ARRAY BIOPHARMA INC
Form 10-Q
February 02, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended December 31, 2011

or

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

For the transition period from to

Commission File Number: 001-16633

Array BioPharma Inc.

(Exact Name of Registrant as Specified in Its Charter)

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

(303) 381-6600

(Registrant s Telephone Number, Including Area Code)

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

Yes x No o

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

Yes x No o

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

Large Accelerated Filer o Accelerated Filer x

Non-Accelerated Filer o Smaller Reporting Company o

(do not check if smaller reporting company)

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

Yes o No x

As of January 31, 2012, the registrant had 61,553,615 shares of common stock outstanding.

ARRAY BIOPHARMA INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2011

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

ARRAY BIOPHARMA INC.

Condensed Balance Sheets

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

(Unaudited)

	December 31, 2011	June 30, 2011
ASSETS		
Current assets		
Cash and cash equivalents	$ 60,363	$ 48,099
Marketable securities	360	15,986
Prepaid expenses and other current assets	4,172	6,477
Total current assets	64,895	70,562
Long-term assets		
Marketable securities	554	623
Property and equipment, net	13,994	15,698
Other long-term assets	2,709	2,491
Total long-term assets	17,257	18,812
Total assets	$ 82,152	$ 89,374
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities		
Accounts payable	$ 4,948	$ 4,460
Accrued outsourcing costs	4,371	5,248
Accrued compensation and benefits	4,759	6,431
Other accrued expenses	7,921	2,312
Deferred rent	3,411	3,333
Deferred revenue	54,468	47,874
Current portion of long-term debt	150	150
Total current liabilities	80,028	69,808
Long-term liabilities		
Deferred rent	13,227	14,968
Deferred revenue	24,766	39,306
Long-term debt, net	90,036	91,390
Derivative liabilities	734	540
Other long-term liabilities	554	4,220
Total long-term liabilities	129,317	150,424
Total liabilities	209,345	220,232
Commitments and contingencies		
Stockholders deficit		
	-	-

Series A junior participating convertible preferred stock, $0.001 par value; 500,000 shares authorized, no shares issued or outstanding		
Series B convertible preferred stock, $0.001 par value; 10,135 shares authorized, issued and outstanding as of December 31, 2011 and June 30, 2011	30,000	30,000
Common stock, $0.001 par value; 120,000,000 shares authorized; 61,548,615 and 57,020,003 shares issued and outstanding, as of December 31, 2011 and June 30, 2010, respectively	62	57
Additional paid-in capital	357,902	346,853
Warrants	39,385	39,385
Accumulated other comprehesive income	-	3
Accumulated deficit	(554,542)	(547,156)
Total stockholders deficit	(127,193)	(130,858)
Total liabilities and stockholders deficit	$ 82,152	$ 89,374

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

ARRAY BIOPHARMA INC.

Condensed Statements of Operations and Comprehensive Loss

(Amounts in Thousands, Except Per Share Data)

(Unaudited)

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**
Revenue				
License and milestone revenue	$ 19,195	$ 11,131	$ 37,657	$ 23,924
Collaboration revenue	4,033	5,370	7,701	11,090
Total revenue	23,228	16,501	45,358	35,014
Operating expenses				
Cost of revenue	6,266	7,382	12,711	14,663
Research and development for proprietary programs	13,150	14,482	25,748	28,337
General and administrative	3,782	3,905	7,502	8,173
Total operating expenses	23,198	25,769	45,961	51,173
Income (Loss) from operations	30	(9,268)	(603)	(16,159)
Other income (expense)				
Realized gains on auction rate securities, net	-	865	-	798
Interest income	3	136	9	356
Interest expense	(3,836)	(4,175)	(6,792)	(8,067)
Total other expenses, net	(3,833)	(3,174)	(6,783)	(6,913)
Net loss	$ (3,803)	$ (12,442)	$ (7,386)	$ (23,072)
Change in unrealized gains and losses on marketable securities	1	(655)	(3)	(1,222)
Comprehensive loss	$ (3,802)	$ (13,097)	$ (7,389)	$ (24,294)
Weighted average shares outstanding - basic and diluted	60,004	55,285	58,515	54,350
Net loss per share - basic and diluted	$ (0.06)	$ (0.23)	$ (0.13)	$ (0.42)

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

ARRAY BIOPHARMA INC.

Condensed Statement of Stockholders Deficit

(Amounts in Thousands)

(Unaudited)

	Preferred Stock		Common Stock		Additional Paid-in		Accumulated Other Comprehensive	Accumulated	
	Shares	Amounts	Shares	Amounts	Capital	Warrants	Income	Deficit	Total
Balance as of July 1, 2011	10,135	$ 30,000	57,020	$ 57	$346,853	$ 39,385	$ 3	$ (547,156)	$ (130,858)
Issuance of common stock under stock option and employee stock purchase plans	-	-	480	-	879	-	-	-	879
Share-based compensation expense	-	-	-	-	1,156	-	-	-	1,156
Issuance of common stock for cash, net of offering costs	-	-	2,936	4	7,046	-	-	-	7,050
Payment of employee bonus with stock	-	-	1,113	1	1,968	-	-	-	1,969
Change in unrealized gain on marketable securities	-	-	-	-	-	-	(3)	-	(3)
Net loss	-	-	-	-	-	-	-	(7,386)	(7,386)
Balance as of December 31, 2011	10,135	$ 30,000	61,549	$ 62	$ 357,902	$ 39,385	$ -	$ (554,542)	$ (127,193)

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

ARRAY BIOPHARMA INC.

Condensed Statements of Cash Flows

(Amounts in Thousands)

(Unaudited)

	Six Months Ended December 31,	
	2011	**2010**
Cash flows from operating activities		
Net loss	$ (7,386)	$ (23,072)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	2,630	2,944
Non-cash interest expense for the Deerfield Credit Facility	2,329	3,315
Loss on prepayment of long-term debt	942	-
Share-based compensation expense	1,156	2,001
Realized gains on auction rate securities, net	-	(798)
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	1,856	(487)
Accounts payable	488	(2,117)
Accrued outsourcing costs	(877)	(579)
Accrued compensation and benefits	297	(400)
Deferred rent	(1,663)	(1,586)
Deferred revenue	(7,946)	(14,124)
Other liabilities and other accrued expenses	2,023	1,935
Net cash used in operating activities	(6,151)	(32,968)
Cash flows from investing activities		
Purchases of property and equipment	(926)	(1,123)
Purchases of marketable securities	(4,940)	(29,423)
Proceeds from sales and maturities of marketable securities	20,552	68,512
Net cash provided by investing activities	14,686	37,966
Cash flows from financing activities		
Proceeds from exercise of stock options and shares issued under the employee stock purchase plan	879	1,491
Proceeds from the issuance of common stock for cash	7,345	3,006
Payment of offering costs	(295)	(150)
Payment of principal of long-term debt	(4,200)	-
Net cash provided by financing activities	3,729	4,347
Net increase in cash and cash equivalents	12,264	9,345
Cash and cash equivalents as of beginning of period	48,099	32,846
Cash and cash equivalents as of end of period	$ 60,363	$ 42,191
Supplemental disclosure of cash flow information		
Cash paid for interest	$ 3,546	$ 4,722

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

NOTE 1 - OVERVIEW AND BASIS OF PRESENTATION

Organization

Array BioPharma Inc. is a biopharmaceutical company focused on the discovery, development and commercialization of targeted small-molecule drugs to treat patients afflicted with cancer and inflammatory diseases. Array has four core proprietary clinical programs: ARRY-614 for myelodysplastic syndromes, ARRY-520 for multiple myeloma, ARRY-797 for pain and ARRY-502 for asthma. In addition, Array has 10 partner-funded clinical programs including two MEK inhibitors in Phase 2: selumetinib with AstraZeneca and MEK162 with Novartis.

Basis of Presentation

We follow the accounting guidance outlined in the Financial Accounting Standards Board Codification. The accompanying unaudited Condensed Financial Statements have been prepared without audit and do not include all of the disclosures required by the Financial Accounting Standards Board Codification, which have been omitted pursuant to the rules and regulations of the Securities and Exchange Commission, whom we refer to as the SEC, relating to requirements for interim reporting. The June 30, 2011 Condensed Balance Sheet data were derived from audited financial statements but do not include all disclosures required by generally accepted accounting principles in the United States, commonly referred to as GAAP. The unaudited Condensed Financial Statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly our financial position as of December 31, 2011 and June 30, 2011, and our results of operations and our cash flows for the quarters ended December 31, 2011 and 2010. Operating results for the quarter ended December 31, 2011 are not necessarily indicative of the results that may be expected for the year ending June 30, 2012.

These unaudited Condensed Financial Statements should be read in conjunction with our audited Financial Statements and the notes thereto included in our Annual Report on Form 10-K for the year ended June 30, 2011 filed with the SEC on August 12, 2011.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Although management bases these estimates on historical data and other assumptions believed to be reasonable under the circumstances, actual results could differ significantly from these estimates under different assumptions or conditions.

We believe the accounting estimates having the most significant impact on the financial statements relate to (i) estimating the stand-alone value of deliverables for purposes of determining revenue recognized under collaborations involving multiple elements; (ii) estimating the periods over which upfront and milestone payments from collaboration agreements are recognized; (iii) estimating accrued outsourcing costs for clinical trials and preclinical testing; and (iv) estimating the fair value of our long-term debt that has associated warrants and embedded derivatives, and the separate estimated fair value of those warrants and

embedded derivatives.

Liquidity

We have incurred operating losses and have an accumulated deficit as a result of ongoing research and development spending. As of December 31, 2011, we had an accumulated deficit of $554.5 million. We had net losses of $3.8 million for the quarter and $7.4 million for the six months ended December 31, 2011. We had net losses of $56.3 million, $77.6 million and $127.8 million for the fiscal years ended June 30, 2011, 2010 and 2009, respectively.

During the first six months of fiscal 2012, our net cash used in operations was $6.2 million, which reflects a $28 million upfront payment we received from Genentech Inc. in September 2011.

We have historically funded our operations from upfront fees, license and milestone revenue received under collaborations and out-licensing transactions; from the issuance and sale of equity securities; and through debt provided by our credit facilities. Since December 2009, we have received approximately $163.8 million under our collaborations, including the following payments:

- In December 2009, we received a $60 million upfront payment from Amgen Inc. under a Collaboration and License Agreement.
- In May and June 2010, we received a total of $45 million in upfront and milestone payments under a License Agreement with Novartis Pharmaceutical International Ltd.
- In December 2010, we received $10 million in a milestone payment under a License Agreement with Celgene Corporation.
- In May 2011, we received $10 million in a milestone payment under a License Agreement with Novartis.
- In September 2011, we received $28 million in an upfront payment from Genentech under a License Agreement.

The recognition of revenue under these agreements is discussed further below in *Note 4 Deferred Revenue*.

Until we can generate sufficient levels of cash from operations, which we do not expect to achieve in the foreseeable future, we will continue to utilize existing cash, cash equivalents and marketable securities, and will continue to depend on funds provided from the sources mentioned above, which may not be available or forthcoming.

Management believes that the cash, cash equivalents and marketable securities as of December 31, 2011, as well as milestone payments that may occur, will not enable us to continue to fund operations in the normal course of business for the next 12 months unless we obtain additional funds through the sale of debt or equity securities or we obtain upfront license fees from one or more new collaborations.

We anticipate that a portion of our funding requirements will be satisfied with milestone payments we expect to receive from existing collaborations in the second half of fiscal 2012. In addition, we plan to continue to satisfy all or a portion of the interest payment obligations under the credit facilities with Deerfield with the proceeds from sales of our common stock or through the issuance of shares of our common stock to Deerfield in accordance with the Facility Agreements with Deerfield. Because sufficient funds may not be available to us when needed from existing collaborations, we expect that we will be required to continue to fund our operations in part through

the sale of debt or equity securities and through licensing select programs that include upfront and/or milestone payments.

Our ability to successfully raise sufficient funds through the sale of debt or equity securities when needed is subject to many risks and uncertainties and, even if we are successful, future equity issuances would result in dilution to our existing stockholders. We also may not successfully consummate new collaborations that provide for additional upfront fees or milestone payments or we may not earn milestone payments under such collaborations when anticipated or at all. In addition, on January 16, 2012, Robert E. Conway resigned as our Chief Executive Officer for personal reasons, and it may be more difficult or not possible for us to raise funds from these sources until we have hired a new Chief Executive Officer.

If we are unable to obtain additional funding from these or other sources when needed, or to the extent needed, it may be necessary to significantly reduce the current rate of spending through further reductions in staff and delaying, scaling back, or stopping certain research and development programs, including more costly Phase 2 and Phase 3 clinical trials on our wholly-owned programs as these programs progress into later stage development. Insufficient liquidity may also require us to relinquish greater rights to product candidates at an earlier stage of development or on less favorable terms to us and our stockholders than we would otherwise choose in order to obtain upfront license fees needed to fund operations. These events could prevent us from successfully executing on our operating plan and in the future could raise substantial doubt about our ability to continue as a going concern. Further, as discussed in Note 5 *Long-term Debt*, the entire debt balance of $92.6 million outstanding with Deerfield becomes due and payable if cash, cash equivalents and marketable securities falls below $20 million at the end of a fiscal quarter. Based on our current forecasts and expectations, which are subject to many factors outside of our control, we do not anticipate that our cash and cash equivalents and marketable securities will fall below this level.

Fair Value Measurements

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

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

Array discloses assets and liabilities measured at fair value based on their level in the hierarchy. Considerable judgment is required in interpreting market and other data to develop estimates of fair value for assets or liabilities for which there are no quoted prices in active markets, which include warrants we have issued to Deerfield in connection with our long-term debt and the embedded derivatives associated with our long-term debt with Deerfield. The use of different assumptions and/or estimation methodologies

may have a material effect on their estimated fair values. Accordingly, the fair value estimates reflected or disclosed may not be indicative of the amount that Array or holders of the instruments could realize in a current market exchange.

Array periodically reviews the realizability of each investment when impairment indicators exist with respect to the investment. If other-than-temporary impairment of the value of an investment is deemed to exist, the cost basis of the investment is written down to the then estimated fair value.

Cash and Cash Equivalents

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

Marketable Securities

We have designated our marketable securities as of each balance sheet date as available-for-sale securities and account for them at their respective fair values. Marketable securities are classified as short-term or long-term based on the nature of these securities and the availability of these securities to meet current operating requirements. Marketable securities that are readily available for use in current operations are classified as short-term available-for-sale securities and are reported as a component of current assets in the accompanying Condensed Balance Sheets. Marketable securities that are not considered available for use in current operations (including when active markets for such securities do not exist) are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying Condensed Balance Sheets.

Securities that are classified as available-for-sale are carried at fair value, including accrued interest, with temporary unrealized gains and losses reported as a component of Stockholders Deficit until their disposition. We review all available-for-sale securities each period to determine if they remain available-for-sale based on our then current intent and ability to sell the security if we need to do so. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in Interest Income in the accompanying Condensed Statements of Operations and Comprehensive Loss. Realized gains and losses on auction rate securities (or ARS) we previously owned, along with declines in value judged to be other-than-temporary are reported in Realized gains/losses on auction rate securities, net in the accompanying Condensed Statements of Operations and Comprehensive Loss when recognized. We sold our remaining ARS during the quarter ended March 31, 2011. The cost of securities sold is based on the specific identification method.

Property and Equipment

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

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

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

Array depreciates leasehold improvements associated with operating leases on a straight-line basis over the shorter of the expected useful life of the improvements or the remaining lease term.

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

Equity Investment

Array has entered into one collaboration and license agreement and may, in the future, enter into additional agreements, in which we received an equity interest as consideration for all or a portion of upfront, license or other fees under the terms of the agreement. We report the value of equity securities received from non-publicly traded companies in which we do not exercise a significant controlling interest at cost as Other Long-term Assets

in the accompanying Condensed Balance Sheets. We monitor this investment for impairment at least annually and make appropriate reductions in the carrying value if it is determined that impairment has occurred, based primarily on the financial condition and near and long-term prospects of the issuer.

Accrued Outsourcing Costs

Substantial portions of our preclinical studies and clinical trials are performed by third party laboratories, medical centers, contract research organizations and other vendors (collectively CROs). These CROs generally bill monthly or quarterly for services performed or bill based upon milestone achievement. For preclinical studies, we accrue expenses based upon estimated percentage of work completed and the contract milestones remaining. For clinical studies, expenses are accrued based upon the number of patients enrolled and the duration of the study. We monitor patient enrollment, the progress of clinical studies and related activities to the extent possible through internal reviews of data reported to us by the CROs, correspondence with the CROs and clinical site visits. Our estimates depend on the timeliness and accuracy of the data provided by our CROs regarding the status of each program and total program spending. We periodically evaluate the estimates to determine if adjustments are necessary or appropriate based on information we receive.

Deferred Revenue

We record amounts received but not earned under our collaboration agreements as Deferred Revenue, which are then classified as either current or long-term in the accompanying Condensed Balance Sheets based on the period during which they are expected to be recognized as revenue. See *Note 4 - Deferred Revenue* for more information.

Long-term Debt and Embedded Derivatives

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

We currently have two embedded derivatives related to our long-term debt with Deerfield, which we collectively refer to as the Embedded Derivatives. One of the Embedded Derivatives is a variable interest rate structure that constitutes a liquidity linked variable spread feature. The other relates to Deerfield s ability to accelerate the repayment of the debt in the event of certain changes in our control that constitutes a significant transaction contingent put option. Deerfield has this right on a change in control if the acquirer does not meet certain financial conditions, based on size and credit worthiness.

Under the fair value hierarchy, we measure the fair value of the Embedded Derivatives using Level III, or unobservable inputs, as there is no active market for them, and calculate fair value using a combination of a discounted cash flow analysis and the Black-Derman-Toy interest rate model.

The fair value of the variable interest rate structure is based on our estimate of the probable effective interest rate over the term of the Deerfield credit facilities. Because the interest rate may vary based on changes in our cash position during the term of the loan, we base the estimate of the effective interest rate over the term of the credit facilities on our cash flow forecasts, which include our expectations of future cash inflows from upfront fees, milestone payments and issuances of equity. The fair value of the put option is based on our estimate of the probability that a change in control that triggers Deerfield s right to accelerate the debt will occur. With those inputs, the fair value of each Embedded Derivative is calculated as the difference between the fair value of the Deerfield credit facilities if the Embedded Derivatives are included and the fair value of the Deerfield credit facilities if the Embedded Derivatives are excluded. Due to the inherent complexity in valuing the Deerfield credit

facilities and the Embedded Derivatives, we have engaged a third party valuation firm to perform the valuation as part of our overall fair value analysis.

The estimated fair value of the Embedded Derivatives was determined based on management s judgment and assumptions. The use of different assumptions could result in significantly different estimated fair values. For example, the value of the Embedded Derivatives as of December 31, 2011 of $734 thousand is based on the assumption that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for ten months out of the remaining 54 months of the facility. If conditions and the resulting assumptions were to change such that it was assumed that the total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for of a total of 30 months out of the remaining 54 months of the facility, the average effective interest rate would increase to 8.1%. This change would cause the Embedded Derivative value to increase by approximately $800 thousand and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss. Further, if conditions and the resulting assumptions were to change such that it was assumed that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for total of the same 30 months and also fall further to between $30 and $40 million as of the end of a month for a total of eight additional months, the effective interest rate would increase to 8.7%. This change would cause the embedded derivative value to increase by $2.0 million from the current level and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss.

The fair value of the Embedded Derivatives is recorded as Derivative Liabilities in the Long-term Liabilities section in the accompanying Condensed Balance Sheets. Changes in the value of the Embedded Derivatives is adjusted quarterly and recorded to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Warrants that we have issued in connection with our long-term debt arrangements have been classified as equity. We value the warrants at issuance based on a Black-Scholes option-pricing model and then allocate a portion of the proceeds under the debt to the warrants based upon their relative fair values. The warrants are recorded in Stockholders Equity with the offset to Debt Discount. The Debt Discount is being amortized from the respective draw dates to the end of the term of the Deerfield credit facilities using the effective interest method and is recorded as Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Transaction fees paid in connection with our long-term debt arrangements that qualify for capitalization are recorded as Other Long-Term Assets in the Condensed Balance Sheets and are amortized to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss using the effective interest method over the term of the underlying debt agreement.

Income Taxes

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

As of December 31, 2011, we had available total net operating loss (NOL) carryforwards of approximately $358.8 million which expire in the years 2019 through 2030 and federal research and experimentation credit carryforwards of $23.2 million, which will expire in the years 2022 through 2030. Capital loss carryforwards begin to expire in 2015. Future realization of these carryforwards and credits depends on our future earnings, if any, and the timing and amount of which are uncertain as of December 31, 2011. Based upon the levels of historical taxable loss and projections of future taxable losses over the periods in which these deferred tax

assets are deductible, management believes that is more likely than not that the company will not realize the benefits of these deductible differences and accordingly has established a full valuation allowance as of December 31, 2011.

Utilization of NOLs and research and development credit carryforwards may be subject to a substantial annual limitation in the event of an ownership change that has occurred previously or could occur in the future pursuant to Section 382 of the Internal Revenue Code (IRC) of 1986, as amended, as well as similar state provisions. An ownership change may limit the amount of NOLs and research and development credit carryforwards that can be utilized annually to offset future taxable income and tax, and may, in turn, result in the expiration of a portion of those carryforwards before utilization. In general, an ownership change, as defined by Section 382, results from transactions that increase the ownership of certain shareholders or public groups in the stock of a corporation by more than 50 percentage points over a three year period.

We began a detailed study of our NOLs and research and development credit carryforwards in the second quarter of fiscal 2012 to determine whether such amounts are likely to be limited by IRC Section 382. Although our study is still in process, we do not believe at this time that there have been any material Section 382 limitations that will significantly impact our ability to offset income with available NOLs and research and development credit carryforwards. Future ownership changes as defined by IRC Section 382 may limit our ability to fully utilize these tax benefits.

Operating Leases

We have negotiated certain landlord/tenant incentives and rent holidays and escalations in the base price of rent payments under our operating leases. For purposes of determining the period over which these amounts are recognized or amortized, the initial term of an operating lease includes the build-out period of leases, where no rent payments are typically due under the terms of the lease and includes additional terms pursuant to any options to extend the initial term if it is more likely than not that we will exercise such options. We recognize rent holidays and rent escalations on a straight-line basis over the initial lease term. The landlord/tenant incentives are recorded as an increase to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the initial lease term. We have also entered into two sale-lease back transactions for our facilities in Boulder and Longmont, Colorado, where the consideration received from the landlord is recorded as an increase to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the lease term. Deferred Rent balances are classified as short-term or long-term in the accompanying Condensed Balance Sheets based upon the period during which the reversal of the liability is expected to occur.

Share-Based Compensation

We use the fair value method of accounting for share-based compensation arrangements, which requires that compensation expense be recognized based on the grant date fair value of the arrangement. Share-based compensation arrangements include stock options granted under our Amended and Restated Stock Option and Incentive Plan and purchases of common stock by our employees at a discount to the market price under our Employee Stock Purchase Plan or ESPP.

The estimated grant date fair value of stock options is based on a Black-Scholes option-pricing model and is expensed on a straight-line basis over the vesting term. Compensation expense for stock options is reduced for forfeitures, which are estimated at the time of grant and revised in subsequent periods if actual forfeitures differ from those estimates. Compensation expense for awards under the ESPP is measured based on a Black-Scholes option-pricing model and incorporates the estimated fair value of

the common stock during each offering period as well as the purchase discount.

Revenue Recognition

Most of our revenue is from our collaborators for non-refundable upfront or license fees, non-refundable milestone payments, that are triggered from specific research or development goals, as well as research funding

for discovering and developing drug candidates. Our collaboration agreements may also include future royalties on sales of products that result from the collaboration, and may also include fees based on annual rates for full-time-equivalent employees or FTEs working on a program. A small portion of our revenue comes from the sale of compounds on a per-compound basis. We combine License and Milestone Revenue, which consists of upfront fees and ongoing milestone payments from collaborators that we recognize during the applicable period. We report FTE fees for discovery and the development of proprietary drug candidates that we out-license as Collaboration Revenue.

We recognize revenue when (a) persuasive evidence of an arrangement exists, (b) we deliver products or render services, (c) the sales price is fixed or determinable and (d) collectability is reasonably assured.

We follow ASC 605-25 *Revenue Recognition - Multiple-Element Arrangements* to determine the recognition of revenue under collaboration agreements that include multiple elements, including research and development services, milestone payments and drug product manufacturing. This standard provides guidance on the accounting for arrangements involving the delivery of multiple revenue elements when delivery of separate units of accounting occurs in different reporting periods. This standard addresses the determination of the units of accounting for multiple-element arrangements and how the arrangement s consideration should be allocated to each unit of accounting. We adopted this accounting standard on a prospective basis for all multiple-element arrangements entered into on or after July 1, 2010 and for any multiple-element arrangements that were entered into prior to July 1, 2010 but materially modified on or after July 1, 2010. The adoption of this standard may result in revenue recognition patterns for future agreements that are materially different from those recognized for our past collaboration arrangements.

For our multiple element transactions entered into on or after July 1, 2010, we evaluate the deliverables to determine if they have stand-alone value and we allocate revenue to the elements based on their relative selling prices. We treat deliverables in an arrangement that do not meet the separation criteria in this standard as a single unit of accounting, generally applying applicable revenue recognition guidance for the final deliverable to the combined unit of accounting. Since the adoption of this standard, we have entered into one agreement with multiple-elements. We have had no material modifications to arrangements that were entered into prior to July 1, 2010.

We recognize revenue from non-refundable upfront payments and license fees on a straight-line basis over the term of performance under the agreement. When the performance period is not specifically identifiable from the agreement, we estimate the performance period based upon provisions contained within the agreement, such as the duration of the research or development term, the existence, or likelihood of achievement of development commitments and any other significant commitments. For agreements entered into prior to July 1, 2010, the performance period is generally the estimated research or development term. For agreements entered into after this date, the performance period for upfront license fees may be shorter because the performance period, measured as the time between the execution date and the completion of the inseparable technology transfer, is typically a shorter period, generally up to six months.

We defer the upfront payments and record them as Deferred Revenue upon receipt, pending recognition. The deferred portions of payments are classified as a short-term or long-term liability in the accompanying Condensed Balance Sheets, depending on the period over which revenue is expected to be recognized.

Most of our agreements provide for milestone payments. In certain cases, we recognize all or a portion of each milestone payment as revenue when the specific milestone is achieved based on the applicable percentage earned of the estimated research or development effort, or other performance obligation that has elapsed, to the total estimated research and/or development effort. In other cases, when the milestone payment is attributed to our future development obligations, we recognize the revenue on a

straight-line basis over the estimated remaining development effort.

We periodically review the expected performance periods under each of our agreements that provide for non-refundable upfront payments and license fees and milestone payments. We adjust the amortization periods when appropriate to reflect changes in assumptions relating to the duration of expected performance periods.

We could accelerate revenue recognition for non-refundable license fees, upfront payments and milestone payments in the event of early termination of programs. Alternatively, we could decelerate such revenue recognition if programs are extended. While changes to such estimates have no impact on our reported cash flows, our reported revenue is significantly influenced by our estimates of the period over which our obligations are expected to be performed.

Cost of Revenue and Research and Development Expenses for Proprietary Programs

We incur costs in connection with performing research and development activities which consist mainly of compensation, associated fringe benefits, share-based compensation, preclinical and clinical outsourcing costs and other collaboration-related costs, including supplies, small tools, facilities, depreciation, recruiting and relocation costs and other direct and indirect chemical handling and laboratory support costs. We allocate these costs between Cost of Revenue and Research and Development Expenses for Proprietary Programs based upon the respective time spent by our scientists on development conducted for our collaborators and for our internal proprietary programs. Cost of Revenue represents the costs associated with research and development, including preclinical and clinical trials that we conduct for our collaborators, including co-development arrangements. Research and Development Expenses for Proprietary Programs consists of direct and indirect costs for our specific proprietary programs. We do not bear any risk of failure for performing these activities and the payments are not contingent on the success or failure of the research program. Accordingly, we expense these costs when incurred.

Where our collaboration agreements provide for us to conduct research and development and for which our partner has an option to obtain the right to conduct further development and to commercialize a product, we attribute a portion of our research and development costs to Cost of Revenue based on the percentage of total programs under the agreement that we conclude is likely to continue to be funded by the partner. These costs may not be incurred equally across all programs. In addition, we continually evaluate the progress of development activities under these agreements and if events or circumstances change in future periods that we reasonably believe would make it unlikely that a collaborator would continue to fund the same percentage of programs, we will adjust the allocation accordingly. See *Note 4 Deferred Revenue*, for further information about our collaborations.

Comprehensive Loss

Our comprehensive loss consists of our net losses and adjustments to unrealized gains and losses on investments in available-for-sale marketable securities. We had no other sources of comprehensive loss for the periods presented.

Net Loss per Share

Basic net loss per share is computed by dividing net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options and warrants issued related to our long-term debt. The treasury stock method is used to calculate the potential dilutive effect of these common stock equivalents. Potentially dilutive shares are excluded from the computation of diluted net loss per share when their effect is anti-dilutive. As a result of our net losses for all periods presented, all potentially dilutive securities were anti-dilutive and therefore have been excluded from the computation of diluted net loss per share.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued FASB ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements* in U.S. GAAP and IFRS. This ASU provides a consistent definition of fair value between U.S. GAAP and International Financial Reporting Standards. Additionally, the ASU changes certain fair value measurement principles and expands the disclosures for fair value measurements. ASU 2011-04 is effective for

interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. We will adopt this disclosure standard in the third quarter of fiscal year ending 2012 and do not anticipate that it will have a material impact on our financial position or results of operations.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force) and the SEC did not or are not believed by management to have a material impact on the Company s present or future financial statements.

NOTE 2 SEGMENTS, GEOGRAPHIC INFORMATION AND SIGNIFICANT COLLABORATORS

Segments

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

Geographic Information

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
North America	$ 19,517	$ 13,149	$ 38,048	$ 28,829
Europe	3,472	3,345	7,068	6,174
Asia Pacific	239	7	242	11
	$ 23,228	$ 16,501	$ 45,358	$ 35,014

Significant Collaborators

The following table identifies collaborators that contributed greater than 10% of total revenue during the periods set forth below.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Genentech, Inc.	54%	21%	41%	22%
Amgen, Inc.	26%	39%	37%	39%
Novartis International Pharmaceutical Ltd.	15%	20%	11%	18%
Celgene Corporation	4%	19%	10%	21%
	99%	99%	99%	100%

The loss of one or more of our significant collaborators could have a material adverse effect on our business, operating results or financial condition. We do not require collateral from our collaborators, and most pay in advance. Although we are impacted by economic conditions in the biotechnology and pharmaceutical sectors, management does not believe significant credit risk exists as of December 31, 2011.

NOTE 3 - MARKETABLE SECURITIES

Marketable securities consisted of the following as of December 31, 2011 (dollars in thousands):

Marketable securities consisted of the following as of June 30, 2011 (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Short-term available-for-sale securities:				
U.S. Government agency securities	$ 15,598	$ 3	$ -	$ 15,601
Mutual fund securities	385	-	-	385
Sub-total	15,983	3	-	15,986
Long-term available-for-sale securities:				
Mutual fund securities	623	0	0	623
Sub-total	623	0	0	623
Total	$ 16,606	$ 3	$ -	$ 16,609

The estimated fair values of these marketable securities were classified into the following fair value measurement categories (dollars in thousands):

	December 31, 2011	June 30, 2011
Quoted prices in active markets for identical assets (Level 1)	$ 914	$ 16,609

Observable inputs other than quoted prices in active markets (Level 2)	-	-
Significant unobservable inputs (Level 3)	-	-
	$ 914	$ 16,609

NOTE 4 DEFERRED REVENUE

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

	December 31, 2011	June 30, 2011
Amgen, Inc.	$ 19,699	$ 30,674
Novartis International Pharmaceutical Ltd.	31,664	38,537
Celgene Corporation	12,977	15,741
Genentech, Inc.	14,894	2,228
Total deferred revenue	79,234	87,180
Less: Current portion	(54,468)	(47,874)
Deferred revenue, long term	$ 24,766	$ 39,306

Amgen Inc.

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

In partial consideration for the rights granted to Amgen under the agreement, Amgen paid us an upfront fee of $60 million. Amgen paid us for research on second generation compounds based on the number of full-time-equivalent scientists working on the discovery program.

Array is also entitled to receive up to approximately $666 million in aggregate milestone payments if all clinical and commercialization milestones specified in the agreement for AMG 151 and at least one backup compound are achieved. We will also receive royalties on sales of any approved drugs developed under the agreement.

We estimate that our obligations under the agreement will continue until December 31, 2012 and, therefore, are recognizing the upfront fee over that three-year period on a straight-line basis from the date of the agreement. This fee is recorded in License and Milestone Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss. We recognized $4.9 million and $9.8 million of revenue under the agreement for the three and six months ended December 31, 2011, respectively, and the same amounts for the same time periods in 2010.

We record revenue for research performed by our scientists working on second generation compounds in Collaboration Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss. We recognized $1.1 million and $2.2 million of revenue under the agreement for the three and six months ended December 31, 2011, respectively. We recognized $1.3 million and $2.4 million of revenue under this agreement for the three and six months ended December 31, 2010, respectively. We do not expect to be paid additional amounts, or recognize additional revenue for research under this agreement because we have completed most of the required deliverables under this agreement.

We are reimbursed for certain development activities, which is recorded in Collaboration Revenue and Cost of Sales in the accompanying Condensed Statements of Operations and Comprehensive Loss. During the three and six months ended December 31, 2010, we recognized $178 thousand and $1.4 million, respectively, in Collaboration Revenue and Cost of Sales. The development phase of this agreement has ended and there were, therefore, no development costs incurred or reimbursed for the three and six months ended December 31, 2011 and we do not expect any to be incurred or reimbursed in the future. Either party may terminate the agreement

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

Novartis International Pharmaceutical Ltd.

Array and Novartis entered into a License Agreement in April 2010 granting Novartis the exclusive worldwide right to co-develop and commercialize MEK162/ARRY-162, as well as other specified MEK inhibitors. Under the agreement, we are responsible for completing the on-going Phase 1b expansion trial of MEK162 in patients with KRAS or BRAF mutant colorectal cancer and for the further development of MEK162 for up to two indications. Novartis is responsible for all other development activities and for the commercialization of products under the agreement, subject to our option to co-detail approved drugs in the U.S.

In consideration for the rights granted to Novartis under the agreement, we received $45 million, comprising an upfront and milestone payment, in the fourth quarter of fiscal 2010. In March 2011, we earned a $10 million milestone payment which was received in the fourth quarter of fiscal 2011. We are also entitled to receive up to approximately $412 million in aggregate milestone payments if all clinical, regulatory and commercial milestones specified in the agreement are achieved. Novartis will also pay us royalties on worldwide sales of any approved drugs. In addition, so long as we continue to co-develop products under the program, the royalty rate on U.S. sales is significantly higher than the rate on sales outside the U.S. as described below.

Array estimates that the obligations under the agreement will continue until April 2014 and, therefore, is recognizing the upfront fee and milestone payments on a straight-line basis from the date the agreement was signed in April 2010 over that four-year period. These amounts are recorded in License and Milestone Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss.

We recognized $2.5 million and $5.0 million of license fee revenue under this agreement for the three and six months ended December 31, 2011 and 2010, respectively. We recognized $938 thousand and $1.9 million in revenue related to the milestone payments during the three and six months ended December 31, 2011, respectively. We recognized $312 thousand and $625 thousand in revenue related to the milestone payments during the three and six months ended December 31, 2010, respectively.

The Novartis agreement also contains co-development rights whereby we can elect to pay a percentage share of the combined total development costs. During the first two years of the co-development period, Novartis will reimburse us for 100% of our development costs. Beginning in the first quarter of fiscal 2013, we will begin paying our percentage share of the combined development costs since inception of the program, up to a maximum amount with annual caps, unless we opt out of paying our percentage share of these costs. If we opt out of paying our share of combined development costs with respect to one or more products, the U.S. royalty rate would then be reduced for any such product based on a specified formula, subject to a minimum that equals the royalty rate on sales outside the U.S. In this event, we would no longer have the right to develop or detail such product.

We record a receivable in the accompanying Condensed Balance Sheets for the amounts due from Novartis for the reimbursement of our development costs. We accrue our percentage share of the combined development costs in the accompanying Condensed Balance Sheets as a current liability in Other Accrued Expenses. We incurred reimbursable development costs of $633 thousand and $1.3 million during the three and six months ended December 31, 2011, respectively. We incurred reimbursable development costs for the same time periods in 2010 of $1.7 million and $3.8 million.

Our share of the combined development costs for the three and six months ended December 31, 2011 was $1.4 million and $2.4 million, respectively. For the same time periods in 2010, we incurred $850 thousand and $1.6 million, respectively, as our share of the combined development costs. These amounts are recorded in Cost of Revenue in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Additionally, we recorded a corresponding payable for our portion of the development costs of $6.0 million in Other Accrued Expenses as of December 31, 2011 and $3.6 million in Other Long-Term Liabilities as of June 30, 2011 in the accompanying Condensed Balance Sheets. The $6.0 million amount is due and payable to Novartis in the first quarter of fiscal year 2013. In addition, we have a related receivable of $633 thousand and $1.0 million in Prepaid and Other Current Assets in the accompanying Condensed Balance Sheets as of December 31, 2011 and June 30, 2011, respectively.

The agreement will be in effect on a product-by-product and county-by-country basis until no further payments are due with respect to the applicable product in the applicable country, unless terminated earlier. Either party may terminate the agreement in the event of an uncured material breach of a material obligation under the agreement by the other party upon 90 days prior notice. Novartis may terminate portions of the agreement following a change in control of Array and may terminate the agreement in its entirety or on a product-by-product basis with 180 days prior notice. Array and Novartis have each further agreed to indemnify the other party for manufacturing or commercialization activities conducted by us under the agreement: negligence, willful misconduct or breach of covenants, warranties or representations made by us under the agreement.

Celgene Corporation

In September 2007, Array entered into a worldwide strategic collaboration with Celgene focused on the discovery, development and commercialization of novel therapeutics in cancer and inflammation. Under the agreement, Celgene made an upfront payment of $40 million to us in part to provide research funding for activities we conducted. We are responsible for all discovery development through Phase 1 or Phase 2a. Celgene has an option to select a limited number of drugs developed under the collaboration that are directed to up to two of four mutually selected discovery targets and will receive exclusive worldwide rights to these two drugs, except for limited co-promotional rights in the U.S. Array retains all rights to the programs for which Celgene does not exercise its option.

In June 2009, the agreement was amended to substitute a new discovery target in place of an existing target and Celgene paid us $4.5 million in consideration for the amendment. No other terms of the agreement with Celgene were modified by the amendment. The option term of this target will expire on or before June 2016, and the option term for the other targets will expire on the earlier of completion of Phase 1 or Phase 2a trials for the applicable drug or September 2014. In September 2009, Celgene notified Array that it was waiving its rights to one of the discovery targets under the collaboration, leaving Celgene the option to select two of the remaining three targets.

Array is entitled to receive, for each drug for which Celgene exercises an option, potential milestone payments of $200 million if certain discovery, development and regulatory milestones are achieved and an additional $300 million if certain commercial milestones are achieved. In November 2010, we earned and subsequently received a $10 million milestone payment upon securing an Investigational New Drug application for one of the programs. We are also entitled to receive royalties on net sales of any drugs.

Upon execution of the agreement, we estimated that the discovery obligations under the agreement would continue through September 2014 and accordingly began recognizing as revenue the upfront fees received from the date of receipt through September 2014. We regularly review and adjust the estimated period of the discovery obligations and during the quarter ended September 30, 2011, we estimated that the remaining period for our discovery obligations under the agreement is likely to be only be through June 2013 and therefore plan to recognize the remaining unamortized balance of $7.3 million through this period on a straight-line basis during the periods when costs are incurred.

We recognized $943 thousand and $2.8 million in revenue related to the license fee and milestone payments during the three and six months ended December 31, 2011, respectively, and $3.2 million and $7.3 million for the three and six months ended December 31, 2010, respectively.

As discussed above, we granted Celgene an option to select up to two of four programs developed under its collaboration agreement and initially concluded that Celgene was likely to continue funding with respect to two of

the four programs by paying the Phase 1 milestone. Accordingly, upon execution of the agreement, we began reporting costs associated with the Celgene collaboration as 50% to Cost of Revenue, with the remaining 50% to Research and Development Expenses for Proprietary Programs. Celgene waived its rights with respect to one of the programs during the second quarter of fiscal 2010, at which time management determined that Celgene was likely to continue funding one of the remaining three programs and pay the Phase 1 milestone. Accordingly, beginning October 1, 2009, we began reporting costs associated with the Celgene collaboration as 33.3% to Cost of Revenue, with the remaining 66.7% to Research and Development Expenses for Proprietary Programs. In the second quarter of fiscal 2011, we concluded that Celgene is likely to continue funding two of the remaining three programs by paying the Phase 1 milestone. Accordingly, beginning October 1, 2010, we began reporting costs associated with the Celgene collaboration as 66.7% to Cost of Revenue, with the remaining 33.3% to Research and Development Expenses for Proprietary Programs.

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

Genentech, Inc.

In addition to our ongoing agreements with Genentech, we entered into an additional oncology partnership for the development of each company s small-molecule Checkpoint kinase 1 (Chk-1) program in August 2011. The partnered drugs include Genentech s compound GDC-0425 and Array s compound ARRY-575. Under the terms of the agreement, Genentech acquired a license to Array s compound ARRY-575 and is responsible for all research, clinical development and commercialization activities of the partnered drugs. Array was required to prepare specified clinical materials for GDC-0575 (ARRY-575) for delivery to Genentech, and we completed this delivery by the date specified in the agreement.

We received an upfront payment of $28.0 million during the first quarter of fiscal 2012 and are eligible to receive payments of up to $685.0 million based on the achievement of clinical and commercial milestones under the agreement. We will also receive up to a double-digit royalty on sales of any drugs resulting from the partnership.

Pursuant to the accounting guidance for revenue recognition for multiple element arrangements, we determined that Array is obligated to deliver two non-contingent deliverables related to the agreement that meet the separation criteria and therefore are treated as separate units of accounting. The two deliverables are (1) the delivery of specified clinical materials for GDC-0575 (ARRY-575) for use in future clinical trials and (2) the transfer of the license and related technology with ongoing regulatory services to assist in filing the Investigational New Drug (IND) application and providing supporting data.

This agreement also includes a contingent deliverable whereby Genentech could, at its sole option, require us to perform chemical and manufacturing control (CMC) activities for additional drug product or improved processes. This CMC option is not considered a deliverable because the scope, likelihood and timing of the potential services are unclear. Certain critical terms of the services have not yet been negotiated, including the fee that we would receive for the service and Genentech could elect to acquire the drug materials without our assistance either by manufacturing them in-house or utilizing a third-party vendor. Therefore, no portion of the $28.0 million upfront payment has been allocated to the contingent CMC services that we may be obligated to perform in the future.

The first non-contingent deliverable required Array to prepare specified clinical materials for delivery to Genentech, and we completed this delivery in December 2011, by the date specified in the agreement. The second and final obligation related to the non-contingent deliverable of assisting in the filing of the IND application is expected to be completed by March 31, 2012. This agreement provides for no general right of return for any non-contingent deliverable. Consequently, the amount of revenue allocated to each deliverable was determined using the relative selling price method under which revenue is allocated to each identified deliverable based on its estimated stand-alone value in relation to the combined estimated stand-alone value of all deliverables. The allocated consideration for each deliverable is then recognized over the related obligation period for that deliverable.

The determination of the stand-alone value for each non-contingent deliverable requires the use of significant estimates by management, including estimates of the time to complete the transfer of related technology and assist in filing the IND. Further, to determine the stand-alone value of the license and initial milestone, we considered the negotiation discussions that lead to the final terms of the agreement, publically available data for similar licensing arrangements between other companies and the economic terms of previous collaborations Array has entered into with other partners.

We recognized $9.9 million in license and milestone revenue and $2.6 million in collaboration revenue from the partnership with Genentech during the quarter ended December 31, 2011. We recognized $18.2 million in license and milestone revenue and $5.0 million in collaboration revenue related to the partnership with Genentech during the six month period ended December 31, 2011.

We recognized $207 thousand in license and milestone revenue and $3.3 million in collaboration revenue from the partnership with Genentech during the three months ended December 31, 2010. We recognized $1.2 million in license and milestone revenue and $6.6 million in collaboration revenue related to the partnership with Genentech during the six month period ended December 31, 2010.

As of December 31, 2011, deferred revenue related to this partnership consisted of $10.5 million and $4.4 million of current and long-term deferred revenue, respectively.

NOTE 5 LONG-TERM DEBT

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

	December 31, 2011	June 30, 2011
Credit Facilities	$ 92,562	$ 96,762
Term Loan	14,850	14,850
Long-term debt	107,412	111,612
Less: Unamortized discount on the Credit Facilities	(17,226)	(20,072)
Long-term debt, net	90,186	91,540
Less: Current portion of long-term debt	(150)	(150)
	$ 90,036	$ 91,390

Credit Facilities

Overview

Array has two outstanding credit facilities with Deerfield. Under the Facility Agreement entered into in April 2008, we borrowed a total of $80 million (the 2008 Loan), which was funded in two $40 million payments in June 2008 and December 2008. Terms of the 2008 Loan, including the interest rate and minimum cash and cash equivalent balances we must maintain, were amended in May 2009 when we entered into a new Facility Agreement with Deerfield. We borrowed an additional $40 million under this Facility Agreement on July 31, 2009 (the 2009 Loan).

In May 2011, we entered into a Securities Purchase Agreement with Deerfield whereby we issued and sold to Deerfield 10,135 shares of our Series B Convertible Preferred Stock (Series B Preferred Stock) for an aggregate purchase price of $30 million, which was satisfied through a reduction of $30 million in principal under the credit facilities that otherwise would have been repaid by April, 2014.

The terms of both credit facilities were also amended pursuant to a letter agreement (the May 2011 Modification) in connection with entering into the Securities Purchase Agreement in May 2011. The May 2011 Modification (i) extended the final payment date from April 2014 to June 30, 2016 for $20 million in principal and accrued interest, and to June 30, 2015 for the remaining principal and accrued interest, (ii) reduced the minimum Cash and Cash Equivalent and Marketable Securities balance we must maintain to avoid an increase in the interest rate, (iii) increased the amount of outstanding debt that is subject to prepayment out of a percentage of our new collaboration and licensing transactions, as discussed below, (iv) reduced the market capitalization qualification criteria for a potential acquirer in a change of control transaction from $7 billion to $3.5 billion which reduced Deerfield s right to accelerate the loan in a potential acquisition situation; and (v) increased the maximum number of shares of our Common Stock that we may issue to satisfy payment of the debt to 11,404,000 shares. Further, we extended the term of all of the warrants to purchase Common Stock previously issued to Deerfield under the credit facilities to June 30, 2016. See the discussion in this Note under the caption *Deerfield Credit Facilities Warrants below*.

We accounted for the amendments to the 2008 Loan in May 2009 and to both credit facilities in May 2011 as modifications rather than extinguishments of the applicable credit facilities.

Terms of the Credit Facilities

As of December 31, 2011 we had $92.6 million in principal outstanding under the Deerfield credit facilities. This compares to $96.8 million in principal outstanding as of June 30, 2011.

Interest and principal may be repaid at our option at any time with cash or shares of our Common Stock that have been registered under the Securities Act of 1933, as amended, with certain restrictions. We are also required, subject to certain exceptions and conditions, to make payments of principal equal to 15% of certain amounts we receive under new licensing, partnering and other similar arrangements up to the full value of the principal and accrued interest outstanding. We received a $28 million upfront payment from a qualifying new collaboration with Genentech in September 2011. In October 2011, $4.2 million was paid to Deerfield and applied against the principal balance.

Prior to the disbursement of the 2009 Loan, simple interest of 2% annually was paid quarterly and compound interest accrued at an additional 6.5% annually on the 2008 Loan. Upon disbursement of the 2009 Loan, compound interest stopped accruing and interest became payable monthly at a rate of 7.5% per annum, subject to adjustments based on our total Cash and Cash Equivalents and Marketable Securities balance as outlined below:

Total Cash, Cash Equivalents and Marketable Securities	**Interest Rate**
$50 million or greater	7.5%
Between $40 million and $50 million	8.5%
Between $30 million and $40 million	11.5%
Less than $30 million	13.5%

If our total Cash, Cash Equivalents and Marketable Securities at the end of a fiscal quarter falls below $20 million, all amounts outstanding under the credit facilities become immediately due and payable.

The credit facilities are secured by a second priority security interest in our assets, including accounts receivable, equipment, inventory, investment property and general intangible assets, excluding copyrights, patents, trademarks, service marks and certain related intangible assets. This security interest and our obligations under the credit facilities are subordinate to our obligations to Comerica Bank and to Comerica s security interest under the Loan and Security Agreement between Array and Comerica Bank dated June 28, 2005, as amended, which is discussed below under the caption *Term Loan and Equipment Line of Credit.*

The Facility Agreements contain representations, warranties and affirmative and negative covenants that are customary for credit facilities of this type. The Facility Agreements restrict our ability to, among other things, sell certain assets, engage in a merger or change in control transaction, incur debt, pay cash dividends and make investments. The Facility Agreements also contain events of default that are customary for credit facilities of this type, including payment defaults, covenant defaults, insolvency type defaults and events of default relating to liens, judgments, material misrepresentations and the occurrence of certain material adverse events.

Debt Issuance Costs

Array paid Deerfield transaction fees of $1.0 million on each of the two disbursements under the 2008 Loan, and of $500 thousand on July 10, 2009 and $500 thousand when the funds were drawn under the 2009 Loan. The transaction fees are included in Other Long-term Assets in the accompanying Condensed Balance Sheets and are amortized to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss over the respective terms of each of the credit facilities in effect at the time.

There were no transaction fees paid to Deerfield for the May 2011 Modification. However, due to the prepayment of $30 million of principal, we charged off a proportional amount of the unamortized debt issuance costs totaling $426 thousand to Loss on Prepayment of Debt, Net in the fourth quarter of fiscal 2011. The remaining unamortized debt issuance costs continue to be amortized as noted above. A total of $60 thousand and $123 thousand of issuance costs was expensed in the three and six months ended December 31, 2011, respectively. A total of $143 thousand and $286 thousand of debt issuance costs were amortized for the three and six months ended December 31, 2010, respectively. In addition, the October 2011 early principal payment to Deerfield of $4.2 million resulted in a proportional write-off of unamortized debt issuance costs of $887 thousand and debt discount fees of $55, totaling to $942 thousand. This amount is included in Interest Expense in the Condensed Statement of Operations and Comprehensive Loss.

Other costs in connection with these transactions were not significant and were expensed as incurred.

Embedded Derivatives

The credit facilities contain two embedded derivatives: (1) the variable interest rate structure described above and (2) Deerfield s right to accelerate the loan upon certain changes of control of Array, which is considered a significant transaction contingent put option. As discussed in *Note 1 Overview and Basis of Presentation* under the caption *Long-term Debt and Embedded Derivatives,* these derivatives are valued and reported in Other Long-Term Liabilities in our financial statements and are collectively referred to as the Embedded Derivatives. Under the fair value hierarchy, Array measured the fair value of the Embedded Derivatives using Level III, or unobservable inputs, as there is no active market for them.

To estimate the fair value of the variable interest rate feature, we make assumptions as to the interest rates that may be in effect during the term, which in turn depends on our Cash and Cash Equivalent and Marketable Securities balance as noted above. Therefore, we must project our monthly cash balances over the term of the Credit Facilities.

To estimate the fair value of the contingent put right, we estimate the probability of a change in control of Array that would trigger Deerfield s acceleration rights as specified in the Facility Agreements, including a change in control in which the acquirer does not meet certain financial conditions, based on size and credit worthiness. Our evaluation of this probability is based on our expectations as to the size and financial strength of probable acquirers, including history of collaboration partners, the probability of an acquisition occurring during the term of the credit facilities and other factors, all of which are inherently uncertain and difficult to predict.

The May 2011 Modification reduced the size of the acquirer that would trigger this provision and reduced the thresholds at which the higher interest rates take effect, which affected our estimated fair value of the Embedded Derivatives. The change in value of the two Embedded Derivatives as a result of the modification was $64 thousand and was recorded during the fourth quarter of fiscal 2011.

The forecasts used by management in determining the estimated fair value of the Embedded Derivatives are inherently subjective and may not reflect actual results, although management believes the assumptions upon which they are based are reasonable. Management will continue to assess the assumptions used in the determination of the fair value of the Embedded Derivatives, and future changes affecting these assumptions could materially affect their estimated fair value, with a corresponding impact on our reported results of operations.

The estimated fair value of the Embedded Derivatives was determined based on management s judgment and assumptions. The use of different assumptions could result in significantly different estimated fair values. For example, the value of the embedded derivative relating to the variable interest rate feature as of December 31, 2011 of $734 thousand is based on the assumption that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for ten months out of the remaining 54 months of the facility. If conditions and the resulting assumptions were to change such that it was assumed that the total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for of a total of 30 months out of the remaining 54 months of the facility, the average effective interest rate would increase to 8.1%. This change would cause the Embedded Derivative value to increase by approximately $800 thousand and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss. Further, if conditions and the resulting assumptions were to change such that it was assumed that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a month for total of the same 30 months and also fall further to between $30 and $40 million as of the end of a month for a total of eight additional months, the effective interest rate would increase to 8.7%. This change would cause the embedded derivative value to increase by $2.0 million from the current level and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss.

Fair Value of the Debt

Array estimates the fair value of the Deerfield debt using a combination of a discounted cash flow analysis and the Black-Derman-Toy interest rate model that incorporates the estimates discussed above for the Embedded Derivatives. The fair value of the debt was determined to be $69.7 million and $72.6 million at December 31, 2011 and June 30, 2011, respectively.

Warrants Issued to Deerfield

In consideration for providing the 2008 Loan, we issued warrants to Deerfield to purchase 6,000,000 shares of Common Stock at an exercise price of $7.54 per share (the Prior Warrants). Pursuant to the terms of the Facility Agreement for the 2009 Loan, the Prior Warrants were terminated and we issued new warrants to Deerfield to purchase 6,000,000 shares of Common Stock at an exercise price of $3.65 (the Exchange Warrants). We also issued Deerfield warrants to purchase an aggregate of 6,000,000 shares of our Common Stock at an exercise price of $4.19 (the New Warrants and collectively with the Exchange Warrants, the Warrants) when the funds were disbursed on July 31, 2009. The Exchange Warrants contain substantially the same terms as the Prior Warrants, except they have a lower per share exercise price. The Warrants were exercisable commencing January 31, 2010, and expire on April 29, 2014, which was extended to June 30, 2016 in connection with the May 2011 Modification.

We allocated the loan proceeds between the debt and the Warrants based upon their relative estimated fair values. The fair values of the Warrants was determined using a Black-Scholes option-pricing model and is recorded in Stockholders Equity with the offset to Debt Discount in the accompanying Condensed Balance Sheets, as discussed below.

When the Exchange Warrants were issued and when the term of the Warrants was extended in connection with the May 2011 Modification, we recorded the change in incremental value in the Warrants to Debt Discount. We calculated the incremental value of the Exchange Warrants as the difference between the value of the Exchange Warrants at the new exercise price ($3.65) and the value of the Prior Warrants at the prior exercise price ($7.54) using a Black-Scholes option-pricing model. We calculated the incremental value of the May 2011 Modification s new Warrant term as the difference in the fair value of the Warrants as of the date of the modification with the

new term (June 30, 2016) and the value of the Warrants with the old term (April 29, 2014) using a Black-Scholes option-pricing model.

A summary of the estimated fair value of the Warrants and the loan proceeds allocated to the debt follows as of the date of each transaction (dollars in thousands):

	Proceeds	Warrant Value
2008 Loan	$ 80,000	$ 20,589
2009 Loan	40,000	12,426
Exchange Warrants	N/A	3,280
May 2011 Modifications	N/A	3,090
		$ 39,385

Debt Discount

The estimated values of the Warrants and of the Embedded Derivatives discussed above were recorded to Debt Discount in the accompanying Condensed Balance Sheets. The Debt Discount attributable to the Warrants and the Embedded Derivatives is amortized from the respective draw dates of the applicable credit facility to the end of the term of the credit facilities, in effect at the time, using the effective interest method. We recorded the amortized portion to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

With the May 2011 Modification and the prepayment of $30 million of principal, we wrote off a proportional amount of the unamortized Debt Discount totaling $5.8 million to Loss on Prepayment of Debt, Net in the fourth quarter of fiscal 2011. The remaining unamortized discount is being amortized as described above, and $890 thousand was expensed for the quarter ended December 31, 2011.

Summary of Interest Expense

Interest expense for the Deerfield credit facilities follows (dollars in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Interest paid	$ 1,586	$ 2,250	$ 3,274	$ 4,500
Amortization of the transaction fees	60	143	123	286

Amortization of the debt discounts	890	1,670	1,959	3,307
Change in value of the Embedded Derivatives	208	(42)	193	(332)
Loss on prepayment of long-term debt	942	-	942	-
Total interest expense on the Deerfield Credit Facility	$ 3,686	$ 4,021	$ 6,491	$ 7,761

The October 2011 early principal payment to Deerfield of $4.2 million resulted in a proportional write-off of unamortized debt issuance costs and debt discount fees in the amount of $942 thousand. This is shown above as a Loss on prepayment of long-term debt which is included in Interest expense.

Term Loan

Array entered into a Loan and Security Agreement (Loan and Security Agreement) with Comerica Bank dated June 28, 2005, which has been subsequently amended. The Loan and Security Agreement provides for a term loan, equipment advances and a revolving line of credit, all of which are secured by a first priority security interest in our assets, other than our intellectual property.

The full $10 million term loan was advanced to us on June 30, 2005. We received the total $5 million of equipment advances by June 30, 2007.

On March 31, 2010, the term and interest rate structure of the Loan and Security Agreement were further amended. The term loan and equipment advances were also combined into one instrument referred to as the term loan. The maturity date was extended three years from October 26, 2010 to October 26, 2013. Effective April 1, 2010, the outstanding balances under the term loan and the equipment advances bear interest on a monthly basis at the Prime Rate, as quoted by Comerica Bank, but will not be less than the sum of Comerica Bank s daily adjusting LIBOR rate plus an incremental contractually predetermined rate. This rate is variable, ranging from the Prime Rate to the Prime Rate plus 4%, based on the total dollar amount we have invested at Comerica and in what investment option those funds are invested.

In addition, revolving lines of credit of $6.8 million have been established to support standby letters of credit in relation to our facilities leases. These standby letters of credit expire on January 31, 2014 and August 31, 2016.

As of December 31, 2011, the term loan had an interest rate of 3.25% per annum. The following table shows actual interest paid and amortization of loan transaction fees that were charged to Interest expense.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Actual interest paid	$ 123	$ 127	$ 247	$ 252
Amortization of transaction fees	27	27	54	54
Total interest expense on Comerica loan	$ 150	$ 154	$ 301	$ 306

The following table outlines the level of Cash, Cash Equivalents and Marketable Securities, which we must hold in accounts at Comerica Bank per the Loan and Security Agreement based on our total Cash, Cash Equivalent and Marketable Securities, which was modified as part of the March 31, 2010 amendment.

Total Cash, Cash Equivalents and Marketable Securities	Cash on Hand at Comerica
Greater than $40 million	$ -

Between $25 million and $40 million	$	10,000,000
Less than $25 million	$	22,000,000

The Loan and Security Agreement contains representations and warranties and affirmative and negative covenants that are customary for credit facilities of this type. The Loan and Security Agreement restricts our ability to, among other things, sell certain assets, engage in a merger or change in control transaction, incur debt, pay cash dividends and make investments. The Loan and Security Agreement also contains events of default that are customary for credit facilities of this type, including payment defaults, covenant defaults, insolvency type defaults and events of default relating to liens, judgments, material misrepresentations and the occurrence of certain material adverse events. We believe that we are in compliance with all existing loan covenants.

The estimated fair value of the Loan and Security Agreement was determined using a discounted cash flow model and was calculated at $14.9 million as of December 31, 2011 and $14.9 million at June 30, 2011.

Commitment Schedule

Array is required to make principal payments under the Credit Facilities and the Term Loan as follows (dollars in thousands):

For the twelve months ended December 31,		
2012	$	150
2013		14,700
2014		-
2015		72,562
2016		20,000
	$	107,412

NOTE 6 SHARE-BASED COMPENSATION EXPENSE

All share-based payments to employees are recognized in the Condensed Statements of Operations and Comprehensive Loss based on the fair value of the award on the grant date. Share-based compensation arrangements include stock option grants under the Option Plan and the ability to purchase common stock at a discount under the ESPP. The fair value of all stock options granted by Array and shares issued under the ESPP is estimated on the date of grant using the Black-Scholes option-pricing model. We recognize share-based compensation expense on a straight-line basis over the vesting term of stock option grants. See *Note 12 - Employee Compensation Plans* to our audited financial statements included in our Annual Report on Form 10-K for the year ended June 30, 2011 for more information about the assumptions we used under this valuation methodology. During the quarters ended December 31, 2011 and 2010, we made no material changes to these assumptions.

The table below shows options issued to purchase additional shares and compensation expense for the periods indicated.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	**2010**	**2011**	**2010**
Shares of stock authorized to be issued by new options	121,000	158,600	271,600	213,300
Stock option compensation expense (in thousands)	$ 508	$ 750	$ 1,051	$ 1,700
ESPP compensation expense (in thousands)	$ 80	$ 153	$ 104	$ 343

As of December 31, 2011, there was $2.7 million of unrecognized compensation expense, including the impact of expected forfeitures, for unvested share-based compensation awards granted under our equity plans, which we expect to recognize over a weighted-average period of 2.3 years.

NOTE 7 EQUITY DISTRIBUTION AGREEMENT

On September 18, 2009, we entered into an Equity Distribution Agreement with Piper Jaffray & Co. (the Agent) pursuant to which we were able to sell, from time to time, up to an aggregate of $25 million in shares of our common stock, through the Agent that were registered on a registration statement on Form S-3 (File No. 333-155221). Sales of the shares made pursuant to the Equity Distribution Agreement were made on the NASDAQ Stock Market by means of ordinary brokers transactions at market prices. This agreement terminated when all of the remaining shares authorized under the agreement were sold in November 2011.

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Number of shares sold	2,935,830	446,611	2,935,830	920,493
Average price per share	$ 2.50	$ 3.33	$ 2.50	$ 3.27
Gross proceeds (in thousands)	$ 7,344	$ 1,487	$ 7,344	$ 3,006
Commissions (in thousands)	$ (220)	$ (45)	$ (220)	$ (90)
Other costs (in thousands)	$ (60)	$ (36)	$ (75)	$ (60)

NOTE 8 EMPLOYEE BONUS

We have an annual performance bonus program for our employees in which employees may receive a bonus payable in cash or in shares of common stock if we meet certain financial, discovery, development and partnering goals during a fiscal year. The bonus is typically paid in the second quarter of the next fiscal year, and we accrue an estimate of the expected aggregate bonus in Accrued Compensation and Benefits in the accompanying Condensed Balance Sheets.

As of December 31, 2011, we accrued $2.3 million in Accrued Compensation and Benefits for the fiscal 2012 Performance Bonus Program. As of June 30, 2011 and 2010, we had accrued in Accrued Compensation and Benefits $3.3 million and $6.5 million, respectively, for the Performance Bonus Programs.

On October 4, 2011, we paid bonuses to approximately 250 eligible employees having an aggregate value of $3.1 million under the fiscal 2011 Performance Bonus Program through the issuance of a total of 1,112,577 shares of our common stock valued at $2.0 million and a payment of cash to satisfy related withholding taxes.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements about our expectations related to the progress and success of drug discovery activities conducted by Array and by our collaborators, our ability to obtain additional capital to fund our operations and/or reduce our research and development spending, realizing new revenue streams and obtaining future out-licensing collaboration agreements that include upfront, milestone and/or royalty payments, our ability to realize upfront milestone and royalty payments under our existing or any future agreements, future research and development spending and projections relating to the level of cash we expect to use in operations, our working capital requirements and our future headcount requirements. In some cases, forward-looking statements can be identified by the use of terms such as may, will, expects, intends, plans, anticipates, estimates, potential, or continue, or the negative thereof or other comparable terms. These statements are based on current expectations, projections and assumptions made by management and are not guarantees of future performance. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, these expectations or any of the forward-looking statements could prove to be incorrect and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition, as well as any forward-looking statements are subject to significant risks and uncertainties, including but not limited to the factors set forth under the heading Risk Factors in Item 1A under Part II of this Quarterly Report and under Item 1A of the Annual Report on Form 10-K for the fiscal year ended June 30, 2011 we filed with the Securities and Exchange Commission on August 12, 2011. All forward-looking statements are made as of the date hereof and, unless required by law, we undertake no obligation to update any forward-looking statements.

The following discussion of our financial condition and results of operations should be read in conjunction with the financial statements and notes to those statements included elsewhere in this quarterly report. The terms we, us, our and similar terms refer to Array BioPharma Inc.

Overview

Array BioPharma Inc. is a biopharmaceutical company focused on the discovery, development and commercialization of targeted small-molecule drugs to treat patients afflicted with cancer and inflammatory diseases. Array has four core proprietary clinical programs: ARRY-614 for myelodysplastic syndromes, ARRY-520 for multiple myeloma, ARRY-797 for pain and ARRY-502 for asthma. In addition, Array has 10 partner-funded clinical programs including two MEK inhibitors in Phase 2: selumetinib with AstraZeneca and MEK162 with Novartis.

The four wholly owned programs that we are developing internally are:

	Program	Target and Indication	Clinical Status
1.	ARRY-520	KSP inhibitor for multiple myeloma or MM	Phase 2
2.	ARRY-797	p38 inhibitor for pain	Phase 2
3.	ARRY-502	CRTh2 inhibitor for asthma	Phase 1
4.	ARRY-614	Dual p38/Tie2 inhibitor for myelodysplastic syndromes	Phase 1

In addition to these development programs, our most advanced partnered drugs in clinical development are:

	Program	Target and Indication	Partner	Clinical Status
1	Selumetinib (AZD6244)	MEK inhibitor for cancer	AstraZeneca	Phase 2
2.	MEK162 (ARRY-162)	MEK inhibitor for cancer	Novartis	Phase 2
3.	AMG 151 (ARRY-403)	Glucokinase activator for Type 2 diabetes	Amgen	Phase 2
4.	ASLAN001 (ARRY-543)	HER2/EGFR inhibitor for cancer	ASLAN	Phase 2
5.	Danoprevir (RG7227)	Protease inhibitor for Hepatitis C virus	InterMune - developed by Roche	Phase 2
6.	LY2603618	Chk-1 inhibitor for cancer	Eli Lilly	Phase 2
8	GDC-0068	AKT inhibitor for cancer	Genentech	Phase 2
7.	VTX-2337	Toll-like receptor for cancer	VentiRx	Phase 1b/2
9	GDC-0575 (ARRY-575) and GDC-0425	Chk-1 inhibitors for cancer	Genentech	Phase 1
10.	ARRY-382	cFMS inhibitor for cancer	Celgene (option)	Phase 1

Any information we report about the development plans or the progress or results of clinical trials or other development activities of our partners is based on information that is publicly disclosed.

Under our partnered drug discovery programs, we are generally entitled to receive payments upon achievement of clinical development and commercialization milestones and royalties based on sales of any resulting drugs. Under our existing partnered program agreements, we have the potential to earn over $3.4 billion in additional milestone payments if we or our collaborators achieve the drug discovery, development and commercialization objectives detailed in those agreements. We also have the potential to earn royalties on any resulting product sales or share in the proceeds from development or commercialization arrangements resulting from 12 drug research and development programs.

Additionally, we have a portfolio of proprietary and partnered drug discovery programs generated by our internal efforts. Our internal drug discovery programs include inhibitors that target Trk receptors for the treatment of pain and G-protein coupled receptor 119, or GPR-119, for the treatment of diabetes. We may choose to out-license select promising candidates through research partnerships.

We have built our clinical and discovery pipeline programs through spending $488.4 million from our inception in 1998 through December 31, 2011. During the first six months of fiscal 2012, we spent $25.7 million in research and development for proprietary

programs. In fiscal 2011, we spent $63.5 million in research and development expenses for proprietary drug discovery, compared to $72.5 million and $89.6 million for fiscal years 2010 and 2009, respectively. Since December 2009, we signed strategic collaborations with Amgen, Genentech and Novartis. Together these collaborations entitled Array to $133.0 million in initial payments, over $2.2 billion in potential milestone payments if all clinical and commercialization milestones under the agreements are achieved plus double digit royalties and/or commercial co-detailing rights. We currently expect to earn approximately $20.0 to $30.0 million in milestones from existing collaborations during calendar year 2012. We have received a total of $561.5 million in research funding and in upfront and milestone payments from our collaboration partners from inception through December 31, 2011.

Our significant and / or recent collaborators under our partnered programs include:

- *Amgen* We entered into a worldwide strategic collaboration with Amgen in December 2009 to develop and commercialize our glucokinase activator, AMG 151, and to discover potential back-up compounds for AMG 151.
- *ASLAN Pharmaceuticals* We entered into a collaboration and license agreement with ASLAN Pharmaceuticals in July 2011 to develop our HER2 / EGFR inhibitor, ASLAN001/(ARRY-543), which is currently entering Phase 2 development for solid tumors.
- *AstraZeneca* In December 2003, we entered into a collaboration and license agreement with AstraZeneca under which AstraZeneca received a license to three of our MEK inhibitors for cancer, including selumetinib, which is currently in multiple Phase 2 clinical trials.
- *Celgene* We entered into a worldwide strategic collaboration agreement with Celgene in September 2007 focused on the discovery, development and commercialization of novel therapeutics in cancer and inflammation. The most advanced drug is ARRY-382, a cFMS inhibitor for cancer, which is currently in a Phase 1 clinical trial.
- *Genentech* We entered into a worldwide strategic collaboration agreement with Genentech in January 2003, which was expanded in 2005, 2008, 2009 and 2011, which is focused on the discovery, development and commercialization of novel therapeutics. The most advanced drug is GDC-0068, an AKT inhibitor for cancer currently in a Phase 2 trial. The other programs under this collaboration are in preclinical development. In August 2011, we entered into an oncology partnership with Genentech for the development of each company s small-molecule Checkpoint kinase 1 (Chk-1) program. The programs include Genentech s compound GDC-0425 (RG7602), currently in Phase 1, and our compound, GDC-0575 (ARRY-575), which is being prepared for an investigational new drug application to initiate a Phase 1 trial in cancer patients.
- *InterMune (program acquired by Roche)* We entered into a collaboration with InterMune in 2002, which resulted in the joint discovery of danoprevir, a novel small molecule inhibitor of the Hepatitis C Virus NS3/4A protease. Roche acquired danoprevir from InterMune in 2010. Danoprevir is currently in Phase 2b clinical trials.
- *Novartis* We entered into a worldwide strategic collaboration with Novartis in April 2010 to develop and commercialize our MEK inhibitor, MEK162, and other MEK inhibitors identified in the agreement. MEK162 is being tested in a Phase 2 trial in patients with melanoma and in three Phase 1b combination trials with other targeted agents in selected patients with advanced solid tumors.

Fiscal Periods

Our fiscal year ends on June 30. When we refer to a fiscal year or quarter, we are referring to the year in which the fiscal year ends and the quarters during that fiscal year. Therefore, fiscal 2012 refers to the fiscal year ending June 30, 2012 and the second or current quarter refers to the quarter ended December 31, 2011.

Business Development and Collaborator Concentrations

We currently license or partner certain of our compounds and/or programs and enter into collaborations directly with pharmaceutical and biotechnology companies through opportunities identified by our business development group, senior management, scientists and customer referrals.

In general, our collaborators may terminate their collaboration agreements with 90 to 180 days prior notice. Our agreement with Genentech can be terminated with 120 days notice. Celgene may terminate its agreement with us with six months notice. Amgen may terminate its agreement with us at any time upon notice of 60 or 90 days

depending on the development activities going on at the time of such notice. Novartis may terminate portions of the agreement following a change in control of Array and may terminate the agreement in its entirety or on a product-by-product basis with 180 days prior notice.

Additional information related to the concentration of revenue among our collaborators is reported in *Note 2 Segments, Geographic Information and Significant Collaborations* to the financial statements included elsewhere in this Quarterly Report.

All of our collaboration agreements are denominated in U.S. dollars.

Critical Accounting Policies and Estimates

Management s discussion and analysis of financial condition and results of operations are based upon our accompanying financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses as well as the disclosure of contingent assets and liabilities. We regularly review our estimates and assumptions. These estimates and assumptions, which are based upon historical experience and on various other factors believed to be reasonable under the circumstances, form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Reported amounts and disclosures may have been different had management used different estimates and assumptions or if different conditions had occurred in the periods presented.

Below is a discussion of the policies and estimates that we believe involve a high degree of judgment and complexity.

Revenue Recognition

Most of our revenue is from our collaborators for non-refundable upfront or license fees and non-refundable milestone payments that are triggered upon achievement of specific research or development goals, as well as research funding for discovering and developing drug candidates. Our collaboration agreements may also include future royalties on sales of products that result from the collaboration, and fees based on annual rates for full-time-equivalent employees, or FTEs, working on a program. A small portion of our revenue comes from the sale of compounds on a per-compound basis. We report License and Milestone Revenue on a combined basis, which consists of upfront fees and ongoing milestone payments from collaborators that we recognize during the applicable period. We report FTE fees for discovery and the development of proprietary drug candidates that we out-license as Collaboration Revenue.

We recognize revenue when (a) persuasive evidence of an arrangement exists, (b) we deliver products or render services, (c) the sales price is fixed or determinable and (d) collectability is reasonably assured.

We follow ASC 605-25 *Revenue Recognition - Multiple-Element Arrangements* to determine the recognition of revenue under collaboration agreements that include multiple elements, including research and development services, milestone payments and drug product manufacturing. This standard provides guidance on the accounting for arrangements involving the delivery of multiple revenue elements when delivery of separate units of accounting occurs in different reporting periods. This standard addresses the determination of the units of accounting for multiple-element arrangements and how the arrangement s consideration should be allocated to each unit of accounting. We adopted this accounting standard on a prospective basis for all multiple-element arrangements entered into on or after July 1, 2010 and will apply this standard to any multiple-element arrangements that were entered into prior to July 1, 2010 that are materially modified on or after July 1, 2010. The adoption of this standard may result in revenue recognition patterns for future agreements that are materially different from those recognized for our past collaboration arrangements.

For our multiple element transactions entered into on or after July 1, 2010, we evaluate the deliverables to determine if they have stand-alone value and we allocate revenue to the elements based on their relative selling prices. We treat deliverables in an arrangement that do not meet the separation criteria in this standard as a single unit of accounting, generally applying applicable revenue recognition guidance for the final deliverable to the combined unit of accounting. Since the adoption of this standard, we have entered into one agreement with multiple-elements. We have had no material modifications to arrangements that were entered into prior to July 1, 2010. For our multiple element transactions entered into before July 1, 2010, we recognize revenue from non-refundable upfront payments and license fees on a straight-line basis over the term of the performance period of the agreement. If the performance period is not specifically identifiable from the agreement, we estimate the performance period based upon provisions contained in the agreement such as the duration of the research or development term, the existence or likelihood of achievement of development commitments and any other significant commitments.

For agreements entered into prior to July 1, 2010, the performance period is generally the estimated research or development term. For agreements entered into after this date, the performance period for upfront license fees may be shorter because the performance period, measured as the time between the execution date and the completion of the inseparable technology transfer, is typically a shorter period, generally up to six months.

We defer the upfront development payments and record them as Deferred Revenue upon receipt, pending recognition. The deferred portion of these payments is classified as a short-term or long-term liability in the accompanying Condensed Balance Sheets, depending on the period over which revenue is expected to be recognized.

Most of our agreements provide for milestone payments. In certain cases, we recognize all or a portion of each milestone payment as revenue when the specific milestone is achieved based on the applicable percentage earned of the total estimated research or development effort or other performance obligation. In other cases, when the milestone payment is attributed to our future development obligations, we recognize the revenue on a straight-line basis over the estimated remaining development effort.

We periodically review the expected performance periods under each of our agreements that provide for non-refundable upfront payments, license fees and milestone payments. We adjust the amortization periods when appropriate to reflect changes in assumptions relating to the duration of expected performance periods. We could accelerate revenue recognition for non-refundable license fees, upfront payments and milestone payments in the event of early termination of programs. Alternatively, we could decelerate such revenue recognition if programs are extended. While changes to such estimates have no impact on our reported cash flows, our reported revenue is significantly influenced by our estimates of the period over which our obligations are expected to be performed.

Cost of Revenue and Research and Development for Proprietary Programs

We incur costs in connection with performing research and development activities which consist mainly of compensation, associated fringe benefits, share-based compensation, preclinical and clinical outsourcing costs and other collaboration-related costs, including supplies, small tools, facilities, depreciation, recruiting and relocation costs and other direct and indirect chemical handling and laboratory support costs. We allocate these costs between Cost of Revenue and Research and Development Expenses for Proprietary Programs based upon the respective time spent by our scientists on development conducted for our collaborators and for our internal proprietary programs. Cost of Revenue represents the costs associated with research and development, including preclinical and clinical trials that we conduct for our collaborators, including co-development arrangements. Research and Development Expenses for Proprietary Programs consists of direct and indirect costs for our specific proprietary programs. We do not bear any risk of failure for performing these activities and the payments are not contingent on the success or failure of the research program. Accordingly, we expense these costs when incurred.

Where our collaboration agreements provide for us to conduct research and development and for which our partner has an option to obtain the right to conduct further development and to commercialize a product, we

attribute a portion of our research and development costs to Cost of Revenue based on the percentage of total programs under the agreement that we conclude is likely to continue to be funded by the partner. These costs may not be incurred equally across all programs. In addition, we continually evaluate the progress of development activities under these agreements and if events or circumstances change in future periods that we reasonably believe would make it unlikely that a collaborator would continue to fund the same percentage of programs, we will adjust the allocation accordingly. See *Note 4 Deferred Revenue*, for further information about our collaborations.

Accrued Outsourcing Costs

Substantial portions of our preclinical studies and clinical trials are performed by third party laboratories, medical centers, contract research organizations and other vendors (collectively CROs). These CROs generally bill monthly or quarterly for services performed or bill based upon milestone achievement. For preclinical studies, we accrue expenses based upon estimated percentage of work completed and the contract milestones remaining. For clinical studies, expenses are accrued based upon the number of patients enrolled and the duration of the study. We monitor patient enrollment, the progress of clinical studies and related activities to the extent possible through internal reviews of data reported to us by the CROs, correspondence with the CROs and clinical site visits. Our estimates depend on the timeliness and accuracy of the data provided by our CROs regarding the status of each program and total program spending. We periodically evaluate the estimates to determine if adjustments are necessary or appropriate based on information we receive.

Marketable Securities

We have designated our marketable securities as of each balance sheet date as available-for-sale securities and account for them at their respective fair values. Marketable securities are classified as short-term or long-term based on the nature of these securities and the availability of these securities to meet current operating requirements. Marketable securities that are readily available for use in current operations are classified as short-term available-for-sale securities and are reported as a component of current assets in the accompanying Condensed Balance Sheets. Marketable securities that are not considered available for use in current operations (including when active markets for such securities do not exist) are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying Condensed Balance Sheets.

Securities that are classified as available-for-sale are carried at fair value, including accrued interest, with temporary unrealized gains and losses reported as a component of Stockholders Deficit until their disposition. We review all available-for-sale securities each period to determine if they remain available-for-sale based on our then current intent and ability to sell the security if we need to do so. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in Interest Income in the accompanying Condensed Statements of Operations and Comprehensive Loss. Realized gains and losses on auction rate securities (or ARS) we previously owned, along with declines in value judged to be other-than-temporary are reported in Realized gains/losses on auction rate securities, net in the accompanying Condensed Statements of Operations and Comprehensive Loss when recognized. The cost of securities sold is based on the specific identification method.

See *Note 3 Marketable Securities* in our Annual Report on Form 10-K for the year ended June 30, 2011 filed with the SEC on August 12, 2011 for additional information about our investments in ARS.

Fair Value Measurements

Our financial instruments are recognized and disclosed at fair value in our financial statements and primarily consist of cash and cash equivalents, marketable securities, long-term investments, trade receivables and payables, long-term debt, embedded derivatives associated with the long-term debt and warrants. Array uses different valuation techniques to measure the fair value of assets and liabilities, as discussed in more detail below. Fair value is defined as the price that would be received or paid to sell the financial instruments in an orderly transaction between market participants at the measurement date. Array uses a framework for measuring

fair value based on a hierarchy that distinguishes sources of available information used in fair value measurements and categorizes them into three levels:

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

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

Array periodically reviews the realizability of each investment when impairment indicators exist with respect to the investment. If other-than-temporary impairment of the value of an investment is deemed to exist, the cost basis of the investment is written down to the then estimated fair value.

Long-term Debt and Embedded Derivatives

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

We currently have two embedded derivatives related to our long-term debt with Deerfield, which we collectively refer to as the Embedded Derivatives. One of the Embedded Derivatives is a variable interest rate structure that constitutes a liquidity linked variable spread feature. The other relates to Deerfield s ability to accelerate the repayment of the debt in the event of certain changes in our control that constitutes a significant transaction contingent put option. Deerfield has this right on a change in control if the acquirer did not meet certain financial conditions, based on size and credit worthiness.

Under the fair value hierarchy, we measure the fair value of the Embedded Derivatives using Level III, or unobservable inputs, as there is no active market for them, and calculate fair value using a combination of a discounted cash flow analysis and the Black-Derman Toy interest rate model.

The fair value of the variable interest rate structure is based on our estimate of the probable effective interest rate over the term of the Deerfield credit facilities. Because the interest rate may vary based on changes in our cash position during the term of the loan, we estimate the effective interest rate over the term of the credit facilities based on our cash flow forecasts, which include our expectations of future cash inflows from upfront fees, milestone payments and issuances of equity. The fair value of the put option is based on our estimate of the probability that a change in control that triggers Deerfield s right to accelerate the debt will occur. With those inputs, the fair value of each Embedded Derivative is calculated as the difference between the fair value of the Deerfield credit facilities if the Embedded Derivatives are included and the fair value of the Deerfield credit facilities if the Embedded Derivatives are excluded. Due to the inherent complexity in valuing the Deerfield credit facilities and the Embedded Derivatives, we have engaged a third party valuation firm to perform the valuation as part of our overall fair value analysis.

The estimated fair value of the Embedded Derivatives was determined based on management s judgment and assumptions and the use of different assumptions could result in significantly different estimated fair values. For

example, the value of the Embedded Derivatives as of December 31, 2011 of $734 thousand is based on the assumption that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of ten months out of the remaining 54 months of the facility. If conditions and the resulting assumptions were to change such that it was assumed that the total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a total of 30 months out of the remaining 54 months of the facility, the average effective interest rate would increase to 8.1%. This change would cause the Embedded Derivative value to increase by approximately $800 thousand and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss. Further, if conditions and the resulting assumptions were to change such that it was assumed that our total cash and marketable securities balance could fall to between $40 million and $50 million as of the end of a total of the same 30 months and also fall further to between $30 and $40 million as of the end of a total of eight additional months, the effective interest rate would increase to 8.7%. This change would cause the embedded derivative value to increase by $2.0 million from the current level and would result in a charge of the same amount to the Statement of Operations and Comprehensive Loss.

The fair value of the Embedded Derivatives is recorded as Derivative Liabilities in the Long-term Liabilities section in the accompanying Condensed Balance Sheets. Changes in the value of the Embedded Derivatives is adjusted quarterly and recorded to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Warrants that we have issued in connection with our long-term debt arrangements have been classified as equity. We value the warrants at issuance based on a Black-Scholes option-pricing model and then allocate a portion of the proceeds under the debt to the warrants based upon their relative fair values. The warrants are recorded in Stockholders Equity with the offset to Debt Discount. The Debt Discount is being amortized from the respective draw dates to the end of the term of the Deerfield credit facilities using the effective interest method and recorded as Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Transaction fees paid in connection with our long-term debt arrangements that qualify for capitalization are recorded as Other Long-Term Assets in the Condensed Balance Sheets and are amortized to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss using the effective interest method over the term of the underlying debt agreement.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board (FASB) issued FASB ASU No. 2011-04*, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements* in U.S. GAAP and IFRS. This ASU provides a consistent definition of fair value between U.S. GAAP and International Financial Reporting Standards. Additionally, the ASU changes certain fair value measurement principles and expands the disclosures for fair value measurements. ASU 2011-04 is effective for interim and annual periods beginning after December 15, 2011 and is to be applied prospectively. The Company will adopt this disclosure standard in the third quarter of the fiscal year ending June 30, 2012.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force) and the Securities Exchange Commission did not or are not believed by management to have a material impact on the Company s present or future financial statements.

Results of Operations

License and Milestone Revenue

License and Milestone Revenue is combined and consists of upfront license fees and ongoing milestone payments from collaborators.

Below is a summary of our license and milestone revenue (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
License revenue	$ 16,814	$ 10,363	6,451	62%	30,896	22,094	8,802	40%
Milestone revenue	2,381	768	1,613	210%	6,761	1,830	4,931	269%
Total license and miltestone revenue	$ 19,195	$ 11,131	$ 8,064	72%	$ 37,657	$ 23,924	$ 13,733	57%

License revenue increased $6.5 million, or 62%, for the current quarter compared to the same period last year. During the current quarter and year to date, we recognized $9.4 and $15.2 million, respectively, under the August 2011 Chk-1 licensing agreement with Genentech. These increases were partially offset by less revenue recognized under the Celgene collaboration due to our revised estimate of the remaining performance period effective October 1, 2011 as discussed in *Note 4 Deferred Revenue* to the accompanying Condensed Financial Statements.

Milestone Revenue increased for the current quarter and year to date compared to the same periods last year due to milestones received at various times from Celgene, Genentech and Novartis.

Collaboration Revenue

Collaboration Revenue consists of revenue for our performance of drug discovery and development activities in collaboration with partners, which include co-development of proprietary drug candidates we out-license as well as screening, lead generation and lead optimization research, custom synthesis and process research and to a small degree the development and sale of chemical compounds.

Below is a summary of our collaboration revenue (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
Collaboration revenue	$ 4,033	$ 5,370	$ (1,337)	-25%	$ 7,701	$ 11,090	$ (3,389)	-31%

Collaboration revenue decreased in the current quarter and year to date compared to the same periods last year due to having fewer scientists engaged on the Genentech programs as well as less revenue from Amgen and Novartis for reimbursed development activities.

Cost of Revenue

Cost of Revenue represents costs attributable to discovery and development including preclinical and clinical trials we may conduct for our collaborators and the cost of chemical compounds sold from our inventory. These costs consist mainly of compensation, associated fringe benefits, share-based compensation, preclinical and clinical outsourcing costs and other collaboration related costs, including supplies, small tools, travel and meals, facilities, depreciation, recruiting and relocation costs and other direct and indirect chemical handling and laboratory support costs.

Below is a summary of our Cost of Revenue (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
Cost of revenue	$ 6,266	$ 7,382	$ (1,116)	-15%	$ 12,711	$ 14,663	$ (1,952)	-13%
Cost of revenue as a percentage of total revenue	27%	45%			28%	42%		

Cost of Revenue decreased for both the current quarter and year to date compared to the same periods in the prior year. The decrease was partially due to the progression of our partnered program with Amgen to develop AMG 151/ARRY-403. We completed our obligations for the program during the first half of fiscal 2011 and therefore have no comparable costs in the current period. Additionally, during the current quarter and year to date we incurred fewer costs under our agreement with Celgene and had fewer scientists engaged on our collaboration with Genentech compared to the prior year. Partially offsetting these decreased costs was an increase in our share of the costs to co-develop MEK162 with Novartis.

Cost of Revenue as a percentage of total revenue for the three and six months ended December 31, 2011 decreased because of increased License and Milestone Revenue being recognized during the period, as well as a reduction in total costs.

Research and Development for Proprietary Programs

Our Research and Development Expenses for Proprietary Drug Discovery include costs associated with our proprietary drug programs for scientific and clinical personnel, supplies, inventory, equipment, small tools, travel and meals, depreciation, consultants, sponsored research, allocated facility costs, costs related to preclinical and clinical trials and share-based compensation. We manage our proprietary programs based on scientific data and achievement of research plan goals. Our scientists record their time to specific projects when possible; however, many activities simultaneously benefit multiple projects and cannot be readily attributed to a specific project. Accordingly, the accurate assignment of time and costs to a specific project is difficult and may not give a true indication of the actual costs of a particular project. As a result, we do not report costs on a program basis.

Below is a summary of our research and development expenses by categories of costs for the periods presented (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
Salaries, benefits and share-based compensation	$ 5,435	$ 6,643	$ (1,208)	-18%	$ 10,598	$ 13,189	$ (2,591)	-20%
Outsourced services and consulting	3,796	3,210	586	18%	7,311	5,809	1,502	26%
Laboratory supplies	1,559	2,260	(701)	-31%	3,122	4,593	(1,471)	-32%
Facilities and depreciation	2,015	1,980	35	2%	4,012	4,001	11	0%
Other	345	389	(44)	-11%	705	745	(40)	-5%
Total research and development for proprietary	$ 13,150	$ 14,482	$ (1,332)	-9%	$ 25,748	$ 28,337	$ (2,589)	-9%

Research and Development for Proprietary Programs decreased for the current quarter and year to date compared to the prior comparative periods because we entered into license agreements for our Chk-1 inhibitor GDC-0575 (ARRY-575) and our HER2/EGFR inhibitor for cancer ASLAN001/(ARRY-543) with Genentech and

ASLAN, respectively, during the first quarter of the current fiscal year. As a result, we are only spending a limited amount on these programs while the technology transfer is ongoing. Further, any cost we do incur on these programs is now included in Cost of Revenue. Compensation-related expenses also decreased as a result of our reduction in force in June 2011.

General and Administrative Expenses

General and Administrative Expenses consist mainly of compensation and associated fringe benefits not included in Cost of Revenue or Research and Development Expenses for Proprietary Drug Discovery and include other management, business development, accounting, information technology and administration costs, including patent filing and prosecution, recruiting and relocation, consulting and professional services, travel and meals, sales commissions, facilities, depreciation and other office expenses.

Below is a summary of our General and Administrative Expenses (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
General and administrative	$ 3,782	$ 3,905	$ (123)	-3%	$ 7,502	$ 8,173	$ (671)	-8%

General and administrative expenses decreased during the three and six months ended December 31, 2011 compared to the same period in the prior year. The decreases were primarily as a result of reduced compensation related expenses related to our reduction in force in June 2011 and reduced costs incurred during the periods to obtain and protect our patents.

Other Income (Expense)

Below is a summary of our Other Income (Expense) (dollars in thousands):

	Three Months Ended December 31,		Change 2011 vs. 2010		Six Months Ended December 31,		Change 2011 vs. 2010	
	2011	2010	$	%	2011	2010	$	%
Realized gains on auction rate securities, net	$ -	$ 865	$ (865)	-100%	$ -	$ 798	$ (798)	-100%
Interest income	3	136	(133)	-98%	9	356	(347)	98%
Interest expense	(3,836)	(4,175)	339	-8%	(6,792)	(8,067)	1,275	-16%
Total other expense, net	$ (3,833)	$ (3,174)	$ (659)	21%	$ (6,783)	$ (6,913)	$ 130	-2%

Below is a summary of the components of Interest Expense (dollars in thousands):

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Credit Facilities:				
Interest paid	$ 1,586	$ 2,250	$ 3,274	$ 4,500
Amortization of the transaction fees	60	143	123	286
Amortization of the debt discounts	890	1,670	1,959	3,307
Change in value of the Embedded Derivatives	208	(42)	193	(332)
Loss on prepayment of long-term debt	942	-	942	-
Total interest expense on Deerfield Credit Facility	3,686	4,021	6,491	7,761
Term Loan:				
Variable interest and amortization of transaction fees	150	154	301	306
Total interest expense on Comerica Loan	150	154	301	306
Total interest expense	$ 3,836	$ 4,175	$ 6,792	$ 8,067

Interest expense was lower in the second quarter of fiscal 2011 compared with the same period in fiscal 2010 as a result of reduced interest paid on the Deerfield Credit Facilities following the early payment of $30 million of principal in May 2011, and the additional principal payment of $4.2 million in October 2011. Interest income was lower for the quarter and year-to-date because of reduced cash balances available to invest.

Liquidity and Capital Resources

We have incurred operating losses and have an accumulated deficit as a result of ongoing research and development spending. As of December 31, 2011, we had an accumulated deficit of $554.5 million. We had net losses of $3.8 million for the quarter and $7.4 million for the six months ended December 31, 2011. We had net losses of $56.3 million, $77.6 million and $127.8 million for the fiscal years ended June 30, 2011, 2010 and 2009, respectively.

We have historically funded our operations from upfront fees, license and milestone revenue received under collaborations and out-licensing transactions; from the issuance and sale of equity securities; and through debt provided by our credit facilities. Since December 2009, we have received approximately $163.8 million under our collaborations, including the following payments:

- In December 2009, we received a $60 million upfront payment from Amgen Inc. under a Collaboration and License Agreement.
- In May and June 2010, we received a total of $45 million in upfront and milestone payments under a License Agreement with Novartis Pharmaceutical International Ltd.
- In December 2010, we received $10 million in a milestone payment under a License Agreement with Celgene Corporation.
- In May 2011, we received $10 million in a milestone payment under a License Agreement with Novartis.

- In September 2011, we received $28 million in an upfront payment from Genentech under a License Agreement.

During the first six months of fiscal 2012, our net cash used in operations was $6.2 million, which reflects a $28 million upfront payment we received from Genentech Inc. in September 2011.

Until we can generate sufficient levels of cash from our operations, which we do not expect to achieve in the foreseeable future, we will continue to utilize our existing cash, cash equivalents and marketable securities, and will continue to depend on funds from the sources mentioned above, which may not be available or forthcoming.

Management believes that the cash, cash equivalents and marketable securities as of December 31, 2011 as well as milestone payments that may occur, will not enable us to continue to fund operations in the normal course of business for the next 12 months unless we obtain additional funds through the sale of debt or equity securities or we obtain upfront license fees from one or more new collaborations.

We anticipate that a portion of our funding requirements will be satisfied with milestone payments we expect to receive from existing collaborations in the second half of fiscal 2012. In addition, we plan to continue to satisfy all or a portion of the interest payment obligations under the credit facilities with Deerfield with the proceeds from sales of our common stock or through the issuance of shares of our common stock to Deerfield in accordance with the Facility Agreements with Deerfield. Because sufficient funds may not be available to us when needed from existing collaborations, however, we expect that we will be required to continue to fund our operations in part through the sale of debt or equity securities and through licensing select programs that include upfront and/or milestone payments.

Our ability to successfully raise sufficient funds through the sale of debt or equity securities when needed is subject to many risks and uncertainties and, even if we are successful, future equity issuances would result in dilution to our existing stockholders. We also may not successfully consummate new collaborations that provide for additional upfront fees or milestone payments, or we may not earn milestone payments under such collaborations, when anticipated or at all. In addition, on January 16, 2012, Robert E. Conway resigned as our Chief Executive Officer for personal reasons, and it may be more difficult or not possible for us to raise funds from these sources until we have hired a new Chief Executive Officer.

Our ability to realize milestone or royalty payments under existing collaboration agreements and to enter into new partnering arrangements that generate additional revenue through upfront fees and milestone or royalty payments is subject to a number of risks, many of which are beyond our control and include the following:

- The drug development process is risky and highly uncertain and we may not be successful in generating proof-of-concept data to create partnering opportunities and, even if we are, we or our collaborators may not be successful in commercializing drug candidates we create;
- Our collaborators have substantial control and discretion over the timing and continued development and marketing of drug candidates we create and, therefore, we may not receive milestone, royalty or other payments when anticipated or at all;
- The drug candidates we develop may not obtain regulatory approval;
- If regulatory approval is received, drugs we develop will remain subject to regulation or may not gain market acceptance, which could delay or prevent us from generating milestone, royalty revenue or product revenue from the commercialization of these drugs; and

- The spending priorities and willingness of pharmaceutical companies to in-license drugs for further development and commercialization may change or decrease.

If we are unable to obtain additional funding from these or other sources when needed, or to the extent needed, it may be necessary to significantly reduce the current rate of spending through further reductions in staff and delaying, scaling back, or stopping certain research and development programs, including more costly Phase 2 and Phase 3 clinical trials on our wholly-owned programs as these programs progress into later stage development. Insufficient liquidity may also require us to relinquish greater rights to product candidates at an

earlier stage of development or on less favorable terms to us or our stockholders than we would otherwise choose in order to obtain upfront license fees needed to fund operations. These events could prevent us from successfully executing on our operating plan and in the future could raise substantial doubt about our ability to continue as a going concern in future periods. Further, as discussed in Note 5 *Long-term Debt*, the entire debt balance of $92.6 million outstanding with Deerfield becomes due and payable if cash, cash equivalents and marketable securities falls below $20 million at the end of a fiscal quarter.

Our assessment of our future need for funding 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:

- Our ability to enter into agreements to out-license, co-develop or commercialize our proprietary drug candidates and the timing of payments under those agreements throughout each candidate s development stage;
- The number and scope of our research and development programs;
- The progress and success of our preclinical and clinical development activities;
- The progress and success of the development efforts of our collaborators;
- Our ability to maintain current collaboration agreements;
- The costs involved in enforcing patent claims and other intellectual property rights;
- The costs and timing of regulatory approvals; and/or
- The expenses associated with unforeseen litigation, regulatory changes, competition and technological developments, general economic and market conditions and the extent to which we acquire or invest in other businesses, products and technologies.

Cash, Cash Equivalents and Marketable Securities

Cash equivalents are short-term, highly liquid financial instruments that are readily convertible to cash and have maturities of 90 days or less from the date of purchase.

Short-term marketable securities consist primarily of U.S. government agency obligations with maturities of greater than 90 days when purchased. Long-term marketable securities as of December 31, 2011 are primarily related to our Deferred Compensation Plan.

Below is a summary of our cash, cash equivalents and marketable securities (dollars in thousands):

	December 31, 2011	**June 30, 2011**	**$ Change**

Cash and cash equivalents	$ 60,363	$ 48,099	$ 12,264
Marketable securities - short-term	360	15,986	(15,626)
Marketable securities - long-term	554	623	(69)
Total	$ 61,277	$ 64,708	$ (3,431)

Cash Flow Activities

Below is a summary of our cash flows (dollars in thousands):

	Six Months Ended December 31,		
	2011	**2010**	**$ Change**
Cash flows provided by (used in):			
Operating activities	$ (6,151)	$ (32,968)	$ 26,817
Investing activities	14,686	37,966	(23,280)
Financing activities	3,729	4,347	(618)
Total	$ 12,264	$ 9,345	$ 2,919

Net cash used in operating activities for the six months ended December 31, 2011 decreased $26.8 million over the same period in the prior year. This was primarily due to the $28.0 million upfront license fee we received from Genentech in September 2011. In the prior year, milestone revenue was lower with a $10.0 million milestone payment received from Celgene.

Net cash provided by investing activities was $14.7 million and $38.0 million in the six months ended December 31, 2011 and 2010, respectively. The decrease of approximately $23.3 million is because we did not purchase additional marketable securities upon the maturity of the securities we held. As a result, cash flows provided by investing activities reflected mostly cash received upon the maturities of those marketable securities.

Net cash provided by financing activities was $3.7 million and $4.3 million in the six months ended December 31, 2011 and 2010, respectively. The difference between the periods is primarily attributable to $7.3 million received for the sale of shares of our common stock under our Equity Distribution Agreement with Piper Jaffray & Co during the prior fiscal year as discussed in *Note 7 Equity Distribution Agreement.* This increase in net cash provided by financing activities was reduced by the payment on the principal of the Deerfield debt of $4.2 million.

Obligations and Commitments

The following table shows our contractual obligations and commitments as of December 31, 2011 (dollars in thousands):

	Less Than 1 Year	**1 to 3 Years**	**4 to 5 Years**	**Over 5 Years**	**Total**

Debt obligations (1)	$ 150	$ 14,700	$ 92,562	$ -	$ 107,412
Interest on debt obligations (3) (4)	6,918	13,110	6,435	-	26,463
Operating lease commitments (2)	8,116	16,478	12,720		37,314
Purchase obligations (2)	8,801	4,039	-	-	12,840
Total	$ 23,985	$ 48,327	$ 111,717	$ -	$ 184,029

(1) Reflected in the accompanying Condensed Balance Sheets.
(2) These obligations are not reflected in the accompanying Condensed Balance Sheets.
(3) Interest on the variable debt obligations under the Term Loan with Comerica Bank is calculated at 3.25%, the interest rate in effect as of December 31, 2011.
(4) Interest on the variable debt obligation under the credit facilities with Deerfield is calculated at 7.5%, the interest rate in effect as of December 31, 2011.

We are obligated under non-cancelable operating leases for all of our facilities and to a limited degree, equipment leases. Original lease terms for our facilities in effect as of December 31, 2011 were five to ten years and generally require us to pay the real estate taxes, certain insurance and other operating costs. Equipment lease terms generally range from three to five years.

Purchase obligations totaling $9.7 million are for outsourced services for clinical trials and other research and development costs. Purchase obligations totaling $1.1 million are for software related expenses. The remaining $2.0 million is for all other purchase commitments.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position, results of operations or cash flows due to adverse changes in financial and commodity market prices and fluctuations in interest rates. All of our collaboration agreements and nearly all purchase orders are denominated in U.S. dollars. As a result, historically and as of December 31, 2011, we have had little or no exposure to market risk from changes in foreign currency or exchange rates.

Our investment portfolio is comprised primarily of readily marketable, high-quality securities diversified and structured to minimize market risks. We target our average portfolio maturity at one year or less. Our exposure to market risk for changes in interest rates relates primarily to our investments in marketable securities. Marketable securities held in our investment portfolio are subject to changes in market value in response to changes in interest rates and liquidity. A significant change in market interest rates could have a material impact on interest income earned from our investment portfolio. A theoretical 100 basis point (1%) change in interest rates and security prices would impact our annual net loss positively or negatively by approximately $612.7 thousand based on the current balance of $61.3 million of investments classified as cash and cash equivalents and short-term and long-term marketable securities available for sale.

As of December 31, 2011, we had $107.4 million of debt outstanding, exclusive of the debt discount of $17 million. The term loan under our senior secured Term Loan with Comerica Bank of $14.9 million is variable rate debt. Assuming constant debt levels, a theoretical change of 100 basis points (1%) on our current interest rate of 3.25% on the Comerica debt as of December 31, 2011 would result in a change in our annual interest expense of $149 thousand. The interest rate on our long-term debt under the credit facilities with Deerfield is variable based on our total cash, cash equivalents and marketable securities balances. However, as long as our total cash, cash equivalents and marketable securities balances remain above $50 million, our interest rate is fixed at 7.5%. Assuming constant debt levels, a theoretical change of 100 basis points on our current rate of interest of 7.5% on the Deerfield credit facilities as of December 31, 2011 would result in a change in our annual interest expense of $858 thousand.

Historically and as of December 31, 2011, we have not used foreign currency derivative instruments or engaged in hedging activities.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our Executive Chairman, Chief Financial Officer and other senior management personnel, we evaluated the effectiveness of the design and operation of our disclosure

controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934). Based on this evaluation, our Executive Chairman and our Chief Financial Officer have concluded that our disclosure controls and procedures as of December 31, 2011 were effective to provide a reasonable level of assurance that the information we are required to disclose in reports that we submit or file under the Securities Act of 1934 (i) is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms; and (ii) is accumulated and communicated to our management, including our Executive Chairman and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to management. Our disclosure controls and procedures include components of our internal control over financial reporting. Management s assessment of the effectiveness of our disclosure controls and procedures is expressed at a reasonable level of assurance because an internal control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the internal control system s objectives will be met.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None

ITEM 1A. RISK FACTORS

Investing in our common stock is subject to a number of risks and uncertainties. We have updated the following risk factors to reflect changes during the quarter ended December 31, 2011 we believe to be material to the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended June 30, 2011 filed with the Securities and Exchange Commission. The risks and uncertainties described below are not the only ones that we face and are more fully described in our Annual Report on Form 10-K and in other reports we file with the Securities and Exchange Commission. Additional risks and uncertainties not presently known to us or that we currently believe are immaterial also may negatively impact our business.

Risks Related to Our Business

We have a history of operating losses and may not achieve or sustain profitability.

We have incurred significant operating and net losses and negative cash flows from operations since our inception. As of December 31, 2011, we had an accumulated deficit of $554.5 million. We had a net loss of $3.8 million for the quarter and $7.4 million for the six months ended December 31, 2011. We had net losses of $56.3 million, $77.6 million, and $127.8 million, for the fiscal years ended June 30, 2011, 2010, and 2009, respectively. We expect to incur additional losses and negative cash flows in the future, and these losses may continue or increase in part due to anticipated levels of expenses for research and development, particularly clinical development, expansion of our clinical and scientific capabilities, and acquisitions of complementary technologies or in-licensed drug candidates. As a result, 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. Much of our current revenue is non-recurring in nature and unpredictable as to timing and amount. While several of our out-licensing and collaboration agreements provide for royalties on product sales, given that none of our drug candidates have been approved for commercial sale, that our drug candidates are at early stages of development and that drug development entails a high degree of risk of failure, we do not expect to receive any royalty revenue for several years, if at all. For the same reasons, we may never realize much of the milestone revenue provided for in our out-license and collaboration agreements. Similarly, drugs we select to commercialize ourselves or partner for later-stage co-development and commercialization may not generate revenue for several years, or at all.

If we need but are unable to obtain additional funding to support our operations, we could be required to reduce our research and development activities or curtail our operations and it may lead to uncertainty about our ability to continue to operate as a going concern.

We have expended substantial funds to discover and develop our drug candidates and additional substantial funds will be required for further development, particularly as our proprietary programs move into more costly Phase 2 and Phase 3 development. Additional funds will be required to manufacture and market any products we own or retain commercial rights to that are approved for commercial sale. In addition, a portion of our cash flow is dedicated to the payment of interest under our existing senior secured Term Loan with Comerica Bank, and to the payment of principal and interest on our credit facilities with Deerfield. Because the successful development of our products is uncertain, we are unable to precisely estimate the actual funds we will require to develop and potentially commercialize them and to meet our other obligations. Our current operating plan and assumptions could also

change as a result of many factors, and we could require additional funding sooner than anticipated.

We have historically funded our operations through revenue from our collaborations and out-license transactions, the issuance of equity securities and debt financing. Management believes that the cash, cash equivalents and marketable securities as of December 31, 2011 will not enable us to continue to fund operations in the normal course of business for the next 12 months unless we obtain additional funds through the sale of debt or equity securities or we obtain upfront license fees from one or more new collaborations.

We anticipate that a portion of our funding requirements will be satisfied with milestone payments we expect to receive from existing collaborations during the next twelve months. In addition, we plan to continue to satisfy all or a portion of the interest payment obligations under the credit facilities with Deerfield with the proceeds from sales of our common stock or through the issuance of shares of our common stock to Deerfield in accordance with the Facility Agreements with Deerfield. Because sufficient funds may not be available to us when needed from existing collaborations, however, we expect that we will be required to continue to fund our operations in part through the sale of debt or equity securities and through licensing select programs that include upfront and/or milestone payments. Our ability to successfully raise sufficient funds through the sale of debt or equity securities when needed is subject to many risks and uncertainties and, even if we are successful, future equity issuances would result in dilution to our existing stockholders. We also may not successfully consummate new collaborations that provide for additional upfront fees or milestone payments, or we may not earn milestone payments under such new or existing collaborations, when anticipated or at all. In addition, on January 16, 2012, Robert E. Conway resigned as our Chief Executive Officer for personal reasons, and it may be more difficult or not possible for us to raise funds from these sources until we have hired a new Chief Executive Officer.

If we are unable to generate enough revenue or secure additional sources of funding, we may be required to curtail operations significantly, which could prevent us from successfully executing our operating plan and could raise substantial doubt as to our ability to continue as a going concern in future periods. Even if we are able to secure the additional sources of funding, it may not be on terms that are favorable or satisfactory to us and may result in significant dilution to our stockholders. These events may result in an inability to maintain a level of liquidity necessary to continue operating our business and the loss of all or part of the investment of our stockholders in our common stock. In addition, if we are unable to maintain certain levels of cash and marketable securities, our obligations under our credit facilities with Deerfield and our loan agreement with Comerica Bank may be accelerated.

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 its agreement with us, our revenue may significantly decrease.

A relatively small number of collaborators account for a significant portion of our revenue, as shown by the table below.

	Six Months Ended December 31,	
	2011	**2010**
Amgen, Inc.	37%	39%
Novartis International Pharmaceutical Ltd.	11%	18%
Celgene Corporation	10%	21%
Genentech, Inc.	41%	22%
	99%	100%

We expect that revenue from a limited number of collaborators, including Celgene, Genentech, and Novartis, will account for a large portion of our revenue in future quarters. In general, our collaborators may terminate their contracts with us upon 60 to 180 days notice for a number of reasons. 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 significantly decrease.

We may not be successful in entering into additional out-license agreements on favorable terms, which may adversely affect our liquidity or require us to change our spending priorities on our proprietary programs.

We are committing significant resources to create our own proprietary drug candidates and to build a commercial-stage biopharmaceutical company. We have built our clinical and discovery programs through

spending $488.4 million from our inception through December 31, 2011. During the first six months of fiscal 2012 we spent $25.7 million in research and development for proprietary programs. In fiscal 2011, we spent $63.5 million in research and development for proprietary programs, compared to $72.5 million and $89.6 million for fiscal years 2010 and 2009, respectively. Our proprietary drug discovery programs are in their early stage of development and are unproven. Our ability to continue to fund our planned spending on our proprietary drug programs and in building our commercial capabilities depends to a large degree on upfront fees, milestone payments and other revenue we receive as a result of our partnered programs. To date, we have entered into eight out-licensing agreements for the development and commercialization of our drug candidates, and we plan to continue initiatives during fiscal 2012 to partner select clinical candidates to obtain additional capital. We may not be successful, however, in entering into additional out-licensing agreements with favorable terms, including upfront, milestone, royalty and/or license payments and the retention of certain valuable commercialization or co-promote rights, as a result of factors, many of which are outside of our control. These factors include:

- Our ability to create valuable proprietary drugs targeting large market opportunities;
- Research and spending priorities of potential licensing partners;
- Willingness of and the resources available to pharmaceutical and biotechnology companies to in-license drug candidates to fill their clinical pipelines;
- The success or failure, and timing, of pre-clinical and clinical trials for our proprietary programs we intend to out-license; and
- Our ability or inability to generate proof-of-concept data and to agree with a potential partner on the value of proprietary drug candidates we are seeking to out-license, or on the related terms.

If we are unable to enter into out-licensing agreements and realize milestone, license and/or upfront fees when anticipated, it may adversely affect our liquidity and we may be forced to curtail or delay development of all or some of our proprietary programs, which in turn may harm our business and the value of our stock. In addition, insufficient funds may require us to relinquish greater rights to product candidates at an earlier stage of development or on less favorable terms to us or our stockholders than we would otherwise choose in order to obtain funding for further development and/or upfront license fees needed to fund our operations.

Because our stock price may be volatile, our stock price could experience substantial declines.

The market price of our common stock has historically experienced and may continue to experience volatility. The high and low closing bids for our common stock were $2.83 and $1.77, respectively, for the first six months of fiscal 2012; $3.58 and $2.06, respectively, during fiscal 2011; $4.45 and $1.72, respectively, during fiscal 2010; and $8.79 and $2.51, respectively, during fiscal 2009. Our quarterly operating results, the success or failure of our internal drug discovery efforts, decisions to delay, modify or cease one or more of our development programs, negative data or adverse events reported on programs in clinical trials we or our collaborators are conducting, uncertainties about our ability to continue to operate as a going concern, changes in general conditions in the economy or the financial markets and other developments affecting our collaborators, our competitors or us could cause the market price of our common stock to fluctuate substantially. This volatility coupled with market declines in our industry over the past several years have 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.

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 had 252 employees as of December 31, 2011 and our future success depends upon our ability to attract, retain and motivate highly skilled scientists and management. Our ability to achieve our business strategies, including progressing drug candidates through later stage development or commercialization, attracting new collaborators and retaining, renewing and expanding existing collaborations, depends on our ability to hire and

retain high caliber scientists and other qualified experts, particularly in clinical development and commercialization. We compete with pharmaceutical and biotechnology companies, contract research companies and academic and research institutions to recruit personnel and face significant competition for qualified personnel, particularly clinical development personnel. We may incur greater costs than anticipated, or may not be successful, in attracting new scientists or management or in retaining or motivating our existing personnel.

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 Dr. Kevin Koch, our President and Chief Scientific Officer; Dr. David L. Snitman, our Chief Operating Officer and Vice President, Business Development; R. Michael Carruthers, our Chief Financial Officer; and John R. Moore, our Vice President and General Counsel. We have employment agreements with each of these employees that are terminable upon 30 days prior notice.

On January 16, 2012, Robert E. Conway resigned as our Chief Executive Officer for personal reasons. Array has commenced a search process for a new Chief Executive Officer. Kyle Lefkoff, Array s prior Chairman, is acting as Executive Chairman of Array on an interim basis and has assumed Mr. Conway s responsibilities until such time as a new Chief Executive Officer is appointed. There can be no assurance, however, that we will be successful in attracting and hiring a new Chief Executive Officer with the experience we are seeking or that our operations will not be disrupted until a new Chief Executive Officer is hired.

Health care reform, including those based on recently enacted legislation and cost control initiatives by third-party payors, could reduce the prices that can be charged for drugs, which could limit the commercial success of our drug candidates.

In March 2010, the President signed the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010, together the "Healthcare Reform Act." These laws substantially change the way health care is financed by both governmental and private insurers and significantly impacts the pharmaceutical industry. The Healthcare Reform Act contains a number of provisions that will be expected to impact our business and operations, in some cases in ways we cannot currently predict. Changes that may affect our business include those governing enrollment in federal healthcare programs, mandatory discounts on pharmaceuticals under federal health care programs, reimbursement changes and fraud and abuse enforcement. These changes will impact existing government healthcare programs and will result in the development of new programs, including Medicare payment for performance initiatives and improvements to the physician quality reporting system and feedback program.

Additional provisions of the Healthcare Reform Act, some of which become effective in 2011, may negatively affect any associated product revenues and prospects for continued profitability in the future. For example, the Healthcare Reform Act imposes a non-deductible annual fee on pharmaceutical manufacturers or importers that sell branded prescription drugs to U.S. government programs that may impact any associated product revenue and therefore revenue we are entitled to receive from royalties on product sales. In addition, as part of the Healthcare Reform Act's provisions closing a funding gap that currently exists in the Medicare Part D prescription drug program (commonly known as the "donut hole"), manufacturers of branded prescription drugs will be required to provide a 50% discount on drugs dispensed to beneficiaries within this donut hole. We expect that the Healthcare Reform Act and other healthcare reform measures that may be adopted in the future could have a material adverse effect on our industry generally and on the ability of Array or our collaborators to successfully commercialize product candidates or could limit or eliminate our future spending on development projects.

In addition to the Healthcare Reform Act, there will continue to be proposals by legislators at both the federal and state levels, regulators and third-party payors to keep healthcare costs down while expanding individual healthcare benefits. Certain of these changes could limit the prices that can be charged for drugs we develop or the amounts of reimbursement available for these products from governmental agencies or third-party payors, or may increase the tax obligations on pharmaceutical companies, increase our rebate liability and discount obligations and so may limit our commercial opportunity and reduce any associated revenue and profits. For example, federal laws require drug manufacturers to pay specified rebates to each state Medicaid program for medicines reimbursed by Medicaid and to provide discounts for out-patient medicines purchased by certain safety net providers and "disproportionate share" hospitals and for purchases by some federal governmental departments such as the Department of Veterans Affairs and the Department of Defense. The rebates paid to state Medicaid programs are based on pricing data reported by manufacturers on a monthly and quarterly basis to the Centers for Medicare and Medicaid Services, the federal agency which administers the Medicaid drug rebate program. These data include the average manufacturer price, or AMP, and in the case of innovator products, the best price for each drug. As a result of the enactment of the Healthcare Reform Act, rebates now also will be due on the utilization of Medicaid managed care organizations, effective March 23, 2010.

Pursuant to the Healthcare Reform Act, the amount of the Medicaid rebate for each unit of a drug has been increased. For most innovator products, in general a drug marketed under a new drug application, or NDA, the minimum rebate has been increased from 15.1% to 23.1% of the AMP for that product, or if it is greater, the difference between the AMP and the best price for the drug. The Medicaid rebate for innovator products also includes an additional rebate amount if price increases for the drug exceed the rate of inflation since the product's launch, and in the case of certain line extension products, the additional rebate can be tied to the price of the original version of the product. The Healthcare Reform Act also caps the total rebate amount for innovator drugs at 100% of the AMP for the drug. In addition, the Healthcare Reform Act and subsequent legislation enacted in August of 2010 changed the definition of AMP. Regulations have been proposed to implement the Medicaid prescription drug provisions of the enacted statutory changes. There may be additional increases in rebates or other costs and charges from government agencies. Regulations continue to be issued and coverage expanded by various governmental agencies relating to these programs, increasing the cost and complexity of compliance.

Health reform also expanded the number of safety net providers and hospitals that receive discounted pricing on out-patient medicines. In some countries other than the U.S., reimbursement, pricing and profitability of prescription pharmaceuticals and biopharmaceuticals are subject to government control. We are unable to predict what additional

legislation or regulation, if any, relating to the healthcare industry or third-party coverage and reimbursement may be enacted in the future or what effect such legislation or regulation would have on our business.

Also, we expect managed care plans will continue to put pressure on the pricing of pharmaceutical and biopharmaceutical products due to a trend toward managed health care, the increasing influence of health maintenance organizations and additional legislative proposals. Cost control initiatives could decrease the price that we, or any potential collaborators, receive for any of our future products, which could adversely affect our profitability. These initiatives may also have the effect of reducing the resources that pharmaceutical and biotechnology companies can devote to in-licensing drug candidates and the research and development of new drugs, which could reduce our resulting revenue. Any cost containment measures or other reforms that are adopted could have a negative impact on our ability to commercialize successfully our products or could limit or eliminate our spending on development of new drugs and affect our profitability.

Other legislation affecting government expenditures more broadly have the potential to affect negatively our product revenues and prospects for continued profitability. For example, the Budget Control Act of 2011 that was signed into law on August 2, 2011 to reduce federal government expenditures may result in reduced payment rates for drugs under different government health care programs. The implementation of this law could decrease the price that we and our potential collaborators receive for our future products.

We face potential liability related to the privacy of health information we obtain from research institutions.

Most health care providers, including research institutions from which we or our collaborators obtain patient information, are subject to privacy regulations promulgated under HIPAA. Our clinical research efforts are not directly regulated by HIPAA. However, conduct by a person that may not be prosecuted directly under HIPAA's criminal provisions could potentially be prosecuted under aiding and abetting or conspiracy laws. Consequently, depending on the facts and circumstances, we could face substantial civil or criminal penalties if we receive individually identifiable health information from a health care provider or research institution that has not satisfied HIPAA's disclosure standards. In addition, international data protection laws including the EU Data Protection Directive and member state implementing legislation may apply to some or all of the clinical data obtained outside of the U.S. Furthermore, certain privacy laws and genetic testing laws may apply directly to our operations and/or those of our collaborators and may impose restrictions on our use and dissemination of individuals' health information. Moreover, patients about whom we or our collaborators obtain information, as well as the providers who share this information with us, may have contractual rights that limit our ability to use and disclose the information. Claims that we have violated individuals' privacy rights or breached our contractual obligations, even if we are not found liable, could be expensive and time-consuming to defend and could result in adverse publicity that could harm our business

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. RESERVED

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number	Description of Exhibit
31.1	Certification of Executive Chairman pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certifications of Executive Chairman and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document**
101.SCH	XBRL Taxonomy Extension Schema Document**
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document**
101.LAB	XBRL Taxonomy Extension Label Linkbase Document**
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document**
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document**

** Furnished electronically with this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Boulder, State of Colorado, on this 1st day of February 2012.

ARRAY BIOPHARMA INC.

By: /s/ Kyle Lefkoff
Kyle Lefkoff
Executive Chairman

By: /s/ R. Michael Carruthers
R. Michael Carruthers
Chief Financial Officer
(Principal Financial and Accounting Officer)