upon indiplon sales. The closing of this transaction is conditioned upon the approval of the Wyeth Board of Directors and termination of waiting periods under the Hart Scott Rodino Act. Both of these conditions have been met and the transaction is scheduled to close on March 15, 2004.

EXHIBIT 10.59

# TAX INDEMNITY AGREEMENT

This TAX INDEMNITY AGREEMENT, dated as of February 9, 2004 (this "Agreement"), is entered into by and between Gary Lyons ("Indemnitor") and Neurocrine Biosciences, Inc., a Delaware corporation ("Neurocrine").

## RECITALS

WHEREAS, Indemnitor previously transferred options to purchase shares of Neurocrine common stock granted under the Neurocrine Biosciences 1992 Incentive Stock Plan (the "Options") to GEL, LLC, and in reliance on professional advice received at the time of such exercise, Neurocrine has not withheld any sums, or paid any amounts, for any federal, state, or local taxing authorities (hereinafter collectively "Taxing Authorities") in connection with such transfers or upon exercise of such Options by GEL, LLC;

WHEREAS, Indemnitor and Neurocrine agree that it was implicit that Indemnitor would bear responsibility for any adverse tax consequences suffered by Neurocrine in connection with the transfer of the Options or the exercise of the Options by GEL, LLC, and Indemnitor and Neurocrine are entering into this Agreement to formalize Indemnitor's implicit promise to indemnify Neurocrine if Neurocrine becomes obligated to pay taxes (other than Neurocrine's share of employment taxes to the extent not greater than the amount Neurocrine would have paid at the time had it treated the issuance and/or exercise of the Options as taxable compensation), interest and/or penalties (including penalties on Neurocrine's share of employment taxes) as a result of its not withholding sums for, or paying any amounts to, any Taxing Authorities in connection with such transfers and option exercises;

WHEREAS, Neurocrine is agreeing not to take certain actions with respect to employment taxes that it may otherwise have taken.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants, promises and representations set forth in this Agreement, and for other good and valuable consideration, the parties agree as follows:

1. Indemnitor Responsible for Taxes and Related Amounts. Indemnitor and Neurocrine agree that Indemnitor is responsible for the payment of (a) all income taxes, (b) the employee's share of Social Security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), (c) any penalties assessed against Neurocrine by reason of nonpayment of unemployment taxes under the Federal Unemployment Tax Act ("FUTA"), and (d) the employee's share of all employment taxes and withholdings under applicable state laws (including state disability insurance) that have been incurred or may ever be incurred in each of (a) through (c) above in so far as such amount are payable respect to the transfer or the exercise

of the Options, as well as for certain interest, penalties, and other amounts as defined in Section 2, below that are related to such taxes.

2. Indemnity. Indemnitor agrees to indemnify and reimburse Neurocrine and hold it harmless from (a) taxes, interest and penalties, that Neurocrine may be required to pay, or in fact pays in accordance with Section 4 below, any Taxing Authority because Neurocrine has not withheld and paid to the Taxing Authorities personal income taxes of the Indemnitor or Indemnitor's share of FICA taxes or (b) interest and penalties that Neurocrine or its subsidiaries may be required to pay by reason of Neurocrine's nonpayment of FUTA taxes with respect to the transfer of the Options by Indemnitor to GEL, LLC, and/or the exercise of the Options by GEL, LLC, or any other transferee; and (c) any interest, penalties, other additions to tax, or other charges that Neurocrine, or its subsidiaries may be required to pay, or in fact pays in accordance with Section 4 below, to any Taxing Authorities because Neurocrine has not paid to the Taxing Authorities the employer's share of FICA taxes or unemployment taxes under the Federal Unemployment Tax Act (other than the FUTA tax otherwise payable by Neurocrine) with respect to the transfer of the Options by Indemnitor to GEL, LLC, and/or the exercise of the Options by GEL, LLC, or any other transferee. Subject to Section 4 below, Indemnitor shall immediately pay to Neurocrine, upon its request, any amounts Indemnitor is required to pay Neurocrine pursuant to this Section 2. Indemnitor's obligation to indemnify shall exist regardless of whether Neurocrine is required to pay the aforementioned taxes, penalties or interest because a Taxing Authority contends that Neurocrine was legally required to withhold or pay such amounts or whether Neurocrine is required to pay such taxes, interest or penalties because of Indemnitor's non-payment or underpayment of such taxes, interest or penalties.

3. Indemnitor to Provide Notice of Tax Directive. If any Taxing Authority notifies Indemnitor that it has reached a conclusion regarding the appropriate tax treatment of the transfer of Options to GEL, LLC, or exercise of Options by GEL, LLC, and indicates as part of such notice that Neurocrine was required to withhold any sums for, or pay any amounts to, such Taxing Authority in connection with any such transfer or exercise, Indemnitor shall promptly advise Neurocrine of such notice and provide to Neurocrine copies of any written correspondence relating to Neurocrine's obligations.

4. Neurocrine's Obligations.

(a) Neurocrine agrees that, prior to a determination by any court of competent jurisdiction that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties described in Sections 1 and 2 above, it will not (except as otherwise contemplated by this Agreement) withhold any sums for, or pay any amounts to, any Taxing Authority or otherwise demand payment from Indemnitor for any amounts payable by such Indemnitor pursuant to Section 2 above unless Indemnitor requests that Neurocrine withhold or pay such amounts, or consents to Neurocrine's taking such action; provided, however, that Neurocrine may withhold and/or pay any such amounts to any Taxing Authority that claims such payments are owed unless Indemnitor pays Neurocrine's out-of-pocket costs and expenses, including reasonable attorneys' fees, incurred in connection with contesting any such claim, to the extent provided in Section 4(b) below. In this regard, Indemnitor shall not be responsible for

reimbursing any out-of-pocket costs or expenses of Neurocrine if Neurocrine determines, pursuant to the fifth sentence of this Section 4, to make a payment to a Taxing Authority rather than oppose such claim. (If Neurocrine initially opposes such a claim by a Taxing Authority but then decides to make a payment, Indemnitor shall be responsible for Neurocrine's out-of-pocket costs and expenses incurred in connection with the opposition, but not after a determination has been made to make the payment.) Indemnitor agrees to pay any amounts that are subject to this Agreement immediately upon the earlier of (i) a determination by any court that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties subject to Section 2, (ii) Indemnitor's requesting that Neurocrine withhold or pay such amounts or Indemnitor's consenting to Neurocrine's taking such action, and (iii) as requested by Neurocrine pursuant to the following sentence. Notwithstanding anything herein to the contrary, the parties understand and agree that (a) at no time will Neurocrine be required to advance any sums to, or extend any credit on behalf of, Indemnitor, and (b) to the extent that (1) an actual demand for payment has been made to Neurocrine by a Taxing Authority, (2) a decision to withhold or otherwise make payment to such Taxing Authority on behalf of Neurocrine has been made by the Board of Directors of Neurocrine based on its determination of the best interests of the stockholders of Neurocrine; and (3) prior to making such a decision, there has been notice to the Indemnitor and an opportunity for Indemnitor and his or her counsel to make a presentation to the Board regarding such matters, Neurocrine shall have the right to immediately demand payment from the Indemnitor, and the Indemnitor shall have the obligation to immediately pay the amount so demanded (and upon receipt by Neurocrine that portion of such amounts representing taxes, interest and penalties shall be remitted to such Taxing Authority), and further, Neurocrine also shall have the right, but not the obligation, to pay any amounts demanded by any Taxing Authority directly and to obtain immediate reimbursement from the Indemnitor, plus interest.

(b) This Agreement is one of several Tax Indemnity Agreements in similar form entered into between Neurocrine and employees of Neurocrine arising from similar transactions. Indemnitor shall be responsible for only his or her pro rata share of the out-of-pocket costs and expenses reimburseable under Section 4(a), which initially is deemed to be 48.32%. Such percentage limitation shall not apply to amounts payable by Neurocrine to Taxing Authorities and otherwise due by Indemnitor under this Agreement. In the event one or more of the other individuals who signed Tax Indemnity Agreements in similar form is no longer contesting claims made by Taxing Authorities, but Neurocrine continues to contest claims made by Taxing Authorities at the request of Indemnitor, Indemnitor's share of Neurocrine's out-of-pocket costs and expenses shall be increased to his or her then-current pro rata share as among all such individuals who continue to contest such claims.

5. Security for Indemnitor's Obligations. In the event Indemnitor's employment with Neurocrine shall terminate, at Neurocrine's request, Indemnitor and Neurocrine will enter into a mutually acceptable arrangement for security of Indemnitor's obligations hereunder in an amount sufficient to cover Indemnitor's reasonable potential liability under this Agreement.

6. Miscellaneous.

(a) Modification and Amendment. This Agreement may not be altered, amended, modified, or otherwise changed in any way except by a written instrument signed by each party.

(b) Headings. The headings and titles of the provisions of this Agreement are inserted for convenience only and shall not affect the construction or interpretation of any provision.

(c) Cumulative Remedies. The right of any party to be indemnified pursuant to this Agreement shall be cumulative and in addition to every other right, power or remedy available to such party, whether available at law, in equity or otherwise. Indemnitor's obligations hereunder may not be reduced by set-off.

(d) Governing Law; Arbitration; Waiver of Jury Trial.

(i) This Agreement shall be governed and construed in accordance with the laws of the State of California, without regard to the laws that might be applicable under conflicts of laws principles.

(ii) All disputes, controversies or claims between Indemnitor and Neurocrine arising, directly or indirectly, out of or relating to this Agreement shall be resolved by final, binding arbitration conducted by a single arbitrator in accordance with the Rules of the American Arbitration Association as then in effect, except as provided herein. Unless the parties otherwise agree, any arbitration shall be held in San Diego County, California. The parties shall be entitled to discovery sufficient to adequately arbitrate the claims and defenses, including access to essential documents and witnesses, as determined by the arbitrator. Costs and fees of the arbitrator shall be borne by the non-prevailing party. The award of the arbitrator, which may include equitable relief, shall be final and not subject to appeal, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction thereof. Any demand for arbitration shall be in writing and must be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date that institution of legal or equitable proceedings based upon such claim dispute or other matter would be barred by the applicable statue of limitations. In no event shall this clause (ii) of Section 6(d) be deemed to preclude a party hereto from instituting legal action seeking relief in the nature of a restraining order, an injunction or the like in order to protect his, her or its rights pending the outcome of an arbitration hereunder and, if any party hereto shall resort to legal action for such types of relief pending the outcome of any such arbitration proceeding or prior to the initiation thereof, such party shall not be deemed to have waived its rights to cause such matter or any other matter to be referred to arbitration pursuant to this Section 6(d).

(iii) EACH PARTY IRREVOCABLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY DISPUTE, CLAIM OR CAUSE OF ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT. THE SCOPE OF THIS WAIVER IS INTENDED TO INCLUDE ANY AND ALL DISPUTES, CLAIMS OR CAUSES OF ACTION, INCLUDING WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS. EACH SUCH PARTY FURTHER WARRANTS AND REPRESENTS THAT IT HAS HAD THE OPPORTUNITY TO HAVE LEGAL COUNSEL REVIEW THIS WAIVER.

(e) Severability. If any provision of this Agreement is found or held to be invalid or unenforceable by any tribunal of competent jurisdiction, then the meaning of such provision will be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it will be severed from the remainder of this Agreement. The remainder of this Agreement will remain in full force and effect.

(f) Counterparts. To facilitate execution, this Agreement may be executed in as many counterparts as may be required. It shall not be necessary that the signatures on behalf of all parties appear on each counterpart of this Agreement. All counterparts of this Agreement shall collectively constitute a single agreement. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

(g) Assignment. The Indemnitor may not assign this Agreement without the prior written consent of the other parties, and any such prohibited assignment shall be void. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the respective legal representatives, successors, assigns, heirs, and devisees of the parties.

(h) Legal Fees. If any party to this Agreement brings an action in arbitration or a court of competent jurisdiction to enforce its rights under this Agreement, the prevailing party shall be entitled to recover its costs and expenses, including without limitation reasonable attorneys' fees, incurred in connection with such action.

(i) Time is of the Essence. Time is of the essence with respect to every provision of this Agreement.

(j) Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by all parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The use of the word "including" shall not be deemed to be limited and shall be read as "including but not limited to." The fundamental premise of this Agreement is that in all events Neurocrine shall incur no obligation or expense in connection with the items identified in Section 2, above, and further that this Agreement shall be interpreted consistently with that intent.

(k) Entire Agreement; No Inconsistent Agreements. This Agreement, together with any exhibits hereto, contains the entire agreement between the parties and supersedes any prior written or oral agreement between said parties concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, oral or written, between or among the parties relating to the subject matter contained in this Agreement, which are not fully expressed herein. The parties also agree that Indemnitor's obligations and responsibilities under this Agreement shall not be limited or subject to indemnity or insurance by Neurocrine through any other agreement or policy relating to the Indemnitor, including any general indemnity agreements or any insurance policy Neurocrine may have.

(l) Further Assurances. Each party hereby agrees to promptly sign any additional instruments or documents which are necessary or appropriate to carry out the purpose of this Agreement.

{Signature Page Follows}

The parties have entered into this Agreement as of the date first set forth above.

NEUROCRINE BIOSCIENCES, INC.

By: /s/ Margaret Valeur-Jensen
---
Name:
Its:

Address:
10555 Science Center Drive
San Diego, California 92121
Telephone: (858) 658-7600
Fax:

/s/ Gary Lyons
---
GARY LYONS

Address:

Telephone:
Fax:

EXHIBIT 10.60

# TAX INDEMNITY AGREEMENT

This TAX INDEMNITY AGREEMENT, dated as of February 10, 2004 (this "Agreement"), is entered into by and between Paul W. Hawran ("Indemnitor") and Neurocrine Biosciences, Inc., a Delaware corporation ("Neurocrine").

## RECITALS

WHEREAS, Indemnitor previously transferred options to purchase shares of Neurocrine common stock granted under the Neurocrine Biosciences 1992 Incentive Stock Plan (the "Options") to PNH, LLC, and in reliance on professional advice received at the time of such exercise, Neurocrine has not withheld any sums, or paid any amounts, for any federal, state, or local taxing authorities (hereinafter collectively "Taxing Authorities") in connection with such transfers or upon exercise of such Options by PNH, LLC;

WHEREAS, Indemnitor and Neurocrine agree that it was implicit that Indemnitor would bear responsibility for any adverse tax consequences suffered by Neurocrine in connection with the transfer of the Options or the exercise of the Options by PNH, LLC, and Indemnitor and Neurocrine are entering into this Agreement to formalize Indemnitor's implicit promise to indemnify Neurocrine if Neurocrine becomes obligated to pay taxes (other than Neurocrine's share of employment taxes to the extent not greater than the amount Neurocrine would have paid at the time had it treated the issuance and/or exercise of the Options as taxable compensation), interest and/or penalties (including penalties on Neurocrine's share of employment taxes) as a result of its not withholding sums for, or paying any amounts to, any Taxing Authorities in connection with such transfers and option exercises;

WHEREAS, Neurocrine is agreeing not to take certain actions with respect to employment taxes that it may otherwise have taken.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants, promises and representations set forth in this Agreement, and for other good and valuable consideration, the parties agree as follows:

1. Indemnitor Responsible for Taxes and Related Amounts. Indemnitor and Neurocrine agree that Indemnitor is responsible for the payment of (a) all income taxes, (b) the employee's share of Social Security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), (c) any penalties assessed against Neurocrine by reason of nonpayment of unemployment taxes under the Federal Unemployment Tax Act ("FUTA"), and (d) the employee's share of all employment taxes and withholdings under applicable state laws (including state disability insurance) that have been incurred or may ever be incurred in each of (a) through (c) above in so far as such amount are payable respect to the transfer or the exercise

of the Options, as well as for certain interest, penalties, and other amounts as defined in Section 2, below that are related to such taxes.

2. Indemnity. Indemnitor agrees to indemnify and reimburse Neurocrine and hold it harmless from (a) taxes, interest and penalties, that Neurocrine may be required to pay, or in fact pays in accordance with Section 4 below, any Taxing Authority because Neurocrine has not withheld and paid to the Taxing Authorities personal income taxes of the Indemnitor or Indemnitor's share of FICA taxes or (b) interest and penalties that Neurocrine or its subsidiaries may be required to pay by reason of Neurocrine's nonpayment of FUTA taxes with respect to the transfer of the Options by Indemnitor to PNH, LLC, and/or the exercise of the Options by PNH, LLC or any other transferee; and (c) any interest, penalties, other additions to tax, or other charges that Neurocrine, or its subsidiaries may be required to pay, or in fact pays in accordance with Section 4 below, to any Taxing Authorities because Neurocrine has not paid to the Taxing Authorities the employer's share of FICA taxes or unemployment taxes under the Federal Unemployment Tax Act (other than the FUTA tax otherwise payable by Neurocrine) with respect to the transfer of the Options by Indemnitor to PNH, LLC, and/or the exercise of the Options by PNH, LLC, or any other transferee. Subject to Section 4 below, Indemnitor shall immediately pay to Neurocrine, upon its request, any amounts Indemnitor is required to pay Neurocrine pursuant to this Section 2. Indemnitor's obligation to indemnify shall exist regardless of whether Neurocrine is required to pay the aforementioned taxes, penalties or interest because a Taxing Authority contends that Neurocrine was legally required to withhold or pay such amounts or whether Neurocrine is required to pay such taxes, interest or penalties because of Indemnitor's non-payment or underpayment of such taxes, interest or penalties.

3. Indemnitor to Provide Notice of Tax Directive. If any Taxing Authority notifies Indemnitor that it has reached a conclusion regarding the appropriate tax treatment of the transfer of Options to PNH, LLC, or exercise of Options by PNH, LLC, and indicates as part of such notice that Neurocrine was required to withhold any sums for, or pay any amounts to, such Taxing Authority in connection with any such transfer or exercise, Indemnitor shall promptly advise Neurocrine of such notice and provide to Neurocrine copies of any written correspondence relating to Neurocrine's obligations.

4. Neurocrine's Obligations.

(a) Neurocrine agrees that, prior to a determination by any court of competent jurisdiction that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties described in Sections 1 and 2 above, it will not (except as otherwise contemplated by this Agreement) withhold any sums for, or pay any amounts to, any Taxing Authority or otherwise demand payment from Indemnitor for any amounts payable by such Indemnitor pursuant to Section 2 above unless Indemnitor requests that Neurocrine withhold or pay such amounts, or consents to Neurocrine's taking such action; provided, however, that Neurocrine may withhold and/or pay any such amounts to any Taxing Authority that claims such payments are owed unless Indemnitor pays Neurocrine's out-of-pocket costs and expenses, including reasonable attorneys' fees, incurred in connection with contesting any such claim, to the extent provided in Section 4(b) below. In this regard, Indemnitor shall not be responsible for

reimbursing any out-of-pocket costs or expenses of Neurocrine if Neurocrine determines, pursuant to the fifth sentence of this Section 4, to make a payment to a Taxing Authority rather than oppose such claim. (If Neurocrine initially opposes such a claim by a Taxing Authority but then decides to make a payment, Indemnitor shall be responsible for Neurocrine's out-of-pocket costs and expenses incurred in connection with the opposition, but not after a determination has been made to make the payment.) Indemnitor agrees to pay any amounts that are subject to this Agreement immediately upon the earlier of (i) a determination by any court that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties subject to Section 2, (ii) Indemnitor's requesting that Neurocrine withhold or pay such amounts or Indemnitor's consenting to Neurocrine's taking such action, and (iii) as requested by Neurocrine pursuant to the following sentence. Notwithstanding anything herein to the contrary, the parties understand and agree that (a) at no time will Neurocrine be required to advance any sums to, or extend any credit on behalf of, Indemnitor, and (b) to the extent that (1) an actual demand for payment has been made to Neurocrine by a Taxing Authority, (2) a decision to withhold or otherwise make payment to such Taxing Authority on behalf of Neurocrine has been made by the Board of Directors of Neurocrine based on its determination of the best interests of the stockholders of Neurocrine; and (3) prior to making such a decision, there has been notice to the Indemnitor and an opportunity for Indemnitor and his or her counsel to make a presentation to the Board regarding such matters, Neurocrine shall have the right to immediately demand payment from the Indemnitor, and the Indemnitor shall have the obligation to immediately pay the amount so demanded (and upon receipt by Neurocrine that portion of such amounts representing taxes, interest and penalties shall be remitted to such Taxing Authority), and further, Neurocrine also shall have the right, but not the obligation, to pay any amounts demanded by any Taxing Authority directly and to obtain immediate reimbursement from the Indemnitor, plus interest.

(b) This Agreement is one of several Tax Indemnity Agreements in similar form entered into between Neurocrine and employees of Neurocrine arising from similar transactions. Indemnitor shall be responsible for only his or her pro rata share of the out-of-pocket costs and expenses reimburseable under Section 4(a), which initially is deemed to be 33.78%. Such percentage limitation shall not apply to amounts payable by Neurocrine to Taxing Authorities and otherwise due by Indemnitor under this Agreement. In the event one or more of the other individuals who signed Tax Indemnity Agreements in similar form is no longer contesting claims made by Taxing Authorities, but Neurocrine continues to contest claims made by Taxing Authorities at the request of Indemnitor, Indemnitor's share of Neurocrine's out-of-pocket costs and expenses shall be increased to his or her then-current pro rata share as among all such individuals who continue to contest such claims.

5. Security for Indemnitor's Obligations. In the event Indemnitor's employment with Neurocrine shall terminate, at Neurocrine's request, Indemnitor and Neurocrine will enter into a mutually acceptable arrangement for security of Indemnitor's obligations hereunder in an amount sufficient to cover Indemnitor's reasonable potential liability under this Agreement.

6. Miscellaneous.

(a) Modification and Amendment. This Agreement may not be altered, amended, modified, or otherwise changed in any way except by a written instrument signed by each party.

(b) Headings. The headings and titles of the provisions of this Agreement are inserted for convenience only and shall not affect the construction or interpretation of any provision.

(c) Cumulative Remedies. The right of any party to be indemnified pursuant to this Agreement shall be cumulative and in addition to every other right, power or remedy available to such party, whether available at law, in equity or otherwise. Indemnitor's obligations hereunder may not be reduced by set-off.

(d) Governing Law; Arbitration; Waiver of Jury Trial.

(i) This Agreement shall be governed and construed in accordance with the laws of the State of California, without regard to the laws that might be applicable under conflicts of laws principles.

(ii) All disputes, controversies or claims between Indemnitor and Neurocrine arising, directly or indirectly, out of or relating to this Agreement shall be resolved by final, binding arbitration conducted by a single arbitrator in accordance with the Rules of the American Arbitration Association as then in effect, except as provided herein. Unless the parties otherwise agree, any arbitration shall be held in San Diego County, California. The parties shall be entitled to discovery sufficient to adequately arbitrate the claims and defenses, including access to essential documents and witnesses, as determined by the arbitrator. Costs and fees of the arbitrator shall be borne by the non-prevailing party. The award of the arbitrator, which may include equitable relief, shall be final and not subject to appeal, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction thereof. Any demand for arbitration shall be in writing and must be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date that institution of legal or equitable proceedings based upon such claim dispute or other matter would be barred by the applicable statue of limitations. In no event shall this clause (ii) of Section 6(d) be deemed to preclude a party hereto from instituting legal action seeking relief in the nature of a restraining order, an injunction or the like in order to protect his, her or its rights pending the outcome of an arbitration hereunder and, if any party hereto shall resort to legal action for such types of relief pending the outcome of any such arbitration proceeding or prior to the initiation thereof, such party shall not be deemed to have waived its rights to cause such matter or any other matter to be referred to arbitration pursuant to this Section 6(d).

(iii) EACH PARTY IRREVOCABLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY DISPUTE, CLAIM OR CAUSE OF ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT. THE SCOPE OF THIS WAIVER IS INTENDED TO INCLUDE ANY AND ALL DISPUTES, CLAIMS OR CAUSES OF ACTION, INCLUDING WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS. EACH SUCH PARTY FURTHER WARRANTS AND REPRESENTS THAT IT HAS HAD THE OPPORTUNITY TO HAVE LEGAL COUNSEL REVIEW THIS WAIVER.

(e) Severability. If any provision of this Agreement is found or held to be invalid or unenforceable by any tribunal of competent jurisdiction, then the meaning of such provision will be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it will be severed from the remainder of this Agreement. The remainder of this Agreement will remain in full force and effect.

(f) Counterparts. To facilitate execution, this Agreement may be executed in as many counterparts as may be required. It shall not be necessary that the signatures on behalf of all parties appear on each counterpart of this Agreement. All counterparts of this Agreement shall collectively constitute a single agreement. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

(g) Assignment. The Indemnitor may not assign this Agreement without the prior written consent of the other parties, and any such prohibited assignment shall be void. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the respective legal representatives, successors, assigns, heirs, and devisees of the parties.

(h) Legal Fees. If any party to this Agreement brings an action in arbitration or a court of competent jurisdiction to enforce its rights under this Agreement, the prevailing party shall be entitled to recover its costs and expenses, including without limitation reasonable attorneys' fees, incurred in connection with such action.

(i) Time is of the Essence. Time is of the essence with respect to every provision of this Agreement.

(j) Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by all parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The use of the word "including" shall not be deemed to be limited and shall be read as "including but not limited to." The fundamental premise of this Agreement is that in all events Neurocrine shall incur no obligation or expense in connection with the items identified in Section 2, above, and further that this Agreement shall be interpreted consistently with that intent.

(k) Entire Agreement; No Inconsistent Agreements. This Agreement, together with any exhibits hereto, contains the entire agreement between the parties and supersedes any prior written or oral agreement between said parties concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, oral or written, between or among the parties relating to the subject matter contained in this Agreement, which are not fully expressed herein. The parties also agree that Indemnitor's obligations and responsibilities under this Agreement shall not be limited or subject to indemnity or insurance by Neurocrine through any other agreement or policy relating to the Indemnitor, including any general indemnity agreements or any insurance policy Neurocrine may have.

(l) Further Assurances. Each party hereby agrees to promptly sign any additional instruments or documents which are necessary or appropriate to carry out the purpose of this Agreement.

{Signature Page Follows}

The parties have entered into this Agreement as of the date first set forth above.

NEUROCRINE BIOSCIENCES, INC.

By: /s/ Margaret Valeur-Jensen
---
Name:
Its:

Address:
10555 Science Center Drive
San Diego, California 92121
Telephone: (858) 658-7600
Fax:

/s/ Paul W. Hawran
---
PAUL W. HAWRAN

Address:

Telephone:
Fax:

EXHIBIT 10.61

# TAX INDEMNITY AGREEMENT

This TAX INDEMNITY AGREEMENT, dated as of February 9, 2004 (this "Agreement"), is entered into by and between Margaret Valeur-Jensen ("Indemnitor") and Neurocrine Biosciences, Inc., a Delaware corporation ("Neurocrine").

## RECITALS

WHEREAS, Indemnitor previously transferred options to purchase shares of Neurocrine common stock granted under the Neurocrine Biosciences 1992 Incentive Stock Plan (the "Options") to VJV, LLC, and in reliance on professional advice received at the time of such exercise, Neurocrine has not withheld any sums, or paid any amounts, for any federal, state, or local taxing authorities (hereinafter collectively "Taxing Authorities") in connection with such transfers or upon exercise of such Options by VJV, LLC;

WHEREAS, Indemnitor and Neurocrine agree that it was implicit that Indemnitor would bear responsibility for any adverse tax consequences suffered by Neurocrine in connection with the transfer of the Options or the exercise of the Options by VJV, LLC, and Indemnitor and Neurocrine are entering into this Agreement to formalize Indemnitor's implicit promise to indemnify Neurocrine if Neurocrine becomes obligated to pay taxes (other than Neurocrine's share of employment taxes to the extent not greater than the amount Neurocrine would have paid at the time had it treated the issuance and/or exercise of the Options as taxable compensation), interest and/or penalties (including penalties on Neurocrine's share of employment taxes) as a result of its not withholding sums for, or paying any amounts to, any Taxing Authorities in connection with such transfers and option exercises;

WHEREAS, Neurocrine is agreeing not to take certain actions with respect to employment taxes that it may otherwise have taken.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants, promises and representations set forth in this Agreement, and for other good and valuable consideration, the parties agree as follows:

1. Indemnitor Responsible for Taxes and Related Amounts. Indemnitor and Neurocrine agree that Indemnitor is responsible for the payment of (a) all income taxes, (b) the employee's share of Social Security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), (c) any penalties assessed against Neurocrine by reason of nonpayment of unemployment taxes under the Federal Unemployment Tax Act ("FUTA"), and (d) the employee's share of all employment taxes and withholdings under applicable state laws (including state disability insurance) that have been incurred or may ever be incurred in each of (a) through (c) above in so far as such amount are payable respect to the transfer or the exercise

of the Options, as well as for certain interest, penalties, and other amounts as defined in Section 2, below that are related to such taxes.

2. Indemnity. Indemnitor agrees to indemnify and reimburse Neurocrine and hold it harmless from (a) taxes, interest and penalties, that Neurocrine may be required to pay, or in fact pays in accordance with Section 4 below, any Taxing Authority because Neurocrine has not withheld and paid to the Taxing Authorities personal income taxes of the Indemnitor or Indemnitor's share of FICA taxes or (b) interest and penalties that Neurocrine or its subsidiaries may be required to pay by reason of Neurocrine's nonpayment of FUTA taxes with respect to the transfer of the Options by Indemnitor to VJV, LLC, and/or the exercise of the Options by VJV, LLC, or any other transferee; and (c) any interest, penalties, other additions to tax, or other charges that Neurocrine, or its subsidiaries may be required to pay, or in fact pays in accordance with Section 4 below, to any Taxing Authorities because Neurocrine has not paid to the Taxing Authorities the employer's share of FICA taxes or unemployment taxes under the Federal Unemployment Tax Act (other than the FUTA tax otherwise payable by Neurocrine) with respect to the transfer of the Options by Indemnitor to VJV, LLC, and/or the exercise of the Options by VJV, LLC, or any other transferee. Subject to Section 4 below, Indemnitor shall immediately pay to Neurocrine, upon its request, any amounts Indemnitor is required to pay Neurocrine pursuant to this Section 2. Indemnitor's obligation to indemnify shall exist regardless of whether Neurocrine is required to pay the aforementioned taxes, penalties or interest because a Taxing Authority contends that Neurocrine was legally required to withhold or pay such amounts or whether Neurocrine is required to pay such taxes, interest or penalties because of Indemnitor's non-payment or underpayment of such taxes, interest or penalties.

3. Indemnitor to Provide Notice of Tax Directive. If any Taxing Authority notifies Indemnitor that it has reached a conclusion regarding the appropriate tax treatment of the transfer of Options to VJV, LLC, or exercise of Options by VJV, LLC, and indicates as part of such notice that Neurocrine was required to withhold any sums for, or pay any amounts to, such Taxing Authority in connection with any such transfer or exercise, Indemnitor shall promptly advise Neurocrine of such notice and provide to Neurocrine copies of any written correspondence relating to Neurocrine's obligations.

4. Neurocrine's Obligations.

(a) Neurocrine agrees that, prior to a determination by any court of competent jurisdiction that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties described in Sections 1 and 2 above, it will not (except as otherwise contemplated by this Agreement) withhold any sums for, or pay any amounts to, any Taxing Authority or otherwise demand payment from Indemnitor for any amounts payable by such Indemnitor pursuant to Section 2 above unless Indemnitor requests that Neurocrine withhold or pay such amounts, or consents to Neurocrine's taking such action; provided, however, that Neurocrine may withhold and/or pay any such amounts to any Taxing Authority that claims such payments are owed unless Indemnitor pays Neurocrine's out-of-pocket costs and expenses, including reasonable attorneys' fees, incurred in connection with contesting any such claim, to the extent provided in Section 4(b) below. In this regard, Indemnitor shall not be responsible for

reimbursing any out-of-pocket costs or expenses of Neurocrine if Neurocrine determines, pursuant to the fifth sentence of this Section 4, to make a payment to a Taxing Authority rather than oppose such claim. (If Neurocrine initially opposes such a claim by a Taxing Authority but then decides to make a payment, Indemnitor shall be responsible for Neurocrine's out-of-pocket costs and expenses incurred in connection with the opposition, but not after a determination has been made to make the payment.) Indemnitor agrees to pay any amounts that are subject to this Agreement immediately upon the earlier of (i) a determination by any court that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties subject to Section 2, (ii) Indemnitor's requesting that Neurocrine withhold or pay such amounts or Indemnitor's consenting to Neurocrine's taking such action, and (iii) as requested by Neurocrine pursuant to the following sentence. Notwithstanding anything herein to the contrary, the parties understand and agree that (a) at no time will Neurocrine be required to advance any sums to, or extend any credit on behalf of, Indemnitor, and (b) to the extent that (1) an actual demand for payment has been made to Neurocrine by a Taxing Authority, (2) a decision to withhold or otherwise make payment to such Taxing Authority on behalf of Neurocrine has been made by the Board of Directors of Neurocrine based on its determination of the best interests of the stockholders of Neurocrine; and (3) prior to making such a decision, there has been notice to the Indemnitor and an opportunity for Indemnitor and his or her counsel to make a presentation to the Board regarding such matters, Neurocrine shall have the right to immediately demand payment from the Indemnitor, and the Indemnitor shall have the obligation to immediately pay the amount so demanded (and upon receipt by Neurocrine that portion of such amounts representing taxes, interest and penalties shall be remitted to such Taxing Authority), and further, Neurocrine also shall have the right, but not the obligation, to pay any amounts demanded by any Taxing Authority directly and to obtain immediate reimbursement from the Indemnitor, plus interest.

(b) This Agreement is one of several Tax Indemnity Agreements in similar form entered into between Neurocrine and employees of Neurocrine arising from similar transactions. Indemnitor shall be responsible for only his or her pro rata share of the out-of-pocket costs and expenses reimburseable under Section 4(a), which initially is deemed to be 7.46%. Such percentage limitation shall not apply to amounts payable by Neurocrine to Taxing Authorities and otherwise due by Indemnitor under this Agreement. In the event one or more of the other individuals who signed Tax Indemnity Agreements in similar form is no longer contesting claims made by Taxing Authorities, but Neurocrine continues to contest claims made by Taxing Authorities at the request of Indemnitor, Indemnitor's share of Neurocrine's out-of-pocket costs and expenses shall be increased to his or her then-current pro rata share as among all such individuals who continue to contest such claims.

5. Security for Indemnitor's Obligations. In the event Indemnitor's employment with Neurocrine shall terminate, at Neurocrine's request, Indemnitor and Neurocrine will enter into a mutually acceptable arrangement for security of Indemnitor's obligations hereunder in an amount sufficient to cover Indemnitor's reasonable potential liability under this Agreement.

6. Miscellaneous.

(a) Modification and Amendment. This Agreement may not be altered, amended, modified, or otherwise changed in any way except by a written instrument signed by each party.

(b) Headings. The headings and titles of the provisions of this Agreement are inserted for convenience only and shall not affect the construction or interpretation of any provision.

(c) Cumulative Remedies. The right of any party to be indemnified pursuant to this Agreement shall be cumulative and in addition to every other right, power or remedy available to such party, whether available at law, in equity or otherwise. Indemnitor's obligations hereunder may not be reduced by set-off.

(d) Governing Law; Arbitration; Waiver of Jury Trial.

(i) This Agreement shall be governed and construed in accordance with the laws of the State of California, without regard to the laws that might be applicable under conflicts of laws principles.

(ii) All disputes, controversies or claims between Indemnitor and Neurocrine arising, directly or indirectly, out of or relating to this Agreement shall be resolved by final, binding arbitration conducted by a single arbitrator in accordance with the Rules of the American Arbitration Association as then in effect, except as provided herein. Unless the parties otherwise agree, any arbitration shall be held in San Diego County, California. The parties shall be entitled to discovery sufficient to adequately arbitrate the claims and defenses, including access to essential documents and witnesses, as determined by the arbitrator. Costs and fees of the arbitrator shall be borne by the non-prevailing party. The award of the arbitrator, which may include equitable relief, shall be final and not subject to appeal, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction thereof. Any demand for arbitration shall be in writing and must be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date that institution of legal or equitable proceedings based upon such claim dispute or other matter would be barred by the applicable statue of limitations. In no event shall this clause (ii) of Section 6(d) be deemed to preclude a party hereto from instituting legal action seeking relief in the nature of a restraining order, an injunction or the like in order to protect his, her or its rights pending the outcome of an arbitration hereunder and, if any party hereto shall resort to legal action for such types of relief pending the outcome of any such arbitration proceeding or prior to the initiation thereof, such party shall not be deemed to have waived its rights to cause such matter or any other matter to be referred to arbitration pursuant to this Section 6(d).

(iii) EACH PARTY IRREVOCABLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY DISPUTE, CLAIM OR CAUSE OF ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT. THE SCOPE OF THIS WAIVER IS INTENDED TO INCLUDE ANY AND ALL DISPUTES, CLAIMS OR CAUSES OF ACTION, INCLUDING WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS. EACH SUCH PARTY FURTHER WARRANTS AND REPRESENTS THAT IT HAS HAD THE OPPORTUNITY TO HAVE LEGAL COUNSEL REVIEW THIS WAIVER.

(e) Severability. If any provision of this Agreement is found or held to be invalid or unenforceable by any tribunal of competent jurisdiction, then the meaning of such provision will be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it will be severed from the remainder of this Agreement. The remainder of this Agreement will remain in full force and effect.

(f) Counterparts. To facilitate execution, this Agreement may be executed in as many counterparts as may be required. It shall not be necessary that the signatures on behalf of all parties appear on each counterpart of this Agreement. All counterparts of this Agreement shall collectively constitute a single agreement. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

(g) Assignment. The Indemnitor may not assign this Agreement without the prior written consent of the other parties, and any such prohibited assignment shall be void. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the respective legal representatives, successors, assigns, heirs, and devisees of the parties.

(h) Legal Fees. If any party to this Agreement brings an action in arbitration or a court of competent jurisdiction to enforce its rights under this Agreement, the prevailing party shall be entitled to recover its costs and expenses, including without limitation reasonable attorneys' fees, incurred in connection with such action.

(i) Time is of the Essence. Time is of the essence with respect to every provision of this Agreement.

(j) Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by all parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The use of the word "including" shall not be deemed to be limited and shall be read as "including but not limited to." The fundamental premise of this Agreement is that in all events Neurocrine shall incur no obligation or expense in connection with the items identified in Section 2, above, and further that this Agreement shall be interpreted consistently with that intent.

(k) Entire Agreement; No Inconsistent Agreements. This Agreement, together with any exhibits hereto, contains the entire agreement between the parties and supersedes any prior written or oral agreement between said parties concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, oral or written, between or among the parties relating to the subject matter contained in this Agreement, which are not fully expressed herein. The parties also agree that Indemnitor's obligations and responsibilities under this Agreement shall not be limited or subject to indemnity or insurance by Neurocrine through any other agreement or policy relating to the Indemnitor, including any general indemnity agreements or any insurance policy Neurocrine may have.

(l) Further Assurances. Each party hereby agrees to promptly sign any additional instruments or documents which are necessary or appropriate to carry out the purpose of this Agreement.

{Signature Page Follows}

The parties have entered into this Agreement as of the date first set forth above.

NEUROCRINE BIOSCIENCES, INC.

By: /s/ Gary Lyons
---

Name:
Its:

Address:
10555 Science Center Drive
San Diego, California 92121
Telephone: (858) 658-7600
Fax:

/s/ Margaret Valeur-Jensen
---

MARGARET VALEUR-JENSEN

Address:

Telephone:
Fax:

EXHIBIT 10.62

# TAX INDEMNITY AGREEMENT

This TAX INDEMNITY AGREEMENT, dated as of February 9, 2004 (this "Agreement"), is entered into by and between Kevin Gorman ("Indemnitor") and Neurocrine Biosciences, Inc., a Delaware corporation ("Neurocrine").

## RECITALS

WHEREAS, Indemnitor previously transferred options to purchase shares of Neurocrine common stock granted under the Neurocrine Biosciences 1992 Incentive Stock Plan (the "Options") to KCG, LLC, and in reliance on professional advice received at the time of such exercise, Neurocrine has not withheld any sums, or paid any amounts, for any federal, state, or local taxing authorities (hereinafter collectively "Taxing Authorities") in connection with such transfers or upon exercise of such Options by KCG, LLC;

WHEREAS, Indemnitor and Neurocrine agree that it was implicit that Indemnitor would bear responsibility for any adverse tax consequences suffered by Neurocrine in connection with the transfer of the Options or the exercise of the Options by KCG, LLC, and Indemnitor and Neurocrine are entering into this Agreement to formalize Indemnitor's implicit promise to indemnify Neurocrine if Neurocrine becomes obligated to pay taxes (other than Neurocrine's share of employment taxes to the extent not greater than the amount Neurocrine would have paid at the time had it treated the issuance and/or exercise of the Options as taxable compensation), interest and/or penalties (including penalties on Neurocrine's share of employment taxes) as a result of its not withholding sums for, or paying any amounts to, any Taxing Authorities in connection with such transfers and option exercises;

WHEREAS, Neurocrine is agreeing not to take certain actions with respect to employment taxes that it may otherwise have taken.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants, promises and representations set forth in this Agreement, and for other good and valuable consideration, the parties agree as follows:

1. Indemnitor Responsible for Taxes and Related Amounts. Indemnitor and Neurocrine agree that Indemnitor is responsible for the payment of (a) all income taxes, (b) the employee's share of Social Security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), (c) any penalties assessed against Neurocrine by reason of nonpayment of unemployment taxes under the Federal Unemployment Tax Act ("FUTA"), and (d) the employee's share of all employment taxes and withholdings under applicable state laws (including state disability insurance) that have been incurred or may ever be incurred in each of (a) through (c) above in so far as such amount are payable respect to the transfer or the exercise

of the Options, as well as for certain interest, penalties, and other amounts as defined in Section 2, below that are related to such taxes.

2. Indemnity. Indemnitor agrees to indemnify and reimburse Neurocrine and hold it harmless from (a) taxes, interest and penalties, that Neurocrine may be required to pay, or in fact pays in accordance with Section 4 below, any Taxing Authority because Neurocrine has not withheld and paid to the Taxing Authorities personal income taxes of the Indemnitor or Indemnitor's share of FICA taxes or (b) interest and penalties that Neurocrine or its subsidiaries may be required to pay by reason of Neurocrine's nonpayment of FUTA taxes with respect to the transfer of the Options by Indemnitor to KCG, LLC, and/or the exercise of the Options by KCG, LLC, or any other transferee; and (c) any interest, penalties, other additions to tax, or other charges that Neurocrine, or its subsidiaries may be required to pay, or in fact pays in accordance with Section 4 below, to any Taxing Authorities because Neurocrine has not paid to the Taxing Authorities the employer's share of FICA taxes or unemployment taxes under the Federal Unemployment Tax Act (other than the FUTA tax otherwise payable by Neurocrine) with respect to the transfer of the Options by Indemnitor to KCG, LLC, and/or the exercise of the Options by KCG, LLC, or any other transferee. Subject to Section 4 below, Indemnitor shall immediately pay to Neurocrine, upon its request, any amounts Indemnitor is required to pay Neurocrine pursuant to this Section 2. Indemnitor's obligation to indemnify shall exist regardless of whether Neurocrine is required to pay the aforementioned taxes, penalties or interest because a Taxing Authority contends that Neurocrine was legally required to withhold or pay such amounts or whether Neurocrine is required to pay such taxes, interest or penalties because of Indemnitor's non-payment or underpayment of such taxes, interest or penalties.

3. Indemnitor to Provide Notice of Tax Directive. If any Taxing Authority notifies Indemnitor that it has reached a conclusion regarding the appropriate tax treatment of the transfer of Options to KCG, LLC, or exercise of Options by KCG, LLC, and indicates as part of such notice that Neurocrine was required to withhold any sums for, or pay any amounts to, such Taxing Authority in connection with any such transfer or exercise, Indemnitor shall promptly advise Neurocrine of such notice and provide to Neurocrine copies of any written correspondence relating to Neurocrine's obligations.

4. Neurocrine's Obligations.

(a) Neurocrine agrees that, prior to a determination by any court of competent jurisdiction that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties described in Sections 1 and 2 above, it will not (except as otherwise contemplated by this Agreement) withhold any sums for, or pay any amounts to, any Taxing Authority or otherwise demand payment from Indemnitor for any amounts payable by such Indemnitor pursuant to Section 2 above unless Indemnitor requests that Neurocrine withhold or pay such amounts, or consents to Neurocrine's taking such action; provided, however, that Neurocrine may withhold and/or pay any such amounts to any Taxing Authority that claims such payments are owed unless Indemnitor pays Neurocrine's out-of-pocket costs and expenses, including reasonable attorneys' fees, incurred in connection with contesting any such claim, to the extent provided in Section 4(b) below. In this regard, Indemnitor shall not be responsible for

reimbursing any out-of-pocket costs or expenses of Neurocrine if Neurocrine determines, pursuant to the fifth sentence of this Section 4, to make a payment to a Taxing Authority rather than oppose such claim. (If Neurocrine initially opposes such a claim by a Taxing Authority but then decides to make a payment, Indemnitor shall be responsible for Neurocrine's out-of-pocket costs and expenses incurred in connection with the opposition, but not after a determination has been made to make the payment.) Indemnitor agrees to pay any amounts that are subject to this Agreement immediately upon the earlier of (i) a determination by any court that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties subject to Section 2, (ii) Indemnitor's requesting that Neurocrine withhold or pay such amounts or Indemnitor's consenting to Neurocrine's taking such action, and (iii) as requested by Neurocrine pursuant to the following sentence. Notwithstanding anything herein to the contrary, the parties understand and agree that (a) at no time will Neurocrine be required to advance any sums to, or extend any credit on behalf of, Indemnitor, and (b) to the extent that (1) an actual demand for payment has been made to Neurocrine by a Taxing Authority, (2) a decision to withhold or otherwise make payment to such Taxing Authority on behalf of Neurocrine has been made by the Board of Directors of Neurocrine based on its determination of the best interests of the stockholders of Neurocrine; and (3) prior to making such a decision, there has been notice to the Indemnitor and an opportunity for Indemnitor and his or her counsel to make a presentation to the Board regarding such matters, Neurocrine shall have the right to immediately demand payment from the Indemnitor, and the Indemnitor shall have the obligation to immediately pay the amount so demanded (and upon receipt by Neurocrine that portion of such amounts representing taxes, interest and penalties shall be remitted to such Taxing Authority), and further, Neurocrine also shall have the right, but not the obligation, to pay any amounts demanded by any Taxing Authority directly and to obtain immediate reimbursement from the Indemnitor, plus interest.

(b) This Agreement is one of several Tax Indemnity Agreements in similar form entered into between Neurocrine and employees of Neurocrine arising from similar transactions. Indemnitor shall be responsible for only his or her pro rata share of the out-of-pocket costs and expenses reimburseable under Section 4(a), which initially is deemed to be 2.97%. Such percentage limitation shall not apply to amounts payable by Neurocrine to Taxing Authorities and otherwise due by Indemnitor under this Agreement. In the event one or more of the other individuals who signed Tax Indemnity Agreements in similar form is no longer contesting claims made by Taxing Authorities, but Neurocrine continues to contest claims made by Taxing Authorities at the request of Indemnitor, Indemnitor's share of Neurocrine's out-of-pocket costs and expenses shall be increased to his or her then-current pro rata share as among all such individuals who continue to contest such claims.

5. Security for Indemnitor's Obligations. In the event Indemnitor's employment with Neurocrine shall terminate, at Neurocrine's request, Indemnitor and Neurocrine will enter into a mutually acceptable arrangement for security of Indemnitor's obligations hereunder in an amount sufficient to cover Indemnitor's reasonable potential liability under this Agreement.

6. Miscellaneous.

(a) Modification and Amendment. This Agreement may not be altered, amended, modified, or otherwise changed in any way except by a written instrument signed by each party.

(b) Headings. The headings and titles of the provisions of this Agreement are inserted for convenience only and shall not affect the construction or interpretation of any provision.

(c) Cumulative Remedies. The right of any party to be indemnified pursuant to this Agreement shall be cumulative and in addition to every other right, power or remedy available to such party, whether available at law, in equity or otherwise. Indemnitor's obligations hereunder may not be reduced by set-off.

(d) Governing Law; Arbitration; Waiver of Jury Trial.

(i) This Agreement shall be governed and construed in accordance with the laws of the State of California, without regard to the laws that might be applicable under conflicts of laws principles.

(ii) All disputes, controversies or claims between Indemnitor and Neurocrine arising, directly or indirectly, out of or relating to this Agreement shall be resolved by final, binding arbitration conducted by a single arbitrator in accordance with the Rules of the American Arbitration Association as then in effect, except as provided herein. Unless the parties otherwise agree, any arbitration shall be held in San Diego County, California. The parties shall be entitled to discovery sufficient to adequately arbitrate the claims and defenses, including access to essential documents and witnesses, as determined by the arbitrator. Costs and fees of the arbitrator shall be borne by the non-prevailing party. The award of the arbitrator, which may include equitable relief, shall be final and not subject to appeal, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction thereof. Any demand for arbitration shall be in writing and must be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date that institution of legal or equitable proceedings based upon such claim dispute or other matter would be barred by the applicable statue of limitations. In no event shall this clause (ii) of Section 6(d) be deemed to preclude a party hereto from instituting legal action seeking relief in the nature of a restraining order, an injunction or the like in order to protect his, her or its rights pending the outcome of an arbitration hereunder and, if any party hereto shall resort to legal action for such types of relief pending the outcome of any such arbitration proceeding or prior to the initiation thereof, such party shall not be deemed to have waived its rights to cause such matter or any other matter to be referred to arbitration pursuant to this Section 6(d).

(iii) EACH PARTY IRREVOCABLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY DISPUTE, CLAIM OR CAUSE OF ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT. THE SCOPE OF THIS WAIVER IS INTENDED TO INCLUDE ANY AND ALL DISPUTES, CLAIMS OR CAUSES OF ACTION, INCLUDING WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS. EACH SUCH PARTY FURTHER WARRANTS AND REPRESENTS THAT IT HAS HAD THE OPPORTUNITY TO HAVE LEGAL COUNSEL REVIEW THIS WAIVER.

(e) Severability. If any provision of this Agreement is found or held to be invalid or unenforceable by any tribunal of competent jurisdiction, then the meaning of such provision will be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it will be severed from the remainder of this Agreement. The remainder of this Agreement will remain in full force and effect.

(f) Counterparts. To facilitate execution, this Agreement may be executed in as many counterparts as may be required. It shall not be necessary that the signatures on behalf of all parties appear on each counterpart of this Agreement. All counterparts of this Agreement shall collectively constitute a single agreement. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

(g) Assignment. The Indemnitor may not assign this Agreement without the prior written consent of the other parties, and any such prohibited assignment shall be void. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the respective legal representatives, successors, assigns, heirs, and devisees of the parties.

(h) Legal Fees. If any party to this Agreement brings an action in arbitration or a court of competent jurisdiction to enforce its rights under this Agreement, the prevailing party shall be entitled to recover its costs and expenses, including without limitation reasonable attorneys' fees, incurred in connection with such action.

(i) Time is of the Essence. Time is of the essence with respect to every provision of this Agreement.

(j) Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by all parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The use of the word "including" shall not be deemed to be limited and shall be read as "including but not limited to." The fundamental premise of this Agreement is that in all events Neurocrine shall incur no obligation or expense in connection with the items identified in Section 2, above, and further that this Agreement shall be interpreted consistently with that intent.

(k) Entire Agreement; No Inconsistent Agreements. This Agreement, together with any exhibits hereto, contains the entire agreement between the parties and supersedes any prior written or oral agreement between said parties concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, oral or written, between or among the parties relating to the subject matter contained in this Agreement, which are not fully expressed herein. The parties also agree that Indemnitor's obligations and responsibilities under this Agreement shall not be limited or subject to indemnity or insurance by Neurocrine through any other agreement or policy relating to the Indemnitor, including any general indemnity agreements or any insurance policy Neurocrine may have.

(l) Further Assurances. Each party hereby agrees to promptly sign any additional instruments or documents which are necessary or appropriate to carry out the purpose of this Agreement.

{Signature Page Follows}

The parties have entered into this Agreement as of the date first set forth above.

NEUROCRINE BIOSCIENCES, INC.

By: /s/ Margaret Valeur-Jensen
---
Name:
Its:

Address:
10555 Science Center Drive
San Diego, California 92121
Telephone: (858) 658-7600
Fax:

/s/ Kevin Gorman
---
KEVIN GORMAN

Address:

Telephone:
Fax:

EXHIBIT 10.63

# TAX INDEMNITY AGREEMENT

This TAX INDEMNITY AGREEMENT, dated as of February 11, 2004 (this "Agreement"), is entered into by and between Paul Conlon ("Indemnitor") and Neurocrine Biosciences, Inc., a Delaware corporation ("Neurocrine").

## RECITALS

WHEREAS, Indemnitor previously transferred options to purchase shares of Neurocrine common stock granted under the Neurocrine Biosciences 1992 Incentive Stock Plan (the "Options") to PDC, LLC, and in reliance on professional advice received at the time of such exercise, Neurocrine has not withheld any sums, or paid any amounts, for any federal, state, or local taxing authorities (hereinafter collectively "Taxing Authorities") in connection with such transfers or upon exercise of such Options by PDC, LLC;

WHEREAS, Indemnitor and Neurocrine agree that it was implicit that Indemnitor would bear responsibility for any adverse tax consequences suffered by Neurocrine in connection with the transfer of the Options or the exercise of the Options by PDC, LLC, and Indemnitor and Neurocrine are entering into this Agreement to formalize Indemnitor's implicit promise to indemnify Neurocrine if Neurocrine becomes obligated to pay taxes (other than Neurocrine's share of employment taxes to the extent not greater than the amount Neurocrine would have paid at the time had it treated the issuance and/or exercise of the Options as taxable compensation), interest and/or penalties (including penalties on Neurocrine's share of employment taxes) as a result of its not withholding sums for, or paying any amounts to, any Taxing Authorities in connection with such transfers and option exercises;

WHEREAS, Neurocrine is agreeing not to take certain actions with respect to employment taxes that it may otherwise have taken.

## AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants, promises and representations set forth in this Agreement, and for other good and valuable consideration, the parties agree as follows:

1. Indemnitor Responsible for Taxes and Related Amounts. Indemnitor and Neurocrine agree that Indemnitor is responsible for the payment of (a) all income taxes, (b) the employee's share of Social Security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), (c) any penalties assessed against Neurocrine by reason of nonpayment of unemployment taxes under the Federal Unemployment Tax Act ("FUTA"), and (d) the employee's share of all employment taxes and withholdings under applicable state laws (including state disability insurance) that have been incurred or may ever be incurred in each of (a) through (c) above in so far as such amount are payable respect to the transfer or the exercise

of the Options, as well as for certain interest, penalties, and other amounts as defined in Section 2, below that are related to such taxes.

2. Indemnity. Indemnitor agrees to indemnify and reimburse Neurocrine and hold it harmless from (a) taxes, interest and penalties, that Neurocrine may be required to pay, or in fact pays in accordance with Section 4 below, any Taxing Authority because Neurocrine has not withheld and paid to the Taxing Authorities personal income taxes of the Indemnitor or Indemnitor's share of FICA taxes or (b) interest and penalties that Neurocrine or its subsidiaries may be required to pay by reason of Neurocrine's nonpayment of FUTA taxes with respect to the transfer of the Options by Indemnitor to PDC, LLC, and/or the exercise of the Options by PDC, LLC, or any other transferee; and (c) any interest, penalties, other additions to tax, or other charges that Neurocrine, or its subsidiaries may be required to pay, or in fact pays in accordance with Section 4 below, to any Taxing Authorities because Neurocrine has not paid to the Taxing Authorities the employer's share of FICA taxes or unemployment taxes under the Federal Unemployment Tax Act (other than the FUTA tax otherwise payable by Neurocrine) with respect to the transfer of the Options by Indemnitor to PDC, LLC, and/or the exercise of the Options by PDC, LLC, or any other transferee. Subject to Section 4 below, Indemnitor shall immediately pay to Neurocrine, upon its request, any amounts Indemnitor is required to pay Neurocrine pursuant to this Section 2. Indemnitor's obligation to indemnify shall exist regardless of whether Neurocrine is required to pay the aforementioned taxes, penalties or interest because a Taxing Authority contends that Neurocrine was legally required to withhold or pay such amounts or whether Neurocrine is required to pay such taxes, interest or penalties because of Indemnitor's non-payment or underpayment of such taxes, interest or penalties.

3. Indemnitor to Provide Notice of Tax Directive. If any Taxing Authority notifies Indemnitor that it has reached a conclusion regarding the appropriate tax treatment of the transfer of Options to PDC, LLC, or exercise of Options by PDC, LLC, and indicates as part of such notice that Neurocrine was required to withhold any sums for, or pay any amounts to, such Taxing Authority in connection with any such transfer or exercise, Indemnitor shall promptly advise Neurocrine of such notice and provide to Neurocrine copies of any written correspondence relating to Neurocrine's obligations.

4. Neurocrine's Obligations.

(a) Neurocrine agrees that, prior to a determination by any court of competent jurisdiction that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties described in Sections 1 and 2 above, it will not (except as otherwise contemplated by this Agreement) withhold any sums for, or pay any amounts to, any Taxing Authority or otherwise demand payment from Indemnitor for any amounts payable by such Indemnitor pursuant to Section 2 above unless Indemnitor requests that Neurocrine withhold or pay such amounts, or consents to Neurocrine's taking such action; provided, however, that Neurocrine may withhold and/or pay any such amounts to any Taxing Authority that claims such payments are owed unless Indemnitor pays Neurocrine's out-of-pocket costs and expenses, including reasonable attorneys' fees, incurred in connection with contesting any such claim, to the extent provided in Section 4(b) below. In this regard, Indemnitor shall not be responsible for

reimbursing any out-of-pocket costs or expenses of Neurocrine if Neurocrine determines, pursuant to the fifth sentence of this Section 4, to make a payment to a Taxing Authority rather than oppose such claim. (If Neurocrine initially opposes such a claim by a Taxing Authority but then decides to make a payment, Indemnitor shall be responsible for Neurocrine's out-of-pocket costs and expenses incurred in connection with the opposition, but not after a determination has been made to make the payment.) Indemnitor agrees to pay any amounts that are subject to this Agreement immediately upon the earlier of (i) a determination by any court that Neurocrine should have withheld and/or paid any of the taxes, interest, or penalties subject to Section 2, (ii) Indemnitor's requesting that Neurocrine withhold or pay such amounts or Indemnitor's consenting to Neurocrine's taking such action, and (iii) as requested by Neurocrine pursuant to the following sentence. Notwithstanding anything herein to the contrary, the parties understand and agree that (a) at no time will Neurocrine be required to advance any sums to, or extend any credit on behalf of, Indemnitor, and (b) to the extent that (1) an actual demand for payment has been made to Neurocrine by a Taxing Authority, (2) a decision to withhold or otherwise make payment to such Taxing Authority on behalf of Neurocrine has been made by the Board of Directors of Neurocrine based on its determination of the best interests of the stockholders of Neurocrine; and (3) prior to making such a decision, there has been notice to the Indemnitor and an opportunity for Indemnitor and his or her counsel to make a presentation to the Board regarding such matters, Neurocrine shall have the right to immediately demand payment from the Indemnitor, and the Indemnitor shall have the obligation to immediately pay the amount so demanded (and upon receipt by Neurocrine that portion of such amounts representing taxes, interest and penalties shall be remitted to such Taxing Authority), and further, Neurocrine also shall have the right, but not the obligation, to pay any amounts demanded by any Taxing Authority directly and to obtain immediate reimbursement from the Indemnitor, plus interest.

(b) This Agreement is one of several Tax Indemnity Agreements in similar form entered into between Neurocrine and employees of Neurocrine arising from similar transactions. Indemnitor shall be responsible for only his or her pro rata share of the out-of-pocket costs and expenses reimburseable under Section 4(a), which initially is deemed to be 7.46%. Such percentage limitation shall not apply to amounts payable by Neurocrine to Taxing Authorities and otherwise due by Indemnitor under this Agreement. In the event one or more of the other individuals who signed Tax Indemnity Agreements in similar form is no longer contesting claims made by Taxing Authorities, but Neurocrine continues to contest claims made by Taxing Authorities at the request of Indemnitor, Indemnitor's share of Neurocrine's out-of-pocket costs and expenses shall be increased to his or her then-current pro rata share as among all such individuals who continue to contest such claims.

5. Security for Indemnitor's Obligations. In the event Indemnitor's employment with Neurocrine shall terminate, at Neurocrine's request, Indemnitor and Neurocrine will enter into a mutually acceptable arrangement for security of Indemnitor's obligations hereunder in an amount sufficient to cover Indemnitor's reasonable potential liability under this Agreement.

6. Miscellaneous.

(a) Modification and Amendment. This Agreement may not be altered, amended, modified, or otherwise changed in any way except by a written instrument signed by each party.

(b) Headings. The headings and titles of the provisions of this Agreement are inserted for convenience only and shall not affect the construction or interpretation of any provision.

(c) Cumulative Remedies. The right of any party to be indemnified pursuant to this Agreement shall be cumulative and in addition to every other right, power or remedy available to such party, whether available at law, in equity or otherwise. Indemnitor's obligations hereunder may not be reduced by set-off.

(d) Governing Law; Arbitration; Waiver of Jury Trial.

(i) This Agreement shall be governed and construed in accordance with the laws of the State of California, without regard to the laws that might be applicable under conflicts of laws principles.

(ii) All disputes, controversies or claims between Indemnitor and Neurocrine arising, directly or indirectly, out of or relating to this Agreement shall be resolved by final, binding arbitration conducted by a single arbitrator in accordance with the Rules of the American Arbitration Association as then in effect, except as provided herein. Unless the parties otherwise agree, any arbitration shall be held in San Diego County, California. The parties shall be entitled to discovery sufficient to adequately arbitrate the claims and defenses, including access to essential documents and witnesses, as determined by the arbitrator. Costs and fees of the arbitrator shall be borne by the non-prevailing party. The award of the arbitrator, which may include equitable relief, shall be final and not subject to appeal, and judgment may be entered upon it in accordance with the applicable law in any court having jurisdiction thereof. Any demand for arbitration shall be in writing and must be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date that institution of legal or equitable proceedings based upon such claim dispute or other matter would be barred by the applicable statue of limitations. In no event shall this clause (ii) of Section 6(d) be deemed to preclude a party hereto from instituting legal action seeking relief in the nature of a restraining order, an injunction or the like in order to protect his, her or its rights pending the outcome of an arbitration hereunder and, if any party hereto shall resort to legal action for such types of relief pending the outcome of any such arbitration proceeding or prior to the initiation thereof, such party shall not be deemed to have waived its rights to cause such matter or any other matter to be referred to arbitration pursuant to this Section 6(d).

(iii) EACH PARTY IRREVOCABLY WAIVES ITS RIGHTS TO A JURY TRIAL OF ANY DISPUTE, CLAIM OR CAUSE OF ACTION RELATED TO OR ARISING OUT OF THIS AGREEMENT. THE SCOPE OF THIS WAIVER IS INTENDED TO INCLUDE ANY AND ALL DISPUTES, CLAIMS OR CAUSES OF ACTION, INCLUDING WITHOUT LIMITATION, CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW AND STATUTORY CLAIMS. EACH SUCH PARTY FURTHER WARRANTS AND REPRESENTS THAT IT HAS HAD THE OPPORTUNITY TO HAVE LEGAL COUNSEL REVIEW THIS WAIVER.

(e) Severability. If any provision of this Agreement is found or held to be invalid or unenforceable by any tribunal of competent jurisdiction, then the meaning of such provision will be construed, to the extent feasible, so as to render the provision enforceable, and if no feasible interpretation would save such provision, it will be severed from the remainder of this Agreement. The remainder of this Agreement will remain in full force and effect.

(f) Counterparts. To facilitate execution, this Agreement may be executed in as many counterparts as may be required. It shall not be necessary that the signatures on behalf of all parties appear on each counterpart of this Agreement. All counterparts of this Agreement shall collectively constitute a single agreement. Signatures to this Agreement may be transmitted by facsimile and such signatures shall be deemed to be originals.

(g) Assignment. The Indemnitor may not assign this Agreement without the prior written consent of the other parties, and any such prohibited assignment shall be void. Subject to the foregoing, this Agreement shall be binding upon and inure to the benefit of the respective legal representatives, successors, assigns, heirs, and devisees of the parties.

(h) Legal Fees. If any party to this Agreement brings an action in arbitration or a court of competent jurisdiction to enforce its rights under this Agreement, the prevailing party shall be entitled to recover its costs and expenses, including without limitation reasonable attorneys' fees, incurred in connection with such action.

(i) Time is of the Essence. Time is of the essence with respect to every provision of this Agreement.

(j) Construction. The parties have participated jointly in the negotiation and drafting of this Agreement. In the event an ambiguity or question of intent or interpretation arises, this Agreement shall be construed as if drafted jointly by all parties and no presumption or burden of proof shall arise favoring or disfavoring any party by virtue of the authorship of any of the provisions of this Agreement. The use of the word "including" shall not be deemed to be limited and shall be read as "including but not limited to." The fundamental premise of this Agreement is that in all events Neurocrine shall incur no obligation or expense in connection with the items identified in Section 2, above, and further that this Agreement shall be interpreted consistently with that intent.

(k) Entire Agreement; No Inconsistent Agreements. This Agreement, together with any exhibits hereto, contains the entire agreement between the parties and supersedes any prior written or oral agreement between said parties concerning the subject matter contained herein. There are no representations, agreements, arrangements or understandings, oral or written, between or among the parties relating to the subject matter contained in this Agreement, which are not fully expressed herein. The parties also agree that Indemnitor's obligations and responsibilities under this Agreement shall not be limited or subject to indemnity or insurance by Neurocrine through any other agreement or policy relating to the Indemnitor, including any general indemnity agreements or any insurance policy Neurocrine may have.

(l) Further Assurances. Each party hereby agrees to promptly sign any additional instruments or documents which are necessary or appropriate to carry out the purpose of this Agreement.

{Signature Page Follows}

The parties have entered into this Agreement as of the date first set forth above.

NEUROCRINE BIOSCIENCES, INC.

By: /s/ Margaret Valeur-Jensen
---
Name:
Its:

Address:
10555 Science Center Drive
San Diego, California 92121
Telephone: (858) 658-7600
Fax:

/s/ Paul Conlon
---
PAUL CONLON

Address:

Telephone:
Fax:

EXHIBIT 21.1

NEUROCRINE BIOSCIENCES INC. SUBSIDIARIES

| NAME OF SUBSIDIARY | STATE OF INCORPORATION |
|---|---|
| Neurocrine International LLC | Delaware |
| Science Park Center LLC | California |

Exhibit 23.1

Consent of Ernst & Young LLP, Independent Auditors

We consent to the incorporation by reference in the Registration Statements Form S-3 (Nos. 333-108726, 333-105917 and 333-73216) and Form S-8 (Nos. 333-105907, 333-101756, 333-92328, 333-65198, 333-57096, 333-44012, 333-87127 and 333-57875) of our report dated January 23, 2004, with respect to the consolidated financial statements of Neurocrine Biosciences, Inc. included in its Annual Report (Form 10-K) for the year ended December 31, 2003, filed with the Securities and Exchange Commission.

/S/ ERNST & YOUNG LLP

San Diego, California
March 9, 2004

EXHIBIT 31.1

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

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

1. I have reviewed this 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 report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

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

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

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

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

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

   a) all significant deficiencies in the design or operation of internal controls 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: March 12, 2004

/s/ Gary A. Lyons
---
Gary A. Lyons
President and Chief Executive Officer

EXHIBIT 31.2

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

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

1. I have reviewed this 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 report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

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

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

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

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

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

   a) all significant deficiencies in the design or operation of internal controls 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: March 12, 2004

/s/ Paul W. Hawran
---
Paul W. Hawran
Executive Vice President and
Chief Financial Officer

EXHIBIT 32

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

In connection with the Quarterly Report of Neurocrine Biosciences, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 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.

March 12, 2004

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

In connection with the Quarterly Report of Neurocrine Biosciences, Inc. (the "Company") on Form 10-K for the year ended December 31, 2003 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:

(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.

March 12, 2004

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