ARRAY BIOPHARMA INC
Form 10-Q
February 02, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2009

or

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

For the transition period from to

Commission File Number: 000-31979

Array BioPharma Inc.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**84-1460811**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
3200 Walnut Street, Boulder, CO	**80301**
(Address of Principal Executive Offices)	*(Zip Code)*

(303) 381-6600

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes o No o

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

Large Accelerated Filer o Accelerated Filer x

Non-Accelerated Filer o Smaller Reporting Company o

(do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of January 28, 2010, the registrant had 50,575,126 shares of common stock outstanding.

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ARRAY BIOPHARMA INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2009

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

ARRAY BIOPHARMA INC.

Condensed Balance Sheets

(Amounts in Thousands, Except Share and Per Share Amounts)

(Unaudited)

	December 31, 2009	June 30, 2009
ASSETS		
Current assets		
Cash and cash equivalents	$ 97,754	$ 33,202
Marketable securities	270	7,296
Prepaid expenses and other current assets	4,322	4,419
Total current assets	102,346	44,917
Long-term assets		
Marketable securities	17,332	16,990
Property and equipment, net	23,964	26,498
Other long-term assets	3,391	6,650
Total long-term assets	44,687	50,138
Total assets	$ 147,033	$ 95,055
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities		
Accounts payable and other accrued expenses	$ 7,556	$ 8,421
Accrued outsourcing costs	5,018	4,759
Accrued compensation and benefits	5,393	7,848
Deferred rent	3,107	3,034
Deferred revenue	40,634	11,233
Current portion of long-term debt	15,000	15,000
Total current liabilities	76,708	50,295
Long-term liabilities		
Deferred rent	19,894	21,481
Deferred revenue	51,762	28,340
Long-term debt, net	94,701	68,170
Derivative liabilities	857	-
Other long-term liability	703	470
Total long-term liabilities	167,917	118,461
Total liabilities	244,625	168,756
Commitments and contingencies		
Stockholders deficit		

Preferred stock, $0.001 par value; 10,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock, $0.001 par value; 120,000,000 shares authorized; 50,565,126 and 48,125,776 shares issued and outstanding, as of December 31, 2009 and June 30, 2009, respectively	51	48
Additional paid-in capital	320,666	312,349
Warrants	36,296	23,869
Accumulated other comprehesive income	5,222	3,234
Accumulated deficit	(459,827)	(413,201)
Total stockholders deficit	(97,592)	(73,701)
Total liabilities and stockholders deficit	$ 147,033	$ 95,055

The accompanying notes are an integral part of these condensed financial statements.

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ARRAY BIOPHARMA INC.

Condensed Statements of Operations and Comprehensive Loss

(Amounts in Thousands, Except Per Share Data)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	**2008**	**2009**	**2008**
Revenue				
Collaboration revenue	$ 4,434	$ 5,041	$ 9,478	$ 9,278
License and milestone revenue	5,210	2,648	8,056	4,158
Total revenue	9,644	7,689	17,534	13,436
Operating expenses				
Cost of revenue	5,235	5,063	11,157	10,183
Research and development for proprietary drug discovery	19,104	23,709	38,305	48,218
General and administrative	4,460	4,480	8,673	8,974
Total operating expenses	28,799	33,252	58,135	67,375
Loss from operations	(19,155)	(25,563)	(40,601)	(53,939)
Other income (expense)				
Impairment of marketable securities	-	(10,452)	(217)	(14,362)
Interest income	1,422	533	1,726	1,413
Interest expense	(4,092)	(2,336)	(7,534)	(4,616)
Total other income (expense)	(2,670)	(12,255)	(6,025)	(17,565)
Net loss	(21,825)	(37,818)	(46,626)	(71,504)
Change in unrealized gains and losses on marketable securities	93	(8)	1,988	1,949
Comprehensive loss	$ (21,732)	$ (37,826)	$ (44,638)	$ (69,555)
Weighted average shares outstanding - basic and diluted	49,405	47,605	48,771	47,589
Net loss per share - basic and diluted	$ (0.44)	$ (0.79)	$ (0.96)	$ (1.50)

The accompanying notes are an integral part of these condensed financial statements.

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ARRAY BIOPHARMA INC.

Condensed Statement of Stockholders Deficit

(Amounts in Thousands)

(Unaudited)

	Preferred Stock		Common Stock		Additional Paid-in		Accumulated Other Comprehensive	Accumulated	
	Shares	Amounts	Shares	Amounts	Capital	Warrants	Income	Deficit	Total
Balance as of June 30, 2009	-	$ -	48,125	$ 48	$ 312,349	$ 23,869	$ 3,234	$ (413,201)	$ (73,701)
Issuance of common stock under stock option and employee stock purchase plans	-	-	683	1	1,096	-	-	-	1,097
Share-based compensation expense	-	-	-	-	2,996	-	-	-	2,996
Issuance of common stock for cash, net of offering costs	-	-	757	1	1,814	-	-	-	1,815
Issuance of common stock warrants	-	-	-	-	-	12,427	-	-	12,427
Payment of employee bonus with stock	-	-	1,000	1	2,411	-	-	-	2,412
Recognition of unrealized gain out of accumulated other comprehensive income to earnings	-	-	-	-	-	-	(394)	-	(394)
Change in unrealized gain on marketable securities	-	-	-	-	-	-	2,382	-	2,382
Net loss	-	-	-	-	-	-	-	(46,626)	(46,626)
Balance as of December 31, 2009	-	$ -	50,565	$ 51	$ 320,666	$ 36,296	$ 5,222	$ (459,827)	$ (97,592)

The accompanying notes are an integral part of these condensed financial statements.

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ARRAY BIOPHARMA INC.

Condensed Statements of Cash Flows

(Amounts in Thousands)

(Unaudited)

	Six Months Ended December 31,	
	2009	**2008**
Cash flows from operating activities		
Net loss	$ (46,626)	$ (71,504)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization expense	3,285	3,255
Non-cash interest expense for the Deerfield Credit Facility	3,363	3,489
Share-based compensation expense	2,996	2,964
Realized gain on marketable security	(1,165)	-
Impairment of marketable securities	217	14,362
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	805	1,323
Accounts payable and other accrued expenses	(865)	474
Accrued outsourcing costs	259	(4,666)
Accrued compensation and benefits	(43)	(2,178)
Deferred rent	(1,514)	(1,289)
Deferred revenue	52,823	2,592
Net cash provided by (used in) operating activities	13,535	(51,178)
Cash flows from investing activities		
Purchases of property and equiment	(748)	(2,289)
Purchases of marketable securities	-	(16,303)
Proceeds from sales and maturities of marketable securities	9,853	41,750
Net cash provided by investing activities	9,105	23,158
Cash flows from financing activities		
Proceeds from exercise of stock options and shares issued under the employee stock purchase plan	1,097	1,585
Proceeds from the issuance of common stock for cash	2,121	-
Payment of offering costs	(306)	-
Proceeds from the issuance of long-term debt and warrants	40,000	40,000
Payment of transaction fee	(1,000)	(1,000)
Net cash provided by financing activities	41,912	40,585
Net increase in cash and cash equivalents	64,552	12,565
Cash and cash equivalents as of beginning of period	33,202	56,448
Cash and cash equivalents as of end of period	$ 97,754	$ 69,013
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 3,631	$ 1,023

The accompanying notes are an integral part of these condensed financial statements.

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ARRAY BIOPHARMA INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

For the quarter ended December 31, 2009

(Unaudited)

NOTE 1 - OVERVIEW AND BASIS OF PRESENTATION

Organization

Array BioPharma Inc. (the Company) a biopharmaceutical company focused on the discovery, development and commercialization of targeted small molecule drugs to treat patients afflicted with cancer and inflammatory diseases. The Company s proprietary drug development pipeline includes clinical candidates that are designed to regulate therapeutically important target proteins. In addition, leading pharmaceutical and biotechnology companies partner with the Company to discover and develop drug candidates across a broad range of therapeutic areas.

Basis of Presentation

The Company follows the accounting guidance outlined in the Financial Accounting Standards Board Codification. The accompanying unaudited Condensed Financial Statements have been prepared without audit and do not include all of the disclosures required by the Financial Accounting Standards Board Codification guidelines, which have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) relating to requirements for interim reporting. The unaudited Condensed Financial Statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly the financial position of the Company as of December 31, 2009, its results of operations for the three and six months ended December 31, 2009 and 2008, and its cash flows for the six months ended December 31, 2009 and 2008. Operating results for the three and six months ended December 31, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2010.

These unaudited Condensed Financial Statements should be read in conjunction with the Company s audited Financial Statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended June 30, 2009 filed with the SEC on August 18, 2009.

Additionally, the Company has evaluated subsequent events occurring through the filing date of this Quarterly Report on Form 10-Q and has determined there were no subsequent events to record or disclose in this report. Certain fiscal 2009 amounts have been reclassified to conform to the current year presentation. Specifically, Accounts Payable and Other Accrued Expenses were aggregated into one line item, Accounts Payable and Other Accrued Expenses, in the accompanying Condensed Balance Sheets.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (U.S.) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Although management bases these estimates on historical data and other assumptions believed to be reasonable under the circumstances, actual results could differ significantly from these estimates.

The Company believes the accounting estimates having the most significant impact on its financial statements relate to (i) estimating the fair value of the Company s auction rate securities (ARS); (ii) estimating accrued outsourcing costs for clinical trials and preclinical testing; (iii) estimating the fair value of the Company s long-term debt that has associated warrants and embedded derivatives, which also requires separate valuation; and (iv) estimating the lives over which up-front payments and milestones from collaboration agreements are recognized.

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ARRAY BIOPHARMA INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

For the quarter ended December 31, 2009

(Unaudited)

Liquidity

The Company has incurred operating losses and has an accumulated deficit primarily as a result of ongoing research and development spending. As of December 31, 2009, the Company had an accumulated deficit of $459.8 million. The Company had net losses of $21.8 million and $37.8 million for the three months ended December 31, 2009 and 2008, respectively, and $46.6 million and $71.5 million for the six months ended December 31, 2009 and 2008, respectively. The Company had net losses of $127.8 million, $96.3 million and $55.4 million for the fiscal years ended June 30, 2009, 2008 and 2007, respectively.

The Company has historically funded its operations through revenue from its collaborations and out-licensing transactions, the issuance of equity securities and through debt provided by its credit facilities. Until the Company can generate sufficient levels of cash from its operations, which the Company does not expect to achieve in the foreseeable future, the Company will continue to utilize its existing cash, cash equivalents and marketable securities that were generated primarily from these sources.

The Company currently uses approximately $21 million per quarter to fund its operations. The Company believes that its existing cash, cash equivalents and marketable securities, excluding the value of the ARS it holds, will enable it to continue to fund its operations at this level for the next 12 months. The Company is currently in active licensing discussions with a number of potential partners on select programs. In December 2009, the Company received a $60 million up front payment from Amgen Inc. under a Collaboration and License Agreement with them for the Company s small-molecule glucokinase activator, AMG 151 / ARRY-403. The Company s current plan contemplates the receipt of significant additional upfront payments from new collaboration or licensing deals in the next 12 months. There can be no guarantee the Company will be successful in receiving such payments. The Company also plans to satisfy its interest payment obligations under the credit facilities with Deerfield Private Design Fund, L.P. and Deerfield Private Design International Fund, L.P. (collectively Deerfield) either through the issuance of shares of common stock to Deerfield in accordance with the facility agreements with Deerfield discussed in Note 5 Long-Term Debt Deerfield Credit Facilities, or with the proceeds from sales of its common stock pursuant to the Equity Distribution Agreement with Piper Jaffray & Co. discussed in Note 8 Equity Distribution Agreement.

If the Company is unable to obtain additional funding from these or other sources to the extent or when needed, it may be necessary to significantly reduce its current rate of spending through further reductions in staff and delaying, scaling back or stopping certain research and development programs. Insufficient funds may also require the Company to relinquish greater rights to product candidates at an earlier stage of development or on less favorable terms to it or its stockholders than the Company would otherwise choose in order to obtain up-front license fees needed to fund its operations.

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ARRAY BIOPHARMA INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

For the quarter ended December 31, 2009

(Unaudited)

Fair Value Measurements

The Company s financial instruments are recognized and measured at fair value in the Company s financial statements and mainly consist of cash and cash equivalents, marketable securities, long-term investments, trade receivables and payables, long-term debt, embedded derivatives associated with the long-term debt, and warrants. The Company uses different valuation techniques to measure the fair value of assets and liabilities, as discussed in more detail below. Fair value is defined as the price that would be received to sell the financial instruments in an orderly transaction between market participants at the measurement date. The Company uses a framework for measuring fair value based on a hierarchy that distinguishes sources of available information used in fair value measurements and categorizes them into three levels:

- Level I: Quoted prices in active markets for identical assets and liabilities.
- Level II: Observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level III: Unobservable inputs.

The Company discloses assets and liabilities measured at fair value based on their level in the hierarchy. Considerable judgment is required in interpreting market data to develop estimates of fair value for assets or liabilities for which there are no quoted prices in active markets, including ARS, warrants issued by the Company and the embedded derivatives associated with the Company s long-term debt. The use of different assumptions and/or estimation methodologies may have a material effect on their estimated fair value. Accordingly, the fair value estimates disclosed by the Company may not be indicative of the amount that the Company or holders of the instruments could realize in a current market exchange.

The Company periodically reviews the realizability of each investment when impairment indicators exist with respect to the investment. If an other-than-temporary impairment of the value of an investment is deemed to exist, the carrying value of the investment is written down to its estimated fair value.

Cash and Cash Equivalents

Cash equivalents consist of short-term, highly liquid financial instruments that are readily convertible to cash and have maturities of 90 days or less from the date of purchase and may consist of money market funds, taxable commercial paper, U.S. government agency obligations and corporate notes and bonds with high credit quality.

Marketable Securities

The Company has designated its marketable securities as of December 31, 2009 and June 30, 2009 as available-for-sale securities and accounts for them at their respective fair values. Marketable securities are classified as short-term or long-term based on the nature of these securities and the availability of these securities to meet current operating requirements. Marketable securities that are readily available for use in current operations are classified as short-term available-for-sale securities and are reported as a component of current assets in the accompanying Condensed Balance Sheets. Marketable securities that are not considered available for use in current operations are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying Condensed Balance Sheets.

Securities that are classified as available-for-sale are carried at fair value, including accrued interest, with temporary unrealized gains and losses reported as a component of Stockholders Deficit until their disposition. The Company reviews all available-for-sale securities each period to determine if it is more likely than not that they will remain available-for-sale based on the Company s intent and ability to sell the security if it is required to do so. The amortized cost of debt securities in this category is adjusted for

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(Unaudited)

amortization of premiums and accretion of discounts to maturity. Such amortization is included in Interest Income in the accompanying Condensed Statements of Operations and Comprehensive Loss. Realized gains and losses are reported in Interest Income and Interest Expense, respectively, in the accompanying Condensed Statements of Operations and Comprehensive Loss as incurred. Declines in value judged to be other-than-temporary are reported in Impairment of Marketable Securities in the accompanying Condensed Statements of Operations and Comprehensive Loss as recognized. The cost of securities sold is based on the specific identification method.

Under the fair value hierarchy, the Company s ARS are measured using Level III, or unobservable inputs, as there is no active market for the securities. The most significant unobservable inputs used in this method are estimates of the amount of time until a liquidity event will occur and the discount rate, which incorporates estimates of credit risk and a liquidity premium (discount). Due to the inherent complexity in valuing these securities, the Company engaged a third-party valuation firm to perform an independent valuation of the ARS beginning with the first quarter of fiscal 2009 and continuing through the current fiscal quarter. While the Company believes that the estimates used in the fair value analysis are reasonable, a change in any of the assumptions underlying these estimates would result in different fair value estimates for the ARS and could result in additional adjustments to the ARS, either increasing or further decreasing their value, possibly by material amounts.

Property and Equipment

Property and equipment are stated at historical cost less accumulated depreciation and amortization. Additions and improvements are capitalized. Certain costs to internally develop software are also capitalized. Maintenance and repairs are expensed as incurred.

Depreciation and amortization are computed on the straight-line method based on the following estimated useful lives:

Furniture and fixtures	7 years
Equipment	5 years
Computer hardware and software	3 years

The Company depreciates leasehold improvements associated with operating leases on a straight-line basis over the shorter of the expected useful life of the improvements or the reasonably assured term of the leases.

The carrying value for property and equipment is reviewed for impairment when events or changes in circumstances indicate the book value of the assets may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows from the use of the asset and its eventual disposition is less than its carrying amount.

Equity Investment

The Company may enter into collaboration and licensing agreements in which it receives an equity interest in consideration for all or a portion of up-front, license or other fees under the terms of the agreement. The Company reports the value of equity securities received from non-publicly traded companies in which it does not exercise a significant controlling interest at cost as Other Long-term Assets in the accompanying Condensed Balance Sheets. The Company monitors its investment for impairment at least annually and makes appropriate reductions in the carrying value if it is determined that an impairment has occurred, based primarily on the financial condition and near term prospects of the issuer.

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(Unaudited)

Accrued Outsourcing Costs

Substantial portions of the Company s preclinical studies and clinical trials are performed by third-party laboratories, medical centers, contract research organizations, and other vendors (collectively CROs). These CROs generally bill monthly or quarterly for services performed or bill based upon milestone achievement. For preclinical studies, the Company accrues expenses based upon estimated percentage of work completed and the contract milestones remaining. For clinical studies, expenses are accrued based upon the number of patients enrolled and the duration of the study. The Company monitors patient enrollment, the progress of clinical studies and related activities to the extent possible through internal reviews of data reported to it by the CROs, correspondence with the CROs and clinical site visits. The Company s estimates depend on the timeliness and accuracy of the data provided by its CROs regarding the status of each program and total program spending. The Company periodically evaluates the estimates to determine if adjustments are necessary or appropriate based on information it receives concerning changing circumstances, conditions or events that may affect such estimates.

Deferred Revenue

The Company records amounts received under its collaboration agreements, but not earned, as Deferred Revenue, which are then classified as current or long-term based on their expected recognition as revenue in the accompanying Condensed Balance Sheets.

Long-term Debt and Embedded Derivatives

The terms of the Company s long-term debt are discussed in detail in Note 5 Long-term Debt. The accounting for these arrangements is complex and is based upon significant estimates by management. The Company reviews all debt agreements to determine the appropriate accounting treatment when the agreement is entered into, and reviews all amendments to determine if the changes require accounting for the amendment as a modification, or extinguishment and new debt. The Company also reviews each long-term debt arrangement to determine if any feature of the debt requires bifurcation and/or separate valuation. These features include hybrid instruments, which are comprised of at least two components ((1) a debt host instrument and (2) one or more conversion features), warrants and other embedded derivatives, such as other rights of the debt holder.

The Company currently has two embedded derivatives related to its long-term debt with Deerfield. The first is a variable interest rate structure that constitutes a liquidity-linked variable spread feature. The second derivative is a significant transaction contingent

put option relating to the ability of Deerfield to accelerate the repayment of the debt in the event of certain changes in control of the Company. Collectively, they are referred to as the Embedded Derivatives. Under the fair value hierarchy, the Company s Embedded Derivatives are measured using Level III, or unobservable inputs as there is no active market for them. The fair value of the variable interest rate structure is based on the Company s estimate of the probable effective interest rate over the term of the credit facilities. The fair value of the put option is based on the Company s estimate of the probability that a change in control that triggers Deerfield s right to accelerate the debt will occur. With those inputs, the fair value of each Embedded Derivative is calculated as the difference between the fair value of the Deerfield credit facilities if the Embedded Derivatives are included, and the fair value of the Deerfield credit facilities if the Embedded Derivatives are excluded. Due to the inherent complexity in valuing the Deerfield credit facilities and the Embedded Derivatives, the Company engaged a third-party valuation firm to perform the valuation as of July 31, 2009, September 30, 2009 and December 31, 2009. The estimated fair value of the Embedded Derivatives was determined based on management s judgment and assumptions. The use of different assumptions could result in significantly different estimated fair values.

The fair value of the Embedded Derivatives was initially recorded as Derivative Liabilities and as Debt Discount in the Company s accompanying Condensed Balance Sheets. Any change in the value of the Embedded Derivatives is adjusted quarterly as appropriate and recorded to Derivative Liabilities in the

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ARRAY BIOPHARMA INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

For the quarter ended December 31, 2009

(Unaudited)

Condensed Balance Sheets and Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss. The Debt Discount is being amortized from the draw date of July 31, 2009 to the end of the term of the Deerfield credit facilities using the effective interest method and recorded as Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Warrants issued by the Company in connection with its long-term debt arrangements are reviewed to determine if they should be classified as liabilities or as equity. All outstanding warrants issued by the Company have been classified as equity. The Company values the warrants at issuance based on a Black-Scholes option pricing model and then allocates a portion of the proceeds under the debt to the warrants based upon their relative fair values.

Any transaction fees relating to the Company s long-term debt arrangements are recorded as Other Long-Term Assets in the Condensed Balance Sheets and amortized to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss using the effective interest method over the term of the underlying debt agreement.

Income Taxes

The Company accounts for income taxes using the asset and liability method. The Company recognizes the amount of income taxes payable or refundable for the year as well as deferred tax assets and liabilities. Deferred tax assets and liabilities are determined based on the difference between the financial statement carrying value and the tax basis of assets and liabilities, and, using enacted tax rates in effect for the year, reflect the expected effect these differences would have on taxable income. Valuation allowances are recorded to reduce the amount of deferred tax assets when, based upon available objective evidence, the expected reversal of temporary differences, and projections of future taxable income, management cannot conclude it is more likely than not that some or all of the deferred tax assets will be realized.

Operating Leases

The Company has negotiated certain landlord/tenant incentives, and rent holidays and escalations in the base price of rent payments under its operating leases. For purposes of determining the period over which these amounts are recognized or amortized, the initial term of an operating lease includes the build-out period of leases, where no rent payments are typically due under the terms of the lease, and includes additional terms pursuant to any options to extend the initial term if it is more likely than not that the Company will exercise such options. The Company recognizes rent holidays and rent escalations on a straight-line

basis over the initial lease term. The landlord/tenant incentives are recorded as an increase to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the initial lease term. The Company has also entered into two sale-lease back transactions for its facilities in Boulder and Longmont, Colorado, where the consideration received from the landlord is recorded as increases to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the initial lease term. Deferred Rent balances are classified as short-term or long-term in the accompanying Condensed Balance Sheets based upon when reversal of the liability is expected to occur.

Share-Based Compensation

The Company uses the fair value method of accounting for share-based compensation arrangements which requires that compensation expense be recognized based on the grant date fair value of the arrangement. Share-based compensation arrangements include stock options granted under the Company s Amended and Restated Stock Option and Incentive Plan (the Option Plan) and purchases of

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ARRAY BIOPHARMA INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

For the quarter ended December 31, 2009

(Unaudited)

common stock by its employees at a discount to the market price under the Company s Employee Stock Purchase Plan (the ESPP).

The estimated fair value of stock options is based on the Black-Scholes option pricing model and is expensed on a straight-line basis over the vesting term. Compensation expense for stock options is reduced for estimated forfeitures, which are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense for purchases under the ESPP is recognized based on a Black-Scholes option pricing model that incorporates the estimated fair value of the common stock during each offering period and the percentage of the purchase discount.

Revenue Recognition

Most of the Company s revenue is from research funding, up-front or license fees and milestone payments derived from discovering and developing drug candidates for the Company s collaborators. The Company s agreements with collaboration partners include fees based on contracted annual rates for full-time-equivalent employees working on a program, and may also include non-refundable license and up-front fees, non-refundable milestone payments that are triggered upon achievement of specific research or development goals, and future royalties on sales of products that result from the collaboration. A small portion of the Company s revenue comes from the sale of compounds on a per-compound basis. The Company reports revenue for discovery, the sale of chemical compounds and the co-development of proprietary drug candidates that the Company out-licenses, as Collaboration Revenue. License and Milestone Revenue is combined and consists of the current period s recognized up-front fees and ongoing milestone payments from collaborators.

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition* (SAB 104), which establishes four criteria, each of which must be met, in order to recognize revenue related to the performance of services or the shipment of products. Revenue is recognized when (a) persuasive evidence of an arrangement exists, (b) products are delivered or services are rendered, (c) the sales price is fixed or determinable, and (d) collectability is reasonably assured.

Collaboration agreements that include a combination of discovery research funding, up-front or license fees, milestone payments and/or royalties are evaluated to determine whether each deliverable under the agreement has value to the customer on a stand-alone basis and whether reliable evidence of fair value for the deliverable exists. Deliverables in an arrangement that do not meet the separation criteria are treated as a single unit of accounting, generally applying applicable revenue recognition guidance for the final deliverable to the combined unit of accounting in accordance with SAB 104.

The Company recognizes revenue from non-refundable up-front payments and license fees on a straight-line basis over the term of performance under the agreement, which is generally the estimated research term. These advance payments are deferred and recorded as Deferred Revenue upon receipt, pending recognition, and are classified as a short-term or long-term liability in the accompanying Condensed Balance Sheets. When the performance period is not specifically identifiable from the agreement, the Company estimates the performance period based upon provisions contained within the agreement, such as the duration of the research term, the specific number of full-time-equivalent scientists working a defined number of hours per year at a stated price under the agreement, the existence, or likelihood of achievement, of development commitments, and other significant commitments of the Company.

The Company also has agreements that provide for milestone payments. In certain cases, a portion of each milestone payment is recognized as revenue when the specific milestone is achieved based on the applicable percentage of the estimated research or development term that has elapsed to the total estimated research and/or development term. In other cases, when the milestone payment finances future development obligations of the Company, the revenue is recognized on a straight-line basis over the estimated remaining development period.

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The Company periodically reviews the expected performance periods under each of its agreements that provide for non-refundable up-front payments and license fees and milestone payments and the amortization periods are adjusted when appropriate. Revenue recognition related to non-refundable license fees and up-front payments and to milestone payments could be accelerated in the event of early termination of programs or alternatively, decelerated, if programs are extended..

Cost of Revenue and Research and Development Expenses for Proprietary Drug Discovery

The Company incurs costs in connection with performing research and development activities which consist mainly of compensation, associated fringe benefits, share-based compensation, preclinical and clinical outsourcing costs and other collaboration-related costs, including supplies, small tools, facilities, depreciation, recruiting and relocation costs and other direct and indirect chemical handling and laboratory support costs. The Company allocates these costs between Cost of Revenue and Research and Development Expenses for Proprietary Drug Discovery based upon the respective time spent on each by its scientists on development conducted for its collaborators and for its internal proprietary programs. Cost of Revenue represents the costs associated with research and development, including preclinical and clinical trials, conducted by the Company for its collaborators. Research and Development Expenses for Proprietary Drug Discovery consist of direct and indirect costs related to specific proprietary programs and related to programs under collaboration agreements which the Company has concluded it is likely to retain the rights to. The Company does not bear any risk of failure for performing these activities and the payments are not contingent on the success or failure of the research program. Accordingly, the Company expenses these costs when incurred.

Where the Company s collaboration agreements provide for it to conduct development of drug candidates, and for which the Company s partner has an option to obtain the right to conduct further development and to commercialize a product, the Company attributes a portion of its research and development costs to Cost of Revenue based on the percentage of total programs under the agreement that the Company concludes is likely to be selected by the partner. These costs may not be incurred equally across all programs. In addition, the Company continually evaluates the progress of development activities under these agreements and if events or circumstances change in future periods that the Company reasonably believes would make it unlikely that a collaborator would exercise an option with respect to the same percentage of programs, the Company will adjust the allocation accordingly.

For example, the Company granted Celgene Corporation an option to select up to two of four programs developed under its collaboration agreement with Celgene and concluded that Celgene was likely to exercise its option with respect to two of the four programs. Accordingly, the Company reported costs associated with the Celgene collaboration as follows: 50% to Cost of Revenue, with the remaining 50% to Research and Development Expenses for Proprietary Drug Discovery. Celgene waived its rights with respect to one of the programs during the second quarter of fiscal 2010, at which time management determined that Celgene is likely to exercise its option to license one of the remaining three programs. Accordingly, beginning October 1, 2009, the Company began reporting costs associated with the Celgene collaboration as follows: 33.3% to Cost of Revenue, with the remaining 66.7% to Research and Development Expenses for Proprietary Drug Discovery. See Note 4, Deferred Revenue, for further information about the Company s collaboration with Celgene.

Net Loss per Share

Basic net loss per share is computed by dividing net loss for the period by the weighted averaged number of common shares outstanding during the period. Diluted net loss per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options and warrants issued related to the Company s long-term debt. The treasury stock method is used to calculate the potential dilutive effect of these common stock equivalents. Potentially dilutive shares are excluded from the computation of diluted net loss per share when their effect is anti-dilutive. As a result of the Company s net losses through the date of these Condensed Financial Statements, all potentially

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dilutive securities were anti-dilutive and therefore have been excluded from the computation of diluted net loss per share.

Comprehensive Income (Loss)

The Company s comprehensive income (loss) consists of the Company s net loss and unrealized gains and losses on investments in available-for-sale marketable securities. The Company had no other sources of comprehensive income (loss) for the fiscal periods presented.

Recent Accounting Pronouncements

Collaborative Arrangements - In the first quarter of fiscal 2010, new guidance relating to the accounting practices and disclosures for collaborative arrangements became effective. A collaborative arrangement is a contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties who are both (a) active participants in the activity and (b) exposed to significant risks and rewards dependent on the commercial success of the activity. If the Company s collaboration agreements are determined to be collaborative arrangements, additional disclosures may be required by this guidance beginning with this Quarterly Report on Form 10-Q. The Company determined that while certain agreements are collaborative arrangements, none of the current activities being performed under those arrangements would require a change to the accounting practices or disclosures made by the Company in its Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

Convertible Debt - In the first quarter of fiscal 2010, guidance relating to the accounting for convertible debt became effective. The Company determined that none of its credit facilities are considered convertible debt as defined under this accounting guidance and therefore this pronouncement had no impact on its financial statements and disclosures.

Fair Value Measurements - In August 2009, new literature was issued giving companies additional guidance relating to the fair value measurements and disclosures of liabilities. The guidance was effective for the Company for the first quarter of fiscal 2010 and was adopted at that time. The effect of the guidance is reflected in the accompanying Condensed Financial Statements.

Revenue Recognition for Multiple Deliverable Arrangements - In October 2009, new guidance was issued related to multiple-deliverable revenue arrangements that are effective for the Company prospectively for revenue arrangements entered into or materially modified subsequent to July 1, 2010. The objective of this change is to address the accounting for multiple-deliverable arrangements to enable companies to account more easily for products or services (deliverables) separately rather than as a combined unit. The Company is currently evaluating the impact of this guidance on its financial statements.

NOTE 2 SEGMENTS, GEOGRAPHIC INFORMATION AND SIGNIFICANT COLLABORATORS

Segments

All operations of the Company are considered to be in one operating segment and, accordingly, no segment disclosures have been presented. The physical location of all of the Company s equipment, leasehold improvements and other fixed assets is within the U.S.

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Geographic Information

All of the Company s collaboration agreements are denominated in U.S. dollars. The following table details revenue from collaborators by geographic area based on the country in which collaborators are located or the ship-to destination for the compounds (dollars in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
North America	$ 9,543	$ 7,408	$ 17,396	$ 13,114
Europe	86	271	109	309
Asia Pacific	15	10	29	13
	$ 9,644	$ 7,689	$ 17,534	$ 13,436

Significant Collaborators

The following collaborators contributed greater than 10% of total revenue during the periods set forth below:

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Genentech, Inc.	46.3%	60.5%	54.3%	63.9%
Celgene Corporation	42.5%	18.6%	32.7%	21.3%
VentiRx Pharmaceuticals, Inc.	0.1%	16.3%	0.6%	11.3%
	88.9%	95.4%	87.6%	96.5%

The loss of one or more significant collaborators could have a material adverse effect on the Company s business, operating results or financial condition. The Company does not require collateral to secure the payment obligations of its collaborators. Although the Company is impacted by economic conditions in the biotechnology and pharmaceutical sectors, most collaborators pay in advance and management does not believe significant credit risk exists as of December 31, 2009.

NOTE 3 - MARKETABLE SECURITIES

The Company s investments in marketable securities include domestic public corporate debt securities, commercial paper issued by domestic public companies, obligations of U.S. federal government agencies and ARS. All of these investments are held in the name of the Company at a limited number of financial institutions. The Company s investments in marketable securities were all classified as available-for-sale as of December 31, 2009 and June 30, 2009.

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Marketable securities consisted of the following as of December 31, 2009 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term available-for-sale securities:				
U.S. Government agency securities	$ -	$ -	$ -	$ -
Mutual fund securities	270	-	-	270
Sub-total	270	-	-	270
Long-term available-for-sale securities:				
Auction rate securities	11,386	5,243	-	16,629
Mutual fund securities	703	-		703
Sub-total	12,089	5,243	-	17,332
Total	$ 12,359	$ 5,243	$ -	$ 17,602

Marketable securities consisted of the following as of June 30, 2009 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term available-for-sale securities:				
U.S. Government agency securities	7,059	-	-	7,059
Mutual fund securities	237	-	-	237
Sub-total	7,296	-	-	7,296
Long-term available-for-sale securities:				
Auction rate securities	13,284	3,234	-	16,518
Mutual fund securities	472	-	-	472
Sub-total	13,756	3,234	-	16,990
Total	$ 21,052	$ 3,234	$ -	$ 24,286

The fair value measurement categories of these marketable securities as of December 31, 2009 and June 30, 2009 were as follows (dollars in thousands):

	December 31, 2009	June 30, 2009
Quoted prices in active markets for identical assets (Level 1)	$ 973	$ 7,768
Significant unobservable inputs (Level 3)	16,629	16,518
	$ 17,602	$ 24,286

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The amortized cost and estimated fair value of available-for-sale securities by contractual maturity as of December 31, 2009 is as follows (dollars in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 270	$ 270
Due in one year to three years	703	703
Due after 10 years or more	11,386	16,629
	$ 12,359	$ 17,602

Auction Rate Securities

During the fiscal year ended June 30, 2008, auctions for all of the ARS were unsuccessful. During the first quarter of fiscal 2009, auctions for the ARS that the Company holds were suspended. The lack of successful auctions resulted in the interest rate on these investments increasing to LIBOR plus additional basis points as stipulated in the auction rate agreements, ranging from 200 to 350 additional basis points, which has continued through the current fiscal quarter. While the Company now earns a higher contractual interest rate on these investments, the investments are not currently liquid and may not be liquid at a time when the Company needs to access these funds. In the event the Company needs to access these funds and liquidate the ARS prior to the time auctions of these investments are successful or the date on which the original issuers retire these securities, the Company may be required to sell them in a distressed sale in a secondary market, most likely for a lower value than their current fair value.

As of December 31, 2009, the Company held six securities with a par value of $28.9 million and a fair value of $16.6 million. As of June 30, 2009, the Company held seven securities with a par value of $32.9 million and a fair value of $16.5 million. The Company sold one of the ARS in the second quarter of fiscal 2010 with a par value of $4 million for $2.8 million and realized a gain of $1.2 million, of which $394 thousand was reclassified to earnings from Accumulated Other Comprehensive Income.

Under the fair value hierarchy, the Company s ARS are measured using Level III, or unobservable inputs, as there is no active market for the securities. The most significant unobservable inputs used in this method are estimates of the amount of time until a liquidity event will occur and the discount rate, which incorporates estimates of credit risk and a liquidity premium (discount). Due to the inherent complexity in valuing these securities, the Company engaged a third-party valuation firm to perform an independent valuation of the ARS beginning with the first quarter of fiscal 2009 and continuing through the current fiscal quarter.

While the Company believes that the estimates used in the fair value analysis are reasonable, a change in any of the assumptions underlying these estimates would result in different fair value estimates for the ARS and could result in additional changes to the ARS values, either increasing or decreasing their value.

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Based on its fair value analysis and fair value estimates as of each quarter end, the Company recorded adjustments to the fair value of its ARS that are summarized below (dollars in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2009	2008	2009	2008
Unrealized gains	$ 506	$ -	$ 2,404	$ -
Gains attributable to the change in unrealized gains	$ 394	$ -	$ 394	$ -
Other current period gains	771	-	771	-
	$ 1,165	$ -	$ 1,165	$ -
Losses attributable to the change in unrealized losses	$ -	$ -	$ -	$ (1,939)
Other current period losses	-	(10,452)	(217)	(12,423)
	$ -	$ (10,452)	$ (217)	$ (14,362)

The Company has recorded cumulative net fair value declines of $12.3 million to the ARS for the six securities held as of December 31, 2009.

A rollforward of adjustments to the fair value of the ARS for the six months ended December 31, 2009 and 2008 follows (dollars in thousands):

	Six Months Ended December 31,	
	2009	2008
Balance as of prior year end	$ 16,518	$ 29,089
Add: Current period gains included in equity	2,404	-
Add: Current period gains included in earnings	771	-
Less: Cost basis of ARS sold	(2,847)	-
Less: Current period losses included in earnings	(217)	(12,423)
Balance as of current quarter end	$ 16,629	$ 16,666

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NOTE 4 DEFERRED REVENUE

Deferred revenue consisted of the following (dollars in thousands):

	December 31, 2009	June 30, 2009
Amgen, Inc.	$ 59,097	$ -
Celgene Corporation	28,689	34,429
Genentech, Inc.	4,610	5,060
Other	-	84
Total deferred revenue	92,396	39,573
Less: Current portion	(40,634)	(11,233)
Deferred revenue, long term	$ 51,762	$ 28,340

Amgen Inc.

In December 2009, the Company granted Amgen the exclusive worldwide right to develop and commercialize the Company s small-molecule glucokinase activator, AMG 151 / ARRY-403. Under the Collaboration and License Agreement, the Company is responsible for completing Phase 1 clinical trials on AMG 151 / ARRY-403. The Company will also conduct further research funded by Amgen to create second generation glucokinase activators. Amgen is responsible for further development and commercialization of AMG 151 / ARRY-403 and any resulting second generation compounds. The Agreement also provides the Company with an option to co-promote any approved drugs with Amgen in the U.S. with certain limitations.

In partial consideration for the rights granted to Amgen under the Agreement, Amgen paid the Company an up-front fee of $60 million. Amgen will also pay the Company for research on second generation compounds based on the number of full-time-equivalent scientists working on the discovery program. The Company is also entitled to receive up to approximately $666 million in aggregate milestone payments if all clinical and commercialization milestones specified in the Agreement for AMG 151 / ARRY-403 and at least one backup compound are achieved, as well as royalties on sales of any approved drugs developed under the Agreement.

The Company estimates that its obligations under the Agreement will continue until December 31, 2012 and, therefore, is recognizing the up-front fee from the date the Agreement was signed on December 13, 2009 through that time. The Company recognized $903 thousand of revenue for the three months ended December 31, 2009, which is recorded in License and Milestone Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Either party may terminate the Agreement in the event of a material breach of a material obligation under the Agreement by the other party upon 90 days prior notice, and Amgen may terminate the Agreement at any time upon notice of 60 or 90 days depending on the development activities going on at the time of such notice. The parties have also agreed to indemnify each other for certain liabilities arising under the Agreement.

Celgene Corporation

In September 2007, the Company entered into a worldwide strategic collaboration with Celgene focused on the discovery, development and commercialization of novel therapeutics in cancer and inflammation. Under the agreement, Celgene made an up-front payment of $40 million to the Company to provide

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research funding for activities conducted by the Company under the agreement. The Company is responsible for all discovery and clinical development through Phase 1 or Phase 2a. Celgene has an option to select a limited number of drugs developed under the collaboration that are directed to up to two of four mutually selected discovery targets and will receive exclusive worldwide rights to the drugs, except for limited co-promotional rights in the U.S. Celgene s option may be exercised with respect to drugs directed at any of the four targets at any time until the earlier of completion of Phase 1 or Phase 2a trials for the drug or September 2014. Additionally, the Company is entitled to receive, for each drug for which Celgene exercises an option, potential milestone payments of $200 million, if certain discovery, development and regulatory milestones are achieved and an additional $300 million if certain commercial milestones are achieved, as well as royalties on net sales. The Company retains all rights to the other programs. In June 2009, the parties amended the Celgene agreement to substitute a new discovery target in place of an existing target, and Celgene paid the Company $4.5 million in consideration for the amendment. No other provisions of the agreement with Celgene were modified by the amendment. In September 2009, Celgene notified the Company it was waiving its rights to one of the programs, leaving them the option to select two of the remaining three targets.

The Company had previously estimated that its discovery obligations under the Agreement would continue through September 2014 and accordingly was recognizing as revenue the up front fees received from the date of receipt through September 2014. Effective October 1, 2009, the Company estimates that its discovery efforts under the Agreement will conclude by September 2011 and the Company would complete its obligations at that time. Therefore, the unamortized balance as of September 30, 2009 is being amortized over the revised shorter period. The Company recognized $4.1 million and $1.4 million for the three months ended December 31, 2009 and 2008, respectively, which is recorded in License and Milestone Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss. The Company recognized $5.7 million and $2.9 million for the six months ended December 31, 2009 and 2008, respectively, which is recorded in License and Milestone Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Celgene can also choose to terminate any drug development program for which it has not exercised an option at any time, provided that it must give the Company prior notice. In this event, all rights to the program remain with the Company and it would no longer be entitled to receive milestone payments for further development or regulatory milestones that it could have achieved Celgene had continued development of the program. Celgene may terminate the agreement in whole, or in part with respect to individual drug development programs for which Celgene has exercised its option, upon six months written notice to the Company. In addition, either party may terminate the agreement, following certain cure periods, in the event of a breach by the other party of its obligations under the agreement.

NOTE 5 LONG-TERM DEBT

Long-term debt consists of the following (dollars in thousands):