ARRAY BIOPHARMA INC
Form 424B4
February 13, 2002

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FILED PURSUANT TO RULE 424(b)(4)
REGISTRATION NO. 333-76828

PROSPECTUS

3,000,000 Shares

Common Stock

We are offering 3,000,000 shares of our common stock. Our common stock is quoted on the Nasdaq National Market under the symbol ARRY. On February 12, 2002, the last reported sale price of our common stock on the Nasdaq National Market was $10.30 per share.

Investing in the shares involves risks. Risk Factors begin on page 7.

	Per Share	Total
Public offering price	$10.00	$30,000,000
Underwriting discount and commission	$ 0.60	$ 1,800,000
Proceeds, before expenses, to Array BioPharma Inc.	$ 9.40	$28,200,000

We have granted the underwriters a 30-day option to purchase up to an additional 450,000 shares of common stock on the same terms and conditions as set forth above to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

Lehman Brothers, on behalf of the underwriters, expects to deliver the shares of common stock on or about February 19, 2002.

LEHMAN BROTHERS

UBS WARBURG

LEGG MASON WOOD WALKER
INCORPORATED

THOMAS WEISEL PARTNERS LLC

February 12, 2002

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Inside Front Cover

[Graphic depicting the placement of the Array Discovery Platform within the full spectrum of the drug discovery and development process.]

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Our trademarks include the Array BioPharma logo and the terms ARRAY BIOPHARMA, ARRAY BIOPHARMA THE DISCOVERY RESEARCH COMPANY, TURNING GENOMICS INTO BREAKTHROUGH DRUGS, and OPTIMER, for which we have pending trademark registrations in the United States, and ARRAY DISCOVERY PLATFORM, for which we assert common law trademark rights. Other trademarks and trade names appearing in this prospectus are the property of the holders of such trademarks and trade names.

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PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the following summary together with the more detailed information regarding our company, our common stock and the financial statements and notes to those statements appearing elsewhere in this prospectus or incorporated here by reference. We urge you to read the entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors, and information incorporated by reference in this prospectus from our other filings with the SEC.

Array BioPharma

We are a drug discovery company inventing new small molecule drugs through the integration of chemistry, biology and informatics. Our experienced scientists use our integrated set of drug discovery technologies, which we call the Array Discovery Platform, to invent novel small molecule drugs in collaboration with leading pharmaceutical and biotechnology companies and to build our own pipeline of proprietary drug candidates.

The drug industry is experiencing revolutionary change fueled by recent advances in genomics and the biological understanding of disease. This research effort has resulted in the identification of thousands of new targets, which are the proteins that may cause disease. As a result of the proliferation of new targets, we believe the drug research and development bottleneck is shifting from the identification of targets to the creation of safe and effective new small molecule or protein-based therapeutics.

Small molecule drugs are invented by chemists and are generally taken as a pill, as opposed to protein therapeutics which are generally given by injection. We believe small molecule drugs have inherent advantages over protein therapeutics, including a greater universe of treatable diseases, lower cost with greater ease of manufacturing and patient preference for a pill over an injection. Although a high proportion of biotechnology research has historically been devoted to protein-based therapeutics, approximately 90% of the top 500 prescription drugs, based on worldwide sales in 2000, are small molecule drugs. Accordingly, we believe that there will be increased emphasis on small molecule drug discovery in the biotechnology industry.

Our aim is to be the industry leader in small molecule drug discovery by utilizing the Array Discovery Platform to efficiently create high-quality drug candidates. Early in the drug discovery process, our scientists use the Array Discovery Platform to engineer desirable drug characteristics into drug candidates. We believe that the early optimization of superior drug characteristics will reduce the failure rate of drug candidates in development, thus increasing research productivity.

To capitalize on opportunities in small molecule drug discovery, we believe that an experienced scientific team with a track record of success is crucial. Accordingly, we have grown our staff to 226 full-time employees as of February 1, 2002, including 162 scientists, of whom 97 have Ph.D.s and 74 have large pharmaceutical or biotechnology company experience. Members of our scientific staff have contributed during their careers to over 20 Investigational New Drug applications and are inventors on over 160 drug-related patents. Additionally, we have increased the laboratory space necessary for our continued growth by securing long-term leases, which will provide up to 219,000 square feet over the next three years and accommodate up to 350 scientists.

Our recent achievements include:

- Increased revenue each quarter since our initial public offering in November 2000, including an increase in revenue from $10.7 million to $26.0 million for the twelve months ended December 31, 2000 and 2001, respectively;

- In collaboration with ICOS Corporation, our first drug discovery agreement has resulted in a clinical candidate. In November 2001, ICOS initiated a clinical trial with IC485 and subsequently made a milestone payment to us;

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Initiated success-based collaboration agreements, which include milestone and/or royalty payments, with Amgen Inc., ICOS, Takeda Chemical Industries, Inc., Trimeris, Inc. and Vertex Pharmaceuticals Incorporated;

Expanded our existing collaborations with pharmaceutical and biotechnology companies such as Eli Lilly and Company, Merck & Co., Inc., Pfizer Inc, Amgen, ICOS and Tularik Inc. to increase their access to the Array Discovery Platform;

Achieved positive earnings before interest, taxes, depreciation and amortization, or EBITDA, of $109,000 for the second quarter of fiscal year 2002;

Enhanced the breadth and depth of the capabilities offered by the Array Discovery Platform from structural biology through process research and development; and

Identified proprietary lead molecules against the kinase family of protein targets for inflammation and oncology indications.

Our Solution

Fundamentally, we believe the quantity of data generated for drug discovery is not as relevant as the quality of the data and its interpretation by experienced scientists. Our model for drug discovery emphasizes the pragmatic integration of appropriate new drug discovery technologies, enabling research tools and knowledge management through an electronic notebook and predictive computational modeling. We believe the Array Discovery Platform lowers the attrition rates for drug candidates in development and increases research productivity through the implementation of processes that help predict clinical success. We believe we have implemented a unique solution to bridge the gap between target discovery and clinical development and address the issues and opportunities in drug discovery by:

Optimizing the decision-making process in drug discovery by coupling experienced multidisciplinary scientific teams with the Array Discovery Platform;

Emphasizing high-quality data generation at every step of the drug discovery process;

Creating and utilizing enabling research tools to accelerate the execution of experiments;

Building knowledge management tools to improve the design of experiments and predict favorable drug characteristics; and

Identifying leads and designing drug candidates against multiple targets within families in a parallel fashion.

Our Strategy

Our objective is to build the industry s premier drug discovery company by:

Continuing to enhance the Array Discovery Platform by developing novel tools and implementing new technologies and processes to accelerate the drug discovery process;

Collaborating with pharmaceutical and biotechnology companies to identify novel drug candidates and receive success payments in the form of milestones and royalties in addition to research funding for each scientist dedicated to the programs; and

Using the Array Discovery Platform to create our own proprietary drug candidates, which we intend to continue to license for co-development and commercialization with pharmaceutical and biotechnology partners.

We believe the Array Discovery Platform enables our scientists to make better decisions at each step of the drug discovery process and that our integrated approach to drug discovery will enable both our

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collaborators and our internal discovery teams to create higher quality drugs more quickly and less expensively. The Array Discovery Platform includes the following capabilities:

Structural biology. Our biology teams create valuable information about the interaction of small molecule drugs with disease targets to improve binding characteristics.

High throughput screening. Once biologists identify a target, our scientists evaluate, or screen, potential drug compounds against the target for their therapeutic value.

Predictive informatics. We use our proprietary software to predict desirable drug characteristics including:

- *Potency.* The amount of a drug required to effectively treat the disease;
- *Selectivity.* The extent to which a drug interacts only with the target; the greater the selectivity, the lower the probability of harmful side effects;
- *Toxicity.* The presence and significance of any harmful side effects;
- *Metabolism.* How rapidly the drug works and how long it stays effective; and
- *Formulation.* How the drug is administered to patients, for example, orally or by injection.

Lead generation. Our lead generation teams create and identify chemical compounds that demonstrate desirable drug characteristics when screened against a target. Compounds that warrant further testing and refinement as potential drug candidates are called leads.

Analytical chemistry. Our analytical chemistry teams evaluate the purity of chemical compounds, analyze the chemical processes to synthesize these compounds and measure important drug properties.

Lead optimization. The scientists on our lead optimization teams use an iterative approach of making small changes in the chemical structure of leads to optimize their interaction with targets and refine their drug characteristics.

Drug metabolism. We have established a series of tests which assess, at an early stage in the drug discovery process, how drugs are modified by the body. Our drug metabolism databases also provide valuable information to help predict the future clinical success of our compounds.

Process research and development. Our scientists improve the chemical synthesis process for drug candidates in order to make scale-up and production more efficient and cost effective and to accelerate the development of valuable drug candidates for human testing.

We believe that we are well positioned to exploit important trends in the drug discovery industry. We believe that the shifting of the drug discovery bottleneck to the creation of drugs, the advantages of small molecule drugs, the current high attrition rates in drug development and the relative scarcity of top-quality chemists will increase the value of our drug discovery capabilities.

We incorporated in Delaware in February 1998 under the name Array BioPharma Inc. Our principal executive offices are located at 3200 Walnut Street, Boulder, CO 80301, and our telephone number is (303)381-6600. Our web site is www.arraybiopharma.com. Information in our web site does not constitute any part of this prospectus.

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The Offering

Unless otherwise indicated, all information in this prospectus assumes no exercise of the underwriters over-allotment option to purchase up to an additional 450,000 shares of common stock.

Common stock offered by us	3,000,000 shares
Common stock to be outstanding after the offering	26,701,245 shares
Use of proceeds	We currently intend to use the estimated net proceeds from this offering to fund our operations, for working capital and for general corporate purposes, including the following: funding continued internal development of new research tools, technologies and systems infrastructure; expanding our facilities; hiring additional personnel; investing in our proprietary drug discovery efforts; and for acquisitions or joint ventures. See Use of Proceeds.
Nasdaq National Market Symbol	ARRY

The number of shares of common stock to be outstanding after this offering is based on 23,701,245 shares outstanding as of February 1, 2002, and excludes:

4,568,798 shares issuable upon exercise of options outstanding as of February 1, 2002, at a weighted average exercise price of $4.41, of which 1,517,928 were exercisable; and

881,437 additional shares available for issuance under our stock option plan; and 607,625 shares available for issuance under our employee stock purchase plan.

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Summary Financial Data

The following summary financial data for the period from February 6, 1998 (inception) to June 30, 1998, and for the twelve-month periods ended June 30, 1999, 2000 and 2001, are derived from our historical audited financial statements. The financial data as of December 31, 2001, and for the six-month periods ended December 31, 2000 and 2001, are derived from our unaudited financial statements appearing elsewhere in this prospectus and, in our opinion, reflect all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of our financial positions and results of operations. The cost of revenue, research and development expenses, and selling, general and administrative expenses data below includes compensation related to stock option grants. This data should be read together with our financial statements, related notes and other financial information included in this prospectus and incorporated here by reference.

	Period from February 6, 1998 (inception) to June 30, 1998	Years Ended June 30,			Six Months Ended December 31,	
		1999	2000	2001	2000	2001
					(unaudited)	
		(in thousands, except per share data)				
Statements of Operations Data:						
Revenue:						
Collaboration revenue	$	$ 1,504	$ 6,774	$ 16,364	$ 6,433	$ 14,858
License, royalty and milestone revenue				642	161	693
Total revenue		1,504	6,774	17,006	6,594	15,551
Costs and expenses:						
Cost of revenue*		1,033	4,445	12,965	5,699	9,537
Research and development expenses*		3,301	3,963	8,265	3,817	6,048
Selling, general and administrative expenses*	62	1,522	3,470	7,668	4,649	3,549
Total operating expenses	62	5,856	11,878	28,898	14,165	19,134
Loss from operations	(62)	(4,352)	(5,104)	(11,892)	(7,571)	(3,583)
Interest expense		(136)	(384)	(587)	(353)	
Interest income	13	181	356	2,092	607	812
Net loss before extraordinary item	(49)	(4,307)	(5,132)	(10,387)	(7,317)	(2,771)
Extraordinary loss from early extinguishment of debt				(225)		
Net loss	(49)	(4,307)	(5,132)	(10,612)	(7,317)	(2,771)
Deemed dividend related to beneficial conversion feature of preferred stock				(5,000)	(5,000)	
Net loss applicable to common stockholders	$ (49)	$ (4,307)	$ (5,132)	$ (15,612)	$ (12,317)	$ (2,771)
Basic and diluted net loss per share:						
Net loss applicable to common stockholders before extraordinary item	$ (0.06)	$ (1.48)	$ (1.68)	$ (0.98)	$ (1.49)	$ (0.12)
Net loss applicable to common stockholders	$ (0.06)	$ (1.48)	$ (1.68)	$ (0.99)	$ (1.49)	$ (0.12)

Number of shares used to compute per share data	864	2,918	3,063	15,693	8,287	23,434
*Includes compensation related to option grants:						
Cost of revenue	$	$	$ 43	$ 998	$ 486	$ 541
Research and development expenses			35	644	302	361
Selling, general and administrative expenses			1,040	3,012	2,549	442
Total	$	$	$ 1,118	$ 4,654	$ 3,337	$ 1,344

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	As of December 31, 2001	
	(unaudited)	
	Actual	As Adjusted
	(in thousands)	
Balance Sheet Data:		
Cash, cash equivalents and marketable securities	$ 36,824	$ 64,524
Property, plant and equipment, net	27,349	27,349
Working capital	34,073	61,773
Total assets	73,687	101,387
Long-term debt, less current portion		
Accumulated deficit	(22,872)	(22,872)
Total stockholders equity	61,598	89,298

The as adjusted balance sheet data as of December 31, 2001, reflects the receipt of the estimated net proceeds from the sale of 3,000,000 shares of our common stock in this offering at the public offering price of $10.00 per share, after deducting the underwriting discount and estimated offering expenses.

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RISK FACTORS

Investment in our common stock involves a high degree of risk. You should consider carefully the following discussion of risks as well as other information in this prospectus before purchasing any shares of our common stock. Each of these risk factors could adversely affect our business, operating results and financial condition, and the value of an investment in our common stock.

Risks Related to Our Business

We may not achieve or sustain profitability.

We are at an early stage of executing our business plan, and we have a limited history of offering our drug discovery capabilities. We have incurred operating and net losses and negative cash flows from operations since our inception. As of December 31, 2001, we had an accumulated deficit of $22.9 million. We had net losses of $10.6 million and $5.1 million for the fiscal years ended June 30, 2001 and 2000, respectively, and $2.8 million for the six-month period ended December 31, 2001. We may continue to incur operating and net losses and negative cash flows from operations, due in part to anticipated increases in expenses for research and development, expansion of our personnel and our business development capabilities, and acquisitions of complementary businesses and technologies. We may not be able to achieve or maintain profitability. Moreover, if we do achieve profitability, the level of any profitability cannot be predicted and may vary significantly from quarter to quarter.

Our business is dependent upon the extent to which the pharmaceutical and biotechnology industries collaborate with drug discovery companies for one or more aspects of their drug discovery process.

We are highly dependent on the outsourcing of drug discovery activities by pharmaceutical and biotechnology companies and on their willingness to spend significant funds on research and development. Our capabilities include aspects of the drug discovery process that pharmaceutical and biotechnology companies have traditionally performed internally. The willingness of these companies to expand or continue their outsourcing of drug discovery activities and their research and development expenditures is based on several factors, such as their ability to hire and retain qualified chemists, the resources available for entering into drug discovery collaborations, the spending priorities among various types of research activities and their policies regarding expenditures during recessionary periods. Any of these factors could cause our revenue to decline. In addition, our ability to convince these companies to use our drug discovery capabilities, rather than develop them internally, will depend on many factors, including our ability to:

provide scientists and technologies that are of the highest caliber;

develop drug discovery technologies that will result in the identification of higher quality drug candidates;

achieve intended results in a timely fashion, with acceptable quality and at an acceptable cost; and

design, create and manufacture sufficient quantities of our chemical compounds for our collaborators.

The importance of these factors varies from company to company, and although we believe we currently address them for our collaborators, we may be unable to meet all or any of them for some of our collaborators in the future. Even if we are able to address these factors, these companies may still decide to perform these activities internally or with other companies that provide drug research and development services similar to ours.

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We may not be able to recruit and retain the experienced scientists and management we need to compete in the drug research and development industry.

We are a relatively small company with 226 full-time employees as of February 1, 2002, and our future success depends on our ability to attract, retain and motivate highly skilled scientists and management. Our ability to maintain, expand or renew existing agreements with our collaborators, enter into new agreements, and provide additional expertise to our existing collaborators depends on our ability to hire and retain scientists with the skills necessary to keep pace with the continuing changes in drug discovery technologies. Competition for experienced scientists is intense. We compete with pharmaceutical and biotechnology companies, including our collaborators, medicinal chemistry outsourcing companies, contract research companies, and academic and research institutions to recruit scientists. Our inability to hire additional qualified personnel may also require an increase in the workload for both existing and new personnel. We may not be successful in attracting new scientists or management or in retaining or motivating our existing personnel. The shortage of experienced scientists, and other factors, may lead to increased recruiting, relocation and compensation costs for such scientists, which may exceed our expectations and resources. These increased costs may reduce our profit margins or make hiring new scientists impracticable.

Our future success also depends on the personal efforts and abilities of the principal members of our senior management and scientific staff to provide strategic direction, manage our operations and maintain a cohesive and stable environment. In particular, we rely on the services of Robert E. Conway, our Chief Executive Officer; Dr. Kevin Koch, our President and Chief Scientific Officer; Dr. David L. Snitman, our Chief Operating Officer and Vice President, Business Development; Dr. Anthony D. Piscopio, our Vice President, Chemistry and Director of Process Chemistry; and R. Michael Carruthers, our Chief Financial Officer. We have employment agreements with all of the above personnel that are terminable upon 30 days prior notice. If we cannot attract and retain qualified scientists and management, we will not be able to continue to provide or expand our drug discovery offerings.

We may not successfully develop a drug candidate that becomes a commercially available drug or enter into additional collaborations that allow us to participate in the future success of our proprietary drug candidates through milestone, royalty and/or license payments.

One of our business strategies is to create our own proprietary drug candidates and then to enter into collaborations for the co-development and commercialization of these drug candidates that will allow us to earn milestone, royalty and/or license payments. Our proprietary drug discovery program is in its early stage of development and is unproven. We have received limited license fees, one milestone payment and limited royalties to date. Although we have expended, and continue to expend, time and money on internal research and development programs, we may not be successful in creating valuable proprietary drug candidates that would enable us to form additional collaborations and receive additional milestone, royalty and/or license payments. Even if we are able to negotiate additional collaborations, we may never discover potential drug candidates that ultimately lead to a commercially available drug. We have not, and may not ever, create or contribute to the creation of a commercial drug.

Because we rely on a small number of collaborators for a significant portion of our revenue, if one or more of our major collaborators terminates or reduces the scope of their agreement with us, our revenue may significantly decrease and our results of operations may be harmed.

A relatively small number of collaborators account for a significant portion of our revenue. During the six months ended December 31, 2001, revenue from ICOS Corporation, Merck & Co., Inc., Eli Lilly and Company and Pfizer Inc accounted for 17%, 16%, 16% and 11%, respectively, of our total revenue. One of our agreements with Merck is terminable upon payment of a termination fee; one of our agreements with ICOS terminates as early as July 2002; our agreement with Eli Lilly terminates in March 2005, or earlier upon payment of a termination fee; and our agreement with Pfizer expires in October 2003. We expect that revenue from a limited number of collaborators will account for a large portion of our revenue in future quarters. In general, our collaborators may terminate their contracts with us upon 30 to 90 days

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notice for a number of reasons or, in some cases, for no reason. In addition, some of our major collaborators can determine the amount of products delivered and research or development performed under these agreements. As a result, if any one of our major collaborators cancels, declines to renew or reduces the scope of its contract with us, our revenue may decrease.

We may not obtain regulatory approval for the sale and manufacture of drug candidates that we develop with our collaborators or on our own.

The development and commercialization of drug candidates for our collaborators and our own internal drug discovery efforts are subject to regulation. Pharmaceutical products require lengthy and costly testing in animals and humans and regulatory approval by governmental agencies prior to commercialization. Approval of a drug candidate as safe and effective for use in humans is never certain and these agencies may delay or deny approval of the products for commercialization despite the substantial time and resources required to obtain approvals and to comply with appropriate statutes and regulations. Regulatory agencies may also delay or deny approval based on additional government regulation or administrative action or on changes in regulatory policy during the period of clinical trials in humans and regulatory review. Similar delays and denials may be encountered in foreign countries. None of our collaborators have obtained regulatory approval to manufacture and sell drug candidates owned by us or identified and/or developed under an agreement with us. If we and/or our collaborators cannot obtain this approval, we may not realize milestone or royalty payments based on commercialization goals for these drug candidates. Even if regulatory approval is obtained, clinical studies may be required after sales of a drug have begun. In addition, the identification of certain side effects after a drug is on the market may result in the subsequent withdrawal of approval, reformulation of a drug, additional preclinical and clinical trials and changes in labeling. Any of these events could delay or prevent us from generating revenue from the commercialization of these drugs.

We may fail to expand collaborator relationships.

One of our business strategies is to continue to expand our existing customer relationships across the full spectrum of the Array Discovery Platform. The number of large pharmaceutical and biotechnology companies that could potentially use our capabilities is limited. As a result, we must expand our existing collaborator relationships in order to maximize our potential revenue. However, we may not be able to expand these existing relationships. We currently provide our drug discovery capabilities to 149 companies, and only 16 of them have chosen to expand their relationship with us to additional types of collaborations.

We may not be able to accelerate the drug discovery process.

One of our business strategies is to accelerate the drug discovery process to identify potential drug candidates using the Array Discovery Platform. It is uncertain whether we will be able to make the drug discovery process more efficient or create higher quality drug candidates. Our ability to accelerate the drug discovery process depends on many factors, including the performance and decision-making capabilities of our scientists. Our information-driven technology platform, which we believe allows our scientists to make better decisions, may not enable our scientists to make correct decisions or develop viable drug candidates.

Our success will depend on our ability to manage our growth.

We began operations in 1998 and are at an early stage of our development. We have experienced and expect to continue to experience growth in the number of our employees and the scope of our operating and financial systems. Growth in our operations is placing and is expected to place a significant strain on our operational, human and financial resources. Our ability to compete effectively will depend, in large part, on our ability to expand, improve and effectively use our operating, management, business development and financial systems to accommodate our expanded operations. The physical expansion of our facilities to accommodate future growth may lead to significant costs and may divert management and business development resources. If we fail to effectively anticipate, implement or manage the changes required to sustain our growth, we may not be able to compete successfully.

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We may not be able to meet the delivery and performance requirements set forth in our collaboration agreements and contracts.

In order to maintain our current collaborator relationships and to meet the performance and delivery requirements in our contracts, we must be able to provide drug discovery capabilities at appropriate levels, with acceptable quality and at an acceptable cost. Our ability to deliver the drug discovery capabilities we offer to our collaborators is limited by many factors, including the difficulty of the chemistry, the lack of predictability in the scientific process and the shortage of qualified scientific personnel. In particular, a large portion of our revenue depends on producing collections of chemical compounds, which requires a high rate of production. Some of our collaborators can influence when we provide our drug discovery capabilities under their contracts, which could increase our current contractual commitments to provide chemical compounds even further. If we are unable to increase or maintain our current rate of compound synthesis to meet our existing or future contractual commitments, it may result in delayed or lost revenue, loss of collaborators or failure to expand our existing relationships.

Our quarterly operating results could fluctuate significantly.

Sales of our drug discovery capabilities, including our Lead Generation Libraries, typically involve significant technical evaluation and/ or commitment of capital by our collaborators. Accordingly, the sales cycles are lengthy and subject to a number of significant risks, including collaborators budgetary constraints and internal acceptance reviews. In addition, some of our collaborators can influence when we deliver products and perform services under their contracts with us. Due to these lengthy and unpredictable sales cycles and the ability of our collaborators to influence our delivery of products and performance of services, our operating results could fluctuate significantly from quarter to quarter. In addition, we expect to continue to experience significant fluctuations in quarterly operating results due to factors such as general and industry specific economic conditions that may affect the research and development expenditures of pharmaceutical and biotechnology companies.

Due to the possibility of fluctuations in our revenue and expenses, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. Our operating results in some quarters may not meet the expectations of stock market analysts and investors. If we do not meet analysts and/or investors expectations, our stock price could decline.

Our development, testing and manufacture of potential drug candidates may expose us to potential liability and losses from product liability lawsuits.

We develop, test and manufacture the precursors to therapeutic drugs generally intended for use in humans. Our drug discovery activities that result in the future manufacture and sale of drugs by our collaborators expose us to the risk of liability for personal injury or death to persons using these drugs. We may be required to pay substantial damages or incur legal costs in connection with defending any of these product liability claims, or we may not receive revenue from expected royalty or milestone payments if the commercialization of a drug is limited or ceases as a result of such claims. We have product liability insurance that contains customary exclusions and provides coverage up to $2.0 million per occurrence and in the aggregate, which we believe is customary in our industry. However, our product liability insurance does not cover every type of product liability claim that we may face or loss we may incur, and may not adequately compensate us for the entire amount of covered claims or losses or for the harm to our business reputation. We may be unable to acquire or maintain additional or maintain our current insurance policies at acceptable costs or at all.

If our use of chemical and hazardous materials violates applicable laws or regulations or causes personal injury, we may be liable for damages.

Our drug discovery activities, including the analysis and synthesis of chemical compounds, involve the controlled use of chemicals, including flammable, combustible, toxic and radioactive materials that are potentially hazardous if misused. Our use, storage, handling and disposal of these materials is subject to

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federal, state and local laws and regulations, including the Resource Conservation and Recovery Act, the Occupational Safety and Health Act and local fire codes, and regulations promulgated by the Department of Transportation, the Drug Enforcement Agency, the Department of Energy, the Colorado Department of Public Health and Environment and the Colorado Department of Human Services, Alcohol and Drug Abuse Division. We may incur significant costs to comply with these laws and regulations in the future. In addition, we cannot completely eliminate the risk of accidental contamination or injury from these materials. In the event of such an accident, we could be liable for any damages that result, and any such liability could exceed our resources and disrupt our business.

Our operations could be interrupted by damage to our specialized laboratory facilities.

Our operations are dependent upon the continued use of our highly specialized laboratories and equipment in Boulder, Colorado and Longmont, Colorado. Catastrophic events, including fires or explosions caused by our chemical synthesis and other drug discovery activities, could damage our laboratories, equipment or inventories of chemical compounds and may materially interrupt our business. We employ safety precautions in our laboratory activities in order to reduce the likelihood of the occurrence of these catastrophic events, however, we cannot eliminate the chance that such an event will occur altogether. The availability of laboratory space in these areas is extremely limited, and rebuilding our facilities could be time consuming and result in substantial delays in fulfilling our agreements with our collaborators. We maintain business interruption insurance to cover lost revenue caused by such occurrences. However, this insurance would not compensate us for the loss of opportunity and potential harm to customer relations that our inability to meet our collaborators needs in a timely manner could create.

Our collaborators may restrict our use of scientific information.

Our ability to improve the efficiency of drug discovery by, among other things, developing an effective database designed to predict chemical compound interactions with targets, depends in part on our generation and use of information that we derive from performing these services and is not proprietary to our collaborators. However, our collaborators may not allow us to use this information with others, such as the general interaction between types of chemistries and types of targets that we generate when performing drug discovery services for them. Without the ability to use this information, we may not be able to develop a database, which may limit our ability to improve the efficiency of the drug discovery services we provide.

Risks Related to Operating in Our Industry

The drug research and development industry is highly competitive, and we compete with some companies that offer a broader range of capabilities and have better access to resources than we do.

The pharmaceutical and biotechnology industries are characterized by rapid and continuous technological innovation. We compete with companies in the United States and abroad that are engaged in the development and production of chemistry discovery capabilities. Our major competitors are medicinal chemistry outsourcing companies, including Albany Molecular Research Inc., ArQule, Inc., Discovery Partners International, Inc. and Evotec OAI, and drug discovery companies, including 3-Dimensional Pharmaceuticals, Inc., Gilead Sciences, Inc., Tularik Inc. and Vertex Pharmaceuticals Incorporated. Some of our competitors offer a broader range of capabilities and have greater access to financial, technical, scientific, business development, recruiting and other resources than we do. Their access to greater resources may allow them to develop processes or technologies, such as databases and molecular modeling tools that predict how effectively compounds will treat a targeted disease, thereby rendering our technologies obsolete or uneconomical. We anticipate that we will face increased competition in the future as new companies enter the market and advanced technologies become available.

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The concentration of the pharmaceutical industry and any further consolidation could reduce the number of our potential collaborators.

We believe there are a limited number of large pharmaceutical companies and these companies represent a significant portion of the market for our capabilities. The number of our potential collaborators could decline even further through consolidation among these companies. If the number of our potential collaborators declines even further, they may be able to negotiate price discounts or other terms that are unfavorable to us.

The intellectual property rights we rely on to protect the technology underlying our tools and techniques may be inadequate to prevent third parties from using our technology or developing competing capabilities or to protect our interests in our proprietary drug candidates.

Our success will depend in part on our ability to protect patents or maintain the secrecy of proprietary processes and other technologies we develop for the testing and synthesis of chemical compounds in the drug discovery process. In addition, one of our business strategies is to develop our own proprietary drug candidates and enter into collaborations with pharmaceutical and biotechnology companies for the development of these drug candidates. In order to protect our rights to our proprietary drug candidates, we must obtain and maintain the intellectual property rights to such drug candidates. We currently have one issued United States patent and seven patent applications on file in the United States, including two that have been allowed and two provisional applications. We are also pursuing limited patent coverage in foreign countries. Any patents that we may own or license now or in the future may not afford meaningful protection for our technology and tools. Our efforts to enforce and maintain our intellectual property rights may not be successful and may result in substantial costs and diversion of management time. In addition, others may challenge patents we may obtain in the future and, as a result, these patents could be narrowed, invalidated or rendered unenforceable, or we may be forced to stop using the technology covered by these patents or to license the technology from third parties. In addition, current and future patent applications on which we depend may not result in the issuance of patents in the United States or foreign countries. Even if our rights are valid, enforceable and broad in scope, competitors may develop products based on similar technology that is not covered by our patents.

In addition to patent protection, we also rely on copyright and trademark protection, trade secrets, know-how, continuing technological innovation and licensing opportunities. In an effort to maintain the confidentiality and ownership of our trade secrets and proprietary information, we require our employees, consultants and advisors to execute confidentiality and proprietary information agreements. However, these agreements may not provide us with adequate protection against improper use or disclosure of confidential information and there may not be adequate remedies in the event of unauthorized use or disclosure. Furthermore, like many companies in our industry, we may from time to time hire scientific personnel formerly employed by other companies involved in one or more areas similar to the activities we conduct. In some situations, our confidentiality and proprietary information agreements may conflict with, or be subject to, the rights of third parties with whom our employees, consultants or advisors have prior employment or consulting relationships. Although we require our employees and consultants to maintain the confidentiality of all confidential information of previous employers, we or these individuals may be subject to allegations of trade secret misappropriation or other similar claims as a result of their prior affiliations. Finally, others may independently develop substantially equivalent proprietary information and techniques, or otherwise gain access to our trade secrets. Our failure to protect our proprietary information and techniques may inhibit or limit our ability to exclude certain competitors from the market and execute our business strategies.

The drug research and development industry has a history of patent and other intellectual property litigation, and we may be involved in costly intellectual property lawsuits.

The drug research and development industry has a history of patent and other intellectual property litigation, and we believe these lawsuits will likely continue. Because we produce and provide many different capabilities in this industry, we face potential patent infringement suits by companies that control

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patents for similar capabilities or other suits alleging infringement of their intellectual property rights. In order to protect or enforce our intellectual property rights, we may have to initiate legal proceedings against third parties. Legal proceedings relating to intellectual property would be expensive, take significant time and divert management s attention from other business concerns, whether we win or lose. The cost of such litigation could affect our profitability. Further, if we do not prevail in an infringement lawsuit brought against us, we might have to pay substantial damages, including treble damages, and we could be required to stop the infringing activity or obtain a license to use the patented technology.

Health care reform could reduce the prices pharmaceutical and biotechnology companies can charge for drugs they sell which, in turn, could reduce the amounts that they have available to retain our services.

We generate a majority of our revenues from contracts with pharmaceutical and biotechnology companies. We therefore depend upon the ability of pharmaceutical and biotechnology companies to earn profits on the drugs they market to devote substantial resources to the research and development of new drugs. Future legislation may limit the prices pharmaceutical and biotechnology companies can charge for the drugs they market. Such laws may have the effect of reducing the resources that pharmaceutical and biotechnology companies can devote to the research and development of new drugs, which could reduce the amount of services that we perform and our resulting revenues.

Risks Related to the Offering

Our stock price has been volatile and could experience substantial declines.

The market price of our common stock has historically experienced and may continue to experience volatility. During the twelve months ended February 1, 2002, the market price of our common stock ranged from $4.17 to $15.89. Our quarterly operating results, announcements of collaborations, the success or failure of the drug development efforts of our collaborators, technological innovations being developed by us or our competitors, changes in general conditions in the economy or the financial markets and other developments affecting our competitors, our collaborators or us could cause the market price of our common stock to fluctuate substantially. In addition, in recent years, the stock market in general, and the market for life sciences companies in particular, have experienced significant price and volume fluctuations. This volatility and the recent market decline has affected the market prices of securities issued by many companies, often for reasons unrelated to their operating performance, and may adversely affect the price of our common stock. In the past, securities class action litigation has often been instituted following periods of volatility in the market price of a company s securities. A securities class action suit against us could result in potential liabilities, substantial costs and the diversion of management s attention and resources, regardless of whether we win or lose.

If we need but are unable to obtain additional funding to support our operations, we could experience a reduction in our ability to expand or be forced to reduce our operations.

We have historically financed our operations in substantial part through the sale of our securities and revenue from our collaborators. The amount of cash we used in our operating activities for the fiscal years ended June 30, 2000 and 2001, was $1.3 million and $2.4 million, respectively, and the amount of cash provided by our operating activities for the six months ended December 31, 2001, was approximately $517,000. Although we anticipate that we will use more cash in our operating activities in future periods, we believe that our existing cash, cash equivalents and marketable securities and anticipated cash flow from existing collaboration agreements together with the proceeds of this public offering will be sufficient to support our current operating plan for at least the next 12 months. However, our current operating plan could change as a result of many factors, and we could require additional funding sooner than anticipated.

To the extent that the cash from our future operating activities is insufficient to meet our future capital requirements, we will have to raise additional funds to continue the development of our tools and services. We may not be able to raise funds on favorable terms, if at all. To the extent that we raise

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additional capital through the sale of equity or convertible debt securities, the issuance of those securities would result in dilution to our stockholders. Moreover, incurring debt financing could result in a substantial portion of our operating cash flow being dedicated to the payment of principal and interest on such indebtedness, could render us more vulnerable to competitive pressures and economic downturns and could impose restrictions on our operations. If adequate funds are not available, we may be required to curtail operations significantly or to obtain funds through other arrangements on unattractive terms.

Anti-takeover provisions in our charter, bylaws and our stockholder rights plan may limit the ability of our stockholders to control our policies and effect a change of control of our company.

There are provisions in our certificate of incorporation and bylaws that may discourage a third party from making a proposal to acquire us, even if some of our stockholders might consider the proposal to be in their best interests. These provisions include the following:

Our certificate of incorporation provides for three classes of directors with the term of office of one class expiring each year, commonly referred to as a staggered board. By preventing stockholders from voting on the election of more than one class of directors at any annual meeting of stockholders, this provision may have the effect of keeping the current members of our Board of Directors in control for a longer period of time than our stockholders may desire.

Our certificate of incorporation authorizes our Board of Directors to issue shares of preferred stock without stockholder approval and to establish the preferences and rights of any preferred stock issued, which would allow the Board of Directors to issue one or more classes or series of preferred stock that could discourage or delay a tender offer or change in control.

In addition, our Board of Directors approved on August 2, 2001, a Rights Agreement, which could deter a potential unsolicited takeover of us by causing substantial dilution of an acquirer of 15% or more of our outstanding common stock. We are also subject to Section 203 of the Delaware General Corporation Law, which, in general, imposes restrictions upon acquirers of 15% or more of our stock.

Our share ownership is concentrated, and our officers, directors and principal stockholders may exert significant control over our business and matters requiring stockholder approval.

On February 1, 2002, our directors, officers and stockholders holding more than 5% of our common stock beneficially owned or controlled approximately 45% of our outstanding common stock. Collectively, these stockholders may have the ability to significantly influence the outcome of all corporate matters requiring stockholder approval. Therefore, they may vote their shares in a way with which you do not agree. In particular, this concentration of ownership may have the effect of delaying, deferring or preventing an acquisition of us and may adversely affect the market price of our common stock.

Future sales of our common stock may depress our stock price.

The market price of our common stock could decline as a result of sales of substantial amounts of our common stock in the public market after the closing of this offering, or the perception that these sales could occur. In addition, these factors could make it more difficult for us to raise funds through future offerings of common stock. There will be 26,701,245 shares of common stock outstanding immediately after this offering, based on the number of shares outstanding on February 1, 2002. All of the shares sold in this offering will be freely transferable without restriction or further registration under the Securities Act of 1933, except for any shares that may be purchased by our executive officers, directors, principal stockholders and certain related parties. As of February 1, 2002, 8,233,052 shares, including options exercisable for shares of common stock, held by our executive officers, directors and certain principal stockholders are subject to lock-up agreements with the underwriters and will be eligible for sale in the public market 90 days from the date of this prospectus.

We have an aggregate of 6,057,860 shares of common stock that have been registered or are freely tradeable under an exemption from registration and are reserved for issuance upon exercise of options

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granted or reserved for grant under our stock option plan and our employee stock purchase plan. Stockholders can sell these shares in the public market upon issuance, subject to restrictions under securities laws. The number of shares we have reserved for issuance under our stock option plan may increase based on our issued and outstanding shares of common stock, and we may register such additional shares in the future. In addition, some of our existing stockholders will be entitled to register their shares of common stock after this offering.

Because we do not intend to pay dividends, stockholders will benefit from an investment in our common stock only if it appreciates in value.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain our future earnings, if any, to finance the expansion of our business and do not expect to pay any cash dividends in the foreseeable future. As a result, the success of an investment in our common stock will depend upon any future appreciation in its value. There is no guarantee that our common stock will appreciate in value or even maintain the price at which stockholders have purchased their shares.

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and the documents we have filed with the SEC that are included or incorporated by reference in this prospectus contain forward-looking statements that are based on our current expectations, assumptions, estimates and projections about our company and our industry. When used in this prospectus and the documents we have filed with the SEC that are included or incorporated by reference in this prospectus, the words may, will, should, predict, continue, plans, expects, anticipates, estimates, intends or the negative of suc expressions are intended to identify forward-looking statements. These statements involve significant risks and uncertainty and include, but are not limited to, statements under the captions Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business and elsewhere in this prospectus.

We cannot guarantee future results, levels of activity, performance or achievements. Because these statements reflect our current expectations concerning future events, our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors. These factors include, but are not limited to, our ability to achieve and maintain profitability, the extent to which the pharmaceutical and biotechnology industries are willing to collaborate with third parties on their drug discovery activities, our ability and the ability of our collaborators to meet drug discovery objectives tied to milestones and royalties, and our ability to attract and retain experienced scientists and management. We are providing this information as of the date of this prospectus and as of the date of documents we have filed with the SEC that are included or incorporated by reference in this prospectus. We undertake no duty to update any forward-looking statements to reflect the occurrence of events or circumstances after the date of such statements or of anticipated or unanticipated events that alter any assumptions underlying such statements.

Information regarding market and industry statistics contained in the Prospectus Summary, Business and other sections of this prospectus is included based on information available to us that we believe is accurate. It is generally based on academic and other publications that are not produced for purposes of securities offerings or economic analysis. This information contains certain assumptions regarding current and future events, trends and activities. Although we believe that this information is generally indicative of the matters reflected in those studies, this information is inherently imprecise and we have not reviewed or included data from all sources. We caution you to read this information in conjunction with the rest of the disclosure in this prospectus, particularly the Risk Factors section.

ABOUT THIS PROSPECTUS

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representation. This prospectus is not an offer to sell or a solicitation of an offer to buy our common stock in any jurisdiction where it is unlawful. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock.

The SEC allows us to incorporate by reference information that we file with them, which means we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. See Where You Can Find More Information. References in this prospectus to our company, we, our and us refer to Array BioPharma Inc.

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USE OF PROCEEDS

We estimate our net proceeds from the sale of the 3,000,000 shares of common stock will be approximately $27.7 million, or approximately $31.9 million if the underwriters exercise their over-allotment option in full, based on the public offering price of $10.00 per share and after deducting the underwriting discount and the estimated offering expenses payable by us.

We currently intend to use the estimated net proceeds from this offering to fund our operations, for working capital and for general corporate purposes, including the following: funding continued internal development of new research tools, technologies and systems infrastructure; expanding our facilities; hiring additional personnel; investing in our proprietary drug discovery efforts; and for acquisitions or joint ventures. Pending the application of the net proceeds towards one of the above uses, we intend to invest the proceeds in investment-grade, interest-bearing securities.

The foregoing represents our current intentions based upon our present plans and business condition. Our management will have broad discretion in the application of the net proceeds from this offering, and the occurrence of unforeseen events or changed business conditions could result in the application of the net proceeds from this offering in a manner other than as described in this prospectus.

DIVIDEND POLICY

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings to finance the growth and development of our business. Therefore, we do not anticipate that we will declare or pay any cash dividends on our common stock in the foreseeable future. Any future determination to pay cash dividends will be at the discretion of our Board of Directors and will be dependent upon our financial condition, results of operations, capital requirements, restrictions under any existing indebtedness and other factors the Board of Directors deems relevant.

PRICE RANGE OF OUR COMMON STOCK

Our common stock has been trading on the Nasdaq National Market under the symbol ARRY since our initial public offering at $7.50 per share on November 17, 2000. Prior to that time, there had not been a market for our common stock. The quarterly intraday high and low sales prices for our common stock as reported by the Nasdaq National Market are shown below.

	High	Low
Fiscal Year Ended June 30, 2001:		
Second Quarter (from November 17, 2000)	$13.00	$7.50
Third Quarter	9.11	4.17
Fourth Quarter	9.50	4.75
Fiscal Year Ending June 30, 2002:		
First Quarter	$11.50	$7.20
Second Quarter	15.89	8.44
Third Quarter (through February 12, 2002)	15.10	9.40

On February 12, 2002, the closing price of our common stock, as reported on the Nasdaq National Market, was $10.30 per share. As of February 1, 2002, there were 171 holders of record of our common stock.

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CAPITALIZATION

The following table shows on an unaudited basis, as of December 31, 2001, our actual capitalization and our capitalization as adjusted for this offering of 3,000,000 shares of our common stock at the public offering price of $10.00 per share, after deducting the underwriting discount and estimated offering expenses payable by us.

The following table should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operation and the financial statements and related notes thereto appearing elsewhere in this prospectus and incorporated here by reference.

	As of December 31, 2001	
	(unaudited)	
	Actual	As Adjusted
	(in thousands)	
Stockholders equity:		
Preferred stock, par value $0.001 per share; 10,000,000 shares authorized; no shares issued and outstanding	$	$
Common stock, $0.001 par value; 60,000,000 shares authorized; 23,601,301 shares issued and outstanding; and 26,601,301 shares issued and outstanding, as adjusted	24	27
Additional paid-in capital	90,642	118,339
Accumulated deficit	(22,872)	(22,872)
Notes receivable for common stock related party	(273)	(273)
Accumulated other comprehensive income	61	61
Deferred compensation	(5,984)	(5,984)
Total stockholders equity	61,598	89,298
Total capitalization	$ 61,598	$ 89,298

The above table excludes the following:

4,647,401 shares of common stock underlying options outstanding as of December 31, 2001, at a weighted-average exercise price of $4.27 per share; and

905,475 and 607,625 shares of common stock available for future issuance or future grants under our stock option plan and our employee stock purchase plan, respectively, as of December 31, 2001.

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DILUTION

Our net tangible book value as of December 31, 2001, was $61.5 million, or $2.61 per share of common stock. Net tangible book value per share is calculated by subtracting our total liabilities from our total tangible assets, which is total assets less intangible assets of $95,000, and dividing this amount by the number of shares of common stock outstanding as of December 31, 2001. Based on the sale by us of 3,000,000 shares of common stock offered in this offering at the public offering price of $10.00 per share and after deducting the underwriting discount and estimated offering expenses payable by us, our net tangible book value as of December 31, 2001, would have been $89.2 million, or $3.35 per share of common stock. This represents an immediate increase in the net tangible book value of $0.74 per share to our existing stockholders and an immediate and substantial dilution in the net tangible book value of $6.65 per share of common stock to new investors. Dilution in net tangible book value per share represents the difference between the amount per share paid by purchasers of shares of common stock in this offering and the net tangible book value per share of our common stock immediately afterwards. The following table illustrates this per share dilution:

Offering price per share		$10.00
Net tangible book value per share as of December 31, 2001	$2.61	
Increase per share attributable to new investors	0.74	
Net tangible book value per share after the offering		3.35
Dilution per share to new investors		$ 6.65

The table and calculations above assume no exercise of outstanding options. As of December 31, 2001, there were 4,647,401 shares of common stock reserved for issuance upon exercise of outstanding options.

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SELECTED FINANCIAL DATA

The following selected financial data for the period from February 6, 1998 (inception) to June 30, 1998, and for the twelve-month periods ended June 30, 1999, 2000 and 2001, are derived from our historical audited financial statements. The financial data as of December 31, 2001, and for the six-month periods ended December 31, 2000 and 2001, are derived from our unaudited financial statements appearing elsewhere in this prospectus and, in our opinion, reflect all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of our financial position and results of operations.

The cost of revenue, research and development expenses, and selling, general and administrative expenses data below includes compensation related to stock option grants. The following data should be read together with the financial statements, related notes and other financial information included in this prospectus and incorporated here by reference.

	Period from February 6, 1998 (inception) to June 30, 1998	Years Ended June 30,			Six Months Ended December 31,	
		1999	2000	2001	2000	2001
					(unaudited)	
		(in thousands, except per share data)				
Statements of Operations Data:						
Revenue:						
Collaboration revenue	$	$ 1,504	$ 6,774	$ 16,364	$ 6,433	$ 14,858
License, royalty and milestone revenue				642	161	693
Total revenue		1,504	6,774	17,006	6,594	15,551
Costs and expenses:						
Cost of revenue*		1,033	4,445	12,965	5,699	9,537
Research and development expenses*		3,301	3,963	8,265	3,817	6,048
Selling, general and administrative expenses*	62	1,522	3,470	7,668	4,649	3,549
Total operating expenses	62	5,856	11,878	28,898	14,165	19,134
Loss from operations	(62)	(4,352)	(5,104)	(11,892)	(7,571)	(3,583)
Interest expense		(136)	(384)	(587)	(353)	
Interest income	13	181	356	2,092	607	812
Net loss before extraordinary item	(49)	(4,307)	(5,132)	(10,387)	(7,317)	(2,771)
Extraordinary loss from early extinguishment of debt				(225)		
Net loss	(49)	(4,307)	(5,132)	(10,612)	(7,317)	(2,771)
Deemed dividend related to beneficial conversion feature of preferred stock				(5,000)	(5,000)	
Net loss applicable to common stockholders	$ (49)	$ (4,307)	$ (5,132)	$ (15,612)	$ (12,317)	$ (2,771)
Basic and diluted net loss per share:						
Net loss applicable to common stockholders before extraordinary item	$ (0.06)	$ (1.48)	$ (1.68)	$ (0.98)	$ (1.49)	$ (0.12)
Extraordinary loss from early extinguishment of debt				(0.01)		

Net loss applicable to common stockholders	$(0.06)	$ (1.48)	$ (1.68)	$ (0.99)	$ (1.49)	$ (0.12)
Number of shares used to compute per share data	864	2,918	3,063	15,693	8,287	23,434
*Includes compensation related to option grants:						
Cost of revenue	$	$	$ 43	$ 998	$ 486	$ 541
Research and development expenses			35	644	302	361
Selling, general and administrative expenses			1,040	3,012	2,549	442
Total	$	$	$ 1,118	$ 4,654	$ 3,337	$ 1,344

	As of June 30,				As of December 31,
	1998	1999	2000	2001	2001
			(in thousands)		(unaudited)
Balance Sheet Data:					
Cash, cash equivalents and marketable securities	$2,608	$ 2,186	$ 5,784	$ 47,712	$ 36,824
Property, plant and equipment, net	6	2,872	6,911	17,421	27,349
Working capital	2,743	1,260	2,210	44,917	34,073
Total assets	2,810	7,125	15,823	70,950	73,687
Long-term debt, less current portion		1,824	2,833		
Accumulated deficit	(49)	(4,357)	(9,489)	(20,101)	(22,872)
Total stockholders equity	2,753	2,557	6,652	62,468	61,598

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion of our financial condition and results should be read in conjunction with the financial statements and the notes to those statements included elsewhere in this prospectus and incorporated here by reference. This discussion may contain forward-looking statements that involve significant risks and uncertainties. Because these statements reflect our current expectations concerning future events, our actual results could differ materially from those anticipated in these forward-looking statements as a result of many factors, such as those set forth under Risk Factors and elsewhere in this prospectus.

Overview

We are a drug discovery company inventing new small molecule drugs through the integration of chemistry, biology and informatics. Our experienced scientists use an integrated set of drug discovery technologies, which we call the Array Discovery Platform, to invent novel small molecule drugs in collaboration with leading pharmaceutical and biotechnology companies and to build our own pipeline of proprietary drug candidates.

We have incurred net losses since inception and expect to incur losses in the near future as we expand our scientific staff and continue to scale-up our operations. To date, we have funded our operations primarily through the issuance of equity securities and revenue from our collaborators. As of December 31, 2001, we had an accumulated deficit of $22.9 million.

We generate revenue by researching, designing, synthesizing and screening chemical compounds for the invention of drug candidates for our collaborators. We report revenue from collaboration agreements, which include lead generation and lead optimization services, custom synthesis and process research and the development and sale of chemical compounds, as collaboration revenue in our statement of operations. License, royalty and milestone revenue are combined and reported separately from collaboration revenue.

Our collaborations include lead generation, lead optimization, custom synthesis and process research and development. We provide lead generation services, including structural biology and screening compound libraries, to invent potential drug candidates for our collaborators and collaborate with them in lead optimization to refine and optimize potential drug candidates. We also design, synthesize and provide libraries of chemical compounds or single compounds to our customers on a custom basis, with either an exclusive or non-exclusive license to use the compounds. Finally, we assist customers in process research and development, which involves developing the processes, and synthesizing for delivery, larger quantities of chemical compounds required for clinical testing.

We license our Lead Generation Libraries, which are a collection of structurally related chemical compounds that may have the potential to become drug candidates, on a non-exclusive basis to our collaborators for internal research purposes. We retain all other rights to the compounds, which permits us to license the same compounds to other customers. Some of our agreements allow our collaborators to obtain exclusive rights to commercialize particular compounds upon the payment of additional fees. We sell our Optimer building blocks, which are the starting materials used to create more complex chemical compounds in the drug discovery process, on a per-compound basis without any restrictions on use. We are also paid under our collaboration agreements based on the number of full-time equivalent employees contractually assigned to a project, plus certain expenses. Custom collections of chemical compounds we create and custom chemical syntheses we perform under our collaboration agreements are typically charged on a per-compound basis, plus a charge for research and development services. In addition, five of our collaboration agreements provide for additional payments upon the achievement of certain drug development milestones, and five of our collaboration agreements provide for royalty payments based on sales of products created as a result of these collaborations. Two of our collaboration agreements provide for an up-front license or technology access fee, and one of our collaboration agreements currently generates a low level of royalty payments. In general, our collaborators may terminate their collaboration agreement with us on 30 to 90 days prior notice. During November 2001, we earned our first milestone

payment from ICOS Corporation with the commencement of a Phase I clinical trial on a jointly identified drug candidate.

We have increased the number of our collaboration agreements, which has diversified our revenue base. During the six months ended December 31, 2001, ICOS, Merck & Co., Inc., Eli Lilly and Company and Pfizer Inc accounted for 17%, 16%, 16% and 11%, respectively, of our total revenue. During fiscal year 2001, ICOS, Eli Lilly and Merck accounted for 24%, 24% and 12%, respectively, of our total revenue.

We recognize revenue from full-time equivalent fees under our collaboration agreements on a monthly or per diem basis as work is performed. Development and fixed-fee revenue is recognized on a percentage-of-completion basis. Per-compound revenue is recognized as compounds are shipped. Revenue from license fees and up-front fees is recognized over the term of the particular license or over the expected term of the particular collaboration agreement. Royalty revenue is recorded when earned. Milestone payments are recognized as revenue based upon the stage of completion of our performance obligations under the related contract.

Cost of revenue consists mainly of compensation, associated fringe benefits and other collaboration-related costs, including recruiting and relocation, fine chemicals, supplies, small tools, facilities, depreciation and other direct and indirect chemical handling and laboratory support costs, excluding any costs related to research and development.

Research and development expenses consist of the same type of scientific expenditures that comprise cost of revenue, except that the expenses are related to the development of our early-stage intellectual property and compounds where we have not yet proven technological feasibility. Costs associated with activities where technological feasibility has been proven are charged directly to cost of revenue.

Selling, general and administrative expenses consist mainly of compensation and associated fringe benefits and other management, business development, accounting, information technology and administration costs, including recruiting and relocation, consulting and professional services, travel and meals, advertising, sales commissions, facilities, depreciation and other office expenses.

We currently license or sell our compounds and enter into collaborations directly with pharmaceutical and biotechnology companies through opportunities identified by our senior management, scientists and customer referrals. In addition, we license or sell our compounds and collaborations in Japan through an agent. International revenue represented 9% of our total revenue during both fiscal years 2000 and 2001 and 16% for the first six months of fiscal year 2002. The majority of our international revenue was attributed to European sales in fiscal year 2000 and to Japanese sales in fiscal year 2001. During the first six months of fiscal year 2002, international revenue was attributed to both European and Japanese sales. All of our collaboration agreements and purchase orders are denominated in United States dollars.

We plan to continue to grow revenue with our existing collaborators and realize new revenue streams through collaborations with a diversified group of pharmaceutical and biotechnology companies. In addition, we expect to enter into additional agreements that allow us to participate in the success of potential drug candidates with our collaborators through milestone and/ or royalty payments. We also expect to enter into agreements to participate in the success of our proprietary potential drug candidates through a combination of licensing fees, milestone and/or royalty payments. We expect our growth to require significant ongoing investment in facilities, scientific personnel and business development resources.

Deferred Stock Compensation

During fiscal years 2000 and 2001, we recorded deferred stock compensation totaling $13.1 million. We recorded compensation expense related to stock option grants of $1.1 million for fiscal year 2000, $4.7 million for fiscal year 2001 and $1.3 million for the six months ended December 31, 2001. The compensation expense related to stock option grants is charged to cost of revenue, research and development expenses, and selling, general and administrative expenses based on the functional responsibility of each employee. As of December 31, 2001, we had a total of $6.0 million of remaining deferred stock compensation to be amortized. We expect to amortize deferred stock compensation

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recorded through December 31, 2001, as follows: $1.1 million during the remainder of fiscal year 2002; $2.4 million in fiscal year 2003; $2.3 million in fiscal year 2004; and approximately $183,000 in fiscal year 2005. To date, we have granted our employees stock options as annual incentive bonus awards. Any future annual incentive bonus awards may include a partial cash component in addition to stock-based compensation.

Deemed Dividend upon Issuance of Convertible Preferred Stock

On August 31, 2000, we issued 1,666,667 shares of our Series C convertible preferred stock at $6.00 per share to investors, resulting in gross proceeds of $10.0 million. All outstanding shares of Series C convertible preferred stock converted on a one-for-one basis into shares of common stock upon the effectiveness of our initial public offering. Subsequent to the commencement of the initial public offering process, we reevaluated the fair value of our Series C convertible preferred stock as of August 31, 2000, and determined it to be $9.00 per share. Accordingly, the incremental fair value of $5.0 million, or $3.00 per share, was deemed to be the equivalent of a dividend on our Series C convertible preferred stock. We recorded the deemed dividend at the date of issuance by offsetting charges and credits to preferred stock, without any effect on total stockholders equity. The deemed preferred stock dividend increases the loss applicable to common stockholders in the calculation of basic net loss per share for fiscal year 2001 and all related interim periods.

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Results of Operations

The following table presents our results of operations for the eight quarters in the period ended December 31, 2001. This information has been compiled from our unaudited interim financial statements. Our unaudited financial statements have been prepared on the same basis as our audited financial statements. All adjustments, consisting only of normal recurring accruals considered necessary for a fair presentation, have been included. The cost of revenue, research and development expenses, and selling, general and administrative expenses data in the following table includes compensation related to stock option grants. The results of operations for any quarter are not necessarily indicative of the results of operations for any future period.

	Three Months Ended,							
	Mar. 31, 2000	Jun. 30, 2000	Sep. 30, 2000	Dec. 31, 2000	Mar. 31, 2001	Jun. 30, 2001	Sep. 30, 2001	Dec. 31, 2001
	(in thousands, except per share data)							
Statements of Operations Data:								
Revenue:								
Collaboration revenue	$ 1,825	$ 2,248	$ 2,761	$ 3,672	$ 4,500	$ 5,430	$ 6,916	$ 7,942
License, royalty and milestone revenue				161	241	241	276	416
Total revenue	1,825	2,248	2,761	3,833	4,741	5,671	7,192	8,358
Costs and expenses:								
Cost of revenue(1)	1,173	1,654	2,408	3,291	3,415	3,851	4,533	5,004
Research and development expenses(1)	1,020	1,327	1,702	2,115	2,160	2,288	2,785	3,262
Selling, general and administrative expenses(1)	888	1,049	1,694	2,955	1,539	1,480	1,829	1,720
Total operating expenses	3,081	4,030	5,804	8,361	7,114	7,619	9,147	9,986
Loss from operations	(1,256)	(1,782)	(3,043)	(4,528)	(2,373)	(1,948)	(1,955)	(1,628)
Interest expense	(87)	(126)	(173)	(180)	(148)	(86)		
Interest income	126	119	130	477	832	653	461	351
Net loss	(1,217)	(1,789)	(3,086)	(4,231)	(1,689)	(1,381)	(1,494)	(1,277)
Deemed dividend related to beneficial conversion feature of preferred stock			(5,000)					
Extraordinary loss from early extinguishment of debt						(225)		
Net loss applicable to common stockholders	$(1,217)	$(1,789)	$(8,086)	$ (4,231)	$ (1,689)	$ (1,606)	$ (1,494)	$ (1,277)
Basic and diluted net loss per share applicable to common stockholders	$ (0.40)	$ (0.55)	$ (2.17)	$ (0.33)	$ (0.07)	$ (0.07)	$ (0.06)	$ (0.05)
Number of shares used to compute per share data	3,047	3,255	3,719	12,855	23,022	23,176	23,351	23,516
Other Financial Data:								
Earnings before interest, taxes, depreciation and amortization:								
Net loss as reported	$(1,217)	$(1,789)	$(3,086)	$ (4,231)	$ (1,689)	$ (1,381)	$ (1,494)	$ (1,277)
Minus: net interest income, (expense)	39	(7)	(43)	297	684	567	461	351
Plus: depreciation	236	311	454	626	781	690	900	1,093
Plus: compensation related to option grants	347	416	707	2,631	698	618	700	644

EBITDA(2):	$ (673)	$(1,055)	$(1,882)	$ (1,271)	$ (894)	$ (640)	$ (355)	$ 109

(1) Includes compensation related to option grants:

Cost of revenue	$ 5	$ 38	$210	$ 277	$264	$247	$271	$271
Research and development expenses	4	31	140	163	176	165	180	180
Selling, general and administrative expenses	338	347	357	2,191	258	206	249	193
Total	$347	$416	$707	$2,631	$698	$618	$700	$644

(2) EBITDA means earnings before interest, taxes, depreciation and amortization (including amortization of compensation related to option grants). EBITDA should be considered in addition to, but not as a substitute for, loss from operations, net loss and other measures of financial performance prepared in accordance with generally accepted accounting principles that are presented in our financial statements. Our calculation of EBITDA may be different from the calculation used by other companies and therefore may not be comparable to similarly titled measures reported by other companies.

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Three and Six Months Ended December 31, 2001 and 2000

Revenue. Total revenue increased to $8.4 million for the three months ended December 31, 2001, up 118% from $3.8 million in the same period of the prior year. Total revenue for the six months ended December 31, 2001 and 2000, was $15.6 million and $6.6 million, respectively, representing growth of 136%. These increases were primarily the result of additional revenue generated from our lead optimization collaborations with Eli Lilly, ICOS and Amgen Inc., and our custom library collaboration with Merck. In addition, combined revenue from subscriptions to our Lead Generation Libraries and sales of our Optimer building blocks increased by $1.7 million and $3.1 million for the three-month and six-month periods ended December 31, 2001, respectively, compared to the same periods in the prior year. For the three-month and six-month periods ended December 31, 2001, we shipped $1.0 million and $1.7 million, respectively, of Optimer building blocks to a single major pharmaceutical company.

Cost of revenue. Cost of revenue increased to $5.0 million for the three months ended December 31, 2001, from $3.3 million in the same period of the prior year. Cost of revenue was $9.5 million and $5.7 million for the six months ended December 31, 2001 and 2000, respectively. These increases reflect the increased cost to support our revenue growth over the same periods. The cost increase during both periods was primarily attributed to recruiting and relocating additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities.

Research and development expenses. Research and development expenses increased to $3.3 million for the three months ended December 31, 2001, from $2.1 million in the same period of the prior year. Research and development expenses were $6.0 million and $3.8 million for the six months ended December 31, 2001 and 2000, respectively. The increase in research and development expenses was primarily attributed to expanded research efforts for our Lead Generation Libraries, custom library collaborations and our own proprietary drug discovery efforts. These expanded research efforts required the recruitment and relocation of additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities.

Selling, general and administrative expenses. Selling, general and administrative expenses totaled $1.7 million for the three months ended December 31, 2001, compared to $3.0 million in the same period of the prior year. Selling, general and administrative expenses were $3.5 million and $4.6 million for the six months ended December 31, 2001 and 2000, respectively. After deducting compensation related to stock option grants, selling, general and administrative expenses were $1.5 million for the three months ended December 31, 2001, up from approximately $763,000 in the same period of the prior year. For the six months ended December 31, 2001, selling, general and administrative expenses after deducting compensation related to stock option grants were $3.1 million, up from $2.1 million in the same period of the prior year. This increase was primarily attributed to additional personnel, higher relocation expenses and other costs associated with being a publicly traded company.

Compensation related to stock option grants. Compensation expense related to stock option grants was approximately $644,000 for the three months ended December 31, 2001, down from $2.6 million in the same period of the prior year. For the six months ended December 31, 2001, these charges were $1.3 million, down from $3.3 million in the same period of the prior year. Compensation expense related to stock option grants was higher in the prior fiscal year periods due to options that vested upon the closing of our initial public offering in November 2000. These noncash charges are recognized on a straight-line basis over the vesting periods of the related options, which are generally four years, except for options with performance-based vesting provisions.

Interest income or expense. Interest expense was $0 for the three months and six months ended December 31, 2001, a decrease of approximately $180,000 and $353,000, respectively, over the comparable periods of the prior year. These decreases resulted from the full repayment of all equipment loan facilities and lines of credit obligations in May and June 2001. Interest income was approximately $351,000 for the three months ended December 31, 2001, a decrease of approximately $126,000 over the comparable period of the prior year. This decrease was primarily due to lower interest rates. For the six months ended

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December 31, 2001, interest income was approximately $812,000, an increase of approximately $205,000 over the comparable period in the prior year. This increase was the result of the investment of the proceeds from our initial public offering in November 2000 for a full six-month period as of December 31, 2001, compared to less than two months for the same period in the prior year.

Years Ended June 30, 2001 and 2000

Revenue. Total revenue increased to $17.0 million in fiscal year 2001 from $6.8 million in fiscal year 2000. This is the result of increased sales in all business areas, and most significantly in collaborations involving lead optimization and custom libraries and product sales from our Lead Generation Libraries. Collaboration revenue increased $7.5 million in fiscal year 2001 over fiscal year 2000. This increase was primarily a result of our new collaboration agreements in fiscal year 2001 as well as expanded collaborations with existing customers.

Cost of revenue. Cost of revenue increased to $13.0 million in fiscal year 2001 from $4.4 million in fiscal year 2000, reflecting the increased cost to support our revenue growth in the same period. The cost increases in fiscal year 2001 were primarily attributed to recruiting and relocating additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities. Cost of revenue was 76% of revenue in fiscal year 2001, compared to 66% in fiscal year 2000. The increased cost of revenue as a percentage of revenue in 2001 as compared to 2000 was due primarily to compensation related to stock option grants and recruiting and relocation to support our growth.

Research and development expenses. Research and development expenses increased to $8.3 million in fiscal year 2001 from $4.0 million in fiscal year 2000. The increase in research and development expenses in fiscal year 2001 was primarily attributed to expanded research efforts for our Lead Generation Libraries, custom library collaborations and our own proprietary drug discovery. These expanded research efforts required the recruitment and relocation of additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities.

Selling, general and administrative expenses. Selling, general and administrative expenses totaled $7.7 million in fiscal year 2001, compared to $3.5 million in fiscal year 2000. The increase in selling, general and administrative expenses in fiscal year 2001 was primarily attributed to compensation related to stock option grants, our increased staffing levels and expanded management and other costs associated with being a publicly traded company.

Compensation related to stock option grants. Compensation expense related to stock option grants was $4.7 million in fiscal year 2001, compared to $1.1 million in fiscal year 2000. The expense for fiscal year 2001 relates most significantly to the selling, general and administrative functional area.

Interest income or expense. We had net interest income of $1.5 million in fiscal year 2001, compared to net interest expense of approximately $28,000 in fiscal year 2000. The net interest income in fiscal year 2001 compared with net interest expense in fiscal year 2000 was primarily due to larger balances of cash, cash equivalents and marketable securities in fiscal year 2001 resulting from our initial public offering in November 2000.

Extraordinary item. During fiscal 2001, we fully repaid all obligations related to equipment loan facilities and lines of credit. In connection with the early extinguishment of these debts, we incurred approximately $225,000 of extraordinary charges related to prepayment penalties charged by the respective financial institutions, including a noncash charge of approximately $90,000 related to the remaining accreted interest expense associated with warrants issued to the lenders. No such extraordinary charges existed in any other prior periods.

Income taxes. There is no current or deferred tax expense for the years ended June 30, 2001 and 2000. At June 30, 2001, we had federal and Colorado income tax net operating loss carryforwards for income tax purposes of $15.3 million, which will expire beginning in 2018 and continuing through 2021.

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We have provided a 100% valuation allowance against the related deferred tax assets, as realization of such tax benefits is not assured.

Years Ended June 30, 2000 and 1999

Revenue. Total revenue increased to $6.8 million in fiscal year 2000 from $1.5 million in fiscal year 1999. The revenue increase from fiscal year 1999 to fiscal year 2000 was primarily a result of a full year of operations in fiscal year 2000 versus a partial year of operations in fiscal year 1999. Sales increased in all business areas, most significantly in lead optimization, process chemistry and sales of our Lead Generation Libraries.

Cost of revenue. Cost of revenue increased to $4.4 million in fiscal year 2000 from $1.0 million in fiscal year 1999, reflecting the increased cost to support our revenue growth in the same period. The cost increases in fiscal year 2000 were primarily attributed to recruiting and relocating additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities. Cost of revenue was 66% of revenue in fiscal year 2000, compared to 69% in fiscal year 1999. The reduction in cost of revenue as a percentage of revenue in 2000 as compared to 1999 was due primarily to a larger revenue base against which to apply certain fixed costs.

Research and development expenses. Research and development expenses increased to $4.0 million in fiscal year 2000 from $3.3 million in fiscal year 1999. The increase in research and development expenses in fiscal year 2000 was primarily attributed to expanded research efforts for our Lead Generation Libraries and custom synthesis collaborations. These expanded research efforts required the recruitment and relocation of additional scientific staff and associated salaries and benefits, and the expenditures associated with equipping and commencing operations in our new and expanded facilities.

Selling, general and administrative expenses. Selling, general and administrative expenses totaled $3.5 million in fiscal year 2000, compared to $1.5 million in fiscal year 1999. The increase in selling, general and administrative expenses in fiscal year 2000 was primarily attributed to our increased staffing levels and expanded management. The recruitment and relocation of senior management was a significant component of our selling, general and administrative expenses in fiscal year 2000.

Compensation related to stock option grants. Compensation expense related to stock option grants was $1.1 million in fiscal year 2000. There was no compensation expense related to stock option grants in fiscal year 1999. The expense for fiscal year 2000 relates primarily to the selling, general and administrative functional area. During fiscal year 2000, we recorded deferred stock compensation totaling $5.8 million. After recording compensation expense related to stock option grants of $1.1 million for fiscal year 2000, we had a total of $4.7 million of remaining deferred stock compensation to be amortized.

Interest income or expense. We had net interest expense of approximately $28,000 in fiscal year 2000, compared to net interest income of approximately $45,000 in fiscal year 1999. The net interest expense in fiscal year 2000 compared with net interest income in fiscal year 1999 was primarily due to increased borrowing to finance equipment purchases, offset partially by larger interest income from our larger balances of cash, cash equivalents and marketable securities in fiscal year 2000.

Liquidity and Capital Resources

As of December 31, 2001, cash, cash equivalents and marketable securities totaled $36.8 million compared to $47.7 million at June 30, 2001. Net cash provided by operating activities was approximately $517,000 for the six months ended December 31, 2001, which included our net loss for the same period of $2.8 million, reduced by noncash charges of $3.3 million. For the six months ended December 31, 2000, net cash used in operating activities was $3.7 million which included a net loss for the same period of $7.3 million, reduced by noncash charges of $4.4 million. The decrease in net cash used in operating activities for the six months ended December 31, 2001, was primarily a result of the decreased net loss for the period partially offset by higher depreciation charges. The decrease in our net loss for the six months ended December 31, 2001, was attributable to additional collaborations and growth in our total revenue.

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During the six months ended December 31, 2001, we invested $12.0 million in capital equipment and leasehold improvements associated with equipping and commencing operations in our new and expanded facilities. Net sales of marketable securities provided $5.5 million of cash, and the exercise of stock options under our stock option plan and the issuance of stock under our employee stock purchase plan provided approximately $619,000 of cash.

Our future capital requirements will depend on a number of factors, including our success in increasing sales of both existing and new products and collaborations, expenses associated with unforeseen litigation, regulatory changes, competition, technological developments and potential future merger and acquisition activity. We believe that our existing cash, cash equivalents and marketable securities and anticipated cash flow from existing collaboration agreements will be sufficient to support our current operating plan for at least the next 12 months. This estimate of our future capital requirements is a forward-looking statement that is based on assumptions that may prove to be wrong and that involve substantial risks and uncertainties. Our actual future capital requirements could vary as a result of a number of factors, including:

the progress of our research activities;

the number and scope of our research programs;

the progress of our preclinical development activities;

the progress of the drug development efforts of our collaborators;

our ability to establish and maintain current and new collaboration agreements;

the costs involved in enforcing patent claims and other intellectual property rights;

the costs and timing of regulatory approvals; and

the costs of establishing business development and distribution capabilities.

Future capital requirements will also depend on the extent to which we acquire or invest in other products, technologies and businesses. Until we can generate sufficient levels of cash from our operations, which we do not expect to achieve in the foreseeable future, we expect to continue to use our existing cash and marketable securities resources that were primarily generated from the proceeds of offerings of our equity securities. In addition, we may finance future cash needs through the sale of equity securities, strategic collaboration agreements and debt financing. We cannot assure you that we will be successful in obtaining collaboration agreements, or in receiving milestone and/ or royalty payments under those agreements, that our existing cash and marketable securities resources will be adequate or that additional financing will be available when needed or that, if available, this financing will be obtained on terms favorable to us or our stockholders. Insufficient funds may require us to delay, scale back or eliminate some or all of our research or development programs or to relinquish greater or all rights to product candidates at an earlier stage of development or on less favorable terms than we would otherwise choose, or may adversely affect our ability to operate as a going concern. If we raise additional funds by issuing equity securities, substantial dilution to existing stockholders may result.

Quantitative and Qualitative Disclosures About Market Risk

Short-term investments. Our interest income is sensitive to changes in the general level of United States interest rates, particularly since a significant portion of our investments are and will be in short-term marketable securities. Due to the nature and maturity of our short-term investments, we have concluded that there is no material market risk exposure.

Foreign currency rate fluctuations. We have not taken any action to reduce our exposure to changes in foreign currency exchange rates, such as options or futures contracts, with respect to transactions with our worldwide customers. All of our collaboration agreements and purchase orders are denominated in United States dollars.

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Inflation. We do not believe that inflation has had a material impact on our business or operating results during the periods presented.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board issued Statement No. 141, *Business Combinations* (SFAS 141) and Statement No. 142, *Goodwill and Other Intangible Assets* (SFAS 142). SFAS 141 requires companies to reflect intangible assets apart from goodwill and supersedes previous guidance related to business combinations. SFAS 142 eliminates amortization of goodwill and amortization of indefinite lived intangible assets. However, SFAS 142 also requires us to perform impairment tests at least annually on all goodwill and other intangible assets. These statements are required to be adopted by us on July 1, 2001, for SFAS 141 and on July 1, 2002, for SFAS 142. The adoption of SFAS 141 and SFAS 142 does not currently impact our financial statements.

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BUSINESS

Overview

We are a drug discovery company inventing new small molecule drugs through the integration of chemistry, biology and informatics. Our experienced scientists use the Array Discovery Platform, our integrated set of drug discovery technologies, to invent novel small molecule drugs in collaboration with leading pharmaceutical and biotechnology companies and to build our own pipeline of proprietary drug candidates.

The drug industry is experiencing revolutionary change fueled by genomics and by the tremendous progress in the biological understanding of disease. Historically, a key bottleneck in the development of new drugs has been the identification of targets, which are the proteins that may cause disease. However, recent advances in genomics and biology have resulted in the identification of thousands of new targets. As a result of the proliferation of new targets, we believe the drug research and development bottleneck is shifting from the identification of new targets to the creation of safe and effective new small molecule or protein-based therapeutics.

Small molecule drugs are invented by chemists and are generally taken as a pill, as opposed to protein-based therapeutics which are generally given by injection. We believe small molecule drugs have inherent advantages over protein-based therapeutics, including a greater universe of treatable diseases, lower cost with greater ease of manufacturing, and patient preference for a pill over an injection. Although a high proportion of biotechnology research has historically been devoted to protein-based therapeutics, approximately 90% of the top 500 prescription drugs, based on worldwide sales in 2000, are small molecule drugs. Accordingly, we believe that there will be increased emphasis on small molecule drug discovery in the biotechnology industry.

Our aim is to be the industry leader in small molecule drug discovery by utilizing the Array Discovery Platform to efficiently create high-quality drug candidates. Early in the drug discovery process, our medicinal chemists use the Array Discovery Platform to engineer into a drug candidate desirable drug characteristics, such as improved potency, specificity and dosing regimen and reduced side effect profile. We believe that the early optimization of superior drug characteristics will reduce the failure rate of drug candidates, thus increasing research productivity.

To capitalize on opportunities in drug discovery, we believe that an experienced scientific team with a track record of success in drug discovery is crucial. Accordingly, we have grown our staff to 226 full-time employees as of February 1, 2002, including 162 scientists, of whom 97 have Ph.D.s and 74 have large pharmaceutical or biotechnology company experience. Members of our scientific staff have contributed during their careers to over 20 Investigational New Drug applications, or INDs, and are inventors on over 160 drug-related patents. Additionally, we have increased the laboratory space necessary for our continued growth by securing long-term leases, which will provide up to 219,000 square feet over the next three years and can accommodate up to 350 scientists.

Our recent achievements include:

Increased revenue each quarter since our initial public offering in November 2000, including an increase in revenue from $10.7 million to $26.0 million for the twelve months ended December 31, 2000 and 2001, respectively;

In collaboration with ICOS Corporation, our first drug discovery agreement has resulted in a clinical candidate. In November 2001, ICOS initiated a clinical trial with IC485 and subsequently made a milestone payment to us;

Initiated success-based collaboration agreements, which include milestone and/or royalty payments, with Amgen Inc., ICOS, Takeda Chemical Industries, Inc., Trimeris, Inc. and Vertex Pharmaceuticals Incorporated;

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Expanded our existing collaborations with pharmaceutical and biotechnology companies such as Eli Lilly and Company, Merck & Co., Inc., Pfizer Inc, Amgen, ICOS and Tularik Inc. to increase their access to the Array Discovery Platform;

Achieved positive earnings before interest, taxes, depreciation and amortization, or EBITDA, of $109,000 for the second quarter of fiscal year 2002;

Enhanced the breadth and depth of the capabilities offered by the Array Discovery Platform from structural biology through process research and development; and

Identified proprietary lead molecules against the kinase family of protein targets for inflammation and oncology indications.

Our objective is to build the industry s premier drug discovery company by:

Continuing to enhance the Array Discovery Platform by developing novel tools and implementing new technologies and processes to accelerate the drug discovery process;

Collaborating with pharmaceutical and biotechnology companies to identify novel drug candidates and receive success payments in the form of milestones and royalties in addition to research funding for each scientist dedicated to the programs; and

Using the Array Discovery Platform to create our own proprietary drug candidates, which we intend to continue to license for co-development and commercialization with pharmaceutical and biotechnology partners.

Drug Discovery and Development

Drug discovery and development is the process of creating and evaluating drugs for the safe and effective treatment of human disease. Today, this process requires biological, chemical and informatics expertise. The role of biology in drug discovery is primarily focused on the early stages of research, including understanding the mechanism of diseases, identifying potential targets for therapeutic intervention and evaluating potential drug candidates. The role of chemistry in drug discovery is the actual invention of safe and effective new chemical entities, or drug candidates, to address these targets. The role of informatics in drug discovery is focused on improving decision-making by identifying and replicating the characteristics of successful drugs, efficiently sharing current knowledge and creating databases to predict future clinical success. Drug discovery and development comprises:

Target identification. Targets are proteins that may play a fundamental role in the onset or progression of a particular disease. Biologists identify targets against which chemists create drugs. Until recently, pharmaceutical researchers were limited to studying approximately 500 biological targets. The number of available biological targets is being vastly expanded through genomics. Pharmaceutical and biotechnology companies are advancing many of these newly identified potential targets into drug discovery. Many other potential targets have yet to be validated, meaning that their roles in causing disease are not completely understood.

Drug discovery. Drug discovery includes structural biology, lead generation, lead optimization and process research and development:

Structural biology. Structural biology is the process of cloning, expressing and purifying proteins to create information about their functions and how they interact with drug candidates.

Lead generation. Lead generation is the process of identifying potential drug compounds, or leads, that interact with a target with sufficient potency and selectivity to warrant further testing and refinement as possible drug candidates. During lead generation, researchers develop tests, called assays, to screen libraries of leads against targets to evaluate their therapeutic value.

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Lead optimization. Lead optimization is the complex, multi-step process of refining the chemical structure of a compound to improve its drug characteristics with the goal of producing a preclinical drug candidate. Researchers focus on a number of considerations in optimizing a drug candidate, including the following drug characteristics:

Potency. The amount of a drug required to effectively treat the disease;

Selectivity. The extent to which a drug interacts only with the target; the greater the selectivity, the lower the probability of harmful side effects;

Toxicity. The presence and significance of any harmful side effects;

Metabolism. How rapidly the drug works and how long it stays effective; and

Formulation. How the drug is administered to patients, for example, orally or by injection.

Process research and development. The process to make compounds for screening in lead generation typically uses a parallel synthesis approach to explore drug characteristics, rather than to optimize ease of synthesis, and usually results in small, milligram quantities of the compound. Before a drug candidate can be taken into clinical trials, kilogram quantities often must be synthesized. The goal of process research is to streamline the synthesis of larger quantities of the compound, typically by minimizing the number of synthetic steps and reducing the time and cost of production.

Preclinical development. Prior to human clinical testing, a potential drug candidate must undergo extensive in vitro, or laboratory, and in vivo, or animal model, studies to predict human drug safety. These studies investigate toxicity over a wide range of doses and the mechanism by which the drug is metabolized. The objective of preclinical testing is to obtain results that will allow a drug candidate to enter human clinical trials through approval of an IND by the Food and Drug Administration.

Clinical development. Clinical trials, or human tests to determine the safety and efficacy of potential drug candidates, are typically conducted in three sequential phases, although the phases may overlap. Successful clinical trials will result in the filing of a New Drug Application, or NDA, with the FDA in order to obtain approval to market the drug in the United States. Similarly, clinical trials must be conducted and regulatory approvals secured before a drug can be marketed in other countries.

Issues and Opportunities in Drug Discovery

Inefficiencies in drug discovery and development. Despite all of the recent technological advances and investment in genomics, biology, chemistry and informatics, drug research and development remains slow, expensive and risky. It is estimated that from 1990 to 2000 annual research and development spending increased approximately 300%, while the number of new drugs approved by the FDA in 2000 increased only 17% from the number approved in 1990. We believe this disparity between the increase in research and development spending and the significantly lower increase in approved new drugs indicates the need for improved productivity in the drug discovery process.

The challenge of turning genomics information from targets into drugs. The research and development process is experiencing a fundamental change fueled by the revolution in genomics, which has resulted in the identification of many new targets. We believe the resulting proliferation of targets from 500 to between 3,000 and 10,000 has shifted the bottleneck in drug research and development from the identification and validation of new targets to the creation of safe and effective drugs for these targets. We believe the knowledge gained from genomics and biology and the resulting drug discovery bottleneck, coupled with the advantages of small molecule drugs, will lead to a dramatic increase in the investment in small molecule drug discovery.

Importance of chemistry in the drug discovery process. The chemical make-up or structure of a drug is the key determinant of its potency, specificity, dosing regimen and side effect profile. Minor modifications in chemical structure can differentiate drugs and determine their success or failure in the

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marketplace. While targets are used for evaluating the drug characteristics of chemical compounds, chemistry is necessary to invent the composition of the actual drug. Therefore, while the ultimate value of intellectual property associated with newly identified targets is currently unknown, the value of intellectual property associated with drugs invented by chemists is known to be significant.

Need for additional capacity and improved research productivity within the pharmaceutical industry. The demands for new and improved drugs coupled with the emerging potential of new targets have increased competition for qualified chemists. Some pharmaceutical companies have revealed plans to significantly increase their internal discovery chemistry capacity over the next five years. Consequently, we believe competition for qualified chemists to fill these positions will continue. To the extent that they cannot hire qualified chemists, these companies must substantially increase their drug discovery productivity, enter into collaborations or acquire additional discovery capabilities.

Need for drug discovery capabilities within the biotechnology industry. Many biotechnology companies are increasing their focus on creating drugs against their proprietary targets. Historically, they have partnered with pharmaceutical companies to create small molecule drugs. These arrangements have often resulted in biotechnology companies relinquishing much of the economic value of their biological discoveries. Accordingly, several biotechnology companies have announced their intention to build small molecule drug discovery capabilities internally or through acquisitions. We believe they face significant barriers in creating a competitive drug discovery platform, which include: the difficulty of hiring multidisciplinary teams of scientists with drug discovery experience; the significant investment necessary to build and equip specialized laboratories; the difficulty in identifying and integrating acquisition opportunities; and, most importantly, the opportunity cost in time required to build an effective drug discovery capability.

The Array Solution

While many new technologies have been introduced into the drug discovery process over the past decade, we do not believe research productivity during this period, as reflected by the number of filings of INDs and new drugs approved by the FDA, has increased proportionately with the investment in these technologies. Fundamentally, we believe the quantity of data generated is not as relevant as the quality of the data and its interpretation by experienced scientists. Our model for drug discovery emphasizes the pragmatic integration of appropriate new drug discovery technologies, enabling research tools and knowledge management through an electronic notebook and predictive computational modeling. Our solution is designed to enable our experienced scientists to optimize and accelerate the drug discovery process through improved decision-making. We believe the Array Discovery Platform lowers the attrition rates in development for drug candidates and increases research productivity through the implementation of processes that help predict clinical success. We believe we have implemented a unique solution to bridge the gap between target discovery and clinical development and address the issues and opportunities in drug discovery by:

Optimizing the decision-making process in drug discovery by coupling experienced multidisciplinary scientific teams with the Array Discovery Platform;

Emphasizing high-quality data generation at every step of the discovery process;

Creating and utilizing enabling research tools to accelerate the execution of experiments;

Building knowledge management tools to improve the design of experiments and predict favorable drug characteristics; and

Identifying leads and designing drug candidates against multiple targets within families in a parallel fashion.

We have assembled a scientific team with experience in both the pharmaceutical and biotechnology industries to implement our solutions. These scientists have contributed in their careers to over 20 INDs and are inventors on over 160 drug-related patents.

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Strategy

Our objective is to become the leading inventor of high-quality drug candidates by building the Array Discovery Platform into the industry s premier drug discovery capability. Our strategies to achieve this objective are as follows:

Accelerate the creation of high-quality drug candidates. We provide a drug discovery capability that we believe creates higher quality drug candidates more efficiently. Our integrated approach simultaneously leverages multiple technologies within the Array Discovery Platform to enable our scientists to share knowledge and is designed to improve decision-making across the organization. Our experienced scientists utilize the Array Discovery Platform to invent drug candidates by understanding the complex relationships between chemical structure and desirable drug characteristics. We believe this approach speeds the creation of high-quality drug candidates.

Become the drug discovery partner of choice. Our drug discovery capabilities bridge the gap between target identification and preclinical testing. We provide collaborators with a fully-integrated drug discovery capability. While collaborators can access individual components of this capability, we intend to continue expanding collaborations across the entire Array Discovery Platform and leveraging the breadth and quality of the Array Discovery Platform to become the drug discovery partner of choice.

Invent our own drug candidates. We apply the Array Discovery Platform to invent our own drug candidates, which we believe will drive greater long-term value for our company. We focus our proprietary drug discovery efforts to opportunistically improve current drug therapies. We intend to maximize our access to targets for our proprietary drug programs through database analysis of human genomics information and scientific literature and through collaborations and joint ventures. We intend to commercialize these drug candidates by entering into collaborations to co-develop and commercialize these drug candidates with pharmaceutical and biotechnology partners.

Create a world-class scientific research environment. We expect to grow our business by continuing to aggressively recruit experienced scientific talent. Our success in recruiting and retaining these scientists depends on our continued focus on the maintenance of our culture, which emphasizes quality science, innovation and empowerment of our scientists, and our ability to provide industry competitive salaries and equity participation in our company. We are committed to continuous process improvement, implementation of new technologies, shared learning among our scientists and innovative organizational design.

Expand our capabilities through internal development and acquisitions. We intend to acquire or develop new technologies and capabilities to expand the Array Discovery Platform. We may acquire additional laboratory sites to meet our collaborators future needs and better attract regional scientific talent.

The Array Discovery Platform

The Array Discovery Platform bridges the gap between target identification and clinical testing, and we believe it is a new model for drug discovery. The Array Discovery Platform includes the following capabilities:

Structural biology. Our experienced biology teams are creating a better understanding of how small molecule drugs interact with targets. These teams clone, express and purify related families of disease proteins across multiple therapeutic areas to gain insights into their function. X-ray crystallography and computational modeling are used to define the three-dimensional structures of these proteins. This process provides valuable information about the interactions between leads and targets.

High throughput screening. We develop our own assays or format assays supplied by a collaborator for high throughput screens and can screen up to 100,000 compounds per week. These assays are then screened against tens of thousands of small molecule compounds to obtain quantitative measures of drug quality. We also screen our Lead Generation Libraries against metabolism and toxicology assays both to establish quality and to populate our predictive databases. Our computational and medicinal chemists then

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mine this information to design focused libraries of small molecule drug candidates. This approach is designed to accelerate the discovery process by taking advantage of the similarities within target families.

Predictive informatics. Predicting drug characteristics, such as potency, dosing frequency and potential side effects, requires powerful data mining and management tools. Our informatics teams are composed of experts in computational chemistry, scientific computing and medicinal chemistry, who work together to increase the probability of success. Our proprietary software searches databases of existing drugs and generates novel predictive databases and modeling programs designed to better forecast the characteristics of successful new drugs. In addition, we use an electronic notebook to allow our scientists to collect and access information directly in the laboratory and throughout the organization. We believe the integration of these technologies improves the decision-making ability of our scientists in the generation of successful drug candidates.

Lead generation. Our lead generation teams create and identify chemical compounds that demonstrate desirable drug characteristics when screened against a target. Compounds that warrant further testing and refinement as potential drug candidates are called leads.

Optimer building blocks

We believe that chemists can create high value compounds more rapidly by using quality building blocks and automated chemical synthesis techniques. We recognize that a constraint in drug discovery is the availability of high-quality building blocks for initiating chemical synthesis. Our chemists have used our proprietary software, Radical, and their experience in assessing drug-relevant chemical structures to design a series of building blocks with desirable drug-relevant properties. These building blocks are added to a core chemical structure, or a scaffold, during compound synthesis and are an important component of our overall drug discovery strategy. We produce primary building block sets for construction of Lead Generation Libraries. We then use sets of complementary secondary building blocks for creating focused libraries to determine structure activity relationships, or SARs, in lead optimization programs.

Lead Generation Libraries

We provide chemical compounds from our Lead Generation Libraries to our collaborators under a non-exclusive license for internal research. We also synthesize custom libraries, which we typically offer on an exclusive basis to individual collaborators, focused on specific target families or our collaborators proprietary scaffolds. We retain all other rights to the compounds in our Lead Generation Libraries, including the right to use these compounds for our internal and collaborative programs, as well as the rights to the synthetic processes used to create these compounds. We create sub-libraries that interact with specific target families, including G-protein coupled receptors, nuclear receptors, enzymes and protein-protein interactions. The majority of all drugs on the market today are aimed at targets within these families.

A critical rate-limiting step in the drug discovery process is the availability of high-quality compound libraries that have been designed for screening specifically against important target classes and subsequent rapid lead optimization. We believe that the production of large compound libraries, by itself, has limited value for creating high-quality leads. Instead, we design our libraries so that any leads require less optimization. We believe this approach will result in clinical candidates with a greater likelihood of clinical success. We design our libraries according to the following criteria:

Biologically-relevant diversity. We have established specific computational parameters to define the diversity of our compound libraries. Our proprietary informatics tools categorize how changes in chemical structure correlate with the biological activity of known drugs and use this information to define our diversity parameters. Libraries can be constructed to optimize diversity and therefore maximize the information provided by each library compound.

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Capture full patent potential. Our scientists maximize the number of distinct drug-like three-dimensional shapes, or pharmacophores, during library design. This approach is designed to optimize the number of discrete, patentable compound sets within a library, with the goal of identifying the key structural features of drug-target interactions.

Target-directed chemical scaffolds. Our chemists create scaffolds designed for disease-related families of targets. We believe this scaffold strategy allows us to synthesize compounds with a higher probability of finding a high-quality lead for a given target. We attach our novel building blocks to these scaffolds to create our library compounds.

Drug-relevant building blocks. We use drug-relevant building blocks to synthesize libraries. We design the library to identify the least complex structure that will interact with a target by using minimally complex building block sets. Any lead generated from our Lead Generation Libraries can be readily optimized due to the availability of more complex building block sets. These focused libraries study the SAR around any lead.

Optimized chemical synthetic processes for high purity. We invest significant effort in the process design and synthesis of each library to ensure that the compounds generated are highly pure and can be readily optimized. The library undergoes analysis during each stage of its development to ensure the identity of each compound and maintain quality.

Analytical chemistry. High purity compounds are crucial to the success of high throughput screening strategies in lead generation. In our experience, low purity compounds result in a higher proportion of false leads which waste discovery resources. Our analytical chemistry teams use automated instrumentation to evaluate the purity of chemical compounds, analyze the chemical processes used to synthesize these compounds and measure important drug properties. This capability allows for the high throughput analysis and purification of thousands of compounds per week.

Lead optimization. Leads that interact with targets may come from several sources including our libraries, *de novo* structure-based design strategies, scientific literature and our collaborations or joint ventures. Regardless of the source, we apply the same defined processes to optimize these leads to clinical drug candidates. We first utilize information regarding the three-dimensional structure of the target-lead interaction to design novel sets of compounds for synthesis. Next, we use our informatics capability to eliminate certain compounds that are predicted to have poor drug characteristics. We then synthesize, analyze and purify this refined set in a parallel format and screen these compounds against select assays to quantify drug characteristics. An iterative process of making small changes in chemical structure, evaluating the results and engineering improvements into the drug candidate is used to optimize its interaction with a target and refine its drug characteristics.

Drug metabolism. When optimizing desirable drug characteristics, it is often critical to determine how drugs are modified by the body at an early stage in the discovery process. We have established a series of assays to identify these metabolic characteristics. These assays include human liver enzyme assays, cellular assays and assays based on fluids obtained from the dosing of compounds in animals. We measure both the rate at which compounds are metabolized and the position of metabolism using mass spectrometry techniques. We also screen our Lead Generation Libraries against these assays to build drug metabolism databases to help predict clinical success of our future compounds.

Process research and development. Our process chemists improve complex synthetic procedures, which we believe allows for more efficient scale-up and production of drug candidates. We design our proprietary processes to lower the cost and increase the rate at which drug candidates can be synthesized. We believe the experience of our process chemists in resolving complex synthetic problems allows us to rapidly develop new synthetic procedures and accelerates the development of valuable drug candidates for human testing. Our goal is to apply these skills and experience to create novel yet efficient processes to synthesize complex molecules.

Process design and scale-up. Once a potential drug candidate has been identified, it is critical to reach a rapid decision as to whether or not to advance the candidate into the clinic. In many cases,

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lack of an adequate quantity of a specific compound for preclinical testing delays that decision. Our efforts reduce the number of steps in complex medicinal chemistry processes and improve yields to allow for the rapid synthesis and scale-up of preclinical and clinical drug candidates.

Custom synthesis. Our chemists can undertake challenging syntheses on a custom basis to produce building blocks, complex intermediates and final products in either small scale or bulk quantities. We synthesize compounds both on a proprietary and non-proprietary basis. We have synthesized for a number of collaborators larger quantities of compounds, which we had previously produced for them. We intend to create proprietary processes that can be licensed to collaborators as they advance potential drug candidates into clinical trials. We have the capacity to produce lots of up to 10 kilograms.

Because no single technology exists to accurately predict clinical outcomes for potential drug candidates, we believe experienced chemists with success in generating clinical candidates are vital to an efficient lead optimization program. Our approach is to work closely with our collaborators, providing multidisciplinary teams of experienced scientists on projects to identify drug candidates. We believe our information-driven technology platform enables our scientists to make better decisions at each step of the drug discovery process. Our organizational structure emphasizes multidisciplinary teams to improve problem solving, which we believe streamlines the drug discovery process. We believe that our integrated approach to drug discovery will enable both our collaborators and our internal discovery teams to create higher quality drugs more quickly and less expensively.

Proprietary Drug Discovery

We use the Array Discovery Platform to invent our own proprietary drug candidates. We plan to co-develop and commercialize these drug candidates in partnership with pharmaceutical and biotechnology companies. Our pragmatic chemical-proteomics approach is designed to increase research productivity by taking advantage of the similarities in drug design strategies for related targets within a family. We identify and access disease-associated targets through database analysis of human genomics information and scientific literature as well as through collaborations and joint ventures. These protein families will typically have similar three-dimensional structures and related biological function and/or enzymatic activity. More importantly, the experimental design expertise required to create drugs against a given target is captured and replicated against the entire target family. In parallel, we synthesize focused compound libraries, which are designed to interact with targets within a family. By screening these libraries against several targets within a family, we seek to generate multiple leads with desirable drug characteristics. Our scientists then optimize the drug characteristics of these leads to provide clinical development candidates.

Our multidisciplinary project teams focus on biologic functions, or pathways, that have been validated as important to the treatment of human disease. We are currently working on a number of target families including cytokine receptors, kinases, proteases and phosphatases, which are important targets for the treatment of arthritis, diabetes and cancer. We have identified proprietary lead series against certain kinases that regulate Tumor Necrosis Factor, or TNF, biosynthesis useful for the treatment of rheumatoid arthritis. We have also identified proprietary lead series against certain kinases that regulate cellular proliferation for the treatment of cancer. In addition, we have proprietary x-ray crystallographic structural data involving a small molecule bound to the Interleukin 1 receptor. This information may facilitate the creation of new oral treatments for arthritis. In each case, drugs that affect these targets have shown efficacy in human clinical trials or animal models of human disease. However, they have significant deficiencies related to mode of delivery, dosing frequency or side effect profile that may limit their use. This combination of efficacy and deficiencies has provided us an opportunity to create an improved product.

Once we have qualified a valuable lead through secondary screening, or have created a significant intellectual property position, we will seek to maximize its risk-adjusted value by advancing the research program independently as far as Phase I clinical testing or initiating collaborations earlier with partners for subsequent lead optimization, co-development and commercialization. Our research efforts on specific

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phosphatase target family members resulted in collaboration agreements with Amgen and Vertex providing an up-front fee, license fees, research funding and/or milestone payments and royalties. At the end of 2001, we regained the rights to the Amgen program while initiating a new research program with Amgen. We expect to enter into future collaborations that may provide similar fees and allow us to participate in the success of potential drug candidates through milestone and royalty payments. With other programs where value is especially high and research progress is rapid, we may move select compounds into Phase I clinical development ourselves or through collaborators.

Commercialization

We intend to maximize the value we capture by focusing our scientific resources on collaborations that use the full breadth of our capabilities and on our proprietary drug programs that enable us to participate in the success of the drug candidates that we create.

Our intent is to increase revenue by continuing to expand our collaborations across the Array Discovery Platform. We enter into collaborations with pharmaceutical and biotechnology companies and receive fees for each scientist dedicated to these programs. In addition, in a number of our current collaboration agreements we are entitled to up-front fees, milestone payments upon achievement of certain drug discovery objectives and/or royalties based on sales of products commercialized by our collaborators as a result of these agreements. We also sell or license research tools including our Optimer building blocks and our Lead Generation Libraries on a non-exclusive basis to multiple collaborators, creating a recurring revenue stream.

We create proprietary drug candidates with the intent of furthering their development and increasing their potential commercial value through collaborations with biotechnology or pharmaceutical partners. In the future, we may choose to advance certain drug candidates as far as early clinical development before entering into a collaboration agreement to maximize the value we retain. As we advance candidates, we will seek collaborations that provide us with an initial licensing fee for exclusive rights to our intellectual property, payments for continued research and down stream payments that include milestone and/or royalty payments.

Our Collaborators

A key element of our strategy is to increase the value we provide collaborators by expanding our relationships with them across complementary development efforts. Below we describe our most significant collaborations:

ICOS. ICOS was our first drug discovery collaborator and has now taken advantage of the entire Array Discovery Platform. Our first agreement with ICOS, initiated in December 1998, addressed lead optimization of up to four ICOS targets. Under this agreement, our scientists, in collaboration with ICOS scientists, developed clinical candidates from ICOS preliminary leads. Based upon the success of this program, ICOS expanded our collaboration in the spring of 1999, by both initiating a second lead optimization program on a separate set of targets and subscribing to our Lead Generation Libraries. In less than one year, our initial collaboration led to the development of a clinical candidate, IC485, for a target called phosphodiesterase 4, or PDE4, for the treatment of inflammatory conditions. To speed the development of this clinical candidate, ICOS chose to access our chemistry process research to refine the production process to produce sufficient quantities for preclinical and early phase clinical testing. In November 2001, ICOS announced the initiation of a Phase I clinical trial for IC485, and we received a milestone payment for the achievement of this objective. We are entitled to additional milestone payments upon the achievement of specific clinical objectives.

In July 2000, we consolidated and expanded our lead optimization agreements with ICOS into a drug discovery collaboration agreement for lead optimization on undisclosed targets. Under this agreement, ICOS has the exclusive worldwide right to develop and market any products resulting from the collaboration. We are compensated based on an annual rate for each full-time equivalent employee working on an ICOS project and are entitled to milestone payments upon achievement of identified

development and commercialization goals for products resulting from the collaboration. The agreement expires in July 2002, and may be terminated upon 90 days notice by ICOS. In March 2001, we expanded this lead optimization agreement and entered into a compound library agreement with ICOS.

In August 2001, we entered into an additional drug discovery collaboration agreement to discover and develop small molecule drugs directed at two specific targets containing the I-Domain allosteric site, or IDAS, structural motif. IDAS-targeted drugs regulate function of the target proteins through a novel allosteric mechanism. ICOS has identified key structural features of proteins containing the IDAS motif that will be exploited by our scientists to systematically produce drugs against targets of this class. Under the terms of this agreement, ICOS will provide us with research funding over two years. Our scientists and ICOS scientists will collaborate in all aspects of lead generation and lead optimization. ICOS will be responsible for clinical development and commercialization. We are entitled to receive success payments upon reaching certain development milestones and royalties based upon sales of products resulting from this collaboration.

Tularik. In February 1999, Tularik acquired a small subset of our Lead Generation Libraries to evaluate the quality of our libraries. Within three months, they initiated a one-year subscription to all of our Lead Generation Libraries. Six months later, Tularik exercised an option to subscribe to our second-year Lead Generation Libraries. We have also expanded our relationship with Tularik by creating focused libraries for a class of targets called orphan nuclear receptors.

Merck. In May 1999, Merck purchased building blocks from our Optimer collection on a non-exclusive basis. This initial introduction led to an agreement for the exclusive development and supply of custom synthesized compounds for Merck. Building on this relationship, in September 2000, we announced an agreement with Merck for process research, synthesis and supply of custom libraries for Merck s drug discovery programs. We will develop processes for the synthesis of each library in collaboration with Merck scientists and utilize our proprietary high-speed synthesis and parallel purification platforms to create these high-quality libraries. Under the terms of the agreement, Merck will provide us with research funding as well as payment upon delivery of compounds.

Eli Lilly. In March 2000, we entered into a research agreement with Eli Lilly to form a chemistry-based research collaboration. Under the terms of the agreement, up to 30 of our scientists will provide drug research in collaboration with Eli Lilly scientists on identified Eli Lilly drug discovery projects. We are compensated based on an annual rate for each full-time equivalent employee working on an Eli Lilly project. Initially, this collaboration focused on certain aspects of our lead optimization chemistry. However, Eli Lilly has since expanded these joint efforts to other aspects of the Array Discovery Platform. Our agreement with Eli Lilly terminates in March 2005, but Eli Lilly may terminate the agreement at any time upon payment of an early termination fee.

Takeda Chemical Industries, Ltd. In July 2001, we entered into a lead generation collaboration agreement with Takeda to create a series of small molecule drug leads against a proprietary Takeda target. Takeda will pay us fees based on the number of our scientists working on the research phase of the agreement. We are entitled to receive success payments based on the attainment of certain development milestones and royalties based upon sales of products resulting from the collaboration.

Vertex. In March 2000, Vertex purchased building blocks from our Optimer collection on a non-exclusive basis. This initial introduction led in August 2001, to a collaboration agreement to discover and develop small molecule drugs directed at two specific targets in the phosphatase protein family. Under this agreement, Vertex will provide us with an up-front fee and research funding over three years. We are responsible for the initial drug discovery, including lead generation and lead optimization. Vertex will be responsible for all aspects of clinical development and commercialization, and we are entitled to receive clinical milestone payments. If products are commercialized as a result of this collaboration, we are entitled to additional milestone payments. These milestones would be paid on an annual basis for a defined term and are tied to predetermined sales levels.

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Amgen. In April 2000, Amgen began working with us by purchasing building blocks from our Optimer collection on a non-exclusive basis. In October 2000, we entered into a research and license agreement with Amgen. Under this agreement, we granted Amgen an exclusive license to one of our proprietary research programs and initiated joint research on potential drug candidates targeting PTP-1B, a target for diabetes. In November 2001, Amgen initiated a new drug discovery program with us, which replaced the PTP-1B program. We retained all rights to the existing PTP-1B program. Under the new program, Amgen will pay an up-front fee and fees based on the number of our scientists working on the research phase of the agreement. We are also entitled to receive success payments based on the attainment of certain milestones.

Compound library agreements. We have entered into agreements with customers, including Tularik in June 1999, which Tularik extended in January 2000, and which expires in January 2002; DuPont in August 2000, which expires in December 2005; F. Hoffmann-La Roche Ltd. in June 2001, which expires in June 2006; and Pfizer in October 2001, which expires October 2003, to provide non-exclusive access on a per-compound basis to compounds in our Lead Generation Libraries for their internal lead generation efforts. These customers have the option to gain exclusive rights to compounds upon payment of either a one-time activation fee or annual fees. We retain all ownership of the intellectual property rights to the compounds and to our Lead Generation Libraries as well as any inventions made by our scientists working under these agreements. These agreements are terminable only upon breach or insolvency of a party.

Business Development

To date, our business development activities have been conducted primarily through direct customer contact by our senior management and scientists and through customer referrals. Because our collaborators are primarily skilled scientists, we use our scientific expertise to initiate and to build strong customer relationships. We have relied upon the services of a consulting company, Transpect, Inc., to aid in our business development efforts in Japan. We market our Optimer building blocks through multiple channels, including targeted mailing of a hardcopy catalog and through an Internet catalog. We plan to continue to grow our business development resources.

Research and Development

Our research and development expenses were $4.0 million in fiscal year 2000, $8.3 million in fiscal year 2001 and $6.0 million in the six months ended December 31, 2001. We conduct research and development in the following areas:

Assay development and high throughput screening automation. We are investing in the development of new assay and high-speed screening technologies to more effectively evaluate potential drug compounds for their therapeutic value, including specificity and metabolism, and to increase our screening capacity.

Informatics. We are continuing our development of database technology to more effectively capture, organize and link the data generated by our scientists and to make this information more seamlessly accessible to any of our drug discovery efforts. In addition, we continue the development of internal software technologies designed to increase the speed and efficacy of our lead generation and lead optimization chemistry.

Libraries. We have ongoing projects to develop and refine technologies necessary to create high-quality compound libraries composed of drug-relevant compounds that can be rapidly optimized. Our research is focused in the areas of designing drug-relevant building blocks and scaffolds, maximizing drug-like characteristics of our library compounds, optimizing library synthesis processes and maximizing biologically-relevant compound diversity.

Internal drug discovery projects. We will continue to invest in internal drug discovery programs intended to create a pipeline of proprietary drug candidates. We intend to co-develop and commercialize any resulting drug candidates through collaborations with pharmaceutical and biotechnology companies.

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Competitors

Competition across the range of our drug discovery focus is currently fragmented. We compete with a number of companies in each of the functional areas of drug discovery that we serve. Our major competitors among medicinal chemistry outsourcing companies include: Albany Molecular Research Inc., ArQule, Inc., Discovery Partners International, Inc. and Evotec OAI. Our major competitors among drug discovery companies include: 3-Dimensional Pharmaceuticals, Inc., Gilead Sciences, Inc., Tularik and Vertex. In addition, we compete with the internal research departments of biotechnology and pharmaceutical companies. Many of these companies, some of which are our collaborators and some of which represent market opportunities for us, are developing or already possess internally the technologies we offer. Academic institutions and other research organizations are also conducting research in areas in which we provide our capabilities, either on their own or through collaborative efforts.

Government Regulation

In the course of our business, we handle, store and dispose of chemicals. We are subject to various federal, state and local laws and regulations relating to the use, manufacture, storage, handling and disposal of hazardous materials and waste products. These environmental laws generally impose liability regardless of the negligence or fault of a party and may expose us to liability for the conduct of, or conditions caused by, others. We have not incurred, and do not expect to incur, material costs to comply with these laws and regulations.

Our customers and collaborators are subject to substantial regulation by governmental agencies in the United States and other countries. Virtually all pharmaceutical products are subject to rigorous preclinical and clinical testing and other approval procedures by the FDA and by foreign regulatory agencies. Various federal and state laws and regulations also govern or influence the manufacturing, safety, labeling, storage, record keeping and marketing of these pharmaceutical products. This approval process is time-consuming and expensive, and there are no assurances that approval will be granted on a timely basis, or at all. Even if regulatory approvals are granted, a marketed product is subject to continual review.

We are subject to other regulations, including regulations under the Occupational Safety and Health Act, regulations promulgated by the United States Department of Agriculture and regulations under other federal, state and local laws.

Intellectual Property

Our success will depend in part on our ability to protect our proprietary software, potential drug candidates and other intellectual property rights. To establish and protect our proprietary technologies and products, we rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality provisions in our contracts with our collaborators.

We attempt to protect our trade secrets by entering into confidentiality agreements with third parties, employees and consultants. Our employees also sign agreements requiring that they assign to us their interests in inventions, original expressions and any corresponding patents and copyrights arising from their work for us. However, it is possible that these agreements may be breached, invalidated or rendered unenforceable, and if so, we may not have an adequate remedy available. Despite the measures we have taken to protect our intellectual property, parties to our agreements may breach the confidentiality provisions or infringe or misappropriate our patents, copyrights, trademarks, trade secrets and other proprietary rights. In addition, third parties may independently discover or invent competing technologies or reverse engineer our trade secrets or other technology.

We have also implemented a patent strategy designed to protect technology, inventions and improvements to inventions that are commercially important to our business. We currently have one issued United States patent and seven patent applications on file in the United States, including two that have been allowed and two provisional applications. We are also pursuing limited patent coverage in foreign countries. Four of our United States patent applications relate to proprietary compounds that are

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pharmaceutical candidates, two relate to inventions based on and used in our research efforts, and two relate to compounds that are pharmaceutical candidates and the compound synthesis process. Two of our United States patent applications relating to proprietary pharmaceutical candidates, along with related foreign patent rights, were assigned to us by Amgen in November 1998.

United States patents issued from applications filed on or after June 8, 1995, have a term of 20 years from the application filing date or earlier claimed priority. All of our patent applications were filed after June 8, 1995. Patents in most other countries have a term of 20 years from the date of filing of the patent application. Because the time from filing patent applications to issuance of patents is often several years, this process may result in a period of patent protection significantly shorter than 20 years, which may adversely affect our ability to exclude competitors from our markets. Our success will depend in part upon our ability to develop proprietary products and technologies and to obtain patent coverage for these products and technologies. We intend to continue to file patent applications covering newly developed products and technologies. We may not, however, commercialize the technology underlying any or all of our existing or future patent applications.

Patents provide some degree of protection for our proprietary technology. However, the pursuit and assertion of patent rights, particularly in areas like pharmaceuticals and biotechnology, involve complex legal and factual determinations and, therefore, are characterized by some uncertainty. In addition, the laws governing patentability and the scope of patent coverage continue to evolve, particularly in biotechnology. As a result, patents may not issue from any of our patent applications or from applications licensed to us. The scope of any of our patents, if issued, may not be sufficiently broad to offer meaningful protection. In addition, our patents or patents licensed to us, if they are issued, may be successfully challenged, invalidated, circumvented or rendered unenforceable so that our patent rights might not create an effective competitive barrier. Moreover, the laws of some foreign countries may not protect our proprietary rights to the same extent as do the laws of the United States. Any patents issued to us or our strategic partners may not provide a legal basis for establishing an exclusive market for our products or provide us with any competitive advantages. Moreover, the patents held by others may adversely affect our ability to do business or to continue to use our technologies freely. In view of these factors, our intellectual property positions bear some degree of uncertainty.

The source code for our proprietary software programs is protected both as a trade secret and as a copyrighted work.

Employees

As of February 1, 2002, we had 226 full-time employees, including 162 scientists, of whom 97 have Ph.D.s and 74 have large pharmaceutical or biotechnology company experience. None of our employees are covered by collective bargaining agreements, and we consider our employee relations to be good.

Legal Proceedings

We may be involved, from time to time, in various claims and legal proceedings arising in the ordinary course of our business. We are not currently a party to any such claims or proceedings which, if decided adversely to us, would either individually or in the aggregate have a material adverse effect on our business, financial condition or results of operations.

Properties

We are headquartered in Boulder, Colorado, where we lease approximately 59,000 square feet of space under a lease that expires April 1, 2008. We have also agreed under this lease to occupy an additional 85,000 square feet of space in our Boulder campus prior to May 1, 2004. We have options to extend the entire Boulder lease for three additional terms for up to 18 years. We also lease two adjacent buildings of approximately 46,000 and 29,000 square feet in Longmont, Colorado under two leases that expire on May 31, 2005 and March 31, 2008, respectively. We have four sequential options to renew the first lease for up to 16 years and three sequential options to renew the second lease for up to 13 years. We believe that these facilities will be sufficient for our anticipated growth for the next 12 months.

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MANAGEMENT

Shown below are the names, ages and positions of our executive officers and directors as of February 1, 2002:

Name	Age	Position With Us
Robert E. Conway	47	Chief Executive Officer and Director
Kevin Koch, Ph.D.	41	President, Chief Scientific Officer and Director
David L. Snitman, Ph.D.	49	Chief Operating Officer, Vice President, Business Development and Director
R. Michael Carruthers	44	Chief Financial Officer and Secretary
Anthony D. Piscopio, Ph.D.	40	Vice President, Chemistry and Director of Process Chemistry
Kyle Lefkoff(b)	42	Chairman
Francis J. Bullock, Ph.D.(a),(b)	65	Director
Marvin H. Caruthers, Ph.D.	61	Director
Kirby L. Cramer(a)	65	Director
Robert W. Overell, Ph.D.(b)	46	Director
John L. Zabriskie, Ph.D.(a)	62	Director

(a) Member of our audit committee.

(b) Member of our compensation committee.

Robert E. Conway has served as our Chief Executive Officer and a member of our Board of Directors since November 1999. From October 1996 to October 1999, Mr. Conway was the Chief Operating Officer and Executive Vice President of the Clinical Trials Division of Hill Top Research, Inc., where he managed 22 company-owned research centers which conducted clinical trials for pharmaceutical and biotechnology companies. From 1979 until 1996, Mr. Conway held various executive positions with Corning, Inc., including Corporate Vice President and General Manager of Corning Hazleton, Inc., a preclinical contract research organization, where he was responsible for North American operations. Mr. Conway serves on the Board of Directors of DEMCO, Inc. Mr. Conway received a B.S. in accounting from Marquette University and an M.B.A. from the University of Cincinnati, and is a Certified Public Accountant.

Kevin Koch, Ph.D., has served as our President, our Chief Scientific Officer and a member of our Board of Directors since May 1998. Prior to joining us, Dr. Koch was an Associate Director of Medicinal Chemistry and Project Leader for the Protease Inhibitor and New Leads project teams from May 1995 to April 1998 for Amgen Inc. From September 1988 until May 1995, Dr. Koch held various positions with Pfizer Central Research, including Senior Research Investigator-Project Coordinator for the Cellular Migration and Immunology Project Teams. Dr. Koch is the treasurer of the Inflammation Research Association. Dr. Koch received a B.S. in chemistry and biochemistry from the State University of New York at Stony Brook and a Ph.D. in synthetic organic chemistry from the University of Rochester.

David L. Snitman, Ph.D., has served as our Chief Operating Officer, our Vice President of Business Development and a member of our Board of Directors since May 1998. Prior to joining us, Dr. Snitman held various positions with Amgen Inc. since December 1981, including Associate Director of New Products and Technology and Manager of Amgen s Boulder facility. Dr. Snitman received a B.S. in chemistry from Northeastern University and a Ph.D. in the synthesis of natural products from the University of Colorado, and was a National Institutes of Health Postdoctoral Fellow at the Massachusetts Institute of Technology.

R. Michael Carruthers has served as our Chief Financial Officer and Secretary since December 1998. Prior to joining us, Mr. Carruthers was Chief Financial Officer of Sievers Instrument, Inc. from October 1993 until December 1998. From May 1989 until October 1993, Mr. Carruthers was the treasurer and controller for the Waukesha division of Dover Corporation. Mr. Carruthers is a Certified Public Accountant and was previously employed as an accountant with Coopers & Lybrand, LLP. Mr. Carruthers

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received a B.S. in accounting from the University of Colorado and an M.B.A. from the University of Chicago.

Anthony D. Piscopio, Ph.D., has served as our Vice President, Chemistry and Director of Process Chemistry since May 1998. Prior to joining us, Dr. Piscopio had been employed by Amgen Inc. since June 1995 in various capacities, including as a founder of Amgen s small molecule drug discovery program. While at Amgen, Dr. Piscopio worked in the area of protease inhibition and pioneered novel high-speed synthesis methodologies for the preparation of B-turn mimetics and other heterocyclic classes. From August 1992 until June 1995, Dr. Piscopio was employed with Pfizer Inc in its Inflammation Group and worked in the areas of G-protein coupled receptor modulation and computer-assisted design of protease inhibitors. Dr. Piscopio received a B.A. in chemistry from West Virginia University and a Ph.D. in synthetic organic chemistry from the University of Wisconsin-Madison, and completed his postdoctoral fellowship at the Scripps Research Institute in La Jolla, California as a National Institutes of Health Postdoctoral Fellow.

Kyle Lefkoff has served as the Chairman of our Board of Directors since May 1998. Since 1995, Mr. Lefkoff has been a General Partner of Boulder Ventures Limited, a venture capital firm and an investor in our company. From June 1986 until June 1995, Mr. Lefkoff was employed by Colorado Venture Management, a venture capital firm. Mr. Lefkoff serves on the Boards of Directors of Trust Company of America, Metabolite Laboratories, Inc. and LeftHand Networks Inc. Mr. Lefkoff received a B.A. in economics from Vassar College and an M.B.A. from the University of Chicago.

Francis J. Bullock, Ph.D., has served as a member of our Board of Directors since May 1998. Since 1993, Dr. Bullock has been a senior consultant for Arthur D. Little, Inc., concentrating on pharmaceutical and biotechnology research and development, as well as the fine chemicals and agricultural chemicals industries. From April 1981 until September 1993, Dr. Bullock served as Senior Vice President, Research Operations at Schering Plough Research Institute. Dr. Bullock serves on the Boards of Directors of Genzyme Transgenics Corporation, Neogenesis, Inc., Atherex and Sopherion. Dr. Bullock received a B.S. in pharmacy from the Massachusetts College of Pharmacy, an A.M. in organic chemistry from Harvard University and a Ph.D. in organic chemistry from Harvard University.

Marvin H. Caruthers, Ph.D., has served as a member of our Board of Directors since August 1998. Since 1979, Dr. Caruthers has been a Professor of Biochemistry and Bioorganic Chemistry at the University of Colorado. Dr. Caruthers is a member of the National Academy of Sciences and the American Academy of Arts and Sciences and was previously a member of the scientific advisory board of Amgen Inc. Dr. Caruthers serves on the Board of Directors of Oxigene, Inc. Dr. Caruthers received a B.S. in chemistry from Iowa State University and a Ph.D. in chemistry from Northwestern University.

Kirby L. Cramer has served as a member of our Board of Directors since August 2000. Mr. Cramer is the Chairman Emeritus of Hazleton Laboratories Corporation, a Covance company, Chairman of the Board of Directors of Northwestern Trust and Investors Advisory Company and Chairman of the Board of Directors of SonoSite, Inc. From 1987 until 1991, Mr. Cramer served as the Chairman of the Board of Directors of Kirschner Medical Corporation. Mr. Cramer serves on the Boards of Directors of Immunex Corporation, Northwestern Trust and Investors Advisory Company, SonoSite, Inc., Huntingdon Life Sciences Group plc, Landec Corporation, D.J. Orthopedics, Inc., Commerce Bank of Washington and Corus Pharma, Inc. Mr. Cramer received a B.A. in history from Northwestern University and an M.B.A. from the University of Washington, and is a graduate of Harvard Business School s Advanced Management Program. Mr. Cramer is a Chartered Financial Analyst.

Robert W. Overell, Ph.D., has served as a member of our Board of Directors since December 1999. Since 1996, Dr. Overell has been with Frazier & Company, a venture capital firm and an investor in our company, and has served as a General Partner since 1998 and a venture partner from 1996 until 1998. Dr. Overell s operational experience in biotechnology companies includes joining Immunex Corporation early in its development and co-founding Target Genetics. Dr. Overell serves on the Board of Directors of Activx, Inc., GeneMachines, Quantum Dot, Inc., SkeleTech, Inc. and XenoPort, Inc. Dr. Overell received

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his B.S. in biological sciences from the University of Newcastle-upon-Tyne and a Ph.D. in biochemistry from the Institute of Cancer Research at the University of London.

John L. Zabriskie, Ph.D., has served as a member of our Board of Directors since January 2001. Dr. Zabriskie is Chief Executive Officer and President of BioSpecific, LLC, and is past Chairman of the Board, Chief Executive Officer and President of NEN Life Science Products, Inc., a leading supplier of kits for labeling and detection of DNA. Prior to joining NEN Life Science Products, Dr. Zabriskie was President and Chief Executive Officer of Pharmacia and Upjohn Inc. As Chairman of the Board and Chief Executive Officer of Upjohn, Dr. Zabriskie led the Upjohn project, which resulted in the $12 billion merger of equals with Pharmacia. Prior to joining Upjohn in 1994, Dr. Zabriskie was Executive Vice President for Merck and Co. Dr. Zabriskie currently serves on the Boards of Directors of Biomira, Inc., Cubist Pharmaceutical Inc., Kellogg Co., MacroChem Corp., AlphaGene Inc., BioSpecific LLC, Mimeon, Nanopharma and Puretech Ventures. Dr. Zabriskie received his undergraduate degree in chemistry from Dartmouth College and his Ph.D. in organic chemistry from the University of Rochester.

Executive Employment Agreement

Effective November 15, 2001, we entered into an employment agreement with Mr. Conway to serve as our Chief Executive Officer. The agreement was entered into at the end of the term of Mr. Conway s prior employment agreement with us, is for an initial term of four years and may then be renewed for additional one-year terms. Either party may terminate the agreement upon 30 days prior written notice to the other party during the initial term or any additional term. Under the agreement, we will pay Mr. Conway an annual salary of $275,000, subject to subsequent adjustment at the discretion of the Board of Directors. In addition, we granted Mr. Conway an option to purchase 400,000 shares of our common stock in November 2001, of which 100,000 shares will vest on each anniversary date of the employment agreement over a four-year period, subject to his continued employment. If Mr. Conway terminates his employment agreement, he would be entitled to exercise any vested options during the 90-day period following such termination. Mr. Conway is also eligible to receive a cash and/or equity performance bonus each fiscal year based on a percentage of his base salary if he meets performance criteria established by our Board of Directors. We also agreed to reimburse Mr. Conway for reasonable out-of-pocket expenses he incurs in connection with his performance of services for us.

If we terminate Mr. Conway s employment as a result of his disability or without cause, we agreed to pay him severance equal to one year of his base salary in equal monthly installments and he would be entitled to receive, pro-rated to the date of termination, any cash and/or equity performance bonus he would have received for that year. If Mr. Conway s employment is terminated following certain changes in control of our company, we agreed to pay him severance equal to two years of his base salary in equal monthly installments. All options granted to Mr. Conway under the agreement would become fully vested upon certain changes in control of our company. Mr. Conway agreed to execute a release acceptable to us in consideration for our severance obligations under the agreement. If Mr. Conway terminates his employment without cause or if we terminate his employment for cause, Mr. Conway will not receive any severance payments, performance bonus or acceleration of any of the options granted to him under the agreement. Mr. Conway is also subject to a non-compete agreement in which he agreed for the term of his employment and for two years thereafter not to engage in any competing activities in the United States or within a 50-mile radius of any area where we are doing business and not to recruit or solicit any of our employees or customers.

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PRINCIPAL STOCKHOLDERS

The following table sets forth certain information regarding the beneficial ownership of our common stock as of February 1, 2002, by:

each of our named executive officers;

each of our directors;

all of our directors and executive officers as a group; and

each person (or group of affiliated persons) known by us to beneficially own more than 5% of our outstanding common stock.

Name	Shares of Common Stock Beneficially Owned(a)	Percentage of Common Stock Owned Beneficially(b)
Named Executive Officers		
Robert E. Conway(c)	795,569	2.9%
Kevin Koch, Ph.D.(d)	773,291	2.9
David L. Snitman, Ph.D.(e)	1,570,211	5.9
Anthony D. Piscopio, Ph.D.(f)	726,694	2.7
R. Michael Carruthers(g)	137,678	*
Directors		
Kyle Lefkoff(h)	112,306	*
Francis J. Bullock, Ph.D.(i)	40,000	*
Marvin H. Caruthers, Ph.D.(j)	450,753	1.7
Kirby L. Cramer		*
Robert W. Overell, Ph.D.(k)	2,121,113	7.9
John L. Zabriskie, Ph.D.(l)	50,000	*
All directors and executive officers as a group (11 persons)(m)	6,777,615	24.6
Five Percent Stockholders		
ARCH Venture Fund III, L.P.(n)	1,711,024	6.4
LeRoy C. Kopp(o)	2,447,875	9.2
Frazier Healthcare II, L.P.(p)	2,121,113	7.9

* Less than 1%.

(a) The information in this table is based upon information furnished to us by each director, executive officer and principal stockholder or contained in the filings, including Schedule 13G, made with the SEC. Unless otherwise indicated, each person has sole voting and investment power with respect to shares shown as beneficially owned by such person. Except as otherwise specified below, the address of each of the beneficial owners identified is c/o Array BioPharma Inc., 3200 Walnut Street, Boulder, CO 80301.

(b) For purposes of calculating the percentage of shares beneficially owned, the number of shares of common stock deemed outstanding consists of 26,701,245 shares of our common stock outstanding after completion of this offering, plus the number of shares of common stock underlying stock options held by the named person that are exercisable within 60 days of February 1, 2002.

(c) Includes 20,000 shares of common stock held in uniform gift to minor accounts for the benefit of Mr. Conway s children and options to purchase 585,000 shares of common stock that are exercisable within 60 days of February 1, 2002.

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(d) Includes options to purchase 26,810 shares of common stock that are exercisable within 60 days of February 1, 2002, 99,000 shares of common stock held in trust for the benefit of Dr. Koch s minor children, and the following shares held by Dr. Koch s spouse: options to purchase 7,665 shares of common stock that are exercisable within 60 days of February 1, 2002 and 32,213 shares of common stock. Dr. Koch is our President and Chief Scientific Officer and member of our Board of Directors.

(e) Includes options to purchase 39,000 shares of common stock that are exercisable within 60 days of February 1, 2002 and 100,000 shares of common stock held in trust for the benefit of Dr. Snitman s children. Dr. Snitman is our Chief Operating Officer and Vice President, Business Development and a member of our Board of Directors.

(f) Includes options to purchase 33,357 shares of common stock that are exercisable within 60 days of February 1, 2002. Dr. Piscopio is our Vice President, Chemistry and Director of Process Chemistry.

(g) Includes options to purchase 54,333 shares of common stock that are exercisable within 60 days of February 1, 2002.

(h) Includes 5,225 shares of common stock held by Boulder Ventures II, LLC of which Mr. Lefkoff is a manager and a member. Mr. Lefkoff disclaims beneficial ownership in these shares except to the extent of his pecuniary interest in such shares.

(i) Includes options to purchase 30,000 shares of common stock that are exercisable within 60 days of February 1, 2002.

(j) All shares of common stock are held by Caruthers Family, LLC, of which Dr. Caruthers is the manager and a member. Dr. Caruthers disclaims beneficial ownership in these shares except to the extent of his pecuniary interest in such shares.

(k) Includes 2,121,113 shares of common stock held by Frazier Healthcare II, L.P. The general partner of Frazier Healthcare II, L.P. is FHMII, L.L.C., and the managing member of FHMII, L.L.C. is Frazier Management, L.L.C. Dr. Overell is a member of Frazier Management, L.L.C., and he shares voting and dispositive power in these shares. Dr. Overell disclaims beneficial ownership in these shares except to the extent of his pecuniary interest in such shares.

(l) Includes options to purchase 20,000 shares of common stock that are exercisable within 60 days of February 1, 2002.

(m) Includes options to purchase 796,165 shares of common stock that are exercisable within 60 days of February 1, 2002.

(n) The general partner of ARCH Venture Fund III, L.P. is Arch Venture Partners, LLC. Steven Lazarus, Robert Nelson, Keith Crandell and Clinton Bybee are each managers of Arch Venture Partners, LLC and share voting and dispositive power in these shares. Messrs. Lazarus, Nelsen, Crandell and Bybee disclaim beneficial ownership in these shares except to the extent of their respective pecuniary interest in such shares. The business address of ARCH Venture Fund III, L.P. is 8725 West Higgens Road, Suite 290, Chicago, IL 60631.

(o) Includes certain shares of common stock held by Kopp Investment Advisors, Inc., and certain shares of common stock owned by Kopp Holding Company. Kopp Investment Advisors, Inc., is wholly-owned by Kopp Holding Company, and Kopp Holding Company is wholly-owned by LeRoy Kopp. The address of LeRoy C. Kopp is 7701 France Avenue South, Suite 500, Edina, MN 55435.

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(p) The general partner of Frazier Healthcare II, L.P. is FHMII, L.L.C., and the managing member of FHMII, L.L.C. is Frazier Management, L.L.C. Dr. Overell, one of our directors, Fred E. Silverstein, Alan Frazier, Nadar Naini and Jon Gilbert are each directly or indirectly members of Frazier Management, L.L.C. and share voting and dispositive power for these shares. Dr. Overell, Dr. Silverstein and Messrs. Frazier, Naini and Gilbert disclaim beneficial ownership in these shares except to the extent of their respective pecuniary interest in such shares. The business address of Frazier Healthcare II, L.P. is 601 Union Street, Suite 3300, Seattle, WA 98101.

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UNDERWRITING

Under the terms of an underwriting agreement, which is filed as an exhibit to the registration statement relating to this prospectus, each of the underwriters named below has agreed to purchase from us the number of shares of common stock shown opposite its name below:

Underwriter	Number of Shares
Lehman Brothers Inc.	1,500,000
UBS Warburg LLC	600,000
Legg Mason Wood Walker, Incorporated	450,000
Thomas Weisel Partners LLC	450,000
Total	3,000,000

The underwriting agreement provides that the underwriters obligations to purchase shares of common stock depend on the satisfaction of the conditions contained in the underwriting agreement and that, if any of the shares of common stock are purchased by the underwriters under the underwriting agreement, all of the shares that the underwriters have agreed to purchase must be purchased. The conditions contained in the underwriting agreement include:

the representations and warranties made by us to the underwriters are true;

there is no material change in the financial markets; and

we deliver customary closing documents to the underwriters.

We have granted to the underwriters an option to purchase up to an aggregate of 450,000 additional shares of common stock, exercisable to cover over-allotments, if any, at the public offering price less the underwriting discount shown on the cover page of this prospectus. The underwriters may exercise this option at any time, and from time to time, until 30 days after the date of the underwriting agreement. To the extent the underwriters exercise this option, each underwriter will be committed, so long as the conditions of the underwriting agreement are satisfied, to purchase a number of additional shares of common stock proportionate to that underwriter s initial commitment as indicated in the preceding table, and we will be obligated, under the over-allotment option, to sell the additional shares of common stock to the underwriters.

The following table summarizes the underwriting discount and commissions to be paid by us in connection with the offering. These amounts are shown assuming both no exercise and full exercise of the underwriters option to purchase up to an additional 450,000 shares. The underwriting discount is the difference between the offering price and the amount the underwriters pay to purchase the shares from us.

	No Exercise	Full Exercise
Per share	$ .60	$ .60
Total	$1,800,000	$2,070,000

We estimate that the total expenses of the offering, excluding the underwriting discount, will be approximately $500,000.

The underwriters have advised us that they propose to offer the shares of common stock directly to the public at the public offering price presented on the cover page of this prospectus, and to selected dealers, who may include the underwriters, at the public offering price less a selling concession not in excess of $.36 per share. The underwriters may allow, and the selected dealers may reallow, a concession not in excess of $.10 per share to brokers and dealers. After the offering, the underwriters may change the offering price and other selling terms.

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We, along with our directors, officers and certain holders of more than 5% of our outstanding equity securities have agreed under lock-up agreements not to, directly or indirectly, offer, sell or dispose of any shares of common stock or any securities which may be converted into or exchanged for shares of common stock without the prior written consent of Lehman Brothers Inc. for a period of 90 days from the date of this prospectus.

We have agreed to indemnify the underwriters against liabilities relating to the offering, including liabilities under the Securities Act of 1933 and liabilities arising from breaches of the representations and warranties contained in the underwriting agreement, and to contribute to payments that the underwriters may be required to make for these liabilities.

This prospectus is not, and under no circumstances is to be construed as, an advertisement or a public offering of shares in Canada or any province or territory thereof. Any offer or sale of shares in Canada will be made only under an exemption from the requirements to file a prospectus supplement or prospectus and an exemption from the dealer registration requirement in the relevant province or territory of Canada in which such offer or sale is made.

Purchasers of the shares of common stock offered in this prospectus may be required to pay stamp taxes and other charges under the laws and practices of the country of purchase, in addition to the offering price listed on the cover of this prospectus. Accordingly, we urge you to consult a tax advisor with respect to whether you may be required to pay those taxes or charges, as well as any other tax consequences that may arise under the laws of the country of purchase.

The underwriters may engage in over-allotment, stabilizing transactions, syndicate covering transactions, and penalty bids or purchases for the purpose of pegging, fixing or maintaining the price of the common stock, in accordance with Regulation M under the Securities Exchange Act of 1934:

Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates a syndicate short position. The short position may be either a covered short position or a naked short position. In a covered short position, the number of shares over-allotted by the underwriters is not greater than the number of shares that they may purchase in the over-allotment option. In a naked short position, the number of shares involved is greater than the number of shares in the over-allotment option. The underwriters may close out any short position by either exercising their over-allotment option and/or purchasing shares in the open market.

Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.

Syndicate covering transactions involve purchases of the common stock in the open market after the distribution has been completed in order to cover syndicate short positions. In determining the source of shares to close out the short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the over-allotment option. If the underwriters sell more shares than could be covered by the over- allotment option, a naked short position, the position can only be closed out by buying shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there could be downward pressure on the price of the shares in the open market after pricing that could adversely affect investors who purchase in the offering.

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Penalty bids permit the underwriters to reclaim a selling concession from a syndicate member when the common stock originally sold by the syndicate member is purchased in a stabilizing or syndicate covering transaction to cover syndicate short positions.

These stabilizing transactions, syndicate covering transactions and penalty bids may have the effect of raising or maintaining the market price of the common stock or preventing or retarding a decline in the market price of the common stock. As a result, the price of the common stock may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the Nasdaq National Market or otherwise and, if commenced, may be discontinued at any time.

Neither we nor any of the underwriters make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the common stock. In addition, neither we nor any of the underwriters make any representation that the underwriters will engage in these stabilizing transactions or that any transaction, once commenced, will not be discontinued without notice.

In connection with the offering, the underwriters and selling group members may engage in passive market making transactions in the common stock on the Nasdaq National Market in accordance with Rule 103 of Regulation M under the Securities Exchange Act of 1934 during the period before the commencement of offers or sales of common stock and extending through the completion of the distribution. A passive market maker must display its bids at a price not in excess of the highest independent bid of the security. However, if all independent bids are lowered below the passive market maker s bid, that bid must be lowered when specified purchase limits are exceeded.

A prospectus in electronic format may be made available on Internet sites or through other online services maintained by one or more of the underwriters and/or selling group members participating in this offering, or by their affiliates. In those cases, prospective investors may view offering terms online and, depending upon the particular underwriter or selling group member, prospective investors may be allowed to place orders online. The underwriters may agree with us to allocate a specific number of shares for sale to online brokerage account holders. Any such allocation for online distributions will be made by the representatives on the same basis as other allocations.

Other than the prospectus in electronic format, information contained in any other web site maintained by an underwriter or selling group member is not part of this prospectus or the registration statement of which this prospectus forms a part, has not been endorsed by us or the underwriters or any selling group member in its capacity as underwriter or selling group member and should not be relied on by investors in deciding whether to purchase any shares of common stock. The underwriters and selling group members are not responsible for information contained in web sites that they do not maintain.

LEGAL MATTERS

The validity of the shares of common stock offered in this prospectus will be passed upon for us by Hogan & Hartson L.L.P., Boulder, Colorado. As of the date of this prospectus, certain attorneys of Hogan & Hartson L.L.P. own an aggregate of 55,380 shares of our common stock. Legal matters relating to the sale of common stock in this offering will be passed upon for the underwriters by Latham & Watkins, Costa Mesa, California.

EXPERTS

The financial statements of Array BioPharma Inc. at June 30, 2001 and 2000, and for each of the three years in the period ended June 30, 2001, appearing in this prospectus and registration statement have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

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WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly, and special reports and proxy statements and other information with the SEC. You may read and copy any document that we file at the SEC s Public Reference Room at 450 Fifth Street, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. Our SEC filings are also available on the SEC s web site at http://www.sec.gov. Copies of certain information filed by us with the SEC are also available on our web site at http://www.arraybiopharma.com. Our web site is not part of this prospectus. Our common stock is listed on the Nasdaq National Market under the symbol ARRY.

INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference information from other documents that we file with them, which means that we can disclose important information by referring to those documents. The information incorporated by reference is considered to be part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information.

We incorporate by reference the documents listed below:

Annual Report on Form 10-K for the fiscal year ended June 30, 2001, filed with the SEC on September 27, 2001.

Quarterly Reports on Form 10-Q for the quarters ended September 30, 2001, and December 31, 2001, filed with the SEC on November 14, 2001, and January 22, 2002, respectively.

Definitive Proxy Statement on Form 14A for our 2001 annual meeting of stockholders, filed with the SEC on October 1, 2001.

Current Reports on Form 8-K, filed with the SEC on August 3, 2001, August 28, 2001, and January 15, 2002.

The description of our common stock contained in our Registration Statement on Form 8-A, filed with the SEC on November 16, 2000, including any amendment or reports filed for the purpose of updating such description.

We also incorporate by reference additional documents that may be filed with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 prior to the sale of all of the shares covered by this prospectus. These include periodic reports, such as Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as proxy statements.

We will provide to you, without charge, upon your written or oral request, a copy of any or all of the documents that we incorporate by reference, including exhibits. Please direct requests to: Array BioPharma Inc., 3200 Walnut Street, Boulder, CO, 80301, Attn: Corporate Secretary, (303) 381-6600.

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

Board of Directors

Array BioPharma Inc.

We have audited the accompanying balance sheets of Array BioPharma Inc. as of June 30, 2001 and 2000, and the related statements of operations, stockholders equity, and cash flows for each of the three years in the period ended June 30, 2001. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Array BioPharma Inc. at June 30, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 2001 in conformity with accounting principles generally accepted in the United States.

/s/ ERNST & YOUNG LLP

Denver, Colorado
July 27, 2001,
except for Footnote 9,
as to which the date is
August 7, 2001

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ARRAY BIOPHARMA INC.

BALANCE SHEETS

	As of June 30,	
	2001	**2000**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,961,699	$ 3,846,407
Marketable securities	29,750,156	1,937,099
Accounts receivable, net of allowances of $15,000 and $0 at June 30, 2001 and 2000, respectively	979,874	885,522
Deposits	84,858	120,129
Inventories	4,137,107	1,557,376
Prepaid expenses and advances	486,556	201,560
Total current assets	53,400,250	8,548,093
Property, plant and equipment, net	17,420,883	6,910,757
Other assets	129,291	364,342
Total assets	$ 70,950,424	$ 15,823,192
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable trade	$ 2,873,468	$ 1,708,750
Advance payments from customers	4,496,591	1,940,433
Accrued compensation and benefits	819,711	359,871
Current portion of long-term debt		1,723,837
Other current liabilities	293,153	605,309
Total current liabilities	8,482,923	6,338,200
Long-term debt, less current portion		2,832,423
Stockholders equity:		
Preferred stock, $0.001 par value; 10,000,000 shares authorized;		
Series A convertible preferred stock; no shares and 6,635,000 shares outstanding at June 30, 2001 and 2000, respectively		6,635
Series B convertible preferred stock; no shares and 3,199,999 shares outstanding at June 30, 2001 and 2000, respectively		3,200
Series C convertible preferred stock; no shares outstanding at June 30, 2001 and 2000, respectively		
Common stock, $0.001 par value; 60,000,000 shares authorized; 23,262,878 and 3,370,207 shares issued and outstanding at June 30, 2001 and 2000, respectively	23,262	3,370
Additional paid-in capital	90,023,407	21,168,078
Accumulated deficit	(20,101,258)	(9,489,113)
Notes receivable for common stock related party	(266,625)	(393,750)
Accumulated other comprehensive income	116,801	
Deferred compensation	(7,328,086)	(4,645,851)
Total stockholders equity	62,467,501	6,652,569

Total liabilities and stockholders equity	$ 70,950,424	$ 15,823,192

See accompanying notes.

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ARRAY BIOPHARMA INC.

STATEMENTS OF OPERATIONS

	Years Ended June 30,		
	2001	**2000**	**1999**
Revenue:			
Collaboration revenue	$ 12,083,650	$ 4,629,000	$ 992,000
Product revenue	4,279,888	2,144,634	511,859
License revenue	642,222		
Total revenue	17,005,760	6,773,634	1,503,859
Cost of revenue*	12,965,378	4,444,958	1,032,910
Gross profit	4,040,382	2,328,676	470,949
Expenses:			
Research and development expenses*	8,264,406	3,962,969	3,300,941
Selling, general and administrative expenses*	7,668,302	3,469,969	1,522,067
Total operating expenses	15,932,708	7,432,938	4,823,008
Loss from operations	(11,892,326)	(5,104,262)	(4,352,059)
Interest expense	(586,554)	(384,378)	(135,904)
Interest income	2,091,911	356,237	180,557
Net loss before extraordinary item	(10,386,969)	(5,132,403)	(4,307,406)
Extraordinary loss from early extinguishment of debt	(225,176)		
Net loss	(10,612,145)	(5,132,403)	(4,307,406)
Deemed dividend related to beneficial conversion feature of preferred stock	(5,000,001)		
Net loss applicable to common stockholders	$(15,612,146)	$(5,132,403)	$(4,307,406)
Basic and diluted net loss per share:			
Net loss applicable to common stockholders before extraordinary item	$ (0.98)	$ (1.68)	$ (1.48)
Extraordinary loss from early extinguishment of debt	(0.01)		
Net loss applicable to common stockholders	$ (0.99)	$ (1.68)	$ (1.48)
Number of shares used to compute per share data	15,692,985	3,063,439	2,918,367
*** Includes compensation related to option grants:**			
Cost of revenue	$ 998,039	$ 42,689	$
Research and development expenses	643,715	34,928	
Selling, general and administrative expenses	3,011,798	1,040,179	
Total	$ 4,653,552	$ 1,117,796	$

See accompanying notes.

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ARRAY BIOPHARMA INC.

STATEMENTS OF STOCKHOLDERS EQUITY

	Preferred Stock		Common Stock		Additional Paid-In		Notes Receivable for Common Stock-	Accumulated Other		
	Shares	Amount	Shares	Amount	Capital	Accumulated Deficit	Related Party	Comprehensive Income	Deferred Compensation	Total
Balance at June 30, 1998	2,500,000	$ 2,500	2,913,367	$ 2,913	$ 3,148,877	$ (49,304)	$ (351,750)	$	$	$ 2,753,236
Issuance of Series A convertible preferred stock, net of issuance costs of $60,381	4,135,000	4,135			4,070,484					4,074,619
Exercise of stock options			10,000	10	2,340					2,350
Interest accrued on notes receivable							(21,000)			(21,000)
Warrants issued in connection with equipment financing					55,075					55,075
Net loss						(4,307,406)				(4,307,406)
Balance at June 30, 1999	6,635,000	6,635	2,923,367	2,923	7,276,776	(4,356,710)	(372,750)			2,556,874
Issuance of Series B convertible preferred stock, net of issuance costs of $63,204	3,199,999	3,200			7,933,594					7,936,794
Exercise of stock options			446,840	447	104,561					105,008
Interest accrued on notes receivable							(21,000)			(21,000)
Compensation related to stock option grants					5,763,647				(4,645,851)	1,117,796
Warrants issued in connection with equipment financing					89,500					89,500
Net loss						(5,132,403)				(5,132,403)
Balance at June 30, 2000	9,834,999	9,835	3,370,207	3,370	21,168,078	(9,489,113)	(393,750)		(4,645,851)	6,652,569
Issuance of Series C convertible preferred stock, net of issuance costs of $28,180	1,666,667	1,667			9,970,155					9,971,822
	(11,501,666)	(11,502)	11,501,666	11,502						

Conversion of preferred stock to common stock									
Issuance of common stock for cash-public offering, net of offering costs of $5,265,840		7,475,000	7,475	50,789,185					50,796,660
Issuance of common stock under stock option and employee stock purchase plans		876,673	876	760,241					761,117
Issuance of common stock upon the exercise of warrants		39,332	39	(39)					
Interest accrued on notes receivable						(17,875)			(17,875)
Repayment of notes receivable						145,000			145,000
Compensation related to stock option grants				7,335,787				(2,682,235)	4,653,552
Net loss					(10,612,145)				(10,612,145)
Change in unrealized gain on marketable securities							116,801		116,801
Comprehensive loss									(10,495,344)
Balance at June 30, 2001	$	23,262,878	$23,262	$90,023,407	$(20,101,258)	$(266,625)	$116,801	$(7,328,086)	$ 62,467,501

See accompanying notes.

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ARRAY BIOPHARMA INC.

STATEMENTS OF CASH FLOWS

	Years Ended June 30,		
	2001	**2000**	**1999**
Operating activities:			
Net loss	$(10,612,145)	$(5,132,403)	$(4,307,406)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	2,553,642	989,127	530,932
Accrued interest on notes receivable for common stock	(17,875)	(21,000)	(21,000)
Compensation related to stock option grants	4,653,552	1,117,796	
Accreted interest related to warrants	122,839	15,053	6,683
Changes in operating assets and liabilities:			
Accounts receivable	(94,352)	(378,280)	(507,242)
Deposits	35,271	132,759	(62,388)
Inventories	(2,579,731)	(578,218)	(979,158)
Prepaid expenses and advances	(284,996)	(122,237)	(77,655)