Neurocrine BIOSCIENCES

2005 ANNUAL REPORT

yesterday

Pipeline: Research and Development

1993

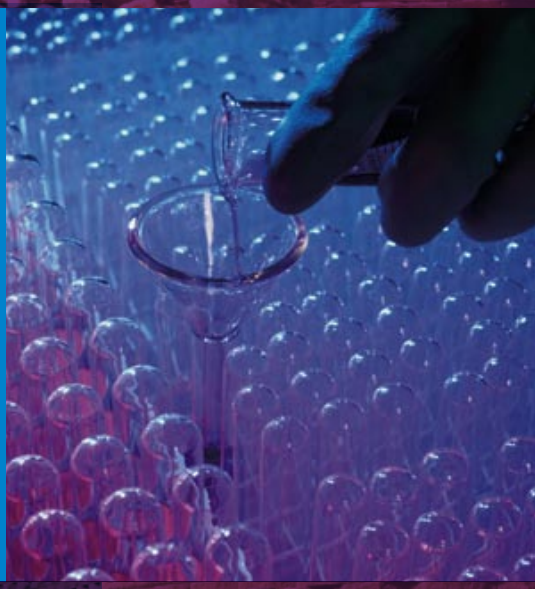
- ***Neurocrine started operation***
- Hired Gary Lyons from Genentech as CEO
- Formed Senior Management Team and brought in key researchers

1994 through 1995

- ***Clinical validation of flagship technologies***
- Developed first leads in Corticotropin Releasing Factor (CRF) program for anxiety/depression
- Synthesized peptides for Altered Peptide Ligand (APL) program
- Established first research collaboration with Janssen Pharmaceutica for CRF Receptor Antagonists

1996 through 1999

- ***Transitioned into clinical development with 5 products in development***
- Implemented business strategy to develop broad diversified product pipeline
- Acquired exclusive worldwide rights to GABA A-receptor subtype agonist (NBI-34060) for insomnia
- Clinical validation showing proof of concept results in 2 lead programs: CRF for anxiety/depression and NBI-34060 for insomnia
- Developed two formulations for NBI-34060: capsules and tablets



2000-2004

- ***Building infrastructure for commercialization***
- Expanded clinical efforts with multiple Phase III clinical program for NBI-34060 for insomnia
- Completed multiple Phase I, pilot Phase I/II trial and Phase II trial with APL NBI-6024 for Type-1 Diabetes
- Entered into collaboration with GlaxoSmithKline (GSK) for CRF Receptor Antagonists
- Added Senior Management Team: legal counsel, clinical development, marketing and head of R&D
- Completed multiple Phase I clinical trials with two GnRH antagonists for certain female health disorders
- Licensed urocortin 2 for cardiovascular diseases from the Research Development Foundation and Salk Institute
- Acquired A2A antagonist compounds for Parkinson's disease from Almirall of Spain
- Constructed new state-of-the-art facility
- *Indiplon* is new development name for NBI-34060
- Neurocrine and Pfizer entered into a worldwide agreement to develop and promote *indiplon*, co-detail Pfizer's antidepressant Zoloft®
- Neurocrine announces U.S. issuance of composition of matter patent for *indiplon* – extending patent life to the year 2020

2005

- ***Completing infrastructure for commercialization***
- Completed building the Neurocrine 200-person sales force
- Completed 17 Phase III clinical trials for *indiplon*, in over 8,000 individuals
- Neurocrine sales force commenced detailing Zoloft with partner Pfizer
- Completed enrollment in Phase II proof of concept trials with GnRH antagonist for endometriosis
- Expanded clinical evaluation of GnRH antagonist for benign prostatic hyperplasia (BPH)
- Completed two Phase I clinical trials for urocortin 2 in Congestive Heart Failure (CHF)
- Filed IND with the FDA to initiate a U.S. Phase II study with urocortin 2 in stable CHF patients

today

patients

Early 2006

- ***Evaluating multiple new compounds in proof of concept clinical trials***
- Responding to FDA's requests on *indiplon*
- Preliminary positive Phase II clinical trial results with urocortin 2 in stable CHF
- Results of Phase II clinical trial with GnRH antagonist in endometriosis demonstrate "proof of concept" safety and efficacy in the clinical setting
- Initiated clinical development of a new compound, H1 antagonist, for the treatment of insomnia
- GSK to begin Phase II clinical trials with CRF antagonist for anxiety/depression and irritable bowel syndrome

PRODUCT PIPELINE:

INDIPLON

GNRH ANTAGONIST

UROCORTIN 2

CRF ANTAGONIST

APL DIABETES

H1 ANTAGONIST

tomorrow

Maintaining and Strengthening Our Pipeline is a High Priority

2006 and Beyond

- ***Advancing the pipeline***
- Planning a third Phase II GnRH antagonist trial in endometriosis over 6-month period
- Planning a Phase II GnRH antagonist trial in BPH for 2006
- Results expected from urocortin 2 Phase II U.S. trial
- Planning a Phase IIb study with urocortin 2 in patients with Acute Decompensated Heart Failure (ADHF). Results expected in 2007
- GSK expects to initiate multiple Phase II clinical trials with CRF antagonist for anxiety/depression in 2006
- Results expected for the Phase II trial with APL NBI-6024 in Type-1 Diabetes in 2006
- H1 antagonist Phase I clinical trial expected to be completed in the second half of 2006
- 2 new compounds from research into clinical development

President's Letter

Gary A. Lyons
Chief Executive Officer, President and Director

This is a time of growth and advancement. The continued development of our product pipeline will remain a high priority.

Having just received the correspondence from the FDA regarding *indiplon*, we are certainly disappointed with the outcome. The FDA actions on our PDUFA date granting an approvable letter for *indiplon* 5 mg and 10 mg capsules and a non-approvable for *indiplon* 15 mg XR tablets requires us to focus on the next steps in the process. We will review with our partner, Pfizer. Following this review we will meet with the FDA to determine the appropriate steps to move forward. We continue to believe that *indiplon* will satisfy a significant unmet medical need for the millions of individuals suffering from insomnia.

We are a multi-product company. We believe that our business strategy, which has been consistently applied since our founding, is as valid now as it was thirteen years ago. We have slowly, strategically and methodically advanced the Company from a discovery research organization to an integrated biopharmaceutical company and have adopted a business plan to weather the ups and downs of drug development. There have been many challenges in the past as there will be in the future. We are proud of our accomplishments and equally proud of the dedication, motivation and the tireless efforts of all the employees and supporters of Neurocrine. As we are working through the issues with the FDA, we continue to be excited regarding our plans for the future of Neurocrine. This is a time of growth and advancement. The continued development of our product pipeline will remain a high priority. We have consistently maintained a strong financial position, and are making progress in both drug discovery and development. We will continue to seek opportunities both internally and externally to continue the growth of the Company in the years ahead and remain committed to exploring new paths to find solutions for unmet medical needs, while also increasing the value to our shareholders and employees.

Together with our Pfizer colleagues, over the past year we have been active in market development activities for *indiplon*. Our clinical team has published several peer-reviewed publications, with over 50 abstracts submitted to 17 different academic congresses or journals. A study showing *indiplon* having an enhanced and higher combination of affinity and selectivity for the specific GABA-A receptor responsible for sleep than the currently marketed non-benzodiazepine sleep agents zolpidem (Ambien®), zaleplon (Sonata®) and zopiclone (Imovane®) was published in the *Journal of Pharmacology of Experimental Therapeutics*.

Indiplon data presentations are anticipated at several major congresses this year, including the American Psychiatric Association (APA), the Associated Professional Sleep Societies (APSS), and the International Society for Pharmacoeconomics and Outcomes Research. These events provide opportunities for our clinical team to continue to present *indiplon* clinical data to physicians and researchers, support insomnia medical education, and establish Neurocrine's corporate identity by exhibiting at these conferences. We are gratified by the interest from the scientific community in furthering their education related to the diagnosis and treatment of insomnia.

Our 200 person sales force has developed important relationships with the psychiatric community. We will leverage these relationships with our sales force after they complete the detailing of Pfizer's anti-depressant Zoloft®. Neurocrine's business development team is also seeking other products for the Neurocrine sales force to detail.

As it is our top priority to maintain a productive and steady stream of new product candidates, our R&D group continues to make significant progress in advancing our pipeline. We entered 2006 with six programs in clinical development along with several pre-clinical projects in development that are being evaluated for Phase I clinical trials.

This is a time of growth and advancement. The continued development of our product pipeline will remain a high priority.

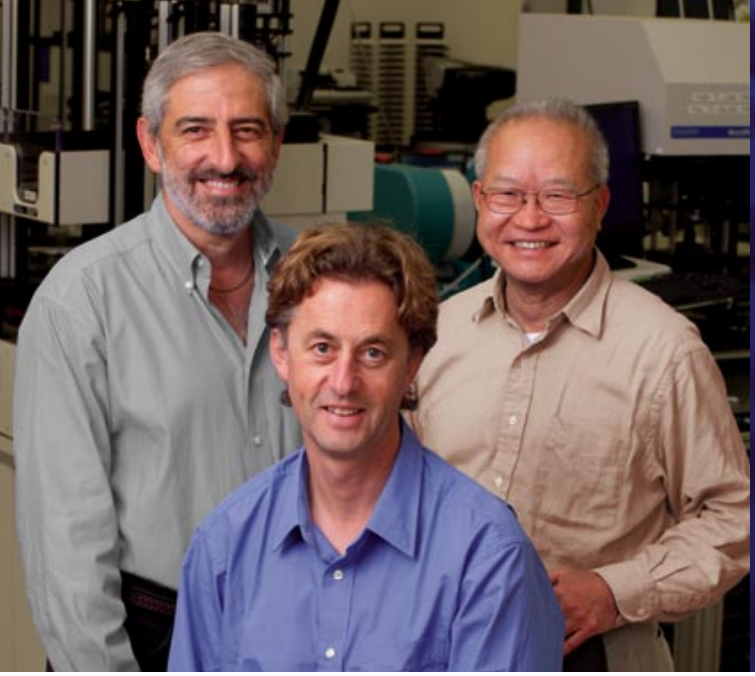
Our proprietary, orally-active small molecule Gonadotropin-Releasing Hormone (GnRH) receptor antagonist program has been an extremely important and successful program this year and will gain further momentum in 2006.

We met our 'proof of concept' criteria in the clinical setting with our lead GnRH antagonist candidate, NBI-56418, in a 3-month efficacy, safety and dose-finding Phase II placebo-controlled clinical trial involving patients with a confirmed diagnosis of endometriosis. We are pleased with the results demonstrating a robust treatment effect with NBI-56418 as shown by two clinical endpoints which measure decrease in severity of disease and pain. The reductions in scores at the highest dose of our drug were comparable to reductions reported for peptide agonists such as Lupron Depot® which, while efficacious, can lead to numerous undesirable side effects and limit utility. From a safety perspective, preliminary information on the adverse event rates showed little difference in the percentage of patients with an adverse event across treatment groups versus placebo. Importantly, there was no increase in symptoms of menopause in the NBI-56418 treated groups as compared with placebo. This study is continuing for a follow-up period of 3 months to further explore safety.

We are also enrolling patients in a second Phase II study with NBI-56418 in patients with endometriosis to further explore dosing, with results expected in the 4th Quarter of 2006. Concurrently, we are moving ahead to select the dosing regimen for an expanded Phase IIb six-month study in several hundred patients with endometriosis. This Phase IIb study is expected to initiate in the 3rd Quarter of 2006. The results from all the completed and ongoing Phase II studies will be the basis for securing agreement to a registration plan acceptable to the FDA, which is estimated to occur next year. We also recently started a Phase I study with NBI-56418 in male volunteers as part of our Benign Prostatic Hyperplasia development program. We expect to provide more details on both the expanded six month trial together with ongoing results from the Phase I trial in the 3rd Quarter of 2006.

Also in Phase II clinical development is our urocortin 2 program, which is progressing from treating moderate Congestive Heart Failure (CHF) patients to the Acute Decompensated Heart Failure (ADHF) patient population. We have completed a clinical trial extending the duration of the infusion of urocortin 2 for up to four hours. Initial results from our Phase II studies in patients with stable CHF indicate that urocortin 2 is generally well tolerated and that the predicted hemodynamic effects on systolic and diastolic blood pressure, heart rate, cardiac work and, most importantly, cardiac output occur over the entire 4-hour infusion. We will announce the full study results in the 3rd Quarter of 2006. Based on our preliminary urocortin 2 data, we are planning additional Phase II studies in patients with ADHF, with results anticipated in the second half of 2007. The first study will include two treatment arms, one for patients for whom heart catheterization is indicated, the other for those not requiring catheterization. These studies are designed to assess the effect of urocortin 2 infusions on a range of parameters including detailed assessment of cardiac hemodynamics via heart catheterization, kidney function, a range of laboratory biomarkers and clinical measures.

In collaboration with GlaxoSmithKline (GSK), our CRF program is progressing as planned through early stage clinical trials with two CRF antagonists now in active development. We look forward to results from these studies within the next 12 months. In addition to ongoing Phase I studies, GSK is planning to initiate Phase II trials in Anxiety/Depression during 2006. In addition to the Anxiety/Depression indication, GSK has an ongoing development program for CRF receptor antagonists in Irritable Bowel Syndrome (IBS). GSK intends to advance the lead CRF receptor antagonist compound into Phase II studies for IBS during 2006. A backup compound has also entered Phase I clinical studies.



Research Fellows

As pictured left to right:

Dimitri E. Grigoriadis, Ph.D.
Alan C. Foster, Ph.D.
Nicholas C. Ling, Ph.D., Emeritus

We will have the results of our two year Phase II study with our APL (NBI-6024) for Type-1 Diabetes this summer. Although we recognized early on that this program was high risk, we felt that it was important to determine unequivocally whether we had the technology to help the many patients suffering from this devastating disease. This is a Phase II, dose-response, safety, tolerability and efficacy trial in approximately 188 adults/adolescents with new onset Type-1 Diabetes.

We are pleased to announce a new program that has entered into Phase I development this year, our highly selective and potent H1 antagonist (NBI-75043) for the treatment of insomnia. We have initiated a single-dose escalation study and will be moving into a multiple dose double-blind, placebo-controlled, night-time sequential dose escalation Phase I clinical trial in the 3rd Quarter of 2006. We expect to initiate a Phase II proof of concept trial in this indication at the end of the year.

Our H1 antagonist compound is the result of the efforts of our R&D group, which continues to meet its goal to fuel our pipeline with at least one new clinical candidate each year. These efforts will insure our pipeline is sufficient to diversify development risk and to provide valuable assets for future business development activities. Our research group is actively pursuing additional leads in multiple areas of CNS and endocrine related disorders. In addition to these programs, our scientists have made great progress in the development and selection of important new potential treatments for Parkinson's disease, pain and a number of other important but underserved CNS therapeutic areas.

2005 was a strong year for Neurocrine financially and we are well-positioned to move forward with our strategic pipeline and corporate goals in 2006. We ended the year with $124 million in revenue and over $270 million in cash at year-end. We continue to prudently manage our cash resources, as we advance our pipeline.

As always our success is based on the accomplishments and outstanding efforts of the dedicated employees throughout our organization. To support our growing infrastructure and pipeline, we have hired two new key members to our management team: Rich Ranieri, Senior Vice President of Human Resources and Chris O'Brien, M.D., Senior Vice President of Clinical Development. To reflect the importance of business development and alliance management to the future of Neurocrine, congratulations go to Kevin Gorman Ph.D., promoted to Executive Vice President and Chief Business Officer. Congratulations also to our new Vice Presidents: Carol Baum, Vice President, Marketing; Tim Coughlin, Vice President, Corporate Controller; and Bill Wilson, Vice President, Information Technology, for their promotions. In addition, we welcome the appointment of Adrian Adams to our Board of Directors. Adrian's extensive experience in launching major pharmaceutical global brands and developing products in many therapeutic areas will be of great benefit to Neurocrine.

In conclusion, 2005 was an important year for Neurocrine, as we continue our efforts toward commercialization as well as continued advancement into new therapeutic areas. My thanks to our shareholders, and collaborators for your trust and support.

Gary A. Lyons
Chief Executive Officer, President and Director

Management Committee

As pictured left to right:

Paul W. Hawran
Executive Vice President and
Chief Financial Officer

Margaret E. Valeur-Jensen, Ph.D., J.D.
Executive Vice President, General Counsel
and Corporate Secretary

Wendell Wierenga, Ph.D.
Executive Vice President of Research
and Development

Kevin C. Gorman, Ph.D.
Executive Vice President and
Chief Business Officer

Richard J. Ranieri
Senior Vice President, Human Resources

Corporate Vice Presidents

As pictured left to right:

Lloyd E. Flanders, Ph.D.
Senior Vice President of Development

Paul J. Conlon, Ph.D.
Senior Vice President of Research (Biology)

Christopher F. O'Brien, M.D.
Senior Vice President of Clinical Development

Carol A. Baum
Vice President of Marketing

Haig Bozigian, Ph.D.
Vice President of Preclinical Development

John Saunders, Ph.D.
Senior Vice President of Research (Chemistry)

Barbara M. Finn
Vice President of Regulatory

As pictured left to right:

Timothy P. Coughlin
Vice President, Corporate Controller

Hernand W. Wilson
Vice President, Information Technology

NATIONAL INSTITUTES OF HEALTH GUIDELINES

State of the **Science**

In June of 2005 the National Institutes of Health (NIH) assembled a turning point State-of-the-Science conference on the Manifestations and Management of Chronic Insomnia in Adults. Leading experts from around the country convened to update the Institute's 1983 report on insomnia to capture the significant scientific advancements over the past 22 years in our understanding and treatment of the condition. After a systematic review of the literature, an independent panel weighed the evidence and prepared a statement that answers the following five questions:

- How is chronic insomnia defined, diagnosed, and classified, and what is known about its etiology?
- What are the prevalence, natural history, incidence, and risk factors for chronic insomnia?
- What are the consequences, morbidities, co-morbidities, and public health burdens associated with chronic insomnia?
- What treatments are used for the management of chronic insomnia, and what is the evidence regarding their safety, efficacy, and effectiveness?
- What are the important future directions for insomnia-related research?

Following are key conclusions and recommendations resulting from the NIH meeting:

- Insomnia is defined by complaints of disturbed sleep in the presence of adequate opportunity and circumstance for sleep.
- Studies suggest that sleep disruption occurs in approximately 30% of the general population and that about 10% suffer from associated daytime functional impairment.
- Historically, insomnia that occurred in the presence of other health conditions was considered "secondary," which lead to under treatment of the insomnia. The term co-morbid insomnia is now recommended.
- Insomnia has a significant impact on the lives of people who suffer from the condition and has a substantial impact on the healthcare system at large.
  - Insomnia can have significant consequences on quality of life and may impair social functioning, work performance, memory and cognitive functioning.
  - The economic burden of chronic insomnia is estimated to be upwards of tens of billions of dollars annually, and further research in outcomes is called for.
- There is a significant need for insomnia education programs directed at physicians, clinicians and the general public.
- Directions for further research included:
  - Development of validated instruments to assess chronic insomnia.
  - Studies to investigate the possible genetic etiology of the disease.
  - Longitudinal research to identify key factors affecting the incidence, natural history and remission of the condition.
  - Effects of insomnia on quality of life, societal costs and benefits associated with intervention.
  - Comparative trials and long-term treatment studies, including studies directed at specific populations.

“The NIH State of the Science conference was a pivotal meeting that reflects a paradigm shift in thinking and our understanding of insomnia as a disease, compared to the last NIH meeting on the topic held over twenty years ago. After a thorough review of the literature and presentations by a number of insomnia thought leaders, the NIH panel produced an excellent consensus statement regarding the body of knowledge which currently exists and recommendations about future research needs.

“One of the greatest challenges that researchers face is translating research findings in a way that best assists health care practitioners, educators, regulators, employers and the general public. This meeting represents a significant opportunity for the sleep community to raise awareness about this highly prevalent condition and the safe and effective treatment options that are available.

“One of the major outcomes of the meeting was the conclusion that of all medications used to treat insomnia, only benzodiazepine receptor agonists (BzRAs) have conclusively been shown to be safe and effective treatments for insomnia, and that the newer BzRAs tend to be safer because of important pharmacokinetic properties.”

Dr. James Walsh
Executive Director, Sleep Medicine and Research Center, St. Luke’s Hospital, St. Louis, Missouri

Tips to stave off sleep problems

National Sleep Foundation

1. Establishing a night-time routine is key to getting restful sleep
2. Give yourself wind-down time – carve out a 20 to 30-minute minimum that you preserve for relaxation before sleeping
3. Try to have dinner by no later than 7 p.m. – eating late can cause sleep problems
4. Try sleeping eight hours a night for a few weeks – you may be surprised how good you feel
5. See a doctor if sleep problems persist

National Sleep Foundation (NSF)

Established in 1990, the National Sleep Foundation (NSF) is an independent nonprofit organization that has been at the forefront of improving public health and safety by achieving understanding of sleep and sleep disorders, and by supporting sleep-related education, research and advocacy.

The NSF is the organizer and sponsor of National Sleep Awareness Week® (NSAW), an annual public education, information, and awareness campaign that coincides with the return to Daylight Saving Time in the Spring. One of the cornerstones of NSAW is the release of NSF's Annual Sleep in America poll. The polls that are conducted by NSF are designed to alert the public, healthcare providers and policymakers to the life and death importance of adequate sleep.

Sleep in America polls that have been conducted by the NSF have revealed the following:

- At least 40 million Americans suffer from sleep disorders, yet 70 percent of adults have never been asked about the quality of their sleep by a physician and fewer than 20 percent ever initiated a discussion.
- Approximately 78 percent of adults report having sleep problems a few nights a week or more.
- More than 44 percent of adults experience daytime sleepiness severe enough to interfere with their daily activities at least a few days each month.
- 29 percent of adults report feeling tired, fatigued or not up to par during wake time 3-4 days/week.

NSF continues to educate the public about the consequences of poor sleep and raise awareness that millions of Americans struggle to stay alert at home, in school, on the job – and on the road. NSF has been recognized for their efforts to raise awareness of the impact of sleep loss and the importance of sleep in society. A few of NSF's educational initiatives include:

- Public Education: Award-winning *Sleepmatters* magazine, NSAW, Sleep in America poll and www.DrowsyDriving.org.
- Research: Pickwick Fellowship: support of young researchers in their professional efforts to study sleep and sleep disorders.
- Partnerships: Federal, State, Non-profit and Corporate partners working to help educate their members about the importance of sleep.

National Sleep Foundation

"Many Americans suffer with sleep problems more than a few nights a week and too many Americans are not getting the recommended amount of sleep they need. This poor quality of sleep or sleep loss erodes their ability to function effectively the next day in both a home and work environment. We at NSF urge people to examine their sleep habits and to seek professional help if they are unable to resolve their sleep difficulties."

Richard L. Gelula
CEO, National Sleep Foundation

National Sleep Foundation (NSF)

Screening Guide

How's Your Sleep?

Check if any of the following apply to you:

- ☐ Snore loudly
- ☐ You or others have observed that you stop breathing or gasp for breath during sleep
- ☐ Feel sleepy or doze off while watching TV, reading, driving or engaged in daily activities
- ☐ Have difficulty sleeping 3 nights a week or more (e.g. trouble falling asleep, wake frequently during the night, wake too early and cannot get back to sleep or wake unrefreshed)
- ☐ Feel unpleasant, tingling, creeping feelings or nervousness in your legs when trying to sleep
- ☐ Interruptions to your sleep (e.g., nighttime heartburn, bad dreams, pain, discomfort, noise, sleep difficulties of family members, light or temperature)

If you have checked one or more of the above statements, you should make an appointment to discuss this with your doctor.

It is helpful to keep a Sleep Diary for at least a week to record how often you experience these symptoms and to determine if there is a pattern that is keeping you from getting sufficient sleep. You can also use an NSF fact sheet called "Sleep Talk with Your Doctor." It lists additional information and items to share with your doctor.

Both of these resources are free to members of the National Sleep Foundation or can be downloaded at www.sleepfoundation.org. Take both of these to your doctor and make the most of your visit.

No part of this message is offered or should be taken as medical advice.

Sleep Problems are a Serious Threat to Your Health, Safety and Well-being

Snore loudly.
Snoring occurs when there is a partial blockage of the airway. Snoring has been linked to increased blood pressure and may be a sign of sleep apnea (see below).

You or others have observed that you stop breathing or gasp for breath during sleep.
Observed pauses in breathing, often accompanied by snoring, are a symptom of a serious condition called sleep apnea. These breathing pauses reduce blood-oxygen levels, strain the heart and cardiovascular system, and contribute to daytime sleepiness (see below).

Feel sleepy or doze off while watching TV, reading, driving or engaged in daily activities.
Sleepiness during the day or at times when you expect to be awake and alert is a sign that you may be suffering from sleep deprivation, a sleep disorder such as sleep apnea or narcolepsy, or another treatable medical condition. Daytime sleepiness puts you at risk for driving drowsy, injury and illness and can significantly impair your mental abilities, emotions and performance.

Have difficulty sleeping 3 nights a week or more.
Experiencing any of these insomnia symptoms a few nights a week is not a normal sleep pattern. Untreated insomnia is a risk factor for the onset of depression and can jeopardize your emotional outlook, social relations and sense of well-being. The toll of sleep loss can also affect your health, your safety and your performance in all areas of life.

Feel unpleasant, tingling, creeping feelings or nervousness in your legs when trying to sleep.
These feelings in your legs indicate that you may have Restless Legs Syndrome (RLS), a neurological movement disorder characterized by a strong urge to move the legs and difficulty falling and staying asleep.

Interruptions to your sleep.
Disruptions compromise both the quantity and quality of sleep and keep you from experiencing continuous, restorative sleep so necessary for performance, safety and health. They can be caused by an acute or chronic medical condition, a bright, noisy or uncomfortable environment, or awakenings caused by other people. Determining the causes of any sleep disruptions will help you and your doctor determine the best treatment.

Insomnia – **In Her Own Words**

"I have had primary insomnia on and off for 20 years.

"Sometimes I take a long time to fall asleep, and if I do fall asleep quickly, I will wake up maybe 4 or 5 hours later. I will wake up in the middle of the night and might not get back to sleep again until the alarm clock goes off. It can take two forms: I'll have a hard time getting to sleep or I'll get to sleep and wake up a few hours later. I end up getting about the same amount of sleep either way.

"The next day I will feel terrible! When I'm really tired, I will feel it a lot more in my muscles and joints from old injuries. When I sleep, it's an instant repair. It's a big, big difference.

"When I do end up getting a good night's sleep – which does occur now and then, I feel like a different person. I need a lot of energy for my daily life – and I do manage to do it, but when I get a good night's sleep, I feel like I'm the 'Energizer Bunny,' it's amazing! It's the difference of night and day, physically and mentally, attitude, mood.

"There can be weeks at a time when I will only sleep 4-5 hours. There is no real pattern. It can happen for days, it can happen for weeks.

"If I don't have a good night's sleep I have to overcompensate physically. Mentally, I can manage to keep myself sharp and alert because I've been dealing with it for so long. It's more that I feel it in my body, tired in my joints and muscles. When you have to start your day at 8 or 9, and you haven't slept, it is exhausting. It is tough."

Alison Woodward
Ballet Teacher (Insomnia Patient)

"Patients with insomnia often complain of impairment in daytime functioning. Such complaints include the report of impairment in cognitive abilities like attention, memory, or concentration. These are among the morbidities of insomnia that can impact one's ability to function effectively in social, occupational, and academic settings. The impact is significant for most sufferers, but especially for those who experience chronic symptoms. One important goal of treatment is the improvement of daytime functioning in people who suffer from chronic insomnia. Therefore, effective and safe treatments that can be used over the long-term are needed, and will significantly improve our standard of care."

Gary Zammit, Ph.D.
President and CEO, Clinilabs, Inc.
Clinical Associate Professor of Psychology (in Psychiatry),
Columbia University College of Physicians and Surgeons;
Director, Sleep Disorders Institute at St. Luke's/Roosevelt Hospital Center

Indiplon

Indiplon for the Treatment of Insomnia

Neurocrine submitted two NDAs for *indiplon* capsules and tablets to the U.S. Food and Drug Administration (FDA) on April 14, 2005 and May 26, 2005, respectively.

The Company has received communication from the FDA indicating that the agency has determined that *indiplon* 5 mg and 10 mg capsules are approvable and that the 15 mg XR tablets are not approvable at this time. The Company will accept the FDA's offer to discuss the applications via a meeting or telephone conference in order to determine the appropriate steps to move forward.

Indiplon is a unique non-narcotic, non-benzodiazepine agent that acts on a specific site of the GABA-A receptor. *Indiplon* has been shown to bind selectively to the specific subtype of GABA-A receptors within the brain believed to be responsible for promoting sleep. *Indiplon* was developed to address different types of sleep problems. Upon approval, *indiplon* will be copromoted in the U.S. with Pfizer.

Insomnia is a prevalent condition in the United States. According to the National Institutes of Health (NIH), approximately 30 percent of America's adults report that they experienced at least one symptom of insomnia a few nights a week or more in the past year. Sleep loss has been found to impair the ability to perform tasks involving memory, learning, and logical reasoning, yet few people understand the importance of sufficient sleep.

Clinical

The Neurocrine Pfizer Alliance is committed to advancing the science of insomnia through presentation of peer-reviewed data at scientific congresses and sponsorship of medical education initiatives. The Neurocrine Medical Affairs team is now fully deployed to support educational programs and scientific exchange of information about insomnia. The team is comprised of highly experienced individuals with a solid foundation in Neuroscience. This year will be an important year for *indiplon* data releases, with our clinical team submitting over 50 data presentations to 17 different academic congresses or journals. Our clinical team anticipates *indiplon* data presentations at several major congresses this year, including the American Psychiatric Association (APA), The Associated Professional Sleep Societies (APSS), and the International Society for Pharmacoeconomics and Outcomes Research.

Other congresses where our clinical team has submitted data include the American College of Clinical Pharmacology, International College of Geriatric Psychopharmacology, American Psychiatric Association, American College of Neuropsychopharmacology, U.S. Psychiatric Congress, the New Clinical Drug Evaluation Unit, American College of Obstetrics and Gynecology, American Academy of Neurology, International Society for Pharmacoeconomics and Outcomes Research, American Academy of Geriatric Psychiatrists, and American Society for Clinical Pharmacology and Therapeutics. Additionally, our clinical team anticipates publication of several *indiplon* clinical manuscripts later this year in top-tier peer-reviewed journals.

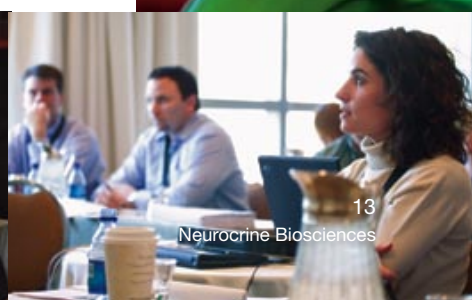
Commercial

Working closely with their counterparts at Pfizer, the Neurocrine marketing team will continue to refine brand strategy, and identify activities related to market development.

This Sales and Marketing infrastructure will enable Neurocrine to expand sales and marketing capabilities for the commercialization of additional Neurocrine compounds from our pipeline or from in-licensing or merger and acquisition activities.

Our 200 person sales force has developed important relationships with the psychiatric community. We will leverage these relationships with our sales force after they complete the detailing of Zoloft®.

We have been very successful in recruiting a sales force that is highly experienced in the industry, specifically in the neuroscience and insomnia markets. The Neurocrine Sales Force has extensive experience calling on psychiatrists, neurologists and sleep specialists. Our field management and representatives average 16 and 7 years of industry experience respectively. The majority of our field force has experience calling on CNS specialists. Neurocrine's business development team is also seeking other products for the Neurocrine sales force to detail.



A Balanced and Diverse Pipeline: Neurocrine is committed to maintaining a steady stream of product candidates in development.

Product Pipeline

PRODUCT	PRECLINICAL	PHASE 1
Indiplon (capsules and tablets)		
NBI-6024 Altered Peptide Ligand		
NBI-56418 GnRH Antagonist		
NBI-56418 GnRH Antagonist		
NBI-69734 Urocortin 2		
CRF-R Antagonist		
CRF-R Antagonist		
CRF-R Antagonist (back-up)		
NBI-75043 H1 Antagonist		

Neurocrine is discovering and developing 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, diabetes, irritable bowel disease, pain and autoimmunity.

PHASE 2	PHASE 3	INDICATION
		Insomnia
		Type-1 Diabetes
		Endometriosis
		BPH
		ADHF
		Anxiety/Depression
		Irritable Bowel Syndrome (IBS)
		Anxiety/Depression
		Insomnia

A Woman's Story: Maria (not pictured)

"I learned I had endometriosis when I was only 16 years old. By the time I was 17 or 18, the pain from the endometriosis was so bad that I would actually pass out several times a day. Looking back, those should have been the years when I was figuring out who I was as a person, but because of the endometriosis, I didn't get a chance to do any of the things I wanted to.

I'm 28 now and have battled the disease for the last decade. At one point I was on 22 medications at the same time — for everything ranging from pain to anxiety to depression. Nothing has given me long-term relief of my pain, not even repeated surgeries. Recently I talked to my family about having a hysterectomy; I said, 'let's just get it out and be done with all this.'

Endometriosis continues to have a big impact on my day-to-day life. I can't clean my house, travel by myself, and on bad days I can't even get out of bed. I'm trained as a nurse, but because of the endometriosis it's difficult for me to meet all the demands of the job. I've been on disability recently and just found out yesterday that I have lost my current nursing job."

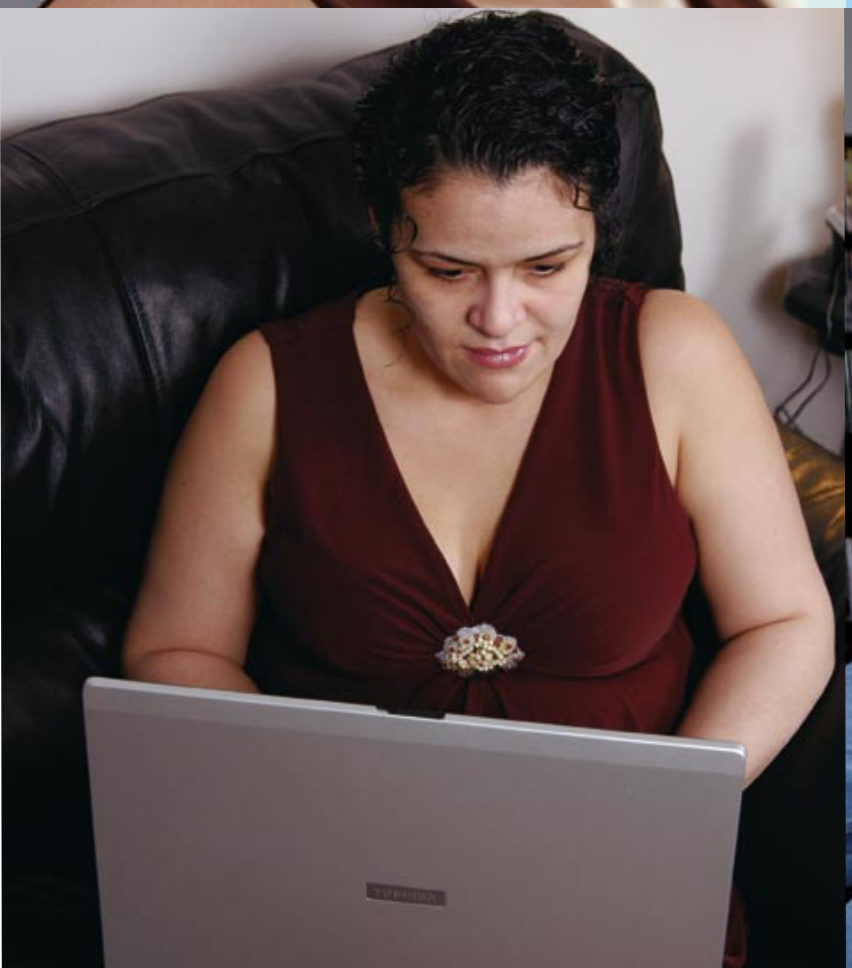
Endometriosis: In Their Own Words

A Woman's Story: Reina

"I was diagnosed with endometriosis in 2000. I had excruciating pain all the time. Sometimes it was so bad I couldn't even get dressed in the morning. My symptoms caused me to miss a lot of school, and my husband also had to miss work because he was caring for me.

I was on oral narcotics to try to control the pain. Contraceptives did not work, so I tried the injectable hormone treatments. I ended up with a lot of symptoms like bad hot flashes and mood swings. It was winter outside and I made my husband keep the bedroom window open because I was burning up. He often ended up sleeping on the couch.

After all the treatments and heartache, I was lucky to get pregnant. Now the symptoms are gone, but once the baby is born the endometriosis will probably attack me again."



GnRH

“I see many young women who are incapacitated by symptoms of even mild endometriosis. The disease can profoundly impact ability to maintain a job or a relationship. Serious co-morbidities such as depression can result.

For many patients, the drugs available today are either not terribly effective or are ‘overkill.’ We have drugs that can ease symptoms, but the impact of these drugs on a woman’s body goes far beyond what is required to treat the endometriosis – causing a range of side effects. This forces us to make a tradeoff between efficacy and side effects.

We need a drug that is effective but without the undesirable effects of some current agents. Neurocrine’s GnRH antagonist has the potential to offer patients this combination.”

W. Paul Dmowski, M.D., Ph.D.
Director of the Institute for the Study and
Treatment of Endometriosis, Oak Brook, Illinois

GnRH Antagonists

Need for New Treatments for Endometriosis

Currently available treatments for the pain associated with endometriosis are not optimal; medical treatments include agents that are either of only modest benefit (e.g., non-steroidal anti-inflammatory drugs) or associated with consequences regarded as unacceptable to many patients and clinicians. Endometrial tissue is under the regulation of sex hormones and, as such, endometriotic pain may be ameliorated when estrogen levels are reduced. The injectable gonadotropin-releasing hormone (GnRH) agonist, leuprolide, is an approved treatment that causes down regulation of the neurohormonal system and profound hormonal suppression. While effective in reducing pain, such agonist therapy is associated with bone loss and other symptoms of estrogen deficiency such as menopause. This unmet medical need could be better served by an oral agent that affords both robust pain control and acceptable tolerability while doing so without unwanted consequences, such as reduction in bone mineral density or inducing symptoms of menopause.

"The symptoms of endometriosis have an enormous impact on a patient's quality of life. Unfortunately, the impact of current treatments on patients can be as great as the disease itself. I find the fact that endometriosis is the leading cause of hysterectomies in women aged between 30 and 34 compelling evidence of this. Current pharmaceutical treatments all force patients to make the choice between fertility and control of their symptoms.

Endometriosis can be a difficult disease for prescribers to treat. Drugs used in endometriosis all come with a range of potentially serious side effects that can limit their usefulness. Effectively managing these side effects adds significant complexity as well as cost.

Neurocrine's oral GnRH antagonist is a fundamentally different approach. It has the potential to be a simpler, gentler, but effective treatment option."

Sanjay Agarwal, M.D., FACOG
Associate Professor of Reproductive Medicine,
UCSD School of Medicine

NBI-56418 for Endometriosis

Nearly 7 million women in the U.S. have endometriosis, many with severe or moderate symptoms. Many more patients are believed to be misdiagnosed or undiagnosed. The impact of endometriosis on the lives of sufferers can be significant – adversely affecting the ability of patients to maintain relationships and employment.

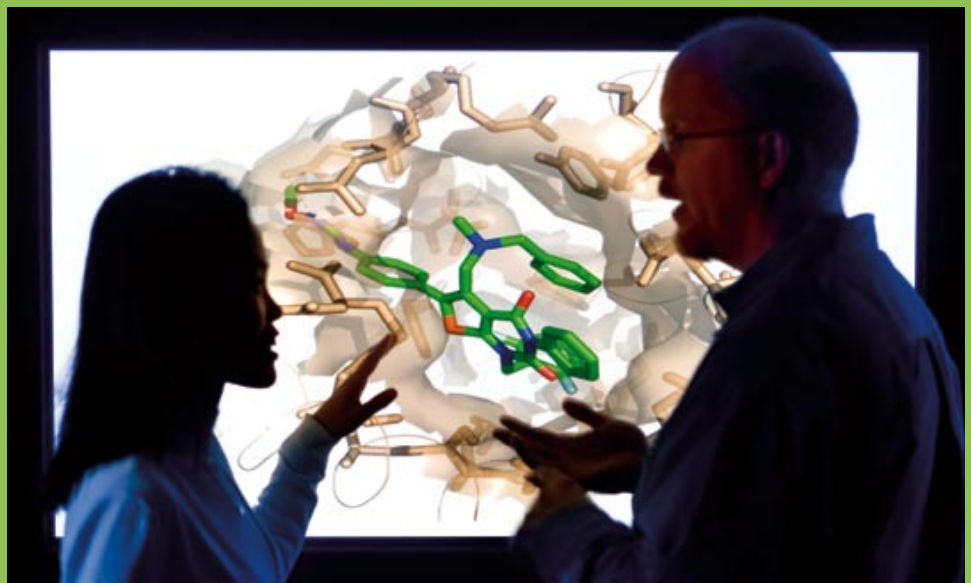
Despite the large number of sufferers and the impact of the disease, current surgical and medical treatments are less than optimal for many. Although indicated for endometriosis, injectable GnRH agonists such as leuprolide and an injectable form of progesterone are associated with a range of potentially unacceptable side effects including bone loss. Prescribers often reserve GnRH agonists for only those patients with very severe endometriosis pain because of concern about these side effects.

For the majority of endometriosis patients suffering from moderate or mild symptoms, the only remaining treatment options are oral contraceptives and analgesics. However, oral contraceptives and analgesics are only partially effective and primarily only in patients with only very mild endometrial symptoms. Many sufferers with mild to moderate disease find their symptoms do not respond to oral contraceptives and analgesics – yet they do not wish to incur the side effects of GnRH agonists or undergo surgery. For these patients there is currently no safe and effective means of controlling their disease.

Based on the large number of endometriosis sufferers and the significant level of unmet need, we believe a highly attractive medical and commercial opportunity exists for a new product that is able to offer patients and prescribers effective control of endometriosis symptoms with limited side effects.

Mechanism of Action

In contrast to the “all-or-none” hormone-suppressing effect of agonist treatments, partial suppression of estradiol may be achieved in a dose-related manner with a GnRH antagonist. NBI-56418 is an orally active, non-peptide small molecule that may offer effective treatment for women with endometriosis while avoiding reduction in bone mineral density and the other undesirable consequences of GnRH agonist therapies.



Endometriosis Clinical Development: Phase II Results

Results from the first three-month placebo-controlled, double-blind Phase II study of Neurocrine's GnRH antagonist (NBI-56418) in 76 patients with endometriosis successfully demonstrated that this orally active, small-molecule was safe, well tolerated and was shown to provide a reduction in pain as measured by the Composite Pelvic Sign and Symptoms Score (CPSSS), and other validated clinical measures for once-daily NBI-56418. In addition, in contrast to injectable GnRH agonists, this oral antagonist was not associated with an increase in hot flashes. The three-month safety follow-up period continues into the 2nd Quarter of 2006. These data will be used to refine the larger six-month study planned for later in 2006.

Neurocrine is continuing to enroll patients in a second Phase II study in patients with endometriosis that was initiated in December 2005 to more fully explore dose response. This study, a multi-dose, double-blind, placebo-controlled trial is enrolling 72 patients and is also designed to assess safety and efficacy over a three-month period with the primary endpoint of reduction in endometriotic pain as measured by CPSSS. Preliminary results are expected to be announced in the 4th Quarter of 2006.

In addition, Neurocrine is initiating a Phase IIb six-month treatment trial in patients with endometriosis in the 3rd Quarter of 2006 to evaluate long-term safety including possible changes in bone mineral density.

NBI-56418 for Other Indications

Neurocrine recently started a Phase I study in male volunteers as part of the Benign Prostatic Hyperplasia (BPH) development program and expects to enter into Phase II studies late in 2006. Benign Prostatic Hyperplasia is a highly prevalent condition, affecting one-third of all of men over age 60. Reflecting the frequency of the condition and the significant impact on the lives of sufferers, sales of current pharmaceutical treatments for BPH in the U.S. are nearly $1.5 billion. Drawbacks of current therapies for BPH include sexual side effects or inadequate response in some patients. Through its novel mechanism of action, our oral GnRH antagonist could offer patients an effective new option for treating BPH with fewer of the unwanted side effects associated with current therapies. Neurocrine recently started Phase I studies of NBI-56418 in male volunteers as part of the Benign Prostatic Hyperplasia development program and expects to enter into Phase II studies late in 2006.

Urocortin 2 for Congestive and Acute Decompensated Heart Failure

Need for New Drugs for Congestive Heart Failure (CHF)
Current therapies for acute and chronic CHF patients address symptoms of fluid overload due to myocardial dysfunction. These available treatments include drugs which specifically dilate peripheral blood vessels, increase kidney excretion of salt and water or force the heart muscle to contract more forcefully and rapidly. The major unmet medical need is for treatment that not only improves the symptoms of acute CHF but also improves long-term outcome measures such as mortality in the months and years following acute intervention.

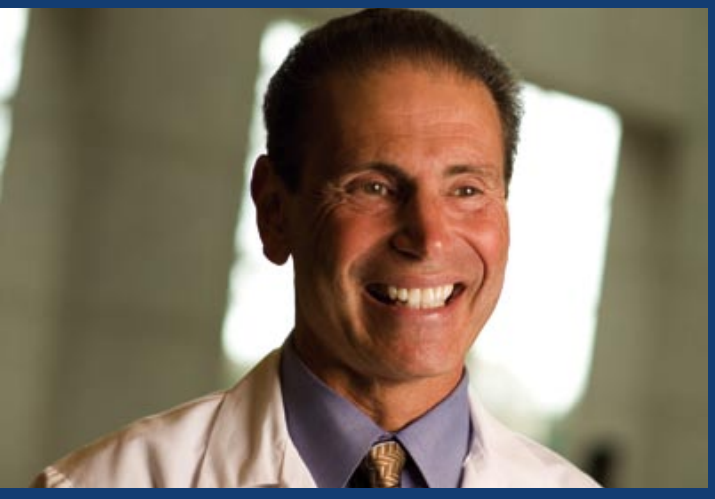
Market Opportunities
There are an estimated one million hospital admissions each year in the United States for acute CHF and many more patients develop acute CHF while hospitalized. Morbidity and mortality associated with acute CHF, especially in the months following the initial discharge from hospital, are notoriously high and the cost to the U.S. healthcare system is more than $20 billion annually. The commercial opportunity for a new agent with a demonstrated improvement on long term morbidity and mortality associated with acute CHF is enormous.

Based on clinical data and urocortin 2's known role in human physiology, we believe NBI-69734 will address the symptoms of heart failure as well as yield substantial improvements in long-term patient stability and mortality.

Mechanism of Action
NBI-69734 was designed to mimic the effect of the recently discovered protein urocortin 2. NBI-69734 selectively stimulates the CRF2 receptor and improves cardiac output with minimal increase in heart rate or cardiac work. It also has the potential of cardioprotection via a novel mechanism for regulating calcium cycling enzymes/channels in heart muscle cells.

NBI-69734 Clinical Development: Phase I and Phase II Clinical Trial Results
Recently, NBI-69734 has been administered in two Phase 1 studies in healthy males and in volunteers with stable Congestive Heart Failure (CHF). One-hour infusions were generally well tolerated and cardiac output increased up to 50% without significant increase in heart rate or cardiac work as measured by pressure rate product. In November 2005, Neurocrine filed an IND application with the FDA to initiate a U.S. Phase II study in stable CHF patients to further evaluate dose/response of NBI-69734 when administered over 4 hours. Initial results indicate that NBI-69734 is generally well tolerated and that the predicted therapeutic effects on systolic and diastolic blood pressure, heart rate, cardiac work and, most importantly, cardiac output appear to occur over the entire 4-hour infusion. Full study results are anticipated in the 3rd Quarter of 2006.

This extended-infusion data will then provide guidance for dosing in the planned Phase IIb studies in the target population of patients with Acute Decompensated Heart Failure (ADHF). Results of this ADHF study are anticipated in the second half of 2007. Once this study has been completed, pivotal Phase III trials, along with supportive Phase II and Phase IIIb trials, will be initiated. The primary clinical concept to be assessed by these late-stage studies is the relationship between acute symptomatic benefits and long-term morbidity and mortality.



“Heart failure is an enormous medical and economic burden, and is set to grow as our population ages; with a doubling in burden over the next couple of decades. We have made significant in-roads in the treatment of chronic heart failure with the use of newer medications and devices. On the other hand, our management of acutely decompensated heart failure (ADHF) still leaves many challenges. Re-hospitalization, medium-term and long-term mortality are still too high.

Current ADHF treatments, despite improving signs and symptoms, are too often complicated by serious side effects that limit their usefulness. Lessons learned from the most recent FDA approved drug for ADHF are worthy of note.

The need for new therapies with new mechanisms of action in ADHF is immediate. Urocortin 2, Neurocrine’s intravenous CRF agonist, could be a welcome addition in our armamentarium in tackling this growing medical problem.”

Barry H. Greenberg, M.D.
Professor of Medicine and Director of the
Advanced Heart Failure Treatment Program at UCSD

CRF for Anxiety/Depression and IBS:

The Corticotropin-Releasing Factor receptor (CRF-R) program partnered with GlaxoSmithKline (GSK) has identified multiple unique high affinity and selective antagonists for the CRF receptor that are currently in clinical trials for depression and anxiety-related disorders and Irritable Bowel Syndrome (IBS). This collaboration is progressing as planned through early-stage clinical trials. Phase I double-blind placebo-controlled trials are ongoing and GSK is planning to initiate Phase II trials in anxiety/depression during 2006. In addition to the anxiety/depression indication, GSK has an ongoing development program for CRF receptor antagonists in IBS. GSK intends to advance the lead CRF receptor antagonist compound into Phase II studies in IBS during 2006. GSK also has advanced a back-up CRF receptor antagonist into Phase I in the 1st Quarter of 2006.

Mechanism of Action

The key hormone in the regulation of the stress response is a brain chemical called corticotropin-releasing factor (CRF) and this hormone has been shown to be overproduced in patients with major depression and anxiety-related disorders. In addition, the receptors for this neurohormone are found in specific brain regions that are responsible for the regulation of mood. CRF receptor antagonists offer a novel mechanism of action with the advantage of being more selective, potentially increasing efficacy with reduced side effects over current existing therapies. Neurocrine has characterized the CRF receptor system, has identified additional members of this protein family and holds a unique strategic position in the CRF field through our intellectual property portfolio and close relationships with leading experts in the neuropsychiatric field.

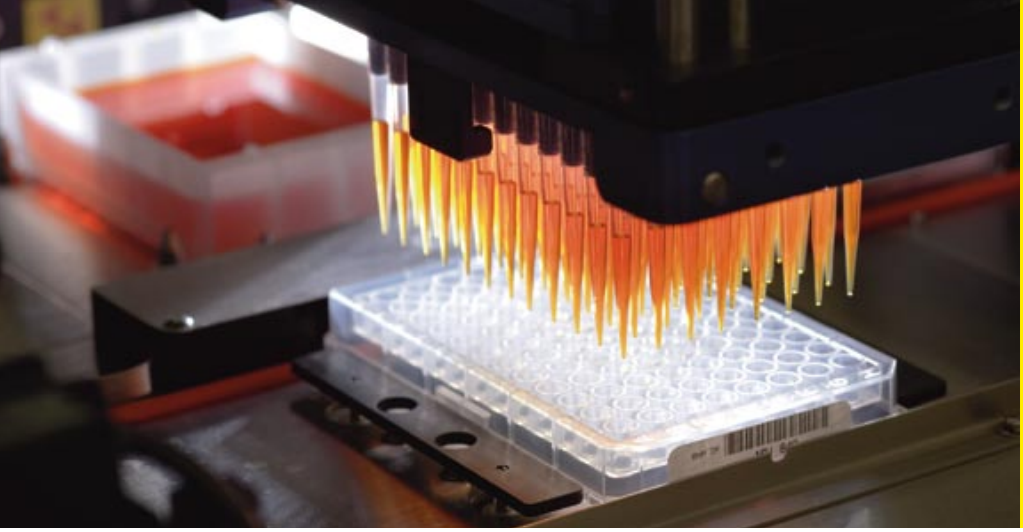
Market Opportunities

Mood disorders, including depression and anxiety, are becoming the most common form of psychiatric disorder, resulting in a high level of disease burden on the general population. Depression is the leading cause of disability affecting quality of life and productivity. In fact, projections place depression as the second leading cause of disability by the year 2020, second only to cardiovascular disease. It is estimated that 25% of the general population will experience a depressive episode at some time in their lives. In the United States, more than 22 million people have symptoms associated with depression and the National Institutes of Mental Health has indicated that over 13% of the United States population has anxiety disorder.

In addition to the potential neuropsychiatric indications for CRF receptor antagonists in anxiety/depression, a great deal of evidence supports an important role of this system in the pathogenesis of stress-related gastrointestional function and more specifically IBS. IBS is a gastrointestinal inflammatory disease that affects approximately 30 million people in the United States, accounting for over $25 billion in direct and indirect costs each year, according to the International Foundation for Functional Gastrointestinal Disorders. Although the exact pathophysiology of IBS is not well understood, there is increasing evidence to suggest that underlying inflammation may influence the symptoms of pain and changes in bowel pattern experienced by patients and that CRF receptor antagonists can improve the gastrointestinal motility and alleviate the pain associated with IBS-like symptoms.

CRF: A New Treatment Option

As good as the current drugs are in treating the symptoms of depression, tolerability issues and the slow onset of efficacy limit their ability to treat all affected individuals. The CRF system remains one of the few examples of a well-developed hypothesis-driven research effort. From the first descriptions of the stress axis to its hypothesized role in human disease, our knowledge of this system has provided many small-molecule, orally active non-peptide compounds that have the potential of becoming drugs that work through this novel mechanism. Together with our partner GSK, we have identified a number of these compounds that are progressing through clinical trials and may well become the next generation of treatment options for stress-related disorders.



Altered Peptide Ligand (APL) for Diabetes

Need for New Drugs for Type-1 Diabetes

According to the International Diabetes Federation, Type-1 Diabetes afflicts nearly 5 million patients globally. The impact of the Type-1 Diabetes is severe; complications of the disease include heart disease, circulatory problems, kidney failure, neurological disorders and blindness. The standard of care for Type-1 Diabetes is daily insulin injections which can control the symptoms of the disease but do not prevent or delay disease progression. A novel therapy such as NBI-6024, with the potential to preserve residual endogenous insulin production, would delay or completely avoid the need for chronic insulin therapy and thus would provide a significant clinical benefit to patients with new onset Type-1 Diabetes.

Mechanism of Action

NBI-6024 inhibits T cells from responding inappropriately to the insulin antigen. Furthermore, this specific protein engenders a protective immune response apparently by inhibiting the autoimmune response associated with diabetes. This treatment therefore has the potential to significantly reduce the incidence of disease in patients who are at risk, as well as to delay the loss of endogenous insulin in patients with new onset Type-1 Diabetes.

Phase I and Phase II study results in 125 patients enrolled in 5 studies have suggested that NBI-6024 is generally safe and well tolerated. The Phase II proof-of-concept trial was designed to assess the safety and efficacy of NBI-6024 in a larger population of new-onset Type-1 Diabetes patients. This two-year, multi-center, international, double-blind, placebo-controlled trial has enrolled 188 patients to date and will come to an end mid-year 2006. Preliminary results are anticipated in 3rd Quarter 2006.

H1 Antagonist for Insomnia

Insomnia has several dimensions and numerous co-morbidities. We are developing the non-narcotic GABA-A selective alpha-1 agonist *indiplon* for the treatment of insomnia. There are, however, other central nervous system pathways that are involved in sleep regulation in addition to the GABA-A channel. Histamine is a brain chemical that controls arousal and wakefulness by binding and activating neuronal H1 receptors. Our scientists have discovered and developed a novel series of potent and highly selective small-molecule H1 antagonists for the treatment of chronic insomnia. By virtue of their selectivity and mechanism of action, we believe that this program is complementary to our *indiplon* program. Our Investigational New Drug Application for our H1 antagonist was submitted in early 2006 and we have initiated single-dose and multi-dose Phase I studies to assess the safety, absorption, metabolism and clinical effects of one of our H1 antagonists. Results from the Phase 1 single-dose and multi-dose studies are anticipated in early 2007.

Research Pipeline

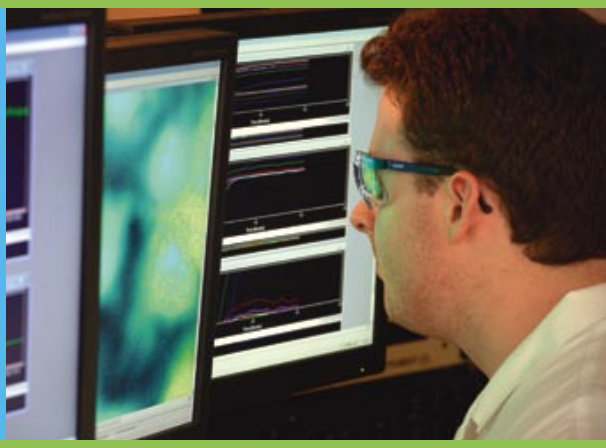
PRODUCT	RESEARCH
GnRH Antagonists	
CRF-R Antagonists	
A2A Antagonists	
Various Pain Targets	

"In biopharmaceutical R&D there are few unique technology-based advantages, as most organizations possess these now commoditized technologies. Neurocrine's competitive advantage in the industry lies in its collaborative and highly integrated drug discovery and development culture coupled with its ability to execute quickly and with high quality. Neurocrine was founded on two leading edge technologies with limited validation. While advancing these programs Neurocrine has balanced its portfolio with programs such as *indiplon* and GnRH and is committed to building a portfolio of development-stage programs that significantly exceed industry success rates.

Neurocrine currently has 315 people in research and development with 127 scientists with Ph.D and M.D. or equivalent degrees, specializing in the research for neurological and endocrinological-related diseases and disorders."

Wendell Wierenga, Ph.D.
Executive Vice President Research and Development for Neurocrine Biosciences

Neurocrine scientists continue to build our R&D pipeline with the goal of bringing one new compound into clinical development each year.



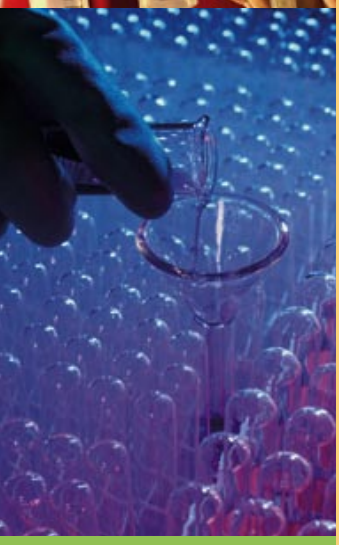
PRECLINICAL	PHASE 1	PHASE 2	PHASE 3	INDICATION
				Endometriosis and BPH
				Stress-Related Diseases
				Parkinson's Disease
				Neuropathic Pain, Attention Deficit Hyperactivity Disorder (ADHD)

Highlights of Research Programs

Neurocrine's drug discovery strategy is to efficiently exploit the technologies of high throughput screening, virtual ligand screening, structure-based design, and pharmacophore-based design, utilize functional pharmacological endpoints based on integral membrane protein targets validated for CNS and metabolic diseases, and incorporate critical, off-target profiling of drug at the earliest phases of drug discovery to yield safe, effective, and pharmacokinetically optimized drug candidates for proof-of-concept evaluation in patients. Neurocrine has the sufficient complement of resources in medicinal chemistry, absorption distribution metabolism elimination (ADME), pharmacokinetics (PK), molecular medicine, pharmacology, analytical sciences, biopharmaceutics, chemical development, clinical, and regulatory sciences to effectively generate an exciting portfolio of clinical candidates and sustain their development through to commercialization. Neurocrine's competitive advantage is in its ability to invest in programs that will generate best-in-class candidates and efficiently manage their development in time and cost effective processes at the leading edge of industry standards.

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

Research Programs



CRF Antagonists

We have a strategic position in the Corticotropin-Releasing Factor (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 R1 and CRF R2, and we have pending patent applications on small molecule organic compounds modulating the CRF receptors.

The CRF receptor 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 antagonists may provide a treatment for anxiety/depression, irritable bowel syndrome, and even insomnia. Researchers have demonstrated that CRF-R antagonists demonstrate dose dependent effect with in vivo preclinical models of these diseases. We continue to develop and evaluate compounds for stress-related disorders and, with GSK, have two compounds in clinical development.

A2A Antagonists

In October 2004, we entered into a licensing agreement with Almirall Prodesfarma, S.A. for the development of A2A receptor antagonists for Parkinson's disease. A2A receptor antagonists have been shown to be effective in both pre-clinical models of Parkinson's disease and in clinical trials with Parkinson's disease patients. This subtype of receptors for the neuromodulator adenosine is selectively localized on neurons in the brain that also express dopamine D2 receptors. The function of these neurons is impaired due to dopamine depletion that occurs in Parkinson's disease and antagonism of A2A receptors appears to help restore normal function. We are in the process of identifying a lead development candidate.

New Targets for the Treatment of Pain and Psychiatric Disorders

In addition, Neurocrine is undertaking focused discovery efforts in neuropathic pain as well as select psychiatric disorders. A wide array of drugs are used in the treatment of neuropathic pain, often with unsatisfactory efficacy or troubling side effects. In spite of the shortcomings of current therapies, the U.S. neuropathic pain market is estimated at more $3 billion with steep growth expected. Tens of billions of dollars are spent on drugs aimed at treating psychiatric disorders, yet significant unmet need remains in this market as well. We are planning to advance drug candidates into clinical evaluation in the next year.

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 Annual Report.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations section contains forward-looking statements pertaining to, among other things, the expected continuation of our collaborative agreements, the receipt of research and development payments thereunder, the future achievement of various milestones in product development and the receipt of payments related thereto, the potential receipt of royalty payments, pre-clinical testing and clinical trials of potential products, the period of time that our existing capital resources will meet our funding requirements, and our financial results of operations. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various risks and uncertainties, including those set forth in this Annual Report on Form 10-K for 2005 filed with the Securities and Exchange Commission.

Overview

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

Critical Accounting Policies

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

Revenue Recognition

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

Clinical Trial Costs

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

revisions have not resulted in material changes to R&D costs, however a modification in the protocol of a clinical trial or cancellation of a trial could result in a charge to our results of operations.

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

The following table summarizes our primary sources of revenue:

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

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

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

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

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

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

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

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

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

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

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

However, the FDA has committed to an action by May 15, 2006 for both NDAs.

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

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

Liquidity and Capital Resources

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

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

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

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

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

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

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

On February 26, 2004, we entered into several agreements with Wyeth and DOV pursuant to which we acquired Wyeth's financial interest in *indiplon* for approximately $95.0 million, consisting of $50.0 million in cash and $45.0 million in our common stock. Wyeth's financial interest in *indiplon* arose from a 1998 license agreement between Wyeth and DOV whereby Wyeth licensed the *indiplon* technology to DOV in exchange for milestone payments and royalties on future sales of *indiplon*. We subsequently licensed the *indiplon* technology from DOV in exchange for milestones and royalties. The February 2004 agreements among us, Wyeth and DOV provide that we will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that we will retain all milestone, royalty and other payments on *indiplon* commercialization that would have otherwise been payable to Wyeth. This decreases our overall royalty obligation on sales of *indiplon* from six percent to three and one-half percent. This transaction has been recorded as a long-term asset (prepaid royalty), and this asset will be amortized over the commercialization period of *indiplon*, based primarily upon *indiplon* sales.

Factors That May Affect Future Financial Condition and Liquidity

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

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

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

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

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

The nature and efforts required to develop our product candidates into commercially viable products include research to identify a clinical candidate, preclinical development, clinical testing, FDA

approval and commercialization. This process may cost in excess of $500 million and can take in excess of 10 years to complete for each product candidate.

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

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

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

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

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

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

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

We believe that our existing capital resources, together with interest income and future payments due under our strategic alliances, will be sufficient to satisfy our current and projected funding requirements for at least the next 12 months. However, we cannot guarantee that our existing capital resources and anticipated revenues will be sufficient to conduct and complete all of our research and development programs as planned.

We will require additional funding to continue our research and product development programs, to conduct preclinical studies and clinical trials, for operating expenses, to pursue regulatory approvals for our product candidates, for the costs involved in filing and prosecuting patent applications and enforcing or defending patent claims, if any, for the cost of product in-licensing and for any possible acquisitions, and we may require additional funding to establish manufacturing and marketing capabilities in the future. We may seek to access the public or private equity markets whenever conditions are favorable. We may also seek additional funding through strategic alliances and other financing mechanisms. We cannot assure you that adequate funding will be available on terms acceptable to us, if at all. If adequate funds are not available, we may be required to curtail significantly one or more of our research or development programs or obtain funds through arrangements with collaborators or others. This may require us to relinquish rights to certain of our technologies or product candidates. To the extent that we are unable to obtain third-party funding for such expenses, we expect that increased expenses will result in increased losses from operations. We cannot assure you that we will successfully develop

our products under development or that our products, if successfully developed, will generate revenues sufficient to enable us to earn a profit.

Interest Rate Risk

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

Cautionary Note on Forward-Looking Statements

Our business is subject to significant risks, including but not limited to, the risks inherent in our research and development activities, including the successful continuation of our strategic collaborations, the successful completion of clinical trials, the lengthy, expensive and uncertain process of seeking regulatory approvals, uncertainties associated both with the potential infringement of patents and other intellectual property rights of third parties, and with obtaining and enforcing our own patents and patent rights, uncertainties regarding government reforms and of product pricing and reimbursement levels, technological change, competition, manufacturing uncertainties and dependence on third parties. Even if our product candidates appear promising at an early stage of development, they may not reach the market for numerous reasons. Such reasons include the possibilities that the product will be ineffective or unsafe during clinical trials, will fail to receive necessary regulatory approvals, will be difficult to manufacture on a large scale, will be uneconomical to market or will be precluded from commercialization by proprietary rights of third parties. For more information about the risks we face, see "Item 1A. Risk Factors" included in the Annual Report on Form 10-K.

New Accounting Pronouncements

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

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

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, or
2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

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

Consolidated Balance Sheets

December 31,	2005	2004
(in thousands, except for par value and share totals)		
Assets		
Current assets:		
Cash and cash equivalents	$ 49,948	$ 61,027
Short-term investments, available-for-sale	223,120	240,102
Receivables under collaborative agreements	858	8,213
Other current assets	5,384	4,473
Total current assets	279,310	313,815
Property and equipment, net	99,307	102,166
Restricted cash	5,775	5,250
Prepaid royalty	94,000	94,000
Other non-current assets	4,731	3,986
Total assets	$483,123	$519,217
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 3,447	$ 5,391
Accrued liabilities	17,895	19,846
Deferred revenues	6,537	27,674
Current portion of long-term debt	5,814	6,674
Total current liabilities	33,693	59,585
Long-term debt	53,590	59,452
Deferred revenues	—	2,000
Other liabilities	5,736	4,353
Total liabilities	93,019	125,390
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, $0.001 par value; 50,000,000 shares authorized; issued and outstanding shares were 37,132,478 in 2005 and 36,532,767 in 2004	37	37
Additional paid-in capital	691,717	674,034
Deferred compensation	—	(312)
Notes receivable from stockholders	—	(69)
Accumulated other comprehensive loss	(1,504)	(1,908)
Accumulated deficit	(300,146)	(277,955)
Total stockholders' equity	390,104	393,827
Total liabilities and stockholders' equity	$483,123	$519,217

See accompanying notes.

Consolidated Statements of Operations

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

See accompanying notes.

Consolidated Statements of Stockholders' Equity

(in thousands)	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Deferred Compensation	Notes Receivable from Stockholders	Accumulated Other Comprehensive Income (loss)	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2002	30,662	$31	$424,084	$(1,240)	$(208)	$3,513	$(201,926)	$224,254
Net loss	—	—	—	—	—	—	(30,256)	(30,256)
Unrealized loss on short-term investments	—	—	—	—	—	(1,849)	—	(1,849)
Comprehensive loss	—	—	—	—	—	—	—	(32,105)
Issuance of common stock for option exercises	820	1	7,486	—	—	—	—	7,487
Issuance of common stock pursuant to the Employee Stock Purchase Plan	55	—	1,725	—	—	—	—	1,725
Issuance of common stock, net of offering costs	3,750	3	187,398	—	—	—	—	187,401
Amortization of deferred compensation, net	—	—	387	456	—	—	—	843
Science Park Center LLC consolidation	—	—	600	—	—	—	—	600
Common shares issued as a stock bonus	13	—	653	—	—	—	—	653
Issuance of warrants	—	—	193	—	—	—	—	193
Issuance of common stock for exercise of warrants	12	—	—	—	—	—	—	—
Stockholder note forgiveness	—	—	—	—	69	—	—	69
Balance at December 31, 2003	35,312	35	622,526	(784)	(139)	1,664	(232,182)	391,120
Net loss	—	—	—	—	—	—	(45,773)	(45,773)
Unrealized loss on short-term investments	—	—	—	—	—	(3,572)	—	(3,572)
Comprehensive loss	—	—	—	—	—	—	—	(49,345)
Issuance of common stock for option exercises	268	1	4,763	—	—	—	—	4,764
Tax benefit of stock options	—	—	236	—	—	—	—	236
Issuance of common stock pursuant to the Employee Stock Purchase Plan	47	—	1,999	—	—	—	—	1,999
Issuance of common stock, related to royalty stream purchase	803	1	44,999	—	—	—	—	45,000
Reversal of offering expenses	—	—	50	—	—	—	—	50
Amortization of deferred compensation, net	—	—	61	472	—	—	—	533
Buyout of minority interest in Science Park LLC	—	—	(600)	—	—	—	—	(600)
Issuance of common stock for exercise of warrants	103	—	—	—	—	—	—	—
Stockholder note forgiveness	—	—	—	—	70	—	—	70
Balance at December 31, 2004	36,533	37	674,034	(312)	(69)	(1,908)	(277,955)	393,827
Net loss	—	—	—	—	—	—	(22,191)	(22,191)
Unrealized gain on short-term investments	—	—	—	—	—	404	—	404
Comprehensive loss	—	—	—	—	—	—	—	(21,787)
Issuance of common stock for option exercises	529	—	14,457	—	—	—	—	14,457
Issuance of common stock pursuant to the Employee Stock Purchase Plan	70	—	2,514	—	—	—	—	2,514
Amortization of deferred compensation, net	—	—	98	312	—	—	—	410
Vesting acceleration of unvested options (Note 6)	—	—	614	—	—	—	—	614
Stockholder note forgiveness	—	—	—	—	69	—	—	69
Balance at December 31, 2005	37,132	$37	$691,717	$ —	$ —	$(1,504)	$(300,146)	$390,104

See accompanying notes.

Consolidated Statements of Cash Flows

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

See accompanying notes.

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Business Activities. Neurocrine Biosciences, Inc. (the Company or Neurocrine) incorporated in California in 1992 and reincorporated in Delaware in 1996. The Company discovers, develops and intends to commercialize drugs for the treatment of neurological and endocrine-related diseases and disorders. The Company's product candidates address some of the largest pharmaceutical markets in the world, including insomnia, anxiety, depression, various female and male health disorders, multiple sclerosis, diabetes and other neurological and endocrine related diseases and disorders.

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

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

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

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

Short-Term Investments Available-for-Sale. In accordance with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Debt and Equity Securities," short-term investments are classified as available-for-sale. Available-for-sale securities are carried at fair value, with the unrealized gains and losses reported in other comprehensive income (loss). The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in interest income. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other income or expense. The cost of securities sold is based on the specific identification method. Interest and dividends on securities classified as available-for-sale are included in interest income.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1. A "modified prospective" method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS 123R for all share-based payments granted after the effective date and (b) based on the requirements of Statement 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date, or
2. A "modified retrospective" method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

As permitted by SFAS 123, the Company currently accounts for share-based payments to employees using APB Opinion 25's intrinsic value method and, as such, the Company generally recognizes no compensation cost for employee stock options. The impact of the adoption of SFAS 123R cannot be predicted at this time because it will be depend on levels of share-based payments granted in the future. However, valuation of employee stock options under SFAS 123R is similar to SFAS 123, with minor exceptions. The impact on the results of operations and earnings per share had the Company adopted SFAS 123, is described in the Stock Based Compensation section of Note 1 above. Accordingly, the adoption of SFAS 123R's fair value method will have a significant impact on the Company's results of operations, although it will have no impact on the Company's overall financial position. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This

requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption. Due to timing of the release of SFAS 123R, the Company has not yet completed the analysis of the ultimate impact that this new pronouncement will have on the results of operations, nor the method of adoption for this new standard.

NOTE 2. SHORT-TERM INVESTMENTS

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

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

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

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

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

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

NOTE 3. PROPERTY AND EQUIPMENT

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

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

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

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

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

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

NOTE 4. ACCRUED LIABILITIES

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

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

NOTE 5. COMMITMENTS AND CONTINGENCIES

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

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

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

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

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

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

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

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

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

NOTE 6. STOCKHOLDERS' EQUITY

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

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

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

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

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

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

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding as of 12/31/05	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Exercisable as of 12/31/05	Weighted Average Exercise Price
$ 1.51 to $20.00	754	2.6	$ 7.97	754	$ 7.97
$20.01 to $35.00	993	4.9	28.95	977	28.93
$35.01 to $38.00	1,346	6.9	36.50	896	36.22
$38.01 to $43.00	920	7.9	40.74	395	39.98
$43.01 to $48.50	908	8.3	46.18	375	45.95
$48.51 to $55.50	952	7.6	50.70	787	51.08
$55.51 to $68.04	671	8.4	58.30	576	57.85
$ 1.51 to $68.04	6,544	6.7	$38.32	4,760	$36.40

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

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

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

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

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

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

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

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

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

NOTE 7. SIGNIFICANT COLLABORATIVE RESEARCH AND DEVELOPMENT AGREEMENTS

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

The Company obtained rights to *indiplon* pursuant to a 1998 Sublicense and Development Agreement with DOV Pharmaceutical, Inc. (DOV) and is responsible for specified milestone payments and royalties to DOV on net sales under the license agreement. Wyeth licensed the *indiplon* technology to DOV in 1998 in exchange for milestone payments and royalties on future sales of *indiplon*. On February 26, 2004, the Company entered into several agreements with Wyeth and DOV pursuant to which the Company acquired Wyeth's financial interest in *indiplon* for approximately $95.0 million, consisting of $50.0 million in cash and $45.0 million of the Company's common stock. The agreements among the Company, Wyeth and DOV provide that the Company will make milestone and royalty payments to DOV net of amounts that DOV would have been obligated to pay to Wyeth such that the Company will retain all milestone, royalty and other payments on *indiplon*

commercialization that would have otherwise been payable to Wyeth, effectively decreasing the Company's royalty obligation on sales of *indiplon* from six percent to three and one-half percent. This transaction was recorded as a prepaid royalty and will be amortized over the commercialization period of *indiplon*, based primarily upon total estimated *indiplon* sales. Additionally, the Company is responsible for specified milestone payments up to $3.5 million to DOV Pharmaceutical under the license agreement, of which $2.0 million was paid during 2004 and the balance will be payable upon commercialization of *indiplon*.

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

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

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

NOTE 8. INCOME TAXES

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

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

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

shown in thousands as of December 31, of the respective years (in thousands):

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

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

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

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

NOTE 9. RETIREMENT PLAN

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

NOTE 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

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

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

Report of Independent Registered Public Accounting Firm on Financial Statements

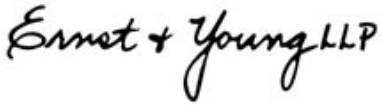
The Board of Directors and Stockholders
Neurocrine Biosciences, Inc.

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

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

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

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



San Diego, California
January 20, 2006

Management's Report on Internal Control Over Financial Reporting

Internal control over financial reporting refers to the process designed by, or under the supervision of, our Chief Executive Officer and Chief Financial Officer, and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles, and includes those policies and procedures that:

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

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

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

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

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

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

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

The Board of Directors and Stockholders
Neurocrine Biosciences, Inc.

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

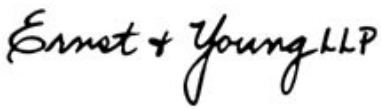
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material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

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

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

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

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



San Diego, California
January 20, 2006

Corporate Information

CORPORATE MANAGEMENT COMMITTEE

Gary A. Lyons
Chief Executive Officer, President and Director

Paul W. Hawran
Executive Vice President and Chief Financial Officer

Kevin C. Gorman, Ph.D.
Executive Vice President and Chief Business Officer

Margaret E. Valeur-Jensen, Ph.D., J.D.
Executive Vice President, General Counsel and Corporate Secretary

Wendell Wierenga, Ph.D.
Executive Vice President of Research and Development

Richard J. Ranieri
Senior Vice President, Human Resources

VICE PRESIDENTS

Paul J. Conlon, Ph.D.
Senior Vice President of Research (Biology)

Lloyd E. Flanders, Ph.D.
Senior Vice President of Development

Christopher F. O'Brien, M.D.
Senior Vice President of Clinical Development

John Saunders, Ph.D.
Senior Vice President of Research (Chemistry)

Carol A. Baum
Vice President of Marketing

Haig Bozigian, Ph.D.
Vice President of Preclinical Development

Timothy P. Coughlin
Vice President, Corporate Controller

Barbara M. Finn
Vice President of Regulatory

Hernand W. Wilson
Vice President, Information Technology

NEUROCRINE FELLOWS

Alan C. Foster, Ph.D.

Dimitri E. Grigoriadis, Ph.D.

Nicholas C. Ling, Ph.D., Emeritus

ACADEMIC FOUNDERS

Wylie W. Vale, Ph.D.
Professor and Head, The Clayton Foundation, Laboratories for Peptide Biology, The Salk Institute

Lawrence Steinman, M.D.
Professor, Department of Neurology and Neurological Sciences, Pediatrics and Genetics, Stanford University School of Medicine

BOARD OF DIRECTORS

Joseph A. Mollica, Ph.D.
Chairman of the Board, Neurocrine Biosciences, Inc. and Chairman, Pharmacopeia Drug Discovery, Inc.

Gary A. Lyons
Chief Executive Officer, President and Director, Neurocrine Biosciences, Inc.

Adrian Adams
Chief Executive Officer, Kos Pharmaceuticals, Inc.

Corinne H. Lyle
President, Global Operations, Edwards Lifesciences Corp.

W. Thomas Mitchell
Former Chairman of the Board and Chief Executive Officer, Genencor International

Richard F. Pops
President and Chief Executive Officer, Alkermes, Inc.

Stephen A. Sherwin, M.D.
Chairman and Chief Executive Officer, Cell Genesys, Inc.

Wylie W. Vale, Ph.D.
Professor and Head, The Clayton Foundation, Laboratories for Peptide Biology, The Salk Institute

CORPORATE HEADQUARTERS

Neurocrine Biosciences, Inc.
12790 El Camino Real
San Diego, CA 92130
Phone: (858) 617-7600
Fax: (858) 617-7601
www.neurocrine.com

AUDITORS

Ernst & Young LLP

TRANSFER AGENT

American Stock Transfer

SEC FORM 10-K

A copy of the Company's annual report to the Securities and Exchange Commission on Form 10-K is available without charge, upon written request to:

Investor Relations
Neurocrine Biosciences, Inc.
12790 El Camino Real
San Diego, CA 92130
Phone: (858) 617-7600
Fax: (858) 617-7602
www.neurocrine.com

MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

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

	High	Low
Year Ended December 31, 2004		
1st Quarter	$62.25	$50.54
2nd Quarter	69.90	47.90
3rd Quarter	54.37	40.67
4th Quarter	51.10	42.87

	High	Low
Year Ended December 31, 2005		
1st Quarter	$50.10	$36.58
2nd Quarter	44.09	33.86
3rd Quarter	52.90	41.20
4th Quarter	65.70	43.31

As of January 26, 2006, there were approximately 80 stockholders of record of our common stock.

DIVIDEND POLICY

The Company has not paid any cash dividends on its Common Stock since its inception and does not anticipate paying cash dividends on its Common Stock in the foreseeable future.

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