Targa Resources Corp.
Form DEF 14A
April 04, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

SCHEDULE 14A

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE

SECURITIES EXCHANGE ACT OF 1934

(AMENDMENT NO.)

Filed by the Registrant x Filed by a Party other than the Registrant ¨

Check the appropriate box:

¨ Preliminary Proxy Statement

¨ Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

x Definitive Proxy Statement

¨ Definitive Additional Materials

¨ Soliciting Material Pursuant to § 240.14a-12

Targa Resources Corp.

(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

x No fee required.

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(1) Title of each class of securities to which transaction applies:

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

TARGA RESOURCES CORP.

1000 Louisiana Street

Suite 4300

Houston, Texas 77002

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

To the Stockholders of Targa Resources Corp.:

Notice is hereby given that the Annual Meeting of Stockholders of Targa Resources Corp. (the Company) will be held at 1000 Louisiana Street, Suite 4300, Houston, TX 77002 on Friday, May 25, 2012, at 8:00 a.m. Central Time (the Annual Meeting). The Annual Meeting is being held for the following purposes:

1. To elect three Class II Directors, each for a term of three years.

2. To ratify the selection of PricewaterhouseCoopers LLP as the Company s independent registered public accountants for 2012.

3. To transact such other business as may properly come before the Annual Meeting.

These proposals are described in the accompanying proxy materials. You will be able to vote at the Annual Meeting only if you were a stockholder of record at the close of business on April 2, 2012.

YOUR VOTE IS IMPORTANT

Please vote over the internet at *www.envisionreports.com/TRGP* or by phone at 1-800-652-8683 promptly so that your shares may be voted in accordance with your wishes and so we may have a quorum at the Annual Meeting. Alternatively, if you did not receive a paper copy of the proxy materials (which includes the proxy card), you may request a paper proxy card, which you may complete, sign and return by mail.

By Order of the Board of Directors,

Paul W. Chung
Secretary

Houston, Texas
April 4, 2012

TARGA RESOURCES CORP.

1000 Louisiana Street

Suite 4300

Houston, Texas 77002

PROXY STATEMENT

2012 ANNUAL MEETING OF STOCKHOLDERS

The Board of Directors of the Company requests your Proxy for the Annual Meeting of Stockholders that will be held Friday, May 25, 2012, at 8:00 a.m. Central Time, at 1000 Louisiana Street, Suite 4300, Houston, TX 77002. By granting the Proxy, you authorize the persons named on the Proxy to represent you and vote your shares at the Annual Meeting. Those persons will also be authorized to vote your shares to adjourn the Annual Meeting from time to time and to vote your shares at any adjournments or postponements of the Annual Meeting.

If you attend the Annual Meeting, you may vote in person. If you are not present at the Annual Meeting, your shares may be voted only by a person to whom you have given a proper Proxy. You may revoke the Proxy in writing at any time before it is exercised at the Annual Meeting by delivering to the Secretary of the Company a written notice of the revocation, by submitting your vote electronically through the internet or by phone after the grant of the Proxy, or by signing and delivering to the Secretary of the Company a Proxy with a later date. Your attendance at the Annual Meeting will not revoke the Proxy unless you give written notice of revocation to the Secretary of the Company before the Proxy is exercised or unless you vote your shares in person at the Annual Meeting.

ELECTRONIC AVAILABILITY OF PROXY STATEMENT AND ANNUAL REPORT

As permitted under the rules of the Securities and Exchange Commission (the SEC), the Company is making this proxy statement and its Annual Report on Form 10-K available to its stockholders electronically via the internet. The Company is sending on or about April 6**,** 2012, a Notice Regarding the Availability of Proxy Materials (the Notice) to its stockholders of record as of the close of business on April 2, 2012, which Notice will include (i) instructions on how to access the Company s proxy materials electronically, (ii) the date, time and location of the Annual Meeting, (iii) a description of the matters intended to be acted upon at the Annual Meeting, (iv) a list of the materials being made available electronically, (v) instructions on how a stockholder can request to receive paper or e-mail copies of the Company s proxy materials, (vi) any control/identification numbers that a stockholder needs to access his or her proxy card and instructions on how to access the proxy card, and (vii) information about attending the Annual Meeting and voting in person.

Stockholders of Record and Beneficial Owners

Most of the Company s stockholders hold their shares through a broker, bank or other nominee rather than directly in their own name. As summarized below, there are some distinctions between shares held of record and those owned beneficially.

Stockholders of Record. If your shares are registered directly in your name with the Company s transfer agent, you are considered the stockholder of record with respect to those shares, and the Notice is being sent directly to you by our agent. As a stockholder of record, you have the right to vote by Proxy or to vote in person at the Annual Meeting. If you received a paper copy of the proxy materials by mail instead of the Notice, the proxy materials include a proxy card or a voting instruction card for the Annual Meeting.

Beneficial Owners. If your shares are held in a brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name, and the Notice will be forwarded to you by your broker or nominee. The broker or nominee is considered the stockholder of record with respect to those shares. As the beneficial owner, you have the right to direct your broker how to vote. Beneficial owners that receive the Notice by mail from the stockholder of record should follow the instructions included in the Notice to view the proxy statement and transmit voting instructions. If you received a paper copy of the proxy materials by mail instead of the Notice, the proxy materials include a proxy card or a voting instruction card for the Annual Meeting.

QUORUM AND VOTING

Voting Stock. The Company s common stock, par value $0.001 per share, is the only class of securities that entitles holders to vote generally at meetings of the Company s stockholders. Each share of common stock outstanding on the record date is entitled to one vote.

Record Date. The record date for stockholders entitled to notice of and to vote at the Annual Meeting was the close of business on April 2, 2012. As of the record date, 42,440,793 shares of common stock were outstanding and entitled to be voted at the Annual Meeting.

Quorum and Adjournments. The presence, in person or by Proxy, of the holders of a majority of the outstanding shares entitled to vote at the Annual Meeting is necessary to constitute a quorum at the Annual Meeting.

If a quorum is not present, a majority of the stockholders entitled to vote who are present in person or by Proxy at the Annual Meeting have the power to adjourn the Annual Meeting from time to time, without notice other than an announcement at the Annual Meeting, until a quorum is present. At any adjourned Annual Meeting at which a quorum is present, any business may be transacted that might have been transacted at the Annual Meeting as originally notified.

Vote Required. Directors will be elected by the affirmative vote of the holders of a plurality of the shares present and entitled to be voted at the Annual Meeting. Ratification of the selection of the Company s auditors will require the affirmative vote of the holders of a majority of the shares present and entitled to be voted at the Annual Meeting. An automated system that the Company s transfer agent administers will tabulate the votes. Brokers who hold shares in street name for customers are required to vote shares in accordance with instructions received from the beneficial owners. Brokers are permitted to vote on discretionary items if they have not received instructions from the beneficial owners, but they are not permitted to vote (a broker non-vote) on non-discretionary items absent instructions from the beneficial owner. Brokers do not have discretionary voting authority with respect to the election of directors. For ratification of the selection of the Company s auditors, brokers will have discretionary authority in the absence of timely instructions from their customers. Abstentions and broker non-votes will count in determining whether a quorum is present at the Annual Meeting. Neither abstentions nor broker non-votes will have any effect on the outcome of voting on director elections. For purposes of voting on the ratification of the selection of auditors, abstentions will be included in the number of shares voting and will have the effect of a vote against the proposal.

Default Voting. A Proxy that is properly completed and submitted will be voted at the Annual Meeting in accordance with the instructions on the Proxy. If you properly complete and submit a Proxy, but do not indicate any contrary voting instructions, your shares will be voted as follows:

FOR the election of the three persons named in this proxy statement as the Board of Directors nominees for election as Class II Directors.

FOR the ratification of the selection of PricewaterhouseCoopers LLP as the Company s auditors for 2012.

If any other business properly comes before the stockholders for a vote at the meeting, your shares will be voted in accordance with the discretion of the holders of the Proxy. The Board of Directors knows of no matters, other than those previously stated, to be presented for consideration at the Annual Meeting.

ITEM ONE

ELECTION OF DIRECTORS

The Board of Directors has nominated the following individuals for election as Class II Directors of the Company to serve for a three year term to expire in 2015 and until either they are reelected or their successors are elected and qualified:

In Seon Hwang

Joe Bob Perkins

Ershel C. Redd, Jr.

Messrs. Hwang, Perkins and Redd are currently serving as Directors of the Company. Their biographical information is contained in the Directors and Executive Officers section below.

The Board of Directors has no reason to believe that any of its nominees will be unable or unwilling to serve if elected. If a nominee becomes unable or unwilling to accept nomination or election, either the number of the Company s directors will be reduced or the persons acting under the Proxy will vote for the election of a substitute nominee that the Board of Directors recommends.

The Board of Directors unanimously recommends that stockholders vote FOR the election of each of the nominees.

DIRECTORS AND EXECUTIVE OFFICERS

After the Annual Meeting, assuming the stockholders elect the nominees of the Board of Directors as set forth in Item One - Election of Directors above, the Board of Directors of the Company will be, and the executive officers and other officers of the Company are:

Name	Age (1)	Position
Rene R. Joyce	64	Executive Chairman of the Board and Director
Joe Bob Perkins	51	Chief Executive Officer and Director
James W. Whalen	70	Advisor to Chairman & CEO and Director
Michael A. Heim	63	President and Chief Operating Officer
Jeffrey J. McParland	57	President-Finance and Administration
Roy E. Johnson	67	Executive Vice President
Paul W. Chung	51	Executive Vice President, General Counsel and Secretary
Matthew J. Meloy	34	Senior Vice President, Chief Financial Officer and Treasurer
John R. Sparger	58	Senior Vice President and Chief Accounting Officer
Charles R. Crisp	64	Director
In Seon Hwang	35	Director
Peter R. Kagan	43	Director
Chris Tong	55	Director
Ershel C. Redd Jr.	64	Director

(1) Ages as of February 17, 2012.

Rene R. Joyce has served as Executive Chairman of the Board of Targa Resources Corp. (the Company), the General Partner (the General Partner) of Targa Resources Partners LP (the Partnership) and TRI Resources Inc. (TRI) since January 1, 2012 and as a director of the Company since its formation on October 27, 2005 and of the General Partner since October 2006. Mr. Joyce previously served as Chief Executive Officer of the Company between October 27, 2005 and December 31, 2011, the General Partner between October 2006 and December 31, 2011 and TRI between February 2004 and December 31, 2011. He also served as director of TRI between 2004 and December 31, 2011 and was a consultant for the TRI predecessor company during 2003. He is also a member of the supervisory directors of Core Laboratories N.V. Mr. Joyce served as a consultant in the energy industry from 2000 through 2003 providing advice to various energy companies and investors regarding their operations, acquisitions and dispositions. Mr. Joyce served as President of onshore pipeline operations of Coral Energy, LLC, a subsidiary of Shell Oil Company (Shell) from 1998 through 1999 and President of energy services of Coral Energy Holding, L.P. (Coral), a subsidiary of Shell which was the gas and power marketing joint venture between Shell and Tejas Gas Corporation (Tejas), during 1999. Mr. Joyce served as President of various operating subsidiaries of Tejas, a natural gas pipeline company, from 1990 until 1998 when Tejas was acquired by Shell. As the founding Chief Executive Officer of TRI, Mr. Joyce brings deep experience in the midstream business, expansive knowledge of the oil and gas industry, as well as relationships with chief executives and other senior management at peer companies, customers and other oil and natural gas companies throughout the world. His experience and industry knowledge, complemented by an engineering and legal educational background, enable Mr. Joyce to provide the board with executive counsel on the full range of business, technical, and professional matters.

Joe Bob Perkins has served as Chief Executive Officer and director of the Company, the General Partner and TRI since January 1, 2012. Mr. Perkins previously served as President of the Company between the date of its formation on October 27, 2005 and December 31, 2011, of the General Partner between October 2006 and December 31, 2011 and of TRI between February 2004 and December 31, 2011. He was a consultant for the TRI predecessor company during 2003. Mr. Perkins was an independent consultant in the energy industry from 2002 through 2003 and was an active partner in RTM Media (an outdoor advertising firm) during a portion of such time period. Mr. Perkins served as President and Chief Operating Officer for the Wholesale Businesses, Wholesale Group and Power Generation Group of Reliant Resources, Inc. and its parent/predecessor companies,

from 1998 to 2002 and Vice President, Corporate Planning and Development, of Houston Industries from 1996 to 1998. He served as Vice President, Business Development, of Coral from 1995 to 1996 and as Director, Business Development, of Tejas from 1994 to 1995. Prior to 1994, Mr. Perkins held various positions with the consulting firm of McKinsey & Company and with an exploration and production company. Mr. Perkins intimate knowledge of all facets of the Company, derived from his service as President from its founding through 2011 and his current service as Chief Executive Officer and director, coupled with his broad experience in the oil and gas industry, and specifically in the midstream sector, his engineering and business educational background and his experience with the investment community enable Mr. Perkins to provide a valuable and unique perspective to the board on a range of business and management matters.

James W. Whalen has served as Advisor to Chairman and CEO of the Company, the General Partner and TRI since January 1, 2012 and as a director of the Company since its formation on October 27, 2005, of the General Partner since February 2007 and of TRI between 2004 and December 2010. Mr. Whalen previously served as Executive Chairman of the Board of the Company and TRI between October 25, 2010 and December 31, 2011 and of the General Partner between December 15, 2010 and December 31, 2011. He also served as President-Finance and Administration of the Company and TRI between January 2006 and October 2010 and the General Partner between October 2006 and December 2010 and for various Targa subsidiaries since November 2005. Between October 2002 and October 2005, Mr. Whalen served as the Senior Vice President and Chief Financial Officer of Parker Drilling Company. Between January 2002 and October 2002, he was the Chief Financial Officer of Diversified Diagnostic Products, Inc. He served as Chief Commercial Officer of Coral from February 1998 through January 2000. Previously, he served as Chief Financial Officer for Tejas from 1992 to 1998. Mr. Whalen brings a breadth and depth of experience as an executive, board member, and audit committee member across several different companies and in energy and other industry areas. His valuable management and financial expertise includes an understanding of the accounting and financial matters that the Partnership and industry address on a regular basis.

Michael A. Heim has served as President and Chief Operating Officer of the Company, the General Partner and TRI since January 1, 2012. Mr. Heim previously served as Executive Vice President and Chief Operating Officer of the Company between the date of its formation on October 27, 2005 and December 2011, of the General Partner between October 2006 and December 2011 and of TRI between April 2004 and December 2011 and was a consultant for the TRI predecessor company during 2003. Mr. Heim also served as a consultant in the energy industry from 2001 through 2003 providing advice to various energy companies and investors regarding their operations, acquisitions and dispositions. Mr. Heim served as Chief Operating Officer and Executive Vice President of Coastal Field Services, a subsidiary of The Coastal Corp. (Coastal) a diversified energy company, from 1997 to 2001 and President of Coastal States Gas Transmission Company from 1997 to 2001. In these positions, he was responsible for Coastal s midstream gathering, processing, and marketing businesses. Prior to 1997, he served as an officer of several other Coastal exploration and production, marketing and midstream subsidiaries.

Jeffrey J. McParland has served as President Finance and Administration of the Company and TRI since October 25, 2010 and of the General Partner since December 15, 2010. He has also served as a director of TRI since December 16, 2010. Mr. McParland served as Executive Vice President and Chief Financial Officer of the Company between October 27, 2005 and October 25, 2010 and of TRI between April 2004 and October 25, 2010 and was a consultant for the TRI predecessor company during 2003. He served as Executive Vice President and Chief Financial Officer of the General Partner between October 2006 and December 15, 2010 and served as a director of the General Partner from October 2006 to February 2007. Mr. McParland served as Treasurer of the Company from October 27, 2005 until May 2007, of the General Partner from October 2006 until May 2007 and of TRI from April 2004 until May 2007. Mr. McParland served as Secretary of TRI between February 2004 and May 2004, at which time he was elected as Assistant Secretary. Mr. McParland served as Senior Vice President, Finance of Dynegy Inc., a company engaged in power generation, the midstream natural gas business and energy marketing, from 2000 to 2002. In this position, he was responsible for corporate finance and treasury operations activities. He served as Senior Vice President, Chief Financial Officer and Treasurer of PG&E Gas Transmission,

a midstream natural gas and regulated natural gas pipeline company, from 1999 to 2000. Prior to 1999, he worked in various engineering and finance positions with companies in the power generation and engineering and construction industries.

Roy E. Johnson has served as Executive Vice President of the Company since its formation on October 27, 2005, of the General Partner since October 2006 and of TRI since April 2004 and was a consultant for the TRI predecessor company during 2003. Mr. Johnson also served as a consultant in the energy industry from 2000 through 2003 providing advice to various energy companies and investors regarding their operations, acquisitions and dispositions. He served as Vice President, Business Development and President of the International Group of Tejas from 1995 to 2000. In these positions, he was responsible for acquisitions, pipeline expansion and development projects in North and South America. Mr. Johnson served as President of Louisiana Resources Company, a company engaged in intrastate natural gas transmission, from 1992 to 1995. Prior to 1992, Mr. Johnson held various positions with a number of different companies in the upstream and downstream energy industry.

Paul W. Chung has served as Executive Vice President, General Counsel and Secretary of the Company since its formation on October 27, 2005, of the General Partner since October 2006 and of TRI since May 2004. Mr. Chung served as Executive Vice President and General Counsel of Coral from 1999 to April 2004; Shell Trading North America Company, a subsidiary of Shell, from 2001 to April 2004; and Coral Energy, LLC from 1999 to 2001. In these positions, he was responsible for all legal and regulatory affairs. He served as Vice President and Assistant General Counsel of Tejas from 1996 to 1999. Prior to 1996, Mr. Chung held a number of legal positions with different companies, including the law firm of Vinson & Elkins L.L.P.

Matthew J. Meloy has served as Senior Vice President, Chief Financial Officer and Treasurer of the Company and TRI since October 25, 2010 and of the General Partner since December 15, 2010. Mr. Meloy served as Vice President Finance and Treasurer of the Company and TRI between April 2008 and October 2010, and as Director, Corporate Development of the Company and TRI between March 2006 and March 2008 and of the General Partner between March 2006 and March 2008. He has served as Vice President Finance and Treasurer of the General Partner between April 2008 and December 15, 2010. Mr. Meloy was with The Royal Bank of Scotland in the structured finance group, focusing on the energy sector from October 2003 to March 2006, most recently serving as Assistant Vice President.

John R. Sparger has served as Senior Vice President and Chief Accounting Officer of the Company and TRI since January 2006 and of the General Partner since October 2006. Mr. Sparger served as Vice President, Internal Audit of the Company between October 2005 and January 2006 and of TRI between November 2004 and January 2006. Mr. Sparger served as a consultant in the energy industry from 2002 through September 2004, including TRI between February 2004 and September 2004, providing advice to various energy companies and entities regarding processes, systems, accounting and internal controls. Prior to 2002, he worked in various accounting and administrative positions with companies in the energy industry, audit and consulting positions in public accounting and consulting positions with a large international consulting firm.

Charles R. Crisp has served as a director of the Company since its formation on October 27, 2005 and of TRI between February 2004 and December 2010. Mr. Crisp was President and Chief Executive Officer of Coral Energy, LLC, a subsidiary of Shell Oil Company from 1999 until his retirement in November 2000, and was President and Chief Operating Officer of Coral from January 1998 through February 1999. Prior to this, Mr. Crisp served as President of the power generation group of Houston Industries and, between 1988 and 1996, as President and Chief Operating Officer of Tejas. Mr. Crisp is also a director of AGL Resources Inc., EOG Resources Inc. and IntercontinentalExchange, Inc. Mr. Crisp brings extensive energy experience, a vast understanding of many aspects of our industry and experience serving on the boards of other public companies in the energy industry. His leadership and business experience and deep knowledge of various sectors of the energy industry bring a crucial insight to the Board of Directors.

In Seon Hwang has served as a director of the Company since May 2006, of TRI between May 2006 and December 2010 and the General Partner since February 2011. Mr. Hwang is a Member and Managing Director of

Warburg Pincus LLC and a general partner of Warburg Pincus & Co., where he has been employed since 2004, and became a partner of Warburg Pincus & Co. in 2009. Prior to joining Warburg Pincus, Mr. Hwang worked at GSC Partners, a distressed investment firm, from 2002 until 2004, the M&A group at Goldman Sachs from 1998 to 2000, and the Boston Consulting Group from 1997 to 1998. He is also a director of Competitive Power Ventures, Omega Energia Renovavel S.A. and serves on the investment committee of Sheridan Production Partners LLC. Mr. Hwang was appointed as a director because certain investment funds managed by Warburg Pincus LLC, for whom Mr. Hwang is a managing director and member, previously controlled us through their ownership of securities in Targa Resources Corp. Mr. Hwang has significant experience with energy companies and investments and broad familiarity with the industry and related transactions and capital markets activity, which enhance his contributions to the Board of Directors.

Peter R. Kagan has served as a director of the Company since its formation on October 27, 2005, of the General Partner since February 2007 and of TRI between February 2004 and December 2010. Mr. Kagan is a member and Managing Director of Warburg Pincus LLC and a general partner of Warburg Pincus & Co., where he has been employed since 1997 and became a partner of Warburg Pincus & Co. in 2002. He is also a member of Warburg Pincus Executive Management Group. He is also a director of Antero Resources Corporation, Broad Oak, Canbriam Energy, Fairfield Energy Limited, Laredo Petroleum and MEG Energy Corp. Mr. Kagan was appointed as a director because certain investment funds managed by Warburg Pincus LLC, for whom Mr. Kagan is a managing director and member, previously controlled us through their ownership of securities in Targa Resources Corp. Mr. Kagan has significant experience with energy companies and investments and broad familiarity with the industry and related transactions and capital markets activity, which enhance his contributions to the Board of Directors.

Chris Tong has served as a director of the Company since January 2006 and of TRI between January 2006 and December 2010. Mr. Tong is a director of Cloud Peak Energy Inc. and Kosmos Energy Ltd. He served as Senior Vice President and Chief Financial Officer of Noble Energy, Inc. from January 2005 until August 2009. He also served as Senior Vice President and Chief Financial Officer for Magnum Hunter Resources, Inc. from August 1997 until December 2004. Prior thereto, he was Senior Vice President of Finance of Tejas Acadian Holding Company and its subsidiaries, including Tejas Gas Corp., Acadian Gas Corporation and Transok, Inc., all of which were wholly-owned subsidiaries of Tejas Gas Corporation. Mr. Tong held these positions from August 1996 until August 1997, and had served in other treasury positions with Tejas since August 1989. Mr. Tong brings a breadth and depth of experience as a chief financial officer in the energy industry, a financial executive, a director of other public companies and a member of other audit committees. He brings significant financial, capital markets and energy industry experience to the board and in his position as the Chairman of our Audit Committee.

Ershel C. Redd Jr. has served as a director of the Company since February 2011. Mr. Redd has served as a consultant in the energy industry since 2008 providing advice to various energy companies and investors regarding their operations, acquisitions and dispositions. Mr. Redd was President and Chief Executive Officer of El Paso Electric Company, a public utility company, from May 2007 until March 2008. Prior to this, Mr. Redd served in various positions with NRG Energy, Inc., a wholesale energy company, including as Executive Vice President Commercial Operations from October 2002 through July 2006, as President Western Region from February 2004 through July 2006, and as a director between May 2003 and December 2003. On May 14, 2003, NRG filed for protection under Chapter 11 of the Federal Bankruptcy Code. On November 24, 2003, NRG s Chapter 11 Plan of Reorganization was confirmed. Mr. Redd served as Vice President of Business Development for Xcel Energy Markets, a unit of Xcel Energy Inc., from 2000 through 2002, and as President and Chief Operating Officer for New Century Energy s (predecessor to Xcel Energy Inc.) subsidiary, Texas Ohio Gas Company, from 1997 through 2000. Mr. Redd brings to the Company extensive energy industry experience, a vast understanding of varied aspects of the energy industry and experience in corporate performance, marketing and trading of natural gas and natural gas liquids, risk management, finance, acquisitions and divestitures, business development, regulatory relations and strategic planning. His leadership and business experience and deep knowledge of various sectors of the energy industry bring a crucial insight to the Board of Directors.

MEETINGS AND COMMITTEES OF DIRECTORS

Board of Directors

Our Board of Directors consists of eight members. The board reviewed the independence of our directors using the independence standards of the New York Stock Exchange (NYSE) and various other factors discussed under Director Independence, and, based on this review, determined that Messrs. Crisp, Hwang, Kagan, Redd and Tong are independent within the meaning of the NYSE listing standards currently in effect. The board held nine meetings during 2011, and its independent directors met in executive session three times during 2011. During 2011, each of the directors attended at least 75% of the aggregate of the total number of meetings of the board and the total number of meetings of all committees of the board on which that director served.

Our directors are divided into three classes serving staggered three-year terms. Class I, Class II and Class III directors will serve until our annual meetings of stockholders in 2014, 2012 and 2013, respectively. The Class I directors are Messrs. Crisp and Whalen, the Class II directors are Messrs. Hwang, Perkins and Redd and the Class III directors are Messrs. Kagan, Tong and Joyce. At each annual meeting of stockholders, directors will be elected to succeed the class of directors whose terms have expired. This classification of our Board of Directors could have the effect of increasing the length of time necessary to change the composition of a majority of the Board of Directors. In general, at least two annual meetings of stockholders will be necessary for stockholders to effect a change in a majority of the members of the Board of Directors.

Committees of the Board of Directors

Our Board of Directors has four standing committees - an Audit Committee, a Compensation Committee, a Nominating and Governance Committee and a Conflicts Committee - and may have such other committees as the Board of Directors shall determine from time to time. Each of the standing committees of the Board of Directors has the composition and responsibilities described below.

Audit Committee

The members of our Audit Committee are Messrs. Tong, Crisp and Redd. Mr. Tong is the Chairman of this committee. Our Board of Directors has affirmatively determined that Messrs. Crisp, Redd and Tong are independent as described in the rules of the NYSE and the Securities Exchange Act of 1934, as amended (the Exchange Act). Our Board of Directors has also determined that, based upon relevant experience, Mr. Tong is an audit committee financial expert as defined in Item 407 of Regulation S-K of the Exchange Act.

This committee oversees, reviews, acts on and reports on various auditing and accounting matters to our Board of Directors, including: the selection of our independent accountants, the scope of our annual audits, fees to be paid to the independent accountants, the performance of our independent accountants and our accounting practices. In addition, the Audit Committee oversees our compliance programs relating to legal and regulatory requirements. We have adopted an Audit Committee charter defining the committee s primary duties in a manner consistent with the rules of the SEC and NYSE or market standards that is posted on the Company s website at *www.targaresources.com*. The Audit Committee held four meetings during 2011.

Compensation Committee

The members of our Compensation Committee are Messrs. Crisp, Hwang and Kagan. Mr. Crisp is the Chairman of this committee. This committee establishes salaries, incentives and other forms of compensation for officers and other employees. Our Compensation Committee also administers our incentive compensation and benefit plans. We have adopted a Compensation Committee charter defining the committee s primary duties in a manner consistent with the rules of the SEC and NYSE or market standards that is posted on the Company s website at *www.targaresources.com*. The Compensation Committee held seven meetings during 2011.

Nominating and Governance Committee

The members of our Nominating and Governance Committee are Messrs. Kagan, Redd and Tong. Mr. Kagan is the Chairman of this committee. This committee identifies, evaluates and recommends qualified nominees to serve on our Board of Directors, develops and oversees our internal corporate governance processes and maintains a management succession plan. We have adopted a Nominating and Governance Committee charter defining the committee s primary duties in a manner consistent with the rules of the SEC and NYSE or market standards that is posted on the Company s website at *www.targaresources.com*. The Nominating and Governance Committee held three meetings during 2011.

In evaluating the director candidates, the Nominating and Governance Committee assesses whether a candidate possesses the integrity, judgment, knowledge, experience, skills and expertise that are likely to enhance the board s ability to manage and direct the affairs and business of the Company, including, when applicable, to enhance the ability of committees of the board to fulfill their duties.

Conflicts Committee

The members of our Conflicts Committee are Messrs. Crisp, Redd and Tong. Mr. Tong is the Chairman of this committee. This Committee reviews matters of potential conflicts of interest, as directed by our Board of Directors. We adopted a Conflicts Committee charter defining the committee s primary duties that is posted on the Company s website at *www.targaresources.com*. The Conflicts Committee did not meet during 2011.

EXECUTIVE COMPENSATION AND OTHER INFORMATION

Compensation Discussion and Analysis

The following discussion and analysis contains statements regarding our and our executive officers future performance targets and goals. These targets and goals are disclosed in the limited context of our compensation programs and should not be understood to be statements of management s expectations or estimates of results or other guidance.

Overview

Compensatory arrangements with our executive officers identified in the Summary Compensation Table (named executive officers) are approved by the Compensation Committee (the Compensation Committee) of our Board of Directors. The Compensation Committee is responsible for overseeing the development of an executive compensation philosophy, strategy, framework and individual compensation elements for our named executive officers based on our business priorities.

The following Compensation Discussion and Analysis describes the material elements of compensation for our named executive officers as determined by the Compensation Committee.

Compensation Philosophy

The Compensation Committee believes that total compensation of executives should be competitive with the market in which we compete for executive talent which encompasses not only midstream natural gas companies, but also other energy industry companies as described in The Role of Peer Groups and Benchmarking below. The following compensation objectives guide the Compensation Committee in its deliberations about executive compensation matters:

- provide a competitive total compensation program that enables us to attract and retain key executives;
- ensure an alignment between our strategic and financial performance and the total compensation received by our named executive officers;
- provide compensation for performance that reflects individual and company performance both in absolute terms and relative to our peer group;
- ensure a balance between short-term and long-term compensation while emphasizing at-risk or variable, compensation as a valuable means of supporting our strategic goals and aligning the interests of our named executive officers with those of our shareholders; and
- ensure that our total compensation program supports our business objectives and priorities.

Consistent with this philosophy and compensation objectives, we do not pay for perquisites for any of our named executive officers, other than minimal parking subsidies.

The Role of Peer Groups and Benchmarking

When evaluating compensation levels for each named executive officer, the Compensation Committee reviews publicly available compensation data for executives in our peer group and compensation surveys and uses that information to set compensation levels for each named executive officer in the context of their roles and levels of responsibility, accountability and decision-making authority. While compensation data from other companies is considered, the Compensation Committee and senior management do not attempt to set compensation components to meet specific benchmarks, such as salaries above the median or total compensation at the 50th percentile. The peer company data that is reviewed by senior management and the Compensation Committee is simply one factor out of many that is used in connection with the establishment of

the compensation for our officers. The other factors considered include, but are not limited to, (i) available compensation data about rankings and comparisons, (ii) effort and accomplishment on a group and individual basis, (iii) challenges faced and challenges overcome, (iv) unique skills, (v) contribution to the management team and (vi) the perception of both the Board of Directors and the Compensation Committee of performance relative to expectations and actual market/business conditions. All of these factors, including peer company data, are utilized in a subjective assessment of each year s decisions relating to annual cash incentives, long-term incentives and base compensation changes with a view towards total compensation and pay-for-performance.

The peer group reviewed by the Compensation Committee in consultation with senior management for compensation comparison includes midstream master limited partnerships (MLPs) and other energy companies to better reflect the market for executive talent in the energy industry. Because many companies in the peer group are larger than the Company as measured by market capitalization and total assets, with the assistance of BDO USA, LLP (BDO), a compensation consultant engaged by the Compensation Committee, compensation data for the peer companies is analyzed using multiple regression analysis to develop a prediction of the total compensation that peer companies of comparable size to the Company would offer similarly-situated executives. This regressed data is then weighted as follows to develop a reference point for judging the adequacy of executive pay at the Company: MLPs (given a 70% weighting), exploration and production companies (E&Ps) (given a 15% weighting) and utility companies (given a 15% weighting). The peer group companies in each of the three categories are:

MLP peer companies: Atlas Pipeline Partners, L.P., Copano Energy, L.L.C., Crosstex Energy, LP, DCP Midstream Partners, LP, Enbridge Energy Partners LP, Energy Transfer Partners, LP, Enterprise Products Partners LP, Magellan Midstream Partners, LP, MarkWest Energy Partners, LP, NuStar Energy LP, ONEOK Partners, LP, Regency Energy Partners LP and Williams Partners LP.

E&P peer companies: Apache Corporation, Anadarko Petroleum Corporation, Cabot Oil & Gas Corp., Cimarex Energy Co., Denbury Resources Inc., Devon Energy Corporation, EOG Resources Inc., Murphy Oil Corp., Newfield Exploration Co., Noble Energy Inc., Penn Virginia Corp., Petrohawk Energy Corp., Pioneer Natural Resources Co., Southwestern Energy Co. and Ultra Petroleum Corp.

Utility peer companies: Centerpoint Energy Inc., Dominion Resources Inc., El Paso Corp., Enbridge Inc., EQT Corp., National Fuel Gas Co., NiSource Inc., ONEOK Inc., Questar Corp., Sempra Energy, Spectra Energy Co., Southern Union Co., TransCanada Corporation and Williams Companies Inc.

Senior management and the Compensation Committee review our compensation practices and peer companies on at least an annual basis.

Role of Senior Management in Establishing Compensation for Named Executive Officers

Typically, under the direction of the Compensation Committee, senior management consults with BDO, the compensation consultant engaged by the Compensation Committee, and reviews market data and evaluates relevant compensation levels and compensation program elements. Based on these consultations and assessment of performance relative to key business priorities, senior management submits emerging conclusions and subsequently a proposal to the Chairman of the Compensation Committee. The proposal includes a recommendation of base salary, annual bonus and new long-term compensation to be paid or awarded to executive officers and employees. The Chairman of the Compensation Committee reviews and discusses the proposal with senior management and the compensation consultant and may discuss it with the other members of the Compensation Committee, other board members, or the full boards of the Company and Targa Resources GP LLC and may request that senior management provide him with additional information or reconsider or revise the proposal. The resulting recommendation is then submitted to the Compensation Committee for consideration, which also meets separately with the compensation consultant. The final compensation decisions are reported to the Board.

Our senior management has no other role in determining compensation for our named executive officers, although the Compensation Committee may delegate the approval of award grants and other transactions and responsibilities regarding the administration of compensatory programs to the Chairman of the Board of Directors or the Chief Executive Officer, provided that such administration and approval of awards does not apply for our Section 16 officers. Our executive officers are delegated the authority and responsibility to determine the compensation for all other employees.

Elements of Compensation for Named Executive Officers

The elements of compensation for our named executive officers consist of the following: (i) annual base salary; (ii) discretionary annual cash bonus awards; (iii) long-term incentive awards, consisting of performance awards under the Partnership s long-term incentive plan and awards under our stock incentive plan; (iv) contributions under our 401(k) and profit sharing plan; (v) participation in our health and welfare plans on the same basis as all of our other employees; and (vi) participation in a change in control-related severance plan.

Base Salary. The base salaries for our named executive officers are set and reviewed annually by the Compensation Committee. The salaries are intended to provide fixed compensation based on historical salaries paid to our named executive officers for services rendered to us, market data on compensation paid to similarly situated executives and responsibilities and performance of our named executive officers.

Annual Cash Incentives. The discretionary annual cash bonus awards available to our named executive officers provide an opportunity to supplement annual base salary based on performance so that, on a combined basis, the annual cash compensation opportunity yields competitive cash compensation levels and drives performance in support of our business strategies. It is our general policy to pay these incentive awards prior to the end of the first quarter of the fiscal year following the fiscal year to which they related. The payment of individual cash bonuses to executive management, including our named executive officers, is subject to the sole discretion of the Compensation Committee.

The discretionary annual cash awards are designed to reward our employees for contributions towards our achievement of financial and operational business priorities (including business priorities of the Partnership) approved by the Compensation Committee and to aid us in retaining and motivating employees. These priorities are not objective in nature they are subjective and performance in regard to these priorities is ultimately evaluated by the Compensation Committee in its sole discretion. As such, success does not depend on achieving a particular target; rather, success is evaluated based on past norms, expectations and unanticipated obstacles or opportunities that arise. For example, hurricanes and deteriorating or changing market conditions may alter the priorities initially established by the Compensation Committee such that certain performance that would otherwise be deemed a negative may, in context, be a positive result. This subjectivity allows the Compensation Committee to account for the full industry and economic context of our actual performance or that of our personnel. The Compensation Committee considers all strategic priorities and reviews performance against the priorities and context but does not assign specific weightings to the strategic priorities in advance.

A discretionary cash bonus pool is recommended by our senior management and approved by the Compensation Committee annually based on our achievement of certain strategic, financial and operational objectives. Near or following the end of each year, senior management recommends to the Compensation Committee the total amount of cash to be allocated to the bonus pool based upon our overall performance relative to these objectives. Following receipt of our senior management s recommendation, the Compensation Committee, in its sole discretion, determines the total amount of cash to be allocated to the bonus pool. Additionally, the Compensation Committee, in its sole discretion, determines the amount of the cash bonus awards to each of our executive officers, including the CEO. The executive officers determine the amount of the cash bonus pool to be allocated to our departments, groups and employees (other than our executive officers) based on performance and on the recommendation of supervisors, managers and line officers.

Long-Term Incentive Awards: Stock Incentive Plan and Partnership Long-Term Incentive Plan Awards. In connection with our initial public offering in December 2010 (the IPO), we adopted the 2010 Stock Incentive Plan (the Stock Incentive Plan) under which we may grant to the named executive officers, other key employees, consultants and directors certain awards, including restricted stock, bonus stock and performance awards. The Stock Incentive Plan provides for discretionary grants of the following types of awards: (a) incentive stock options qualified as such under U.S. federal income tax laws, (b) stock options that do not qualify as incentive stock options, (c) phantom stock awards, (d) restricted stock awards, (e) performance awards, (f) bonus stock awards, or (g) any combination of such awards, although we are currently utilizing only restricted stock and bonus stock awards. The maximum aggregate number of shares of our common stock that may be granted in connection with awards under the Stock Incentive Plan is 5 million, of which approximately 1.9 million shares were awarded in connection with our IPO. The Stock Incentive Plan awards are granted on such terms and conditions and at such purchase price (if any) determined by the Compensation Committee and may, but need not be, subject to performance criteria, objectives, or forfeiture. Additional details relating to shares of restricted stock and bonus stock granted under the Stock Incentive Plan are included below under Application of Compensation Elements Equity Ownership Generally and Outstanding Equity Awards at 2011 Fiscal Year-End.

We may grant to the named executive officers and other key employees performance unit awards under the Partnership s long-term incentive plan linked to the performance of the Partnership s common units, with the amounts vesting under such awards dependent on the Partnership s performance compared to a peer-group consisting of the Partnership and other publicly traded partnerships. These awards, which may be settled in cash or equity, are designed to further align the interests of the named executive officers and other key employees with those of the Partnership s equity holders. Additional details relating to our peer group applicable to LTIP awards payouts are included below under Application of Compensation Elements Long-Term Incentive Awards.

Awards to our named executive officers under the Stock Incentive Plan and Partnership s long-term incentive plan are made near or following the end of each year. For 2011, the long-term incentive component of compensation was allocated approximately twenty-five percent to restricted stock awards under the Stock Incentive Plan and seventy-five percent to equity settled performance unit awards under the Partnership s long-term incentive plan.

Retirement Benefits. We offer eligible employees a Section 401(k) tax-qualified, defined contribution plan (the 401(k) Plan) to enable employees to save for retirement through a tax-advantaged combination of employee and Company contributions and to provide employees the opportunity to directly manage their retirement plan assets through a variety of investment options. Our employees, including our named executive officers, are eligible to participate in our 401(k) Plan and may elect to defer up to 30% of their annual compensation on a pre-tax basis and have it contributed to the plan or contribute such amount on a post-tax basis via a Roth contribution, subject to certain limitations under the Internal Revenue Code of 1986, as amended (the Code). In addition, we make the following contributions to the 401(k) Plan for the benefit of our employees, including our named executive officers: (i) 3% of the employee s eligible compensation; and (ii) an amount equal to the employee s contributions to the 401(k) Plan up to 5% of the employee s eligible compensation. We may also make discretionary contributions to the 401(k) Plan for the benefit of employees depending on our performance. Contributions made by the Company may be subject to certain limitations under the Code for certain employees.

Health and Welfare Benefits. All full-time employees, including our named executive officers, may participate in our health and welfare benefit programs, including medical, health, life insurance and dental coverage and disability insurance.

Perquisites. It is the Compensation Committee s policy not to pay for perquisites for any of our named executive officers, other than minimal parking subsidies.

Severance and Change in Control Benefits. We maintained the Targa Resources Officer Change in Control Severance Program (the Officer Change in Control Program) during the 2011 year for certain officers and key employees other than executive officers. Mr. Meloy was the only named executive officer that met the criteria of an officer under the Officer Change in Control Program and participated in this plan during the 2011 year. Following the 2011 year, we adopted the Targa Resources Executive Officer Change in Control Severance Program (the Executive Change in Control Program) for our executive officers. Mr. Meloy and the other named executive officers will now participate in the Executive Change in Control Program during the 2012 calendar year. The two plans are similar in the fact that they provide for certain severance payments in the event that a participant incurs a qualifying termination within an eighteen month period following a change in control, although the amounts payable will differ between participants and plans. For more details on the terms and conditions of each of these plans, as well as the potential payment that would have been due to Mr. Meloy in the 2011 year under the Officer Change in Control Program, please see the section below under Potential Payments Upon Termination or Change in Control.

Relation of Compensation Elements to Compensation Philosophy

Our named executive officers, other executives and Section 16 officers and directors, through a combination of personal investment and equity grants, own approximately 11.2% of our fully diluted equity. Based on our named executive officers ownership interests in us and their direct ownership of the Partnership s common units, they own, directly and indirectly, approximately 0.4% of the Partnership s limited partner interests. The Compensation Committee believes that the executive officers ownership interests and the elements of the annual compensation programs available to them align the interests of the executive officers and investors and drive the officers performance in support of our and the Partnership s business strategies.

Application of Compensation Elements

Base Salary. Base salaries for our named executive officers have been established based on historical levels for these officers, taking into consideration officer salaries in our peer group and the value of the total compensation opportunities available to our executive officers including the long-term equity component of our compensation program. During 2010, the Compensation Committee engaged BDO to conduct a new review of executive and key employee compensation to help it assure that compensation goals were being met and that the most recent trends in compensation were appropriately considered. The compensation review indicated that the compensation for our named executive officers was not consistent with compensation paid at MLP peer companies or with our expanded peer group generally when the data is adjusted for company size. In order to begin closing this gap in compensation, the Compensation Committee authorized increases in base salary for our executive officers in 2010 and the Compensation Committee authorized the following increased base salaries for our named executive officers effective April 1, 2011.

	Effective April 1, 2011	Prior Salary
Rene R. Joyce	$ 547,000	$ 475,000
Joe Bob Perkins	468,000	412,000
James W. Whalen	468,000	412,000
Michael A. Heim	415,000	369,000
Matthew J. Meloy	235,000	207,500

Annual Cash Incentives. The Compensation Committee approved our 2011 Annual Incentive Plan (the Bonus Plan) in February 2011. The funding of the cash bonus pool and the payment of individual cash bonuses to executive management, including our named executive officers, are subject to the sole discretion of the Compensation Committee and will generally be determined near or following the end of the year to which the bonus relates. The target amount of the cash bonus pool is determined by summing, on an employee by employee basis, the product of base salaries and market-based target bonus percentages that generally range from 6.0% to

100% of each participant s base salary. For 2011 bonus pool funding purposes, the percentage of salary that was set as the target amount for each named executive officer s bonus was as follows: Mr. Joyce, 100%; Messrs. Perkins, Whalen and Heim, 80%, and Mr. Meloy, 40%.

The CEO and the Compensation Committee relied on compensation consultants and market data from peer companies and broader industry compensation practices to establish the threshold, target and maximum percentage levels, which are generally consistent with both peer company and broader energy compensation practices. The Compensation Committee, after consultation with the CEO, established the following overall threshold, target and maximum levels for the Company s bonus pool: 50% of the cash bonus pool would be funded in the event that the Compensation Committee determined that our business priorities had been met for the year at a threshold level; 100% for the target level and 200% for the maximum level. The Compensation Committee approved the following eight key business priorities to be considered when funding the bonus pool and making awards under the 2011 Bonus Plan: (i) continue to control all operating, capital and general and administrative costs, (ii) invest in our businesses, (iii) continue priority emphasis and strong performance relative to a safe workplace, (iv) reinforce business philosophy and mindset that promotes compliance with all aspects of our business including environmental and regulatory compliance, (v) continue to manage tightly credit, inventory, interest rate and commodity price exposures, (vi) execute on major capital and development projects, such as finalizing negotiations, completing projects on time and on budget, and optimizing economics and capital funding, (vii) pursue selected growth opportunities, including new gathering and processing build-outs leveraging our NGL logistics platform for development projects, other fee-based capital expenditure projects and potential purchases of strategic assets and (viii) execute on all business dimensions to maximize value and manage risks.

In January 2012, the Compensation Committee approved a cash bonus pool equal to 200% of the target level for the employee group, including our named executive officers, under the Bonus Plan for performance during 2011 in recognition of outstanding efforts and organizational performance. The Compensation Committee determined to pay these above-target level bonuses because it considered overall performance, including organizational performance, to have substantially exceeded expectations in 2011 based on the eight key business priorities it established for 2011. The Compensation Committee considered or subjectively evaluated (rather than measured) organizational performance by reviewing the apparent overall performance of our personnel with respect to the initial and subsequent business priorities relative to both the overall and management-specific performance expectations of the Compensation Committee, each on an absolute level and relative to the Compensation Committee s sense of peer performance. This subjective assessment that performance substantially exceeded expectations was based on a qualitative evaluation rather than a mechanical, quantitative determination of results across each of the key business priorities. Aspects of performance important to this qualitative determination included (i) very strong execution on financial performance, (ii) outstanding pursuit and capture of growth projects, (iii) recent and ongoing capital projects completed or being completed on time and on budget and (iv) strong safety and environmental performance and record and corporate philosophy to promote and maintain safe working conditions as represented by safety awards and industry recognition. This subjective evaluation that performance had substantially exceeded expectations occurred with the background and ongoing context of detailed board and committee refinements of the 2011 business priorities both before the beginning of and during the year, continued board and committee discussion and active dialogue with management about priorities and performance, including routine reports sent to the board or the committee and presentations and discussions in subsequent board and committee meetings, and further board and committee discussion of performance relative to expectations near the end and following the end of 2011. The extensive business and board experience of the Compensation Committee and of our Board of Directors provides the perspective to make this subjective assessment in a qualitative manner and to evaluate management performance overall and the performance of the executive officers.

With respect to Mr. Meloy s bonus payment, the Compensation Committee determined that a performance multiplier of 1.25x should be applied to Mr. Meloy s target bonus amount for the year, which is a similar multiple to the multiple used for other higher performing employees, based on his 2011 contribution in his first

full year as the Chief Financial Officer. All other executives recommended and received a 1.0x multiplier equivalent to the average of the bonus pool. The named executive officers received the following bonus awards, which are equivalent to 200% of each individual s target bonus amount and reflects a 1.25x multiplier for Mr. Meloy and a 1.0x multiplier for the other named executives officers as previously discussed:

Rene R. Joyce	$ 1,094,000
Joe Bob Perkins	748,800
James W. Whalen	748,800
Michael A. Heim	664,000
Matthew J. Meloy	235,000

In addition to the cash bonus awards approved under the Bonus Plan, in February 2011, the Compensation Committee approved an aggregate cash bonus pool of $1.5 million for our executive officers and two other employees in recognition of their role in extraordinary execution of the business priorities, completion of drop downs to the Partnership and clarification of our strategic direction in 2010.

Equity Ownership Generally. Prior to the closing of our IPO, we used both stock options and restricted stock to compensate our employees, including our named executive officers. Based on recommendations by our compensation consultant after completing its compensation review for 2010**,** we have recently awarded, and we expect future awards under our incentive plans to consist primarily of, restricted stock, restricted units and performance based awards of restricted stock or units or cash-settled performance units (rather than stock options or unit options). In connection with our IPO, our employees, including the named executive officers, were granted an aggregate of approximately 1.9 million shares of restricted stock and bonus stock under the Stock Incentive Plan.

Long-Term Incentive Awards. On February 14, 2011, our named executive officers were awarded restricted common stock of the Company under our Stock Incentive Plan that will vest in three years from the grant date as follows: 7,690 shares to Mr. Joyce, 4,250 shares to Mr. Perkins, 4,250 shares to Mr. Whalen, 3,770 shares to Mr. Heim, and 1,260 shares to Mr. Meloy.

On February 17, 2011, our named executive officers were awarded equity-settled performance units under the Partnership s long-term incentive plan that will vest in June 2014 as follows: 21,110 performance units to Mr. Joyce, 11,690 performance units to Mr. Perkins, 11,690 performance units to Mr. Whalen, 10,360 performance units to Mr. Heim, and 3,470 performance units to Mr. Meloy. These performance unit awards will be settled by the issuance of an equivalent number of Partnership common units at the time of vesting plus associated distributions over the three year period multiplied by a performance vesting percentage which may be zero or range from 25% to 150%. This equity settlement value of each unit may be higher or lower than the Partnership common unit price at the time of the grant. If the Partnership s performance equals or exceeds the performance for the 25th percentile of the peer group but is less than or equal to the 50th percentile of the group, then 25% to 100% of the award will vest**.** If the Partnership s performance equals or exceeds the performance for the 50th percentile of the group but is less than or equal to the 75th percentile of the group, then 100% to 150% of the award will vest. The vesting between the 25th percentile and the 50th percentile will be done on an interpolated basis between 25% and 100% and the vesting between the 50th percentile and 75th percentile will be done on an interpolated basis between 100% and 150%. If the Partnership s performance is above the performance of the 75th percentile of the group, the performance percentage will be 150% of the award. If the Partnership s performance is below the performance of the 25th percentile of the group, the performance percentage will be zero. The performance period for these performance unit awards began on June 30, 2011 and ends on June 30, 2014. The Partnership s peer group companies for purposes of our long-term incentive awards for 2011 were: Copano, Crosstex, DCP Midstream, Enbridge Energy Partners, Energy Transfer Partners, Magellan Midstream, MarkWest Energy Partners, Martin Midstream, ONEOK Partners, Plains All American Pipeline, Regency Energy Partners, Targa Resources Partners LP and Williams Energy Partners.

Set forth below is the performance for the median of the peer group for each of the 2011 equity-settled performance unit grants and a comparison of the Partnership s performance to the peer group as of December 31, 2011:

	Performance (1)		
Grant	**Peer Group Median**	**Partnership**	**Partnership Position (2)**
2011 Performance Units	8.6%	10.7%	Second Quartile (6 of 13)

1) Total return measured by (i) subtracting the average closing price per share/unit for the first ten trading days of the performance period (the Beginning Price) from the sum of (a) the average closing price per share/unit for the last ten trading days ending on the date that is 15 days prior to the end of the performance period plus (b) the aggregate amount of dividends/distributions paid with respect to a share/unit during such period (the result being referred to as the Value Increase) and (ii) dividing the Value Increase by the Beginning Price. The performance period for the 2011 awards begins on June 30, 2011, and all awards end on the third anniversary of such date.

2) Award level based on Partnership Position and linear interpolation as described above.

In January 2009 and in December 2009, we granted our executive officers cash-settled performance unit awards linked to the performance of the Partnership s common units that will vest in June of 2012 and June of 2013, respectively, with the amounts vesting under such awards dependent on the Partnership s performance compared to a peer-group consisting of the Partnership and other publicly traded partnerships. The Partnership s peer group companies for purposes of the long-term incentive awards made in 2009 is the same peer group used for the equity settled performance units awarded to our executives in 2011.

Severance and Change in Control Benefits. Certain of our equity compensation award agreements contain a single trigger for accelerated vesting of equity awards, which means vesting accelerates upon our change in control irrespective of whether the officer is terminated. We also have certain change-of-control severance plans (the Officer Change in Control Program and the Executive Change in Control Program) that provide for post-termination payments following a qualifying termination in connection with a change in control event, or what is commonly referred to as a double trigger benefit. We believe that these provisions create important retention tools for us, as providing for accelerated vesting of equity awards upon a change in control enables employees to realize value from these awards in the event that we undergo a change in control transaction, while post-termination payments provide employees with value in the event of certain terminations of employment that were beyond their control. In addition, we believe that these benefits may, in part, mitigate some of the potential uncertainty created by a potential or actual change in control transaction, including future employment of the named executive officers. We believe that change in control protections allows management to focus on the business transaction at hand without any distractions regarding the effects of a change in control. Likewise, post-termination payments allow management to focus on making the objective business decisions that are in the interest of our company. Further, we believe that such protections encourage the named executive officers to review objectively any proposed transaction in determining whether such proposed transaction is in the best interest of our shareholders, whether or not the executive will continue to be employed. Executive officers at other companies in our industry and the general market against which we compete for executive talent commonly have equity compensation plans that provide for accelerated vesting upon a change in control event of that company and post-termination payments, and we intend to provide this benefit to the named executive officers in order to remain competitive in attracting and retaining skilled professionals in our industry.

Changes for 2012

Base Salary. The Compensation Committee authorized, and executive management will implement, the following increased base salaries for our named executive officers effective March 1, 2012:

	Effective March 1, 2012	Current Salary
Rene R. Joyce	$ 560,000	$ 547,000
Joe Bob Perkins	480,000	468,000
James W. Whalen	480,000	468,000
Michael A. Heim	460,000	415,000
Matthew J. Meloy	275,000	235,000

Annual Cash Incentives. In preparing the Company s business plan for 2012, senior management developed and proposed a set of strategic priorities to the Compensation Committee. In January 2012, the Compensation Committee approved our 2012 Annual Incentive Compensation Plan (the 2012 Bonus Plan), the cash bonus plan for performance during 2012, and established the following nine key business priorities: (i) continue to control all operating, capital and general and administrative costs, (ii) invest in our businesses, (iii) continue priority emphasis and strong performance relative to a safe workplace, (iv) reinforce business philosophy and mindset that promotes compliance with all aspects of our business including environmental and regulatory compliance, (v) continue to manage tightly credit, inventory, interest rate and commodity price exposures, (vi) execute on major capital and development projects, such as finalizing negotiations, completing projects on time and on budget, and optimizing economics and capital funding, (vii) pursue selected growth opportunities, including new gathering and processing build-outs, fee-based capital expenditure projects and potential purchases of strategic assets, (viii) pursue commercial and financial approaches to achieve maximum value and manage risks and (ix) execute on all business dimensions, including the financial business plan. The Compensation Committee also established the following overall threshold, target and maximum levels for the Company s bonus pool: 50% of the cash bonus pool will be funded in the event that the Compensation Committee determines that our business priorities have been met for the year at a threshold level; 100% for the target level and 200% for the maximum level. As with the Bonus Plan, funding of the cash bonus pool and the payment of individual cash bonuses to executive management, including our named executive officers, are subject to the sole discretion of the Compensation Committee.

For 2012, pursuant to our annual incentive plan and in accordance with prior approval by the Compensation Committee, each executive s target amount is set as a percentage of his annual base salary. Mr. Joyce s target amount is set at 100% and Messrs. Perkins, Whalen and Heim s target amount is set at 80%. Mr. Meloy s target amount was 40% for 2011. In January 2012 the Compensation Committee decided to increase Mr. Meloy s target amount to 50% to recognize his increased responsibilities as the Chief Financial Officer. Other than Mr. Meloy, the 2012 bonus targets for the named executive officers are the same levels that were utilized for the 2011 year.

Long-Term Incentive Awards. On January 12, 2012, our named executive officers were awarded restricted common stock of the Company under our stock incentive plan for the 2012 compensation cycle that will vest in three years from the grant date as follows: 6,565 shares to Mr. Joyce, 5,035 shares to Mr. Perkins, 4,235 shares to Mr. Whalen, 4,399 shares to Mr. Heim, and 1,866 shares to Mr. Meloy.

On January 12, 2012, our named executive officers were awarded equity-settled performance units under the Partnership s long-term incentive plan for the 2012 compensation cycle that will vest in June 2015 as follows: 21,240 performance units to Mr. Joyce, 16,290 performance units to Mr. Perkins, 13,702 performance units to Mr. Whalen, 14,233 performance units to Mr. Heim, and 6,039 performance units to Mr. Meloy. The vesting and settlement value of these performance unit awards will be determined using the formula adopted for the performance unit awards granted on February 17, 2011 except that the performance period for the 2012 awards will begin on June 30, 2012 and end on June 30, 2015. Please see Application of Compensation Elements Long-Term Incentive Awards .

Severance and Change in Control Benefits. On January 12, 2012, we adopted the Executive Change in Control Program. Specific terms, conditions, and potential payments are detailed under Potential Payments Upon Termination or Change in Control.

Tax and Accounting Considerations. We account for the equity compensation expense for our employees, including our named executive officers, under the rules of FASB ASC Topic 718, which requires us to estimate and record an expense for each award of long-term incentive compensation over the vesting period of the award. Accounting rules also require us to record cash compensation as an expense at the time the obligation is accrued.

Review of the Results of the Say-on-Pay Proposal: At the 2011 Annual Meeting, the Company s stockholders were requested to conduct a non-binding advisory vote to approve the compensation of the Company s named executive officers. The Board proposal seeking approval, on an advisory basis, of the compensation of the Company s named executive officers was approved by the stockholders. The Board and Compensation Committee reviewed the results of the vote and concluded that no changes to the Company s compensation design and philosophy needed to be considered as a result of the vote.

Compensation Committee Interlocks and Insider Participation

No member of our Compensation Committee has been an employee of ours at any time. None of our executive officers served on the Board of Directors or Compensation Committee of a company that has an executive officer that served on our board or Compensation Committee. No member of our board is an executive officer of a company in which one of our executive officers serves as a member of the Board of Directors or Compensation Committee of that company.

Messrs. Kagan and Hwang, both of whom were members of our Compensation Committee during 2011, were affiliates of Warburg Pincus during 2011. Mr. Kagan was a director of Broad Oak during 2011, from whom we bought natural gas and NGL products and provided other services and in which affiliates of Warburg Pincus own a controlling interest. Mr. Kagan was also a director of Antero Resources Corporation (Antero) during 2011, from whom we bought natural gas and NGL products and in which affiliates of Warburg Pincus own a controlling interest. Mr. Kagan was a director of Laredo Petroleum, Inc. during 2011, from whom we bought natural gas and in which affiliates of Warburg Pincus own a controlling interest. Messrs. Kagan and Hwang are party to indemnification agreements with us. Warburg Pincus is a party to the Registration Rights Agreement with us. Please read Transactions With Related Persons for a description of these transactions.

Compensation Committee Report

Messrs. Crisp, Hwang and Kagan are the current members of our Compensation Committee. In fulfilling its oversight responsibilities, the Compensation Committee has reviewed and discussed with management the compensation discussion and analysis contained in our Annual Report on Form 10-K for the year ended December 31, 2011 and this proxy statement. Based on these reviews and discussions, the Compensation Committee recommended to our Board of Directors that the compensation discussion and analysis be included in our Annual Report on Form 10-K for the year ended December 31, 2011 and this proxy statement for filing with the SEC.

The information contained in this report shall not be deemed to be soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filings with the SEC, or subject to the liabilities of Section 18 of the Exchange Act, except to the extent that the company specifically incorporates it by reference into a document filed under the Securities Act of 1933, as amended, or the Exchange Act.

The Compensation Committee

Charles R. Crisp, Chairman Peter R. Kagan In Seon Hwang

Executive Compensation Tables

The following Summary Compensation Table sets forth the compensation of our named executive officers for 2011, 2010 and 2009. Additional details regarding the applicable elements of compensation in the Summary Compensation Table are provided in the footnotes following the table.

Summary Compensation Table for 2011

Name	Year	Salary	Bonus (2)	Stock Awards ($) (3)	All Other Compensation (4)	Total Compensation
Rene R. Joyce (1)	2011	$ 529,000	$ 1,094,000	$ 979,380	$ 23,394	$ 2,625,774
Chief Executive Officer	2010	410,000	1,120,067	5,358,408	22,410	6,910,885
	2009	337,500	510,000	1,398,946	20,187	2,266,633
Matthew J. Meloy	2011	228,125	235,000	160,859	19,771	643,755
Senior Vice President,	2010	195,625	224,100	493,350	19,740	932,815
Chief Financial Officer						
and Treasurer						
Joe Bob Perkins (1)	2011	454,000	748,800	542,079	20,715	1,765,594
President	2010	361,250	823,191	3,831,960	20,448	5,036,849
	2009	303,750	459,000	970,109	20,129	1,752,988
James W. Whalen (1)	2011	454,000	748,800	542,079	29,587	1,774,466
Executive Chairman of	2010	356,750	593,280	3,831,960	22,338	4,804,328
the Board of Directors	2009	297,000	445,500	543,150	19,936	1,305,586
Michael A. Heim (1)	2011	403,500	664,000	480,517	22,400	1,570,417
Chief Operating Officer	2010	328,000	1,469,275	2,699,620	21,776	4,518,671
	2009	281,000	424,500	810,117	20,089	1,535,706

(1) Mr. Joyce became Executive Chairman of the Board of Directors in January 2012 but served as Chief Executive Officer during the 2011 year. Mr. Perkins became Chief Executive Officer in January 2012 but served as President during the 2011 year. Mr. Whalen became Advisor to Chairman and Chief Executive Officer in January 2012 but served as Executive Chairman of the Board of Directors during the 2011 year. Mr. Heim became President and Chief Operating Officer in January 2012 but served as Chief Operating Officer during the 2011 year.

(2) For 2011, represents payments pursuant to our Bonus Plan. For the 2010 year, payments pursuant to our Bonus Plan were made in the following amounts: Mr. Joyce, $855,000; Mr. Meloy, $224,100; Mr. Perkins, $593,280; Mr. Whalen, $593,280; and Mr. Heim, $531, 360. For 2010, also represents discretionary cash bonuses paid to the named executive officers in recognition of the executive team s role in extraordinary execution of the business priorities, completion of drop downs to the Partnership and clarification of our strategic direction in 2010 ($265, 067 for Mr. Joyce , $229,911 for Mr. Perkins, and $205,915 for Mr. Heim). For 2010, $732,000 of the amount reported for Mr. Heim represents a cash bonus paid in lieu of equity in connection with the IPO**.** For 2009, represents payments pursuant to our Bonus Plan. Please see Application of Compensation Elements Annual Cash Incentives. Note that, in prior filings, the payments reported under this column pursuant to our Bonus Plan for the 2009 and 2010 years were reported in the Non-Equity Incentive Plan Compensation column. As discussed above, payments pursuant to our Bonus Plan are discretionary and not based on objective performance measures.

(3) Includes restricted stock awards and equity-settled performance units. For 2010, includes bonus stock and restricted stock awards. Amounts represent the aggregate grant date fair value of awards computed in accordance with FASB ASC Topic 718. Assumptions used in the calculation of these amounts are included in Note 22 to our Consolidated Financial Statements beginning on page F-1 of our Annual Report on Form 10-K. Detailed information about the amount recognized for specific awards is reported in the table under Grants of Plan-Based Awards for 2011 below. The grant date fair value of a common stock award granted on February 14, 2011, assuming vesting will occur, is $31.745 and the grant date fair value of an equity settled performance award on February 17, 2011 is $34.83 assuming the probable outcome of the

performance criteria assigned to the awards. The grant date value of a equity-settled performance unit award granted on February 17, 2011 (for the 2011 compensation cycle) assuming the highest performance condition will be achieved, is $34.83 per unit and a payout of 150% of the units granted. Accordingly, the highest aggregate value of the performance unit awards granted in 2011 for the named executive officers is as follows: Mr. Joyce - $1,102,892; Mr. Meloy - $181,290; Mr. Perkins - $610,774; Mr. Whalen - $610,774; and Mr. Heim - $541,258.

(4) For 2011 All Other Compensation includes the (i) aggregate value of matching and non-matching contributions to our 401(k) plan and (ii) the dollar value of life insurance coverage provided by the Company.

Name	401(k) and Profit Sharing Plan	Dollar Value of Life Insurance	Total
Rene R. Joyce	19,600	3,794	$ 23,394
Matthew J. Meloy	19,600	171	19,771
Joe Bob Perkins	19,600	1,115	20,715
James W. Whalen	19,600	9,987	29,587
Michael A. Heim	19,600	2,800	22,400

Grants of Plan Based Awards for 2011

The following table and the footnotes thereto provide information regarding grants of plan-based equity and non-equity awards made to the named executive officers during 2011:

		Estimated Future Payouts Under Equity Incentive Plan Awards (#)(1)			All Other Stock Awards: Number of Shares of Stocks or Units	Grant Date Fair Value of Stock and Unit Awards
Name	Grant Date	Threshold (#)	Target (#)	Maximum (#)	(1)	(2)
Mr. Joyce	02/14/11				7,690	$ 244,119
	02/17/11	5,278	21,110	31,665		735,261
Mr. Meloy	02/14/11				1,260	39,999
	02/17/11	868	3,470	5,205		120,860
Mr. Perkins	02/14/11				4,250	134,916
	02/17/11	2,923	11,690	17,535		407,163
Mr. Whalen	02/14/11				4,250	134,916
	02/17/11	2,923	11,690	17,535		407,163
Mr. Heim	02/14/11				3,770	119,679
	02/17/11	2,590	10,360	15,540		360,839

(1) The grants on February 14, 2011 are restricted common stock awards granted under our Stock Incentive Plan. The grants on February 17, 2011 are equity-settled performance units granted under the Partnership s long-term incentive plan. For a detailed description of how performance achievements will be determined for the Partnership s performance units, see Application of Compensation Elements Long-Term Incentive Awards.

(2) The dollar amounts shown for the common stock awards granted on February 14, 2011 are determined by multiplying the shares reported in the table by $31.745 (the grant date fair value of awards computed in accordance with FASB ASC Topic 718). The dollar amounts shown for the performance units granted on February 17, 2011 are determined by multiplying the number of units reported in the table under the Target column by $34.83 (the grant date fair value of awards computed in accordance with FASB ASC Topic 718).

Narrative Disclosure to Summary Compensation Table and Grants of Plan Based Awards Table

A discussion of 2011 salaries, bonuses, incentive plans and awards is included in Compensation Discussion and Analysis.

Stock Incentive Plan

Restricted Stock Awards. Subject to the terms of the applicable restricted stock agreement, restricted stock granted under the Stock Incentive Plan during 2011 vests 100% three years from the date of grant. The named executive officers have all of the rights of a stockholder of the Company with respect to the restricted stock granted in 2011 including, without limitation, voting rights. The named executive officers do not have the right to receive any dividends or other distributions, including any special or extraordinary dividends or distributions, with respect to the restricted stock granted in 2011 unless and until the restricted stock vests. Dividends on unvested restricted stock are credited to an unfunded account maintained by the Company. These credited dividends are paid to the employee when the shares of restricted stock vest. In the event all or any portion of the restricted stock granted in 2011 fails to vest, such restricted stock and dividends will be forfeited to us.

LTIP Performance Unit Awards. Subject to the terms of the applicable performance unit award agreement, performance units granted under the Partnership s long-term incentive plan during 2011 vest in June 2014. The vesting and settlement value of these performance unit awards will be determined using the formula adopted for the performance unit awards, as described under Application of Compensation Elements Long-Term Incentive Awards. The named executive officers do not have the rights of a unitholder of the Partnership with respect to the performance unit awards granted in 2011. The named executive officers do not have the right to receive any distribution with respect to the performance unit awards granted in 2011 unless and until the performance units vest. Distributions on unvested performance unit awards are credited to an unfunded account maintained by the Partnership. These credited distributions are paid to the employee when the performance units vest. In the event all or any portion of the performance units granted in 2011 fails to vest, such performance units and distributions will be forfeited to us. Please see Compensation Discussion and Analysis Elements of Compensation for Named Executive Officers Long-Term Incentive Awards: Stock Incentive Plan and Partnership Long-Term Incentive Awards and Application of Compensation Elements Long-Term Incentive Awards for a detailed discussion of the grants of restricted stock and performance unit awards.

Outstanding Equity Awards at 2011 Fiscal Year-End

The following table and the footnotes related thereto provide information regarding each stock option and other equity-based awards outstanding as of December 31, 2011 for each of our named executive officers.

	Outstanding Equity Awards at 2011 Fiscal Year-End			
	Stock Awards			
Name	Number of Shares of Stock That Have not Vested (1)	Market Value of Shares of Stock That Have not Vested (2)	Equity Incentive Plan Awards: Number of Unearned Performance Units That have not Vested (3)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Performance Units That have not Vested (4)
Rene R. Joyce	128,815	$ 5,241,482	85,167	$ 3,750,672
Matthew J. Meloy	23,685	963,743	17,466	768,892
Joe Bob Perkins	72,230	2,939,039	54,952	2,419,976
James W. Whalen	72,230	2,939,039	33,558	1,481,962
Michael A. Heim	64,655	2,630,812	47,482	2,090,324

(1) Represents shares of our restricted common stock awarded on December 10, 2010 and February 14, 2011. The 340,395 shares granted in 2010 (121,125 shares held by Mr. Joyce, 22,425 shares held by Mr. Meloy, 67,980 shares held by Mr. Perkins, 67,980 shares held by Mr. Whalen, and 60,885 shares held by Mr. Heim) vest as follows: 60% on December 10, 2012 and 40% on December 10, 2013. The 21,220 shares granted in 2011 (7,690 shares held by Mr. Joyce, 1,260 shares held by Mr. Meloy, 4,250 shares held by Mr. Perkins, 4,250 shares held by Mr. Whalen, and 3,770 shares held by Mr. Heim) vest 100% on February 14, 2014.

(2) The dollar amounts shown are determined by multiplying the number of shares of common stock reported in the table by the sum of the closing price of a share of common stock on December 31, 2011 ($40.69).

(3) Represents the number of performance units awarded on January 22, 2009, December 3, 2009 and February17, 2011 under the Partnership s and our long-term incentive plans. With respect to Mr. Meloy, the performance units were granted on August 4, 2009, August 2, 2010 and February 17, 2011. These awards vest in June 2012, June 2013 and June 2014, based on the Partnership s performance over the applicable period measured against a peer group of companies. These awards are discussed in more detail under the heading Application of Compensation Elements Long-Term Incentive Awards.

(4) The dollar amounts shown are determined by multiplying the number of performance units reported in the table by the sum of the closing price of a common unit of the Partnership on December 31, 2011 ($37.28) and the related distribution equivalent rights for each award and assume full payout under the awards at the time of vesting.

Option Exercises and Stock Vested in 2011

The following table provides the amount realized during 2011 by each named executive officer upon the vesting of our restricted common stock and performance units. None of our named executive officers exercised stock option awards during the 2011 year and currently, there are no stock options outstanding under any of our plans.

	Stock Vested for 2011	
Name	**Number of Shares Acquired on Vesting (1)**	**Value Realized on Vesting (2)**
Rene R. Joyce	4,000	$ 170,880
Matthew J. Meloy	1,500	62,089
Joe Bob Perkins	3,500	149,520
James W. Whalen	3,500	149,520
Michael A. Heim	3,500	149,520

(1) Represents performance units granted in January 2008 that vested in August 2011 and were settled by cash payment (Mr. Meloy s grant was made in August 2008).

(2) Computed by multiplying the number of performance units by the value of an equivalent Partnership common unit at the time of vesting and adding associated distributions over the vesting period.

Potential Payments Upon Termination or Change in Control

Aggregate Payments. The table below reflects the aggregate amount of payments that we believe our named executive officers would have received under our Stock Incentive Plan, the Partnership s long-term incentive plan, the Officer Change in Control Program and the Executive Change in Control Program upon a termination of employment and/or a change in control that occurred on December 31, 2011. Details regarding individual plans and arrangements follow the table.

Name	**Change of Control (No Termination)**	**Qualifying Termination Following Change in Control**	**Termination by us without Cause**	**Termination for Death or Disability**
Rene R. Joyce	$ 8,352,952	$ 8,352,952	$ 8,352,952	$ 8,352,952
Matthew J. Meloy	1,601,202	2,301,839	1,601,202	1,601,202
Joe Bob Perkins	4,904,523	4,904,523	4,904,523	4,904,523

James W. Whalen	4,000,856	4,000,856		4,000,856

We may have disagreements with our warrant holders.

We previously had a disagreement with one of our two warrant holders regarding whether such holder was entitled to receive exchange warrants following the exercise of its warrants in full. Although we entered into a Settlement Agreement and Release with this holder, we may have a similar dispute with the other warrant holder. Moreover, we may be involved with other disagreements with our warrant holders in the future. Such disagreements may lead to litigation which may be expensive and consume management's time, or involve settlements, the terms of which may not be favorable to us.

Our rights agreement and certain provisions in our charter documents and Delaware law could delay or prevent a change in management or a takeover attempt that you may consider to be in your best interest.

We have adopted certain anti-takeover provisions, including a stockholders' rights agreement, dated as of October 30, 2002, between us and Computershare Trust Company, Inc., as Rights Agent, as amended. The rights agreement will cause substantial dilution to any person who attempts to acquire us in a manner or on terms not approved by our board of directors.

The rights agreement and Certificate of Designations for the Series B Preferred, as well as other provisions in our certificate of incorporation and bylaws and under Delaware law, could delay or prevent the removal of directors and other management and could make more difficult a merger, tender offer or proxy contest involving us that you may consider to be in your best interest. For example, these provisions:

allow our board of directors to issue preferred stock without stockholder approval;

limit who can call a special meeting of stockholders;

eliminate stockholder action by written consent; and

establish advance notice requirements for nomination for election to the board of directors or for proposing matters to be acted upon at stockholders meetings.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

As set forth in the below table, the principal facilities that we occupy include approximately 268,000 square feet of research, development, warehouse and office space located at various addresses in the same business park on Nancy Ridge Drive in San Diego, California and approximately 67,000 square feet of manufacturing, warehouse and office space located in Zofingen, Switzerland.

Location	Own/ Lease	Description
6114 Nancy Ridge Drive	Lease with option to purchase	This chemical development facility consists of approximately 40,000 square feet (which includes approximately 18,000 of internal square feet and approximately 22,000 square feet of integrated external space), of which approximately 5,000 square feet is office space. The remaining approximately 35,000 square feet of space is dedicated to process research and scale-up chemistry, the production of intermediates and other compounds for research and development purposes, and the production of active

Location	Own/ Lease	Description
		pharmaceutical ingredients to support our clinical trials. We are using this facility for the production of scale-up lots for our internal research programs, safety studies and clinical trials. We commenced cGMP operations in this facility in the second quarter of 2004. In May 2007, we completed a sale and leaseback of this facility, and have an option to purchase it back.
6118 Nancy Ridge Drive	Lease with option to purchase	This facility of approximately 30,000 square feet consists of approximately 50% laboratory space and 50% office space. In May 2007, we completed a sale and leaseback of this facility, and have an option to purchase it back.

6122-6124-6126 Nancy Ridge Drive	Lease with option to purchase	The portion of this facility we lease consists of approximately 40,000 square feet, of which approximately 24,000 square feet is laboratory space and 16,000 square feet is office space. We sublease to another company approximately 2,000 square feet of office space in this facility. We have assigned our option to purchase the entire facility, which includes approximately 68,000 square feet, and have an option to purchase it back.
6138-6150 Nancy Ridge Drive	Lease with option to purchase	This facility of approximately 55,000 square feet consists of approximately 33,000 square feet of laboratory space and 22,000 square feet of office space. In December 2003, we completed a sale and leaseback of this facility, and have an option to purchase it back.
6154 Nancy Ridge Drive	Lease with option to purchase	This facility of approximately 68,000 square feet consists of approximately 56,000 square feet of office space and 12,000 square feet of warehouse space. We are in the process of improving and substantially expanding this facility by approximately 75,000 square feet. In May 2007, we completed a sale and leaseback of this facility, and have an option to purchase it back.
6162 Nancy Ridge Drive	Own	This facility includes approximately 20,000 square feet of warehouse and office space. We are leasing this facility to another company through April 2008, and the lease can be extended at the tenant's option in monthly increments through July 2008.
6166 Nancy Ridge Drive	Lease	This facility of approximately 37,000 square feet consists of approximately 23,000 square feet of laboratory space and 14,000 square feet of office space.
Zofingen, Switzerland	Own	This facility of approximately 67,000 square feet consists of approximately 35,000 square feet of manufacturing space, 25,000 square feet of warehouse space and 7,000 square feet of office space.

We expect to need additional space depending on the success of our clinical programs and whether we partner or internally develop our programs.

Item 3. Legal Proceedings.

None.

Item 4. Submission of Matters to a Vote of Security Holders.

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this Annual Report on Form 10-K.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market information

Our common stock is listed on the NASDAQ Global Market under the symbol "ARNA." The following table sets forth, for the periods indicated, the high and low sale prices for our common stock as reported by the NASDAQ Global Market and its predecessor, the NASDAQ National Market.

	High	Low
Year ended December 31, 2006		
First Quarter	$ 20.68	$ 14.21
Second Quarter	$ 18.19	$ 10.26
Third Quarter	$ 12.97	$ 9.18
Fourth Quarter	$ 17.69	$ 11.93

	High	Low
Year ended December 31, 2007		
First Quarter	$ 14.58	$ 9.96
Second Quarter	$ 14.74	$ 10.34
Third Quarter	$ 14.78	$ 10.56
Fourth Quarter	$ 11.39	$ 7.76

Holders

As of February 29, 2008, there were approximately 169 stockholders of record of our common stock, one of which is Cede & Co., a nominee for Depository Trust Company, or DTC. Shares of common stock that are held by financial institutions as nominees for beneficial owners are deposited into participant accounts at DTC, and are considered to be held of record by Cede & Co. as one stockholder.

Dividends

We have never paid cash dividends on our capital stock. We anticipate that we will retain earnings, if any, to support operations and finance the growth and development of our business and, therefore, do not expect to pay cash dividends in the foreseeable future. In addition, we are prohibited from paying cash dividends on any of our capital stock other than our series B redeemable convertible preferred stock without the approval of the holders of our series B redeemable convertible preferred stock.

Securities authorized for issuance under equity compensation plans

The following table summarizes our compensation plans under which our equity securities are authorized for issuance as of December 31, 2007:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders*	7,149,602	$ 8.05	3,060,452**
Equity compensation plans not approved by security holders			
Total*	7,149,602	$ 8.05	3,060,452**

* Includes stock options with a per share weighted-average exercise price of $10.43 and performance-based restricted stock unit awards which have no per share weighted-average exercise price.

** Includes 449,594 shares of common stock available for future issuance under our 2001 Employee Stock Purchase Plan, as amended.

In 2003, we set up a deferred compensation plan for our executive officers, whereby executive officers may elect to defer their shares of restricted stock. At December 31, 2007, a total of 107,919 shares of restricted stock were in the plan. All of the shares contributed to this plan were previously granted to executive officers under an equity compensation plan approved by our stockholders.

On March 3, 2008, the Compensation Committee of our board of directors granted 1,155,600 stock options to employees, including executive officers, and directors. On March 3, 2008, the Compensation Committee also granted 371,800 performance-based restricted stock unit awards to certain employees, substantially all of whom were not previously granted performance-based restricted stock unit awards, and none of which were granted to executive officers. The stock options, which generally vest 25% per year over four years and are exercisable for up to 10 years from the date of grant, had an exercise price equal to the fair market value of our stock on the date of grant, which was $6.99 per share.

Item 6. Selected Financial Data.

The following Selected Financial Data should be read in conjunction with "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Item 8. Financial Statements and Supplementary Data" included below in this Annual Report on Form 10-K.

	Years ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except share and per share data)				
Revenues					
Collaborative agreements	$ 19,332	$ 30,569	$ 23,233	$ 13,686	$ 12,734
Collaborative agreements with affiliates					100
Total revenues	19,332	30,569	23,233	13,686	12,834
Expenses					
Research and development	149,524	103,388	79,710	58,579	52,867
General and administrative	26,571	18,466	13,122	11,066	9,808
Amortization of acquired technology	1,537	1,537	1,537	1,825	1,621
Total operating expenses	177,632	123,391	94,369	71,470	64,296
Interest and other income (expense), net	15,134	6,574	3,235	(208)	4,403
Net loss	(143,166)	(86,248)	(67,901)	(57,992)	(47,059)
Dividends on redeemable convertible preferred stock	(2,114)	(2,031)	(1,813)	(1,437)	(27)
Accretion of discount on redeemable convertible preferred stock			(7,372)	(1,852)	(36)
Net loss allocable to common stockholders	$ (145,280)	$ (88,279)	$ (77,086)	$ (61,281)	$ (47,122)
Net loss per share allocable to common stockholders, basic and diluted	$ (2.31)	$ (1.89)	$ (2.24)	$ (2.40)	$ (1.74)

	Years ended December 31,				
Shares used in calculating net loss per share allocable to common stockholders, basic and diluted	62,782,850	46,750,596	34,377,693	25,527,617	27,159,234

	As of December 31,				
	2007	2006	2005	2004	2003
	(In thousands)				
Balance Sheet Data:					
Cash and cash equivalents	$ 386,989	$ 373,044	$ 73,781	$ 58,686	$ 60,472
Short-term investments, available-for-sale	11,196	15,781	54,158	54,628	93,545
Accounts receivable	1,901	310	848	22,590	28
Total assets	487,506	468,465	198,129	206,365	229,898
Total deferred revenues	4,049	13,054	24,144	30,070	3,973
Total lease financing obligations	62,307	13,678	13,485	13,259	13,000
Redeemable convertible preferred stock	53,922	51,808	49,777	29,092	25,776
Deferred compensation			(396)	(780)	(2,648)
Accumulated deficit	(479,451)	(334,171)	(245,892)	(168,806)	(107,525)
Total stockholders' equity	336,377	366,115	99,540	126,723	183,148

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

You should read the following discussion and analysis in conjunction with "Item 8. Financial Statements and Supplementary Data" included below in this Annual Report on Form 10-K, or Annual Report. Operating results are not necessarily indicative of results that may occur in future periods.

This discussion and analysis contains forward-looking statements that involve a number of risks, uncertainties and assumptions. Actual events or results may differ materially from our expectations. Important factors that could cause actual results to differ materially from those stated or implied by our forward-looking statements include, but are not limited to, those set forth in "Item 1A. Risk Factors" in this Annual Report. All forward-looking statements included in this Annual Report are based on information available to us as of the time we file this Annual Report and, except as required by law, we undertake no obligation to update publicly or revise any forward-looking statements.

OVERVIEW

We have incurred net losses of $479.5 million from our inception in April 1997 through December 31, 2007, and expect to incur substantial and increasing net losses for the next several years or more as we continue our research and development activities, including our clinical program for our lead drug candidate, lorcaserin hydrochloride, or lorcaserin, for the treatment of obesity, and our clinical programs for APD125 for the treatment of insomnia and APD791 for the treatment of arterial thromboembolic diseases. We expect that the external expenses for our ongoing Phase 3 lorcaserin program, the majority of which we expect will be expensed through the first half of 2009, will be substantial. To date, we have generated cash and funded our operations primarily through the sale of common and preferred stock, payments from collaborators and sale leaseback transactions. From our inception through December 31, 2007, we have generated $1.0 billion in cash from these sources, of which $839.6 million was through sales of stock, $140.0 million was through payments from our current and past collaborators and $61.1 million was from sale leaseback transactions.

Recent 2008 and 2007 highlights include:

In January 2008, announced the initiation of a Phase 1 clinical trial of a second generation oral niacin receptor agonist intended for the treatment of atherosclerosis under our partnership with Merck & Co., Inc., or Merck.

In January 2008, entered into strategic cooperation agreements with Siegfried Ltd that are primarily related to the manufacturing of lorcaserin, which is expected to be necessary for our planned New Drug Application submission to the United States Food and Drug Administration, or FDA, and for commercialization of lorcaserin after regulatory marketing approval. The agreements include a long-term supply agreement for our purchase of lorcaserin active pharmaceutical ingredient, or API, the purchase of certain drug product facility assets, including fixtures, equipment, other personal property and real estate assets, a contract manufacturing agreement whereby we will manufacture certain products for Siegfried, and a services agreement.

In January 2008, reported positive Phase 1a clinical trial results of APD791, our oral, internally discovered drug candidate intended for the treatment and prevention of arterial thromboembolic diseases, and initiated a Phase 1b clinical trial to further evaluate this drug candidate.

In January 2008, announced that initial clinical trial results for APD668, an oral drug candidate discovered by Arena and investigated for the treatment of type 2 diabetes under our partnership with Ortho-McNeil Pharmaceutical, Inc., a Johnson & Johnson company, or Ortho-McNeil, suggest that the Glucose-Dependent Insulinotropic Receptor, or GDIR, may improve glucose control in patients with type 2 diabetes. Based on the data from those studies, Ortho-McNeil put APD668 on hold and has advanced a potentially more potent Arena-discovered GDIR agonist into preclinical development.

In December 2007, initiated BLOSSOM and BLOOM-DM, the second and third Phase 3 clinical trials evaluating the efficacy and safety of lorcaserin for the treatment of obesity. These one-year, double-blind, randomized and placebo-controlled trials are expected to collectively enroll approximately 3,750 overweight and obese patients. Consistent with our proposal, the FDA has allowed us to eliminate the requirement to perform echocardiographic testing prior to enrolling patients in both of these trials.

In November 2007, completed a public offering of 11.0 million shares of our common stock at $9.91 per share, resulting in net proceeds of $103.2 million.

In September 2007, announced positive preliminary results from our Phase 2a clinical trial of APD125 in patients with chronic insomnia. In this Phase 2a clinical trial, APD125 significantly improved endpoints measuring improvements in sleep maintenance with no observations of next day cognitive impairment.

In September 2007, reported that an independent Echocardiographic Data Safety Monitoring Board, or ESMB, found no reason to stop our ongoing pivotal Phase 3 lorcaserin BLOOM trial following a planned review of unblinded echocardiograms performed after patients completed six months of dosing in the trial. The review confirmed that differences, if any, in the rates of FDA-defined valvulopathy in patients treated with lorcaserin and in the control group did not meet predetermined stopping criteria. The review also confirmed that the rate of FDA-defined valvulopathy is consistent with our statistical powering assumptions used in the design of the Phase 3 clinical trial program to monitor patients for any increased risk of developing valvulopathy.

In May 2007, completed the sale to an affiliate of BioMed Realty Trust, Inc., or BioMed, of three properties owned and occupied by us and the assignment to BioMed of an option to purchase a fourth property currently leased and primarily occupied by us. We received net proceeds of $48.5 million for the properties and the purchase option. Concurrently with the closing of the transaction, we leased back the three properties sold to BioMed under leases with 20-year terms and two consecutive options to extend such terms for five years each. As part of the transaction, we also retained the option to purchase from BioMed all the properties included in the transaction on the 10th, 15th or 20th anniversary of the execution date of the leases.

In February 2007, completed patient enrollment in our BLOOM trial, a double-blind, randomized and placebo-controlled trial that enrolled over 3,100 patients at approximately 100 sites in the United States.

We will need to raise a substantial amount of cash to continue to develop our drug candidates and sustain our research efforts. At December 31, 2007, we had $398.2 million in cash, cash equivalents and short-term investments. The drug development process is long, uncertain and expensive, and our ability to achieve our goals depends on numerous factors, many of which are out of our control. We will seek to balance the need to invest heavily in research to find new drugs and in clinical development and manufacturing to advance our drug candidates against the need to sustain our operations long enough for our collaborators or us to commercialize the results of our efforts. As a result, we expect to

continue to incur significant and increasing losses over the next several years. We do not expect to generate positive operating cash flows for at least several years and, accordingly, we will need to raise additional funds through equity, debt or other financing, or through partnering one or more of our more advanced programs. Our cash used in operations is expected to increase as we continue our clinical-stage programs and our research efforts, continue to incur general and administrative expenses, including prosecuting patents, and have reached the end of the research funding portion of our collaborations with Ortho-McNeil and Merck in the fourth quarter of 2007. Absent any new collaboration, we expect to recognize no revenues from research funding in 2008 and thereafter.

SUMMARY OF REVENUES AND EXPENSES

We are providing the following summary of our revenues and expenses to supplement the more detailed discussion below. The following tables are stated in millions.

Revenues

	Years ended December 31,		
Collaborations	**2007**	**2006**	**2005**
Ortho-McNeil	$ 13.4	$ 18.5	$ 13.4
Merck	5.9	12.1	9.8
Total revenues	$ 19.3	$ 30.6	$ 23.2

Research and development expenses

	Years ended December 31,		
Type of expense	**2007**	**2006**	**2005**
External preclinical and clinical study fees and expenses	$ 73.5	$ 40.4	$ 30.2
Personnel costs	43.4	34.0	25.4
Facility and equipment costs	15.1	13.3	11.8
Research supplies	12.3	12.2	10.5
Other	5.2	3.5	1.8
Total research and development expenses	$ 149.5	$ 103.4	$ 79.7

General and administrative expenses

	Years ended December 31,		
Type of expense	**2007**	**2006**	**2005**
Personnel costs	$ 13.1	$ 8.8	$ 6.2
Legal, accounting and other professional fees	8.7	6.0	4.0
Facility and equipment costs	3.0	2.4	1.9
Other	1.8	1.3	1.0
Total general and administrative expenses	$ 26.6	$ 18.5	$ 13.1

YEAR ENDED DECEMBER 31, 2007 COMPARED TO YEAR ENDED DECEMBER 31, 2006

Revenues. We recorded revenues of $19.3 million during the year ended December 31, 2007, compared to $30.6 million during the year ended December 31, 2006. All of our revenues recorded during the year ended December 31, 2007 resulted from our collaborations with Ortho-McNeil and Merck, and included $9.5 million in amortization of

milestone achievements and technology access and development fees received in prior years, $5.9 million in research funding, and $3.9 million for patent activities. All of our revenues during the year ended December 31, 2006 were also from our collaborations with Ortho-McNeil and Merck, and included a $5.0 million milestone earned under our Ortho-McNeil collaboration and a $4.0 million milestone earned under our Merck collaboration, both of which we recognized immediately in accordance with our revenue recognition policy, $9.6 million in amortization of milestone achievements and technology access and development fees, $8.1 million in research funding, and $3.9 million in additional sponsored research and patent activities.

In October 2004, we extended and expanded the collaboration we entered into with Merck in 2002, and Merck purchased $7.5 million of our stock at a price of $8.00 per share, approximately a 70%

premium to the then current market price. We performed an evaluation on this stock purchase and determined that $3.9 million of the $7.5 million purchase price was an upfront payment related to the collaboration extension and expansion. Accordingly, we recognized the $3.9 million upfront payment, as well as the remaining portion of the unamortized upfront payment at October 2004 of $1.3 million, over the extended research portion of the collaboration term of three years. Additionally, in October 2004, we achieved a $1.0 million milestone under this collaboration which was also recognized over the extended term of the research portion of the collaboration because it was reasonably assured to be achieved at the time we extended and expanded the collaboration. In February 2007, we amended the collaboration to reduce the number of Arena research employees funded under the collaboration in exchange for Merck purchasing $1.0 million of our common stock. This equity investment, equal to the reduction in their research funding obligation, was at a price of $24.81 per share, approximately a 70% premium to the then current market price. We performed an evaluation on this stock purchase and determined that $0.5 million of the $1.0 million purchase price was an upfront payment related to the collaboration amendment. Accordingly, we recognized this upfront payment and the unamortized portion of the previously received upfront payments over the remaining term of the research portion of the collaboration. The research portion of this collaboration ended in October 2007.

In December 2004, we entered into our collaboration and license agreement with Ortho-McNeil. This collaboration included a $17.5 million upfront payment, as well as research funding of $2.4 million per year, initially until December 2006 and subsequently extended until December 2007. We amortized this $17.5 million upfront payment over three years. In December 2004, we achieved two milestones of $2.5 million each under this collaboration, which we also recognized over three years because they were reasonably assured to be achieved at the time we entered into the collaboration. The research portion of this collaboration ended in December 2007.

Our collaborators often pay us before we recognize such payments as current revenues and, accordingly, these payments are recorded as deferred revenues until earned. As of December 31, 2007, we had $4.0 million in deferred revenues, all of which is attributable to our license agreement with TaiGen Biotechnology Co., Ltd. and is expected to be recognized as revenue in 2009. Absent any new collaboration, we do not expect to record any revenues from research funding in 2008. Future revenues for research or clinical milestones that have not yet been achieved are difficult to predict, and our revenues may vary significantly from quarter to quarter and year to year. We expect that any significant revenues over the next several years will depend on the clinical success of our partnered programs as well as whether we partner lorcaserin, APD125, APD791 or any of our other current or future drug candidates. Ultimately, we expect our future revenues in the long term to primarily depend upon the regulatory approval and commercialization of our partnered or internally developed drugs.

Research and development expenses. Research and development expenses, which account for the majority of our expenses, consisted primarily of costs associated with external clinical and preclinical study fees, manufacturing costs and other related expenses, and the development of our earlier-stage programs and technologies. Our most significant research and development costs are for clinical trials (including payments to contract research organizations, or CROs), preclinical study fees, personnel costs, research supplies, and facility and equipment costs. We expense research and development costs to operations as they are incurred when these expenditures relate to our research and development efforts and have no alternative future uses. In the fourth quarter of 2007, we expensed $4.6 million of lorcaserin clinical drug supply for which we previously had an alternative future use. As of December 31, 2007, we had no capitalized research and development costs. Other than external expenses for our clinical and preclinical programs, we generally do not track our research and development expenses by project; rather, we track such expenses by the type of cost incurred.

Research and development expenses for the year ended December 31, 2007 increased $46.1 million to $149.5 million, from $103.4 million for the year ended December 31, 2006. The difference was due primarily to (i) a $33.1 million increase in external clinical and preclinical study fees and expenses,

including manufacturing costs, as we continued the first of our three Phase 3 clinical trials and initiated the second and third clinical trials for lorcaserin, and completed a Phase 2a clinical trial of APD125 and a Phase 1a clinical trial of APD791, and (ii) an increase in personnel costs of a total of $9.4 million as we increased the number of our research and development employees from 301 at the end of 2006 to 349 at the end of 2007 and recorded an increase of $1.3 million to $4.2 million in non-cash, share-based compensation related to the expensing of share-based compensation under Statement of Financial Accounting Standards, or SFAS, No. 123R, "Share-Based Payment." Included in the $73.5 million in external clinical and preclinical study fees and expenses for the year ended December 31, 2007 was $51.3 million related to our lorcaserin program, $15.7 million related to our APD125 program and $3.1 million related to our APD791 program. Included in the $40.4 million in external clinical and preclinical study fees and expenses for the year ended December 31, 2006 was $30.2 million related to our lorcaserin program, $4.9 million related to our APD125 program and $2.9 million related to our APD791 program. Nearly all of the increase in research and development personnel related to the development of our internal programs, primarily lorcaserin, APD125 and APD791. Assuming favorable results from our month-12 ESMB review of BLOOM, we expect to continue to incur significant research and development expenses as we continue our ongoing and planned clinical development.

Cumulatively through December 31, 2007, we have recorded $106.9 million, $29.7 million and $6.1 million in external clinical and preclinical study fees and other related expenses for lorcaserin, APD125 and APD791, respectively. While expenditures on current and future clinical development programs are expected to be substantial and to increase, they are subject to many uncertainties, including whether we develop our drug candidates with a partner or independently. As a result of such uncertainties, we cannot predict with any significant degree of certainty the duration and completion costs of our research and development projects or whether, when and to what extent we will generate revenues from the commercialization and sale of any of our product candidates. The duration and cost of clinical trials may vary significantly over the life of a project as a result of unanticipated events arising during clinical development and a variety of factors, including:

the number of trials and studies in a clinical program;

the number of patients who participate in the trials;

the number of sites included in the trials;

the rates of patient recruitment and enrollment;

the duration of patient treatment and follow-up;

the costs of manufacturing our drug candidates; and

the costs, requirements, timing of, and the ability to secure regulatory approvals.

However, based upon our current plans, we expect to incur $114.0 million to $124.0 million in external clinical and preclinical study fees and other related expenses in 2008, which includes $90.0 million, $18.0 million and $3.0 million for lorcaserin, APD125 and APD791, respectively. This assumes that we continue all three of the ongoing Phase 3

clinical trials of lorcaserin, as well as the clinical development of APD125 and APD791 in 2008. We do not expect to receive regulatory approval for any of our drug candidates until late 2010 at the earliest, if at all.

General and administrative expenses. General and administrative expenses for the year ended December 31, 2007 increased $8.1 million to $26.6 million, from $18.5 million for the year ended December 31, 2006. This increase was due primarily to (i) personnel costs increasing by a total of $4.3 million as we increased our general and administrative employees from 54 at the end of 2006 to 68 at the end of 2007 and recorded an increase of $2.5 million to $4.6 million in non-cash, share-based compensation under SFAS No. 123R, and (ii) an increase of $1.9 million in patent costs primarily

related to our partnered programs. To the extent our partners reimburse us for patent costs, the reimbursements are classified as revenues. Such reimbursements totaled $3.9 million in 2007 and $2.1 million in 2006. We expect partner reimbursements for patent costs will be significantly lower in 2008 than in 2007. We also expect that our general and administrative expenses will be higher in the future due primarily to increases in the number of personnel, as well as commercialization, marketing and business development expenses.

Amortization of acquired technology. We recorded $1.5 million for amortization of acquired technology for both of the years ended December 31, 2007 and 2006 related to our patented Melanophore technology, our primary screening technology, which we acquired in 2001 for $15.4 million. The Melanophore technology is being amortized over its estimated useful life of 10 years. We expect to recognize $1.5 million in each of the next three years for amortization of this technology.

Interest and other income, net. Interest and other income, net, totaled $15.1 million for the year ended December 31, 2007, compared to $6.6 million for the year ended December 31, 2006. Interest and other income, net, for the year ended December 31, 2007 was comprised primarily of (i) $18.8 million in interest income and (ii) interest expense and financing costs of $3.7 million, which included lease payments accounted for in accordance with SFAS No. 66 "Accounting for Sales of Real Estate" and SFAS No. 98 "Accounting for Leases" on our lease financing obligations. Interest and other income, net, for the year ended December 31, 2006 was comprised primarily of (i) $12.7 million in interest income, (ii) a $4.6 million non-cash charge related to a warrant issued as part of a settlement with one of our warrant holders, and (iii) interest expense and financing costs of $1.8 million. The increased interest income resulting from higher cash balances throughout 2007 was partially offset by increased interest expense recorded in connection with our 2007 lease financing. Due to declining interest rates and lower cash balances due to our ongoing and planned clinical development, we expect our 2008 interest income to be less than 2007.

Dividends on redeemable convertible preferred stock. We recorded a dividend expense of $2.1 million related to our series B redeemable convertible preferred stock, or Series B Preferred, for the year ended December 31, 2007, compared to $2.0 million for the year ended December 31, 2006. The holders of our Series B Preferred are entitled to dividends that accrue at 4% annually. This dividend expense, which may be paid in common stock or by increasing the stated value of the Series B Preferred, increases the net loss allocable to common stockholders. Assuming that the Series B Preferred is held until the applicable mandatory redemption dates, we expect to record dividends on the Series B Preferred of $2.2 million, $0.5 million and $0.2 million for the years ending December 31, 2008, 2009 and 2010, respectively.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

Revenues. We recorded revenues of $30.6 million during the year ended December 31, 2006, compared to $23.2 million during the year ended December 31, 2005. All of our revenues during the year ended December 31, 2006 were from our collaborations with Ortho-McNeil and Merck, and included a $5.0 million milestone earned under our Ortho-McNeil collaboration and a $4.0 million milestone earned under our Merck collaboration, both of which we recognized immediately in accordance with our revenue recognition policy. Also included in our revenues during the year ended December 31, 2006 was $9.6 million in amortization of milestone achievements and technology access and development fees, $8.1 million in research funding, and $3.9 million in additional sponsored research and patent activities. All of our revenues during the year ended December 31, 2005 were also from our collaborations with Ortho-McNeil and Merck, and included a $2.0 million milestone earned under our Merck collaboration and recognized immediately in accordance with our revenue recognition policy, $9.6 million in amortization of milestone achievements and technology access and development

fees, $8.1 million in research funding, and $3.5 million in additional sponsored research and patent activities.

Research and development expenses. Research and development expenses for the year ended December 31, 2006 increased $23.7 million to $103.4 million, from $79.7 million for the year ended December 31, 2005. The difference was due primarily to (i) external clinical and preclinical study fees and expenses, including manufacturing costs, increasing by $10.2 million as we initiated our larger and more costly Phase 3 clinical program for lorcaserin during the third quarter of 2006 and continued to advance APD791 closer to clinical development, and (ii) personnel costs increasing by a total of $8.6 million as we increased the number of our research and development employees from 266 at the end of 2005 to 301 at the end of 2006 and recorded an additional $2.9 million in non-cash, share-based compensation related to the expensing of share-based compensation under SFAS No. 123R. Included in the $40.4 million in external clinical and preclinical study fees and expenses for the year ended December 31, 2006 was $30.2 million related to our lorcaserin program, $4.9 million related to our APD125 program and $2.9 million related to our APD791 program. Included in the $30.2 million in external clinical and preclinical study fees and expenses for the year ended December 31, 2005 was $20.2 million related to our lorcaserin program and $6.7 million related to our APD125 program. Nearly all of the increase in research and development personnel related to the development of our internal programs, primarily lorcaserin, APD125 and APD791.

General and administrative expenses. General and administrative expenses for the year ended December 31, 2006 increased $5.4 million to $18.5 million, from $13.1 million for the year ended December 31, 2005. This increase was due primarily to (i) personnel costs increasing by a total of $2.6 million as we increased our general and administrative employees from 48 at the end of 2005 to 54 at the end of 2006 and recorded an additional $2.1 million in non-cash, share-based compensation under SFAS No. 123R, and (ii) an increase of $1.6 million in patent costs related to our partnered programs and our internal programs and technologies. To the extent our partners reimburse us for patent costs, the reimbursements are classified as revenues. Such reimbursements totaled $2.1 million in 2006 and $1.1 million in 2005.

Amortization of acquired technology. We recorded $1.5 million for amortization of acquired technology for both of the years ended December 31, 2006 and 2005 related to our patented Melanophore technology.

Interest and other income, net. Interest and other income, net, totaled $6.6 million for the year ended December 31, 2006, compared to $3.2 million for the year ended December 31, 2005. Interest and other income, net, for the year ended December 31, 2006 was comprised primarily of (i) $12.7 million in interest income, (ii) a $4.6 million non-cash charge related to a warrant issued as part of a settlement with one of our warrant holders, and (iii) interest expense and financing costs of $1.8 million. Interest and other income, net, for the year ended December 31, 2005 was comprised primarily of (i) $4.4 million in interest income, (ii) interest expense and financing costs of $1.8 million, and (iii) a $0.5 million payment received for the termination of our Fujisawa collaboration and classified as other income. The increase in interest income in the year ended December 31, 2006 was the result of both higher cash balances from the two public offerings we completed in 2006 and higher average interest rates in 2006 compared to 2005.

Dividends on redeemable convertible preferred stock. We recorded a dividend expense of $2.0 million related to our Series B Preferred for the year ended December 31, 2006, compared to $1.8 million for the year ended December 31, 2005. In April 2005, we issued an additional $11.5 million in redeemable convertible preferred stock as a result of the preferred stockholders' exercise of their unit warrants.

Accretion of discount on redeemable convertible preferred stock. We recorded as an expense accretion of discount and deemed dividend on our redeemable convertible preferred stock in the amount of $7.4 million for the year ended December 31, 2005 in accordance with Emerging Issues Task Force, or EITF, Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments." We allocated the total proceeds received in our preferred stock financing among the series B-1 redeemable convertible preferred stock, or Series B-1 Preferred, and the related warrants and unit warrants, estimating the value of the warrants and unit warrants at $6.5 million using the Black-Scholes method. The fair value of the common stock into which the redeemable convertible preferred stock was convertible into on the date of issuance exceeded the proceeds allocated to the redeemable convertible preferred stock by $2.8 million, resulting in a beneficial conversion feature that we recognized as an increase to paid-in capital and as a deemed dividend to the redeemable convertible preferred stock. As a result of the public offering we completed in February 2005, which resulted in the Series B-1 Preferred becoming immediately redeemable at the option of the holders, we recorded a charge in the first quarter of 2005 of $7.4 million to accrete the remaining unaccreted discount and deemed dividend on the redeemable convertible preferred stock.

LIQUIDITY AND CAPITAL RESOURCES

Short term

Our sources of liquidity include our cash balances and short-term investments. As of December 31, 2007, we had $398.2 million in cash and cash equivalents and short-term investments. In addition to our cash and investments, other potential sources of near-term liquidity include (i) equity, debt or other financing, (ii) the out-licensing of our drug candidates, internal drug programs and technologies, (iii) the sale of facilities that we own, and (iv) milestone payments from our collaborators.

To date, we have generated cash and funded our operations primarily through the sale of common and preferred stock, payments from collaborators and sale leaseback transactions. From our inception through December 31, 2007, we have generated $1.0 billion in cash from these sources, of which $839.6 million was through sales of stock, $140.0 million was through payments from our current and past collaborators and $61.1 million was from sale leaseback transactions.

We anticipate that our research and development expenditures will increase significantly as we continue our Phase 3 program for lorcaserin, initiate a Phase 2b clinical trial of APD125, and continue a Phase 1b clinical trial of APD791. We expect that the external expenses for our Phase 3 lorcaserin program, the majority of which we expect will be expensed through the first half of 2009, will be substantial. A large portion of these external clinical trial expenses are expected to be paid through CROs. Our contracts with the primary CROs for our Phase 3 lorcaserin program can be terminated if, depending on the contract, we give five or 30 days prior written notice, or less in certain circumstances. In addition to costs related to these clinical trials, we expect to incur significant manufacturing and other pre-launch costs for lorcaserin. We estimate that our Phase 3 lorcaserin program will continue in 2009 and could take significantly longer than expected to complete for various reasons including those set forth in "Item 1A. Risk Factors" in this Annual Report.

The research funding we received from our collaborations with Ortho-McNeil and Merck ended in the fourth quarter of 2007 and, absent any new collaborations, we expect no revenues from research funding to be recognized in 2008 or thereafter from our existing collaborators. We expect to recognize, in Swiss francs, CHF 8.2 million, or $7.4 million, in revenues from our contract manufacturing agreement with Siegfried in 2008, and that such revenues will be offset by related costs and expenses.

We believe we have sufficient cash to meet our objectives over at least the next year, including continuing our development programs for lorcaserin, APD125 and APD791, continuing development of our other lead internal programs, discovering and developing additional drug candidates, integrating our Swiss operations, continuing to build our

development and manufacturing capabilities, including

our manufacturing facilities in Switzerland, and maintaining our research discovery capabilities. We will continue to monitor and evaluate the proper level of research, development and manufacturing expenditures, and may adjust such expenditures based upon a variety of factors, such as our month-12 ESMB and other clinical trial and preclinical results for our drug candidates, as well as our ability to generate cash through financings and collaborative activities. We expect our 2008 capital expenditures will be higher than in 2007 due to the purchase of our Swiss manufacturing facilities in January 2008 and planned purchases of equipment and improvements to our San Diego facilities, including a significant expansion of our property located at 6154 Nancy Ridge Drive that is expected to cost approximately $16.2 million, of which up to $15.0 million is expected to be reimbursed by the owner of the property in early 2009, less applicable commissions.

The holders of our Series B-1 Preferred can require us to redeem all or some of their outstanding shares of Series B-1 Preferred at any time. We will be required to redeem any shares of Series B-1 Preferred that remain outstanding on December 24, 2008 at a price equal to the amount of the original holder's original investment, plus all accrued but unpaid dividends thereon to the date of such payment. The aggregate redemption price of our Series B-1 Preferred at December 31, 2007 was $41.1 million, and we expect the aggregate redemption price at the mandatory redemption date of December 24, 2008 to be $42.8 million. We may be able to satisfy all or a portion of this amount with shares of our common stock. Our ability and decision whether to use cash or stock to satisfy any redemption will depend on, among other factors, the amount of cash we have, our stock price and the amount of common stock then held by our preferred stockholders.

In May 2007, we sold to BioMed three properties that we owned and continue to occupy, and assigned to BioMed an option to purchase a fourth property that we currently lease and primarily occupy for total consideration of $50.1 million, resulting in net proceeds to us of $48.5 million. Concurrently with the closing of the transaction, we leased back the three properties sold to BioMed under leases with 20-year terms and two consecutive options to extend such terms for five years each. Initial base rent for these three properties (net of taxes, insurance and maintenance costs (i.e. triple net) for which we are responsible) is an aggregate of $4.5 million annually, subject to an annual increase of 2.5% and other specified adjustments. If, at our election, we complete certain improvements to the properties sold, BioMed will pay us up to an additional $16.0 million (less applicable commissions) and our lease payments would increase. The amount of such increase would depend on the year in which such improvements are completed, if ever, with the initial amount of such increase for 2007 set at, assuming we receive the full $16.0 million (before applicable commissions), $1.4 million per year and increasing by approximately 2.5% each year. We expect to receive $1.0 million of such additional amount for improvements in the first quarter of 2008, but that we will not receive the remaining $15.0 million until 2009, if ever. Such additional amounts, if any, will be reduced by applicable commissions.

We will continue to lease a portion of the property that is subject to BioMed's purchase option from the current owner through the expiration of the lease with such owner, at which time we expect that BioMed will exercise the purchase option and rent will commence under a lease with BioMed for a term that is concurrent with the leases for the other three properties and at an initial base rent for such property (triple net) of $0.8 million per year, which would be subject to an annual increase of 2.5%. If BioMed is unable to exercise the option due to (i) an amendment to our lease with the current owner of such property that adversely affects such option and such amendment is not consented to by BioMed, or (ii) any casualty loss or proceeding in eminent domain pursuant to which BioMed has a right not to exercise the option in accordance with our agreement of purchase and sale, and BioMed elects not to exercise the option as a consequence of the occurrence of any event described in (i) and (ii) above, we would be required to pay BioMed $12.1 million. If BioMed elects to not exercise the option due to (ii) above, the lease payments on the remaining three properties would be reduced. The amount of such reduction would depend on the year in which BioMed elects to not

exercise the option, if ever, with the initial amount of such reduction for 2007 set at $1.1 million per year and increasing by 2.5% each year. In addition, subject to certain restrictions, we will have the option to repurchase all of the properties included in the transaction on the 10th, 15th or 20th anniversary of the execution date of the leases, and earlier if the leases are terminated under certain circumstances.

In January 2008, we entered into strategic cooperation agreements with Siegfried Ltd that are primarily related to the manufacturing of lorcaserin, which is expected to be necessary for our planned New Drug Application, or NDA, submission to the FDA and for commercialization of lorcaserin after regulatory marketing approval. The agreements include an asset purchase agreement for the purchase from Siegfried Ltd of certain drug product facility assets and technology, including fixtures, equipment, other personal property and real estate assets in Zofingen, Switzerland. We paid CHF 21.8 million, or $19.8 million, of the cash purchase price in January 2008, and will pay the remaining cash portion of the purchase price of CHF 10.0 million in three equal installments in the third, fourth and fifth years after closing. This transaction also included a long-term supply agreement, a contract manufacturing agreement and a services agreement.

We will continue to be opportunistic in our efforts to generate cash. We also continue to regularly evaluate potential acquisitions and in-licensing opportunities. Any such transaction may impact our liquidity as well as affect our expenses if, for example, our operating expenses increase as a result of such license or acquisition or we use our cash to finance the license or acquisition.

Long term

We will need to raise or generate significant amounts of cash to achieve our objectives of internally developing drugs, which take many years and potentially several hundreds of millions of dollars to develop, and continuing our research programs. If we decide to market and commercialize lorcaserin or any other drug candidate independently or with a partner, we may need to invest heavily in associated marketing and commercialization costs. Such costs will be substantial and some will need to be incurred prior to receiving marketing approval from the FDA. We do not currently have adequate internal liquidity to meet these objectives in the long term. In order to do so, we will need to continue our out-licensing activities and look to other external sources of liquidity, including the public and private financial markets and strategic partners.

The length of time that our current cash and cash equivalents, short-term investments and any available borrowings will sustain our operations will be based on, among other things, our progress in preclinical and clinical testing, the time and costs related to current and planned clinical trials and regulatory decisions, our research, development and manufacturing costs (including personnel costs), the progress in our collaborations, costs associated with intellectual property, our capital expenditures, and costs associated with securing any in-licensing opportunities. We do not know whether adequate funding will be available to us or, if available, that such funding will be available on acceptable terms. Any significant shortfall in funding could result in the partial or full curtailment of our development and/or research efforts, which, in turn, will affect our development pipeline and ability to generate cash in the future.

In addition to the public and private financial markets, potential sources of liquidity in the long term are milestone and royalty payments from existing and future collaborators and revenues from sales of our drugs.

Sources and Uses of Our Cash

Net cash used in operating activities was $128.1 million during the year ended December 31, 2007, and was used primarily to fund our net losses in the period, adjusted for non-cash expenses. Non-cash expenses included $8.8 million in share-based compensation, $7.8 million in depreciation and amortization expense, $1.5 million in amortization of acquired technology, as well as changes in operating assets and liabilities. Net cash used in operating activities was $71.0 million during the year ended December 31, 2006, and was used primarily to fund our net losses in the period, adjusted for non-cash expenses. Non-cash expenses included $7.4 million in depreciation and amortization expense, $5.0 million in share-based compensation, a $4.6 million charge related to a warrant settlement, $1.5 million in amortization of acquired technology, as well as changes in operating assets and liabilities. Net cash used in operating activities during the year ended December 31, 2005 was $42.9 million, and was used primarily to fund our net losses in the period, adjusted for non-cash expenses, including $6.9 million in depreciation and amortization expense, $1.5 million in amortization of acquired technology, $0.4 million in amortization of deferred compensation, as well as changes in operating assets and liabilities. We expect net cash used in operating activities will increase substantially assuming favorable results from the ESMB's month-12 review of echocardiograms in BLOOM and that we continue our clinical development programs and hiring of employees, primarily in clinical development.

Net cash of $12.6 million was used in investing activities during the year ended December 31, 2007, and was primarily the result of $14.2 million used for improvements to our facilities and purchases of equipment and $3.2 million used to purchase a facility on our San Diego campus, partially offset by net proceeds from short-term investments of $5.0 million. Net cash of $25.1 million was provided by investing activities during the year ended December 31, 2006, and was primarily the result of net proceeds from short-term investments of $39.1 million, partially offset by $3.6 million used to purchase a facility on our San Diego campus and $10.6 million used for equipment and improvements to our facilities. Net cash used in investing activities during the year ended December 31, 2005 was $2.9 million, and was primarily the result of $3.6 million used for the purchase of equipment and improvements to our facilities, partially offset by net proceeds from the sale of short-term investments of $0.4 million. We expect our 2008 capital expenditures will be higher than 2007 due to the purchase of our Swiss manufacturing facilities in January 2008 and planned purchases of equipment and improvements to our San Diego facilities, including a major expansion of approximately 75,000 square feet at our facility located at 6154 Nancy Ridge Drive that is expected to cost approximately $16.2 million.

Net cash of $154.7 million was provided by financing activities during the year ended December 31, 2007. This was due primarily to net proceeds of $103.2 million we received in November 2007 from the sale of 11,000,000 shares of our common stock at $9.91 per share, as well as net proceeds of $48.5 million we received in May 2007 from our lease financing transaction and net proceeds of $3.5 million received from option exercises, purchases under our employee stock purchase plan, and from the equity component of the $1.0 million payment we received from Merck in February 2007, which were partially offset by $0.5 million in principal payments on our lease financing obligations. Net cash of $345.2 million was provided by financing activities during the year ended December 31, 2006 due primarily to net proceeds of $165.1 million and $169.0 million we received in December 2006 and February 2006, respectively, from the sale of shares of our common stock, as well as proceeds of $8.3 million from the exercise of warrants to purchase our common stock in March 2006. Net cash of $60.8 million was provided by financing activities during the year ended December 31, 2005, and was due primarily to net proceeds of $48.2 million we received in February 2005 from the sale of shares of our common stock and $11.5 million received in April 2005 from our preferred stockholders' exercise of their unit warrants.

Contractual Obligations Table

The following table summarizes our contractual obligations as of December 31, 2007:

		Payments due by period (in thousands)			
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 Years**
Series B Preferred	$ 53,922	$ 41,113	$ 12,809	$	$
Operating leases	5,946	1,115	2,427	2,148	256
Purchase obligations	449	449			
Financing obligations	131,809	5,597	12,659	13,300	100,253
Total	$ 192,126	$ 48,274	$ 27,895	$ 15,448	$ 100,509

The holders of our Series B-1 Preferred can require us to redeem all or some of their outstanding shares of Series B-1 Preferred at any time at such shares' stated value, which includes dividends that accrue at 4% annually. In addition, if not earlier redeemed, we are required to redeem our Series B-1 Preferred on December 24, 2008. If not previously converted, we are required to redeem the Series B-2 Preferred on April 22, 2010, at such shares' stated value, which includes dividends that accrue at 4% annually. Although we may be able to satisfy all or a portion of these amounts with shares of our common stock if certain criteria are met, the above table includes the full cash redemption price for both series of preferred stock as of December 31, 2007.

We have entered into agreements with CROs to conduct our clinical trials, and expect to continue to enter into such agreements. We will make payments to these sites and organizations primarily based upon the number of subjects enrolled and the length of their participation in the trials.

In determining the amount of our purchase obligations for contracts, we have included only the minimum obligation we have under our contracts (which analysis often assumed that such contracts were terminated on December 31, 2007) and did not include any amount which was previously paid, accrued, expensed or associated with a contingent event, such as a change in control or termination of a key employee.

In December 2003, we completed the sale and leaseback of one of our properties for total consideration of $13.0 million and in May 2007, we completed the sale and leaseback of three of our properties and assigned an option to purchase a fourth property for total consideration of $50.1 million. We have accounted for these transactions in accordance with SFAS No. 66, "Accounting for Sales of Real Estate" and SFAS No. 98, "Accounting for Leases." Our option to repurchase these properties in the future is considered continued involvement under SFAS No. 66 and, therefore, we have applied the financing method under SFAS No. 98. Under the financing method, the book value of the properties and related accumulated depreciation remain on our balance sheet and no sale is recognized. Instead, the sales price of the properties is recorded as a financing obligation and a portion of each lease payment is recorded as interest expense. At December 31, 2007, we expect interest expense over the term of these leases to total $79.5 million. We have included our lease obligations related to these properties in the above table as "financing obligations." At December 31, 2007, in accordance with SFAS No. 98, our total financing obligation for both of these transactions was $62.3 million. The aggregate residual value of the facilities at the end of the lease terms is $10.0 million.

In January 2008, we entered into strategic cooperation agreements with Siegfried Ltd. The agreements include an asset purchase agreement for the purchase from Siegfried Ltd of certain drug product facility assets, including fixtures, equipment, other personal property and real estate assets in Zofingen, Switzerland. We paid CHF 21.8 million, or

$19.8 million, of the cash purchase price in January 2008, and will pay the remaining cash portion of the purchase price of CHF 10.0 million in

three equal installments in the third, fourth and fifth years after closing. This contractual obligation is not included in the above table.

The following is a summary of our significant collaborations as of December 31, 2007:

Ortho-McNeil Pharmaceutical, Inc.

In December 2004, we entered into a collaboration and license agreement with Ortho-McNeil to further develop compounds for the potential treatment of type 2 diabetes and other disorders. In January 2005, we received a non-refundable $17.5 million upfront payment and two milestone payments of $2.5 million each, and, in February 2006, we received a $5.0 million milestone payment related to Ortho-McNeil's initiation of a Phase 1 clinical trial of the then lead drug candidate, APD668. In September 2006, Ortho-McNeil exercised its option to extend the research portion of the collaboration through December 2007, beyond which date we no longer perform services or have significant involvement. Based on the data from studies of APD668, in January 2008 Ortho-McNeil decided to put APD668 on hold and has advanced a potentially more potent Arena-discovered GDIR agonist into preclinical development. We are eligible to receive a total of $295.0 million in milestone payments for each compound, as well as royalty payments associated with Ortho-McNeil's commercialization of any products discovered under the agreement. These milestones include development and approval milestone payments of up to $132.5 million for the first indication and $62.5 million for the second indication for each compound, and up to $100.0 million in sales milestone payments for each product resulting from the collaboration. From the inception of this collaboration through December 31, 2007, we received $27.5 million from Ortho-McNeil in upfront and milestone payments and $7.2 million in research funding. We recognized the upfront payment ratably over three years, along with the two milestones received in January 2005 as their achievability was reasonably assured at the time we entered into the collaboration.

Our agreement with Ortho-McNeil will continue until the expiration of Ortho-McNeil's payment obligations under the agreement, unless the agreement is terminated earlier by either party. We and Ortho-McNeil each have the right to terminate the agreement early on 60 days prior written notice if the other party commits an uncured material breach of its obligations. Ortho-McNeil may terminate the agreement at any time by providing at least 60 days prior written notice. Upon termination of the agreement, all rights to the compounds developed under the collaboration will revert to us.

For the year ended December 31, 2007, we recognized revenues under the Ortho-McNeil agreement of $13.4 million, which included $7.3 million from amortization of milestones and technology access and development fees received in prior years, $3.8 million for patent activities, and $2.3 million in research funding. For the year ended December 31, 2006, we recognized revenues under the Ortho-McNeil agreement of $18.5 million, which included $7.5 million from amortization of milestones and technology access and development fees received in prior years, $5.0 million from a milestone earned, $2.4 million in research funding, and $3.6 million for additional sponsored research and patent activities. For the year ended December 31, 2005, we recognized revenues under this agreement of $13.4 million, which included $7.5 million from amortization of milestones and technology access and development fees received in prior years, $2.4 million in research funding, and $3.5 million in additional sponsored research and patent activities. At December 31, 2007, there were no deferred revenues remaining under this agreement.

Merck & Co., Inc.

In October 2002, we entered into a research and licensing agreement with Merck to collaborate on three G protein-coupled receptors, or GPCRs, to develop therapeutics for atherosclerosis and related disorders. We believe one or more of these GPCRs plays a role

in regulating plasma lipid profiles, including HDL cholesterol, the so-called "good cholesterol," and is responsible for the HDL-raising

activity of niacin. In October 2004, we extended and expanded this collaboration, and Merck selected one of our compounds for preclinical development. In February 2007, we amended our Merck collaboration to reduce the number of Arena research employees funded under the collaboration in exchange for Merck making a $1.0 million equity investment in Arena equal to the reduction in their research funding obligation and at approximately a 70% premium to the then current market price.

In September 2006, we announced that Merck completed a Phase 2 clinical trial of MK-0354, a niacin receptor agonist discovered by us and intended for the treatment of atherosclerosis and related disorders. Based on the results of this trial, Merck discontinued development of MK-0354. In January 2008, Merck initiated a Phase 1 clinical trial of a second generation niacin receptor agonist under our partnership for atherosclerosis and other disorders.

From the inception of this collaboration through December 31, 2007, we received $18.0 million from Merck in upfront and milestone payments, and equity investments totaling $8.5 million. We may receive additional milestone payments of up to $28.0 million for Merck's clinical and marketing achievements, as well as royalty payments associated with Merck's commercialization of any products discovered under the agreement. In addition, we received research funding from Merck through October 2007 totaling $27.5 million when, under our amended agreement, Merck's obligation for research funding ended, and beyond which date we no longer perform services or have significant involvement.

Our agreement with Merck will continue until the expiration of all royalty obligations under the agreement, unless the agreement is terminated early by either party. Either Merck or we can terminate our agreement if the other party breaches its material obligations under the agreement by causes and reasons within its control, has not cured such breach within 90 days of receiving a letter requesting such cure, and there is no dispute as to whether such breach has occurred. The non-breaching party in such a termination would receive the rights to continue the program. In addition, Merck can terminate the agreement at anytime by giving 90 days notice, but all milestones and royalties would still be payable as provided in the agreement.

As part of the extension and expansion of our collaboration with Merck in October 2004, Merck purchased $7.5 million of our stock at approximately a 70% premium to the then current market price. We performed an evaluation on this Merck stock purchase and determined that $3.9 million of this $7.5 million purchase price was an upfront payment related to the collaboration extension and expansion. Accordingly, we recognized the $3.9 million upfront payment, as well as the remaining portion of the unamortized upfront payment at October 2004 of $1.3 million, over the extended collaboration term of three years. Additionally, in October 2004, we achieved a $1.0 million milestone under the collaboration which we also recognized over the extended collaboration term of three years because the milestone was reasonably assured to be achieved at the time we extended and expanded this collaboration.

In connection with the February 2007 amendment of the collaborative agreement with Merck, we performed an evaluation on the stock purchase, which was at a purchase price of $24.81 per share, and determined that $0.5 million of the $1.0 million purchase price was an upfront payment related to the collaboration amendment. Accordingly, we recognized this upfront payment and the unamortized portion of the previously received upfront payments over the remaining term of the research portion of the collaboration. Merck's obligation for research funding ended in October 2007, beyond which date we no longer perform services or have significant involvement.

For the year ended December 31, 2007, we recognized revenues under the Merck agreement of $5.9 million, which included $3.6 million in research funding, $2.2 million from amortization of milestones and technology access and development fees received in prior years, and $0.1 million for patent activities. For the year ended December 31, 2006,

we recognized revenues under the Merck agreement of $12.1 million, which included $5.7 million in research funding, $4.0 million from a

milestone earned, $2.1 million from amortization of milestones and technology access and development fees received in prior years, and $0.3 million for additional sponsored research and patent activities. For the year ended December 31, 2005, we recognized revenues under this agreement of $9.8 million, which included $5.7 million in research funding, $2.1 million from amortization of milestones and technology access and development fees received in prior years, and $2.0 million from a milestone earned. At December 31, 2007, there were no deferred revenues remaining under this agreement.

Recently issued accounting standards

In June 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in accordance with United States generally accepted accounting principles, or GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. We are evaluating the effect, if any, the adoption of SFAS No. 157 will have on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of SFAS No. 115," which allows an entity to voluntarily choose to measure certain financial assets and liabilities at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are evaluating the effect, if any, the adoption of SFAS No. 159 will have on our consolidated financial statements.

In June 2007, the FASB ratified the consensus reached by the EITF on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities." EITF Issue No. 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed or such time when the entity does not expect the goods to be delivered or services to be performed. EITF Issue No. 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The adoption of EITF Issue No. 07-3 will not have a material effect on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations," which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and interim periods within those fiscal years. We are evaluating the effect, if any, the adoption of SFAS No. 141R will have on our consolidated financial statements.

CRITICAL ACCOUNTING POLICIES AND MANAGEMENT ESTIMATES

The SEC defines critical accounting policies as those that are, in management's view, important to the portrayal of our financial condition and results of operations and demanding of management's judgment. Our discussion and analysis of financial condition and results of operations is based on our consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures. We base our estimates on historical experience and on various assumptions that we believe are reasonable under the

circumstances, the results of which form the basis for making judgments about the carrying values of

assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Our critical accounting policies include:

Clinical trial expenses. We accrue clinical trial expenses based on work performed. In determining the amount to accrue, we rely on estimates of total costs incurred based on the enrollment of subjects, the completion of studies and other events. We follow this method because we believe reasonably dependable estimates of the costs applicable to various stages of a clinical trial can be made. However, the actual costs and timing of clinical trials are highly uncertain, subject to risks and may change depending on a number of factors. Differences between the actual clinical trial costs and the estimated clinical trial costs that we have accrued in any prior period are recorded in the subsequent period in which the actual costs become known. Historically, these differences have not been material and we have not had to make material adjustments in the amounts recorded in a subsequent period; however, material differences could occur in the future.

Revenue recognition. Our revenue recognition policies are in accordance with SEC Staff Accounting Bulletin, or SAB, No. 104, "Revenue Recognition," and EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which provide guidance on revenue recognition in financial statements. Some of our agreements contain upfront technology access fees, research funding, milestone achievements and royalties.

Revenue from a milestone achievement is recognized when earned, as evidenced by acknowledgment from our collaborator, provided that (i) the milestone event is substantive and its achievability was not reasonably assured at the inception of the agreement, (ii) the milestone represents the culmination of an earnings process, (iii) the milestone payment is non-refundable and (iv) our performance obligations after the milestone achievement will continue to be funded by our collaborator at a level comparable to the level before the milestone achievement. If all of these criteria are not met, the milestone achievement is recognized over the remaining minimum period of our performance obligations under the agreement. We defer non-refundable upfront fees under our collaborations and recognize them over the period in which we have significant involvement or perform services, using various factors specific to each collaboration. Amounts we receive for research funding for a specified number of full-time researchers are recognized as revenue as the services are performed. Advance payments we receive in excess of amounts earned are classified as deferred revenues until earned.

Share-based compensation. On January 1, 2006, we adopted SFAS No. 123R using the modified-prospective transition method. Under this method, prior period results are not restated. Compensation expense recognized subsequent to adoption includes: (i) compensation expense for all share-based awards granted prior to, but unvested as of, January 1, 2006, based on the grant-date fair value, estimated in accordance with the original provision of SFAS No. 123 using the Black-Scholes option pricing model, and (ii) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant-date fair value, estimated in accordance with the provisions of SFAS No. 123R using the Black-Scholes option pricing model.

The determination of the grant-date fair value of share-based awards using the Black-Scholes option pricing model is based on the exercise price of the award and our stock price on the date of grant, as well as assumptions for expected volatility, the expected life of options granted and the risk-free interest rate. Changes in the assumptions can have a material impact on the compensation expense we recognize. Expected volatility for awards granted after adoption of SFAS No. 123R is based on a combination of 75% historical volatility of our common stock and 25% market-based implied volatility from traded options on our common stock, with historical volatility being more heavily weighted due to the low volume of traded options on our common stock. Prior to adoption of SFAS No. 123R, our computation of expected volatility was based only on the historical volatility of our

common stock. The expected life of options granted under SFAS No. 123R is determined based on historical experience of similar awards, giving consideration to the contractual terms of the share-based awards, vesting schedules and post-vesting cancellations. Prior to the adoption of SFAS No. 123R, an average expected life of five years was used in determining the fair value of option grants based on the vesting period of the options and the short period of time our stock had been publicly traded. The risk-free interest rates are based on the US Treasury yield curve, with a remaining term approximately equal to the expected term used in the option pricing model.

As compensation expense recognized is based on awards ultimately expected to vest, it is reduced for estimated forfeitures. SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. If actual forfeitures do vary from estimates, we will recognize the difference in compensation expense in the period the actual forfeitures occur or when options vest.

For the year ended December 31, 2007, we recorded total non-cash, share-based compensation expense of $8.8 million.

Accounting for lease financing obligations. We have accounted for our sale leaseback transactions in accordance with SFAS No. 66 and SFAS No. 98. Our option to repurchase these properties in the future is considered continued involvement under SFAS No. 66 and, therefore, we have applied the financing method under SFAS No. 98. Under the financing method, the book value of the properties and related accumulated depreciation remain on our balance sheet and no sale is recognized. Instead, the sales price of the properties is recorded as a financing obligation, and a portion of each lease payment is recorded as interest expense. We estimated and apply an incremental borrowing rate to the lease payments to record interest expense.

Intangibles. Purchase accounting requires estimates and judgments to allocate the purchase price to the fair market value of the assets received and liabilities assumed. In February 2001, we acquired Bunsen Rush Laboratories, Inc. for $15.0 million in cash and assumed $0.4 million in liabilities. We allocated $15.4 million to the patented Melanophore technology acquired in such transaction. The Melanophore technology, our primary screening technology, is being amortized over its estimated useful life of 10 years, which was determined based on an analysis, as of the acquisition date, of the conditions in, and the economic outlook for, the pharmaceutical and biotechnology industries and the patent life of the technology. As with any intangible asset, we will continue to evaluate the value of the Melanophore technology. If, in the future, we determine that the Melanophore technology has become impaired or we no longer use it internally as our primary screening technology, we may record a write-down of the carrying value or we will accelerate the amortization if we determine that its life has been shortened.

The above listing is not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP. See our audited consolidated financial statements and notes thereto included elsewhere in this Annual Report, which contain additional accounting policies and other disclosures required by GAAP.

INCOME TAXES

As of December 31, 2007, we had $345.0 million of Federal net operating loss carryforwards and $25.3 million of Federal research and development tax credit carryforwards for income tax purposes which expire on various dates beginning in 2012. These amounts reflect different treatment of expenses for financial reporting and for tax purposes. United States tax law contains provisions that may limit our ability to use net operating loss and tax credit carryforwards in any year, including if there has been a significant ownership change.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

Our management establishes and oversees the implementation of board-approved policies covering our investments. We manage our market risk in accordance with our investment guidelines which (i) emphasize preservation of principal over other portfolio considerations, (ii) require investments to be placed in US government and agency obligations and in debt instruments that are rated investment grade, (iii) establish guidelines for the diversification of our investment portfolio, and (iv) require investments to be placed with maturities that maintain safety and liquidity. We target our portfolio to have an average duration of no more than four years with no one instrument having a duration exceeding five years and one month. We do not invest in derivative instruments, or any financial instruments for trading purposes. Our primary market risk exposure as it affects our cash equivalents, short-term investments, and securities available-for-sale is interest rate risk. We monitor our interest rate risk on a periodic basis and we ensure that our cash equivalents, short-term investments, and securities available-for-sale are invested in accordance with our investments guidelines. Managing credit ratings and the duration of our financial investments enhances the preservation of our capital.

We model interest rate exposure by a sensitivity analysis that assumes a hypothetical parallel shift downward in the US Treasury yield curve of 100 basis points. Under these assumptions, if the yield curve were to shift lower by 100 basis points from the level existing at December 31, 2007, we would expect future interest income from our portfolio to decline by less than $4.0 million over the next 12 months. As of December 31, 2006, this same hypothetical reduction in interest rates would have resulted in a decline in interest income of less than $3.9 million over the 12 months following December 31, 2006. The difference in these two estimates is due to the difference in our cash and cash equivalents, short-term investments, and securities available-for-sale between the two periods.

The model we use is not intended to forecast actual losses in interest income, but is used as a risk estimation and investment management tool. These hypothetical changes and assumptions are likely to be different from what actually occurs in the future. Furthermore, such computations do not incorporate actions our management could take if the hypothetical interest rate changes actually occur. As a result, the impact on actual earnings will likely differ from those quantified herein.

We have a wholly owned subsidiary in Switzerland, which exposes us to foreign exchange risk. The functional currency of our subsidiary in Switzerland is the Swiss franc. Accordingly, all assets and liabilities of our subsidiary are translated to US dollars based on the applicable exchange rate on the balance sheet date. Expense components are translated to US dollars at weighted-average exchange rates in effect during the period. Gains and losses resulting from foreign currency translation are included as a component of our stockholders' equity. Other foreign currency transaction gains and losses are included in our results of operations and, to date, have not been significant. We have not hedged exposures denominated in foreign currencies or any other derivative financial instrument, but may do so in the future.

Item 8. Financial Statements and Supplementary Data.

ARENA PHARMACEUTICALS, INC.
INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of Arena Pharmaceuticals, Inc.

We have audited the accompanying consolidated balance sheets of Arena Pharmaceuticals, Inc. as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arena Pharmaceuticals, Inc. at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, Arena Pharmaceuticals, Inc. changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123 (revised 2004) on January 1, 2006.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Arena Pharmaceuticals, Inc.'s internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California
February 29, 2008

ARENA PHARMACEUTICALS, INC.

Consolidated Balance Sheets

(In thousands, except share and per share data)

	December 31, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 386,989	$ 373,044
Short-term investments, available-for-sale	11,196	15,781
Accounts receivable	1,901	310
Prepaid expenses and other current assets	9,162	10,551
Total current assets	409,248	399,686
Land, property and equipment, net	65,940	56,500
Acquired technology, net	4,875	6,412
Other non-current assets	7,443	5,867
Total assets	$ 487,506	$ 468,465
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 26,922	$ 20,769
Accrued compensation	3,136	2,178
Deferred revenues		13,054
Current portion of lease financing obligations	231	
Total current liabilities	30,289	36,001
Deferred rent	793	863
Deferred revenues	4,049	
Lease financing obligations, less current portion	62,076	13,678
Commitments		
Series B redeemable convertible preferred stock, $.0001 par value: 4,650 shares authorized, issued and outstanding at December 31, 2007 and 2006; liquidation preference $46,500 at December 31, 2007 and 2006	53,922	51,808
Stockholders' equity:		
Series A preferred stock, $.0001 par value: 350,000 shares authorized at December 31, 2007 and 2006; no shares issued and outstanding at December 31, 2007 and 2006		
Common stock, $.0001 par value: 142,500,000 shares authorized at December 31, 2007 and 2006; 72,260,254 and 60,771,401 shares issued and outstanding at December 31, 2007 and 2006, respectively	8	6
Additional paid-in capital	838,913	723,363
Treasury stock 3,000,000 shares at December 31, 2007 and 2006	(23,070)	(23,070)
Accumulated other comprehensive loss	(23)	(13)

	December 31, 2007	December 31, 2006
Accumulated deficit	(479,451)	(334,171)
Total stockholders' equity	336,377	366,115
Total liabilities and stockholders' equity	$ 487,506	$ 468,465

See accompanying notes.

ARENA PHARMACEUTICALS, INC.

Consolidated Statements of Operations

(In thousands, except share and per share data)

	Years ended December 31,		
	2007	**2006**	**2005**
Revenues:			
Total revenues	$ 19,332	$ 30,569	$ 23,233
Operating expenses:			
Research and development	149,524	103,388	79,710
General and administrative	26,571	18,466	13,122
Amortization of acquired technology	1,537	1,537	1,537
Total operating expenses	177,632	123,391	94,369
Loss from operations	(158,300)	(92,822)	(71,136)
Interest and other income (expense):			
Interest income	18,850	12,691	4,426
Interest expense	(3,746)	(1,838)	(1,838)
Non-cash warrant settlement		(4,554)	
Loss on sale of investments	(116)	(8)	(28)
Other income, net	146	283	675
Total interest and other income (expense), net	15,134	6,574	3,235
Net loss	(143,166)	(86,248)	(67,901)
Dividends on redeemable convertible preferred stock	(2,114)	(2,031)	(1,813)
Accretion of discount on redeemable convertible preferred stock			(7,372)
Net loss allocable to common stockholders	$ (145,280)	$ (88,279)	$ (77,086)
Net loss per share allocable to common stockholders, basic and diluted	$ (2.31)	$ (1.89)	$ (2.24)
Shares used in calculating net loss per share allocable to common stockholders, basic and diluted	62,782,850	46,750,596	34,377,693

See accompanying notes.

ARENA PHARMACEUTICALS, INC.

Consolidated Statements of Stockholders' Equity

(In thousands, except share data)

	Common Stock							
	Shares	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Deferred Compensation	Accumulated Deficit	Total Stockholders' Equity
Balance at December 31, 2004	**26,566,419**	**$ 3**	**$ 319,540**	**$ (23,070)**	**$ (164)**	**$ (780)**	**$ (168,806)**	**$ 126,723**
Issuance of common stock upon exercise of options	75,790		405					405
Issuance of common stock under the employee stock purchase plan	197,862		784					784
Issuance of restricted stock	8,000		54			(54)		
Issuance of common stock in public offering, net of offering costs of $3,599	8,625,000	1	48,150					48,151
Amortization of deferred compensation						438		438
Dividends on redeemable convertible preferred stock							(1,813)	(1,813)
Accretion of discount and deemed dividend on redeemable convertible preferred stock							(7,372)	(7,372)
Restricted shares released from deferred compensation plan	17,500							
Net loss							(67,901)	(67,901)
Net unrealized gain on available-for-sale securities and investments					125			125
Net comprehensive loss								(67,776)
Balance at December 31, 2005	**35,490,571**	**$ 4**	**$ 368,933**	**$ (23,070)**	**$ (39)**	**$ (396)**	**$ (245,892)**	**$ 99,540**
Issuance of common stock upon exercise of	180,364		1,184					1,184

	Common Stock							
options								
Issuance of common stock under the employee stock purchase plan			1,649					1,649
Issuance of restricted stock	307,086 81,000							
Issuance of common stock upon exercise of warrants	829,856		8,298					8,298
Issuance of common stock in public offering, net of offering costs of $10,809	10,637,524	1	168,964					168,965
Issuance of common stock in public offering, net of offering costs of $9,574	13,225,000	1	165,127					165,128
Issuance of warrants in settlement			4,554					4,554
Share-based compensation expense, net of forfeitures			4,298					4,298
Reclassification of deferred compensation			(396)			396		
Compensation expense related to restricted stock			752					752
Dividends on redeemable convertible preferred stock							(2,031)	(2,031)
Restricted shares released from deferred compensation plan	20,000							
Net loss							(86,248)	(86,248)
Net unrealized gain on available-for-sale securities and investments					26			26
Net comprehensive loss								(86,222)
Balance at December 31, 2006	**60,771,401**	**$ 6**	**$ 723,363**	**$ (23,070)**	**$ (13)**	**$**	**$ (334,171)**	**$ 366,115**
Issuance of common stock upon exercise of options	206,571		1,230					1,230
Issuance of common stock under the employee stock purchase plan	235,726		1,862					1,862
	40,306		480					480

	Common Stock							
Issuance of common stock to Merck								
Issuance of common stock in public offering, net of offering costs of $5,847		2	103,162					103,164
Share-based compensation expense, net of forfeitures	11,000,000		8,556					8,556
Compensation expense related to restricted stock			260					260
Dividends on redeemable convertible preferred stock							(2,114)	(2,114)
Restricted shares released from deferred compensation plan	6,250							
Net loss							(143,166)	(143,166)
Net unrealized gain on available-for-sale securities and investments					11			11
Translation loss					(21)			(21)
Net comprehensive loss								(143,176)
Balance at December 31, 2007	**72,260,254**	**$ 8**	**$ 838,913**	**$ (23,070)**	**$ (23)**	**$**	**$ (479,451)**	**$ 336,377**

See accompanying notes.

ARENA PHARMACEUTICALS, INC.

Consolidated Statements of Cash Flows

(In thousands)

	Years ended December 31,		
	2007	**2006**	**2005**
OPERATING ACTIVITIES			
Net loss	$ (143,166)	$ (86,248)	$ (67,901)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	7,848	7,361	6,850
Amortization of acquired technology	1,537	1,537	1,537
Amortization of deferred compensation			438
Non-cash share-based compensation	8,816	5,050	
Non-cash warrant settlement		4,554	
Amortization/accretion of short-term investment premium/discount	(398)	(717)	154
Amortization of prepaid financing costs	305		
Amortization of lease financing obligations	(361)		
Deferred rent	(70)	(45)	(24)
Deferred interest expense	(677)	193	226
Loss on disposal of equipment	114	8	19
Changes in operating assets and liabilities:			
Accounts receivable	(1,591)	538	21,742
Prepaid expenses and other assets	1,389	(4,830)	(389)
Deferred revenues	(9,005)	(11,090)	(9,497)
Accounts payable, accrued expenses and accrued compensation	7,111	12,672	3,986
Net cash used in operating activities	(128,148)	(71,017)	(42,859)
INVESTING ACTIVITIES			
Purchases of short-term investments, available-for-sale	(60,998)	(17,976)	(152,639)
Proceeds from sales/maturities of short-term investments	65,992	57,096	153,079
Purchases of land, property and equipment	(17,423)	(14,231)	(3,581)
Proceeds from sale of equipment	21	1	69
Deposits, restricted cash and other assets	(188)	166	186
Net cash provided by (used in) investing activities	(12,596)	25,056	(2,886)
FINANCING ACTIVITIES			
Principal payments on lease financing obligations	(481)		
Proceeds from lease financing	48,455		
Proceeds from exercise of warrants		8,298	
Proceeds from issuance of redeemable convertible preferred stock and warrants			11,500
Proceeds from issuance of common stock	106,736	336,926	49,340

	Years ended December 31,		
Net cash provided by financing activities	154,710	345,224	60,840
Effect of exchange rate changes on cash and cash equivalents	(21)		
Net increase in cash and cash equivalents	13,945	299,263	15,095
Cash and cash equivalents at beginning of year	373,044	73,781	58,686
Cash and cash equivalents at end of year	$ 386,989	$ 373,044	$ 73,781
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Interest paid	$ 4,295	$ 1,499	$ 1,460
Unrealized gain on short-term investments, available-for-sale	$ 11	$ 26	$ 125

See accompanying notes.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Company

Arena Pharmaceuticals, Inc., or the Company, was incorporated on April 14, 1997, and commenced operations in July 1997. The Company operates in one business segment and is a clinical-stage biopharmaceutical company with a pipeline of internally discovered small molecule drug candidates that target G protein-coupled receptors, or GPCRs.

Principles of Consolidation

The consolidated financial statements include the activities of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation.

Financial Statement Preparation

The preparation of financial statements in conformity with United States generally accepted accounting principles, or GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with original maturities of three months or less when purchased.

Short-term Investments, Available-for-Sale

In accordance with Statement of Financial Accounting Standards, or SFAS, No. 115, "Accounting for Certain Debt and Equity Securities," short-term investments are classified as available-for-sale. The Company defines short-term investments as income-yielding securities that can be readily converted to cash. These securities are carried at fair value, with unrealized gains and losses reported as a separate component of accumulated other comprehensive income or loss. The cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in interest income. Realized gains and losses and declines in securities judged to be other than temporary are included in other income or expense. The cost of securities sold is based on the specific identification method. Interest and dividends on available-for-sale securities are included in interest income.

Fair Value of Financial Instruments

Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities are carried at cost, which management believes approximates fair value due to the short-term maturity of these instruments. Short-term investments are carried at fair value. Based on borrowing rates currently available to the Company for loans with similar terms, management believes the carrying value of the lease financing obligations approximates fair value.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentration of Credit Risk and Major Customers

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist primarily of cash, cash equivalents and short-term investments. The Company limits its exposure to credit loss by placing its cash and investments, in accordance with its board-approved investment policy, in US government and agency obligations and in debt instruments that are rated investment grade.

Merck & Co., Inc., or Merck, and Ortho-McNeil Pharmaceutical, Inc., a Johnson & Johnson company, or Ortho-McNeil, accounted for 100% of total revenues for the years ended December 31, 2007, 2006 and 2005. Ortho-McNeil accounted for 98%, 90% and 99% of accounts receivable as of December 31, 2007, 2006 and 2005, respectively.

Property and Equipment

Property and equipment are stated at cost and depreciated over the estimated useful lives of the assets (generally three to seven years) using the straight-line method. Buildings and building improvements are stated at cost and depreciated over an estimated useful life of approximately 20 years using the straight-line method. Leasehold improvements are stated at cost and amortized over the shorter of the estimated useful lives of the assets or the lease term. Capital improvements are stated at cost and amortized over the estimated useful lives of the assets.

Intangible Assets

Purchase accounting requires estimates and judgments to allocate the purchase price to the fair market value of the assets received and liabilities assumed. In February 2001, the Company acquired Bunsen Rush Laboratories, Inc., or Bunsen Rush, for $15.0 million in cash and assumed $0.4 million in liabilities. The Company allocated $15.4 million to the patented Melanophore technology, its primary screening technology, acquired in such transaction. Acquired technology from the Company's acquisition of Bunsen Rush is being amortized over its estimated useful life of 10 years, which was determined based on an analysis, as of the acquisition date, of the conditions in, and the economic outlook for, the pharmaceutical and biotechnology industries and the patent life of the technology. As with any intangible asset, the Company continues to evaluate the value of the Melanophore technology. If, in the future, the Company determines that the technology has become impaired or no longer uses this technology internally as a primary screening technology, the Company may record a write-down of the carrying value or accelerate the amortization if it determines that the technology life has been shortened. Accumulated amortization from acquired technology totaled $10.5 million and $9.0 million at December 31, 2007 and 2006, respectively. As of December 31, 2007, the Company anticipates that total charges of $1.5 million will be recognized from the amortization of acquired technology in each of the next three years.

Long-lived Assets

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company reviews the recoverability of long-lived and finite-lived intangible assets when circumstances indicate that the carrying amount of assets may not be recoverable. This review is based on various analyses, including undiscounted cash flow projections. In the event such analysis indicated an impairment, the Company would record an impairment loss, if any, based on the fair value of the

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

assets. The Company did not record any impairments or write-offs of long-lived or finite-lived intangible assets in the years ended December 31, 2007, 2006 or 2005.

Deferred Rent

For financial reporting purposes, rent expense is recognized on a straight-line basis over the term of the lease. The difference between rent expense and amounts paid under lease agreements is recorded as deferred rent in the liability section of the accompanying consolidated balance sheets.

Share-based Compensation

Prior to January 1, 2006, the Company accounted for share-based compensation in accordance with the provisions of Accounting Principles Board, or APB, Opinion No. 25, "Accounting for Stock Issued to Employees" and its related Interpretations, which state that no compensation expense is recorded for stock options or other share-based awards to employees and directors that are granted with an exercise price equal to or above the fair value per share of the Company's common stock on the grant date. In the event that stock options were granted with an exercise price below the fair value of the Company's common stock on the grant date, the difference between the fair value of its common stock and the exercise price of the stock option was recorded as deferred compensation. For stock options granted to its employees and directors, the Company adopted the disclosure-only requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," which allowed compensation expense to be disclosed in the notes to the financial statements based on the fair value of the options granted at the date of the grant. Compensation expense for options granted to non-employees other than directors had been determined in accordance with SFAS No. 123 and Emerging Issues Task Force, or EITF, Issue No. 96-18, "Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services." Such expense was based on the fair value of the options issued using the Black-Scholes option pricing model and was periodically remeasured as the underlying options vested in accordance with EITF Issue No. 96-18.

On January 1, 2006, the Company adopted SFAS No. 123R, "Share-Based Payment," using the modified-prospective transition method. Under this method, prior period results are not restated. Compensation expense recognized subsequent to adoption includes: (i) compensation expense for all share-based awards granted prior to, but unvested as of, January 1, 2006, based on the grant-date fair value, estimated in accordance with the original provisions of SFAS No. 123, and (ii) compensation expense for all share-based awards granted subsequent to January 1, 2006, based on the grant-date fair value, estimated in accordance with the provisions of SFAS No. 123R. Compensation expense related to share-based awards, which is recognized on a straight-line basis over the vesting period, is included in research and development and in general and administrative expenses in the accompanying consolidated statements of operations.

The Company measures the value of restricted stock awards based on the fair value of the stock on the grant date. The restrictions generally lapse in equal annual installments over a vesting period of two, three or four years. Prior to the adoption of SFAS No. 123R, deferred compensation for grants of restricted stock equivalent to the fair value of the shares at the date of grant was recorded as a separate component of stockholders' equity and subsequently amortized to compensation expense over the vesting period of each

award. The remaining unamortized deferred compensation of $0.4 million at January 1, 2006 was reclassified to additional paid-in capital upon adoption of SFAS No. 123R. In

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

accordance with SFAS No. 123R, stockholders' equity is now credited as compensation expense is recognized over the applicable vesting period.

The Company recorded total share-based compensation expense for all share-based awards of $8.8 million and $5.0 million during the years ended December 31, 2007 and 2006, respectively, and recorded expense of $0.4 million for amortization of deferred compensation during the year ended December 31, 2005.

Revenue Recognition

The Company's revenue recognition policies are in accordance with SEC Staff Accounting Bulletin, or SAB, No. 101, "Revenue Recognition in Financial Statements," as amended by SAB No. 104, "Revenue Recognition," and EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," which provide guidance on revenue recognition in financial statements. Some of the Company's agreements contain upfront technology access fees, research funding, milestone achievements and royalties. Revenue from a milestone achievement is recognized when earned, as evidenced by acknowledgment from the Company's collaborator, provided that (i) the milestone event is substantive and its achievability was not reasonably assured at the inception of the agreement, (ii) the milestone represents the culmination of an earnings process, (iii) the milestone payment is non-refundable and (iv) the Company's performance obligations after the milestone achievement will continue to be funded by the collaborator at a level comparable to the level before the milestone achievement. If all of these criteria are not met, the milestone is recognized over the remaining minimum period of the Company's performance obligations under the agreement. Non-refundable upfront fees under the Company's collaborations are deferred and recognized over the period in which the Company has significant involvement or performs services, using various factors specific to the collaboration. Amounts received for research funding for a specified number of full-time researchers are recognized as revenue as the services are performed. Advance payments received in excess of amounts earned are classified as deferred revenues until earned.

Research and Development Costs

Research and development expenses, which consist primarily of costs associated with external clinical trial and preclinical study fees, manufacturing costs and other related expenses, and the development of our earlier-stage programs and technologies, are expensed as incurred when these expenditures relate to our research and development efforts and have no alternative future uses.

Clinical Trial Expenses

The Company accrues clinical trial expenses based on work performed. In determining the amount to accrue, the Company relies on estimates of total costs incurred based on the enrollment of subjects, the completion of studies and other events. The Company follows this method because it believes reasonably dependable estimates of the costs applicable to various stages of a clinical trial can be made. However, the actual costs and timing of clinical trials are highly uncertain, subject to risks and may change depending on a number of factors. Differences between the actual clinical trial costs and the estimated clinical trial costs that have been accrued in any prior period are recorded in the subsequent period in which the actual costs become known. Historically, these

differences have not been material and the Company has not had to make material adjustments in a subsequent period.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Patent Costs

Costs related to filing and prosecuting patent applications are expensed to general and administrative as incurred as recoverability of such expenditures is uncertain.

Comprehensive Income (Loss)

In accordance with SFAS No. 130, "Reporting Comprehensive Income," all components of comprehensive income (loss), including unrealized gains and losses on investment securities and foreign currency translation adjustment, are reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources.

Net Loss Per Share

Basic and diluted net loss per share allocable to common stockholders are presented in conformity with SFAS No. 128, "Earnings per Share." In accordance with SFAS No. 128, basic and diluted net loss per share has been computed using the weighted-average number of shares of common stock outstanding during the period, less any shares subject to repurchase or forfeiture.

The total number of shares of common stock outstanding excluded from the calculation of basic and diluted net loss per share because they were subject to repurchase or forfeiture was 99,811, 71,420 and 195,329 for the years ended December 31, 2007, 2006 and 2005, respectively. Had they been dilutive, such shares would have been included in the computation of diluted net loss per share. In addition, the Company has excluded all unvested performance-based restricted stock unit awards, which are subject to forfeiture, outstanding stock options, preferred stock and warrants from the calculation of basic and diluted net loss per share allocable to common stockholders because these securities are antidilutive for all years presented.

Pro Forma Information under SFAS No. 123 for Year Ended December 31, 2005

Prior to adopting the provisions of SFAS No. 123R, the Company provided pro forma disclosures of estimated share-based compensation expense as permitted under SFAS No. 123. For pro forma purposes, the fair value of stock options was estimated at the date of grant using the Black-Scholes option pricing model and amortized to expense over the options' vesting periods using the assumptions stated below. The following table illustrates the pro forma effect on net loss allocable to common stockholders and net loss per share, in thousands except per share data, as if the Company had accounted for its employee and director stock options and stock issued under the 2001 Arena

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee Stock Purchase Plan, as amended, or the Purchase Plan, using the fair value method prescribed by SFAS No. 123.

	Year ended December 31, 2005
Net loss allocable to common stockholders, as reported	$ (77,086)
Add: Stock-based employee compensation expense included in net loss allocable to common stockholders, as reported, net of related tax effects	438
Fair value of stock-based employee compensation	(4,347)
Pro forma net loss	$ (80,995)
Net loss per share:	
Basic and diluted as reported	$ (2.24)
Basic and diluted pro forma	$ (2.36)
Assumptions used for employee stock options:	
Risk-free interest rate	4.2%
Dividend yield	0%
Stock price volatility	44%
Expected life (years)	4.99
Weighted-average estimated fair value per share	$ 3.03
Assumptions used for Purchase Plan:	
Risk-free interest rate	3.8%
Dividend yield	0%
Stock price volatility	48%
Expected life (years)	0.25
Weighted-average estimated fair value per share	$ 1.78

Effect of New Accounting Standards

In June 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and for interim periods within those fiscal years. The Company is evaluating the effect, if any, the adoption of SFAS No. 157 will have on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of SFAS No. 115," which allows an entity to voluntarily choose to measure certain financial assets and liabilities at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is evaluating the effect, if any, the adoption of SFAS

No. 159 will have on its consolidated financial statements.

In June 2007, the FASB ratified the consensus reached by the EITF on EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities." EITF Issue No. 07-3 requires that nonrefundable advance payments for goods or services that will be used or rendered for future research and development

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(1) THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

activities be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed or such time when the entity does not expect the goods to be delivered or services to be performed. EITF Issue No. 07-3 is effective, on a prospective basis, for fiscal years beginning after December 15, 2007. The adoption of EITF Issue No. 07-3 will not have a material effect on the Company's consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations," which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any noncontrolling interest in the acquiree. SFAS No. 141R also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008, and interim periods within those fiscal years. The Company is evaluating the effect, if any, the adoption of SFAS No. 141R will have on its consolidated financial statements.

(2) AVAILABLE-FOR-SALE SECURITIES

The following table summarizes the investment categories comprising available-for-sale securities at December 31, 2007 and 2006, in thousands:

December 31, 2007	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Federal agency notes	$ 1,276	$ 4	$	$ 1,280
Corporate debt securities	9,922		(6)	9,916
Total available-for-sale securities	$ 11,198	$ 4	$ (6)	$ 11,196

December 31, 2006	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Federal agency notes	$ 11,905	$	$ (1)	$ 11,904
Corporate debt securities	3,877			3,877
Total available-for-sale securities	$ 15,782	$	$ (1)	$ 15,781

The amortized cost and estimated fair value of available-for-sale securities by contractual maturity at December 31, 2007 are shown below, in thousands:

	Amortized Cost	Estimated Fair Value

Due in one year or less	$ 9,922	$ 9,916
Due after one year through four years	1,276	1,280
Total	$ 11,198	$ 11,196

Proceeds from the sales of available-for-sale securities totaled $66.0 million, $57.1 million and $153.1 million in 2007, 2006 and 2005, respectively.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(3) PROPERTY AND EQUIPMENT

Property and equipment consisted of the following, in thousands:

	December 31,	
	2007	**2006**
Laboratory and computer equipment	$ 36,585	$ 30,373
Furniture, fixtures and office equipment	1,721	1,503
Land, building and capital improvements	50,917	47,311
Leasehold improvements	16,818	9,804
	106,041	88,991
Less accumulated depreciation and amortization	(40,101)	(32,491)
Net property and equipment	$ 65,940	$ 56,500

Depreciation expense was $7.8 million, $7.4 million and $6.9 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(4) ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following, in thousands:

	December 31,	
	2007	**2006**
Accounts payable	$ 4,161	$ 3,165
Accrued contracts and study fees	19,766	14,328
Other accrued liabilities	2,995	3,276
Total	$ 26,922	$ 20,769

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(5) COMMITMENTS

Leases

The following table summarizes the Company's real property leasing arrangements and essential provisions as of December 31, 2007:

Address on Nancy Ridge Drive, San Diego, California	Own/ Lease	Description of Arrangements
6166	Lease	In 1997, the Company began leasing this property under a lease that included an option to buy the property for $2.1 million. In 1998, the Company assigned the option to another company in exchange for $0.7 million in cash, and such company exercised the option and leased the property to the Company under a lease that expires in 2013. The $0.7 million is being recognized on a straight-line basis as a reduction in the rent expense on the underlying lease. The Company has two five-year options to extend the lease term. The new lease terms stipulate annual increases in monthly rental payments of 2.75% beginning in April 2000.
6122-6124-6126	Lease with option to purchase	In 2002, the Company leased a property located at 6124-6126 Nancy Ridge Drive. Under the terms of this lease, effective April 2003, monthly rental payments increased by 2% and are subject to a 2% annual increase thereafter. In 2005, the Company amended this lease to include additional square footage in a contiguous building, 6122 Nancy Ridge Drive. As discussed in the below section on 6114, 6118, 6154 Nancy Ridge Drive, the Company assigned its option to buy this entire building for $7.9 million when the lease ends in March 2012.
6138-6150	Lease with option to purchase	In 2003, the Company completed the sale and leaseback of this property. The sales price for this property was $13.0 million and net proceeds to the Company were $12.6 million. The Company has accounted for this transaction in accordance with SFAS No. 66 "Accounting for Sales of Real Estate" and SFAS No. 98 "Accounting for Leases." The Company's option to repurchase this property in the future is considered continued involvement under SFAS No. 66 and, therefore, the Company

Address on Nancy Ridge Drive, San Diego, California	Own/ Lease	Description of Arrangements
		has applied the financing method under SFAS No. 98. Under the financing method, the book value of the property and related accumulated depreciation remain on the Company's balance sheet and no sale is recognized. Instead, the sales price of the property is recorded as a financing obligation and a portion of each lease payment is recorded as interest expense. The term of the lease, which became effective in December 2003, is 15 years, with monthly rental payments increasing by 2.5% annually, beginning in January 2005. The Company has the right to repurchase this property through year 14 of the lease. The Company recorded interest expense of $0.4 million in the year ended December 31, 2007 and $1.6 million in each of the years ended December 31, 2006 and 2005 related to this lease. At December 31, 2007, in accordance with SFAS No. 98, the total financing obligation on the accompanying consolidated balance sheets related to this transaction was $12.5 million.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(5) COMMITMENTS (Continued)

6114, 6118, 6154	Lease with option to purchase	In May 2007, the Company completed the sale and leaseback of these properties. The total consideration for these properties and the assignment of the option to purchase the property located at 6122-6124-6126 Nancy Ridge Drive was $50.1 million, resulting in net proceeds to the Company of $48.5 million after financing costs and commissions. Concurrently with the closing of the transaction, the Company leased back the three properties under leases with 20-year terms and two consecutive options to extend such terms for five years each. In addition, subject to certain restrictions, the Company has the option to repurchase all of the properties included in the transaction on the 10th, 15th or 20th anniversary of the execution date of the leases, and earlier if the leases are terminated under certain circumstances. The Company has accounted for this transaction in accordance with SFAS No. 66 and SFAS No. 98. The Company's option to repurchase this property in the future is considered continued involvement under SFAS No. 66 and, therefore, the Company has applied the financing method under SFAS No. 98. Initial base rent for the three properties (net of taxes, insurance and maintenance costs (i.e. triple net) for which the Company is responsible) that were purchased as part of this transaction is an aggregate of $4.5 million annually, subject to an annual increase of 2.5% and other specified adjustments. The Company recorded interest expense of $3.1 million in the year ended December 31, 2007 related to this transaction. At December 31, 2007, in accordance with SFAS No. 98, the total financing obligation related to this transaction was $49.8 million.

In accordance with the terms of two of the above leases, the Company is required to maintain restricted cash balances, which are included in other non-current assets on the accompanying consolidated balance sheets, on behalf of the landlord as rent deposits throughout the term of the lease. In accordance with the terms of one of the leases, the Company has paid a security deposit equal to one month rent as a security deposit, which is also included in other non-current assets on the accompanying consolidated balance sheets. A total of $1.1 million is recorded in other non-current assets related to these three leases.

The Company recognizes rent expense on a straight-line basis over the term of each lease. Rent expense was $1.1 million in each of the years ended December 31, 2007 and 2006 and $1.0 million in the year ended December 31, 2005.

At December 31, 2007 the Company expects interest expense over the terms of the leases related to the facilities accounted for under SFAS No. 66 and SFAS No. 98 to total $79.5 million. As of December 31, 2007, the total financing obligation for these facilities

was $62.3 million. The aggregate residual value of the facilities at the end of the lease terms is $10.0 million.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(5) COMMITMENTS (Continued)

Annual future obligations as of December 31, 2007 are as follows, in thousands:

Year ending December 31,	Financing Obligation	Operating Leases
2008	$ 5,597	$ 1,115
2009	6,251	1,199
2010	6,408	1,228
2011	6,568	1,258
2012	6,732	890
Thereafter	100,253	256
Total minimum lease payments	$ 131,809	$ 5,946

(6) COLLABORATIONS

Ortho-McNeil Pharmaceutical, Inc.

In December 2004, the Company entered into a collaboration and license agreement with Ortho-McNeil to further develop compounds for the potential treatment of type 2 diabetes and other disorders. In January 2005, the Company received a non-refundable $17.5 million upfront payment and two milestone payments of $2.5 million each and, in February 2006, the Company received a $5.0 million milestone payment related to Ortho-McNeil's initiation of a Phase 1 clinical trial of the then lead drug candidate, APD668. In September 2006, Ortho-McNeil exercised its option to extend the research portion of the collaboration through December 2007, beyond which date the Company no longer performs services or has significant involvement. The Company is eligible to receive a total of $295.0 million in milestone payments for each compound, as well as royalty payments associated with Ortho-McNeil's commercialization of any products discovered under the agreement. These milestones include development and approval milestone payments of up to $132.5 million for the first indication and $62.5 million for the second indication for each compound, and up to $100.0 million in sales milestone payments for each product resulting from the collaboration. From the inception of this collaboration through December 31, 2007, the Company received $27.5 million from Ortho-McNeil in upfront and milestone payments and $7.2 million in research funding. The Company recognized the upfront payment ratably over three years, along with the two milestones received in January 2005 as their achievability was reasonably assured at the time the Company entered into the collaboration.

The agreement with Ortho-McNeil will continue until the expiration of Ortho-McNeil's payment obligations under the agreement, unless the agreement is terminated earlier by either party. The Company and Ortho-McNeil each have the right to terminate the agreement early on 60 days prior written notice if the other party commits an uncured material breach of its obligations. Ortho-McNeil may terminate the agreement at any time by providing at least 60 days prior written notice. Upon termination of the agreement, all rights to the compounds developed under the collaboration will revert to the Company.

For the year ended December 31, 2007, the Company recognized revenues under the Ortho-McNeil agreement of $13.4 million, which included $7.3 million from amortization of milestones and technology access and development fees received in prior years, $3.8 million for patent activities, and $2.3 million in research funding. For the year ended December 31, 2006, the Company recognized

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(6) COLLABORATIONS (Continued)

revenues under this agreement of $18.5 million, which included $7.5 million from amortization of milestones and technology access and development fees received in prior years, $5.0 million from a milestone earned, $2.4 million in research funding, and $3.6 million for additional sponsored research and patent activities. For the year ended December 31, 2005, the Company recognized revenues under this agreement of $13.4 million, which included $7.5 million from amortization of milestones and technology access and development fees received in prior years, $2.4 million in research funding, and $3.5 million for additional sponsored research and patent activities. At December 31, 2007, there were no deferred revenues remaining under this agreement.

Merck & Co., Inc.

In October 2002, the Company entered into a research and licensing agreement with Merck to collaborate on three G protein-coupled receptors, or GPCRs, to develop therapeutics for atherosclerosis and related disorders. The Company believes one or more of these GPCRs plays a role in regulating plasma lipid profiles, including HDL cholesterol, the so-called "good cholesterol," and is responsible for the HDL-raising activity of niacin. In October 2004, Merck extended and expanded the collaboration and selected one of the Company's compounds for preclinical development. In February 2007, the Company amended the Merck collaboration to reduce the number of the Company's research employees funded under the collaboration in exchange for Merck making a $1.0 million equity investment in the Company equal to the reduction in their research funding obligation and at approximately a 70% premium to the then current market price. In September 2006, the Company announced that Merck completed a Phase 2 clinical trial of MK-0354, a niacin receptor agonist discovered by the Company and intended for the treatment of atherosclerosis and related disorders. From the inception of this collaboration through December 31, 2007, the Company received $18.0 million from Merck in upfront and milestone payments and equity investments totaling $8.5 million. The Company may receive additional milestone payments of up to $28.0 million for Merck's clinical and marketing achievements, as well as royalty payments associated with Merck's commercialization of any products discovered under the agreement.

In addition, the Company received research funding from Merck through October 2007 totaling $27.5 million when, under the Company's amended agreement, Merck's obligation for research funding ended, and beyond which date the Company no longer performs services or has significant involvement.

The agreement with Merck will continue until the expiration of all royalty obligations under the agreement, unless the agreement is terminated early by either party. Either Merck or the Company can terminate the agreement if the other party breaches its material obligations under the agreement by causes and reasons within its control, has not cured such breach within 90 days of receiving a letter requesting such cure, and there is no dispute as to whether such breach has occurred. The non-breaching party in such a termination would receive the rights to continue the program. In addition, Merck can terminate the agreement at anytime by giving 90 days notice, but all milestones and royalties would still be payable as provided in the agreement.

As part of the extension and expansion of the collaboration with Merck in October 2004, Merck purchased $7.5 million of the Company's stock at approximately a 70% premium to the then current market price. The Company performed an evaluation on this stock purchase and determined that $3.9 million of the $7.5 million purchase price was an upfront payment related to the collaboration extension and expansion. Accordingly, the

Company recognized the $3.9 million upfront payment, as

well as the remaining portion of the unamortized upfront payment at October 2004 of $1.3 million, over the extended collaboration term of three years. Additionally, in October 2004, the Company achieved a $1.0 million milestone under the collaboration which the Company also recognized over the extended collaboration term of three years because the milestone was reasonably assured to be achieved at the time the Company extended and expanded its collaboration with Merck.

In connection with the February 2007 amendment of the collaborative agreement with Merck, the Company performed an evaluation on the stock purchase, which was at a purchase price of $24.81 per share, and determined that $0.5 million of the $1.0 million purchase price was an upfront payment related to the collaboration amendment. Accordingly, the Company recognized this upfront payment and the unamortized portion of the previously received upfront payments over the remaining term of the research portion of the collaboration. Merck's obligation for research funding ended in October 2007, beyond which date the Company no longer performs services or has significant involvement.

For the year ended December 31, 2007, the Company recognized revenues under the Merck agreement of $5.9 million, which included $3.6 million in research funding, $2.2 million from amortization of milestones and technology access and development fees received in prior years, and $0.1 million for patent activities. For the year ended December 31, 2006, the Company recognized revenues under this agreement of $12.1 million, which included $5.7 million in research funding, $4.0 million from a milestone earned, $2.1 million from amortization of milestones and technology access and development fees received in prior years, and $0.3 million for additional sponsored research and patent activities. For the year ended December 31, 2005, the Company recognized revenues under this agreement of $9.8 million, which included $5.7 million in research funding, $2.1 million from amortization of milestones and technology access and development fees received in prior years, and $2.0 million from a milestone earned. At December 31, 2007, there were no deferred revenues remaining under this agreement.

(7) REDEEMABLE CONVERTIBLE PREFERRED STOCK AND WARRANTS

In December 2003, the Company sold to two institutional investors 3,500 shares of series B-1 redeemable convertible preferred stock, or Series B-1 Preferred, together with (i) seven-year warrants to purchase up to 1,486,200 shares of common stock at an exercise price of $10.00 per share; and (ii) unit warrants giving such investors the right to purchase from the Company for a period of approximately 16 months from December 24, 2003, at their option, up to $11.5 million of series B-2 redeemable convertible preferred stock, or Series B-2 Preferred, and collectively with our Series B-1 Preferred, Series B Preferred, and additional seven-year warrants to purchase up to 450,000 shares of common stock at an initial exercise price of $10.00 per share. The aggregate purchase price was $35.0 million, and the Company received $34.2 million in net cash proceeds after closing costs. In addition, the Company issued 45,000 shares of common stock, valued at $0.3 million based on the fair value of the common stock on the date of the closing of the Series B-1 Preferred, as a finder's fee. In April 2005, the investors exercised their unit warrants in full, resulting in aggregate gross proceeds to the Company of $11.5 million.

In accordance with EITF Issue No. 00-27, "Application of Issue No. 98-5 for Certain Convertible Instruments," the Company allocated the components of the sale of the Series B-1 Preferred between the Series B-1 Preferred, the warrants and the unit warrants on the basis of the relative fair values at the date of issuance using the Black-Scholes

model. The aggregate amount allocated to the warrants

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(7) REDEEMABLE CONVERTIBLE PREFERRED STOCK AND WARRANTS (Continued)

and unit warrants was $6.5 million. The fair value of the common shares into which the Series B-1 Preferred was convertible on the date of issuance exceeded the proceeds allocated to the Series B-1 Preferred by $2.8 million, resulting in a beneficial conversion feature that was recognized as an increase to paid-in capital and as a deemed dividend to the Series B-1 Preferred.

The Company valued the components of the Series B-1 Preferred as follows, in thousands:

Series B-1 Preferred	$ 25,740
Warrants	4,535
Deemed dividend	2,800
Unit warrants	1,925
Total	$ 35,000

The holders of the Company's Series B-1 Preferred can require the Company at any time to redeem all or some of their shares of Series B-1 Preferred at such shares' stated value, plus accrued but unpaid dividends thereon to the date of payment and any applicable penalties. The stated value is the original holder's investment plus any dividends settled by increasing the stated value at the time the dividend is payable. The Company may be able to satisfy all or a portion of any redemption with shares of its common stock. The Series B-1 Preferred is convertible into common stock at a fixed conversion price of $7.50 per share. As a result of the public offering the Company completed in February 2005 which resulted in the Series B-1 Preferred becoming immediately redeemable at the option of the holders, the Company recorded a charge of $7.4 million in 2005 to accrete the remaining unaccreted discount and deemed dividend on the redeemable convertible preferred stock. The Company will be required to redeem any shares of the Series B-1 Preferred that remain outstanding on December 24, 2008 at a price equal to the amount of the original holder's original investment, plus all accrued but unpaid dividends thereon to the date of such payment. The Series B-1 Preferred, which accrues dividends at 4% annually, had an aggregate redemption price of $41.1 million at December 31, 2007.

If not previously converted, the Company must redeem the Series B-2 Preferred on April 22, 2010, or earlier under certain circumstances, at such shares' stated value, plus accrued but unpaid dividends thereon to the date of payment and any applicable penalties. The Series B-2 Preferred, which accrues dividends at 4% annually, had an aggregate redemption price of $12.8 million at December 31, 2007. The Company may be able to satisfy all or a portion of any redemption with shares of its common stock. The Series B-2 Preferred is convertible into common stock at a fixed conversion price of $7.00 per share. Otherwise, the Series B-2 Preferred has substantially identical terms as the Series B-1 Preferred. The holders of the Company's Series B-2 Preferred will be entitled to require the Company to redeem their shares of Series B-2 Preferred at such shares' stated value, plus accrued but unpaid dividends thereon to the date of payment and any applicable penalties if, in the future, the average of the closing price of the Company's common stock for any 30 consecutive trading days is below $7.00 per share, which is the conversion price for the Series B-2 Preferred.

Assuming that the Series B-1 Preferred and the Series B-2 Preferred are held until the applicable mandatory redemption date, the Company expects to record dividends on

redeemable convertible preferred stock of $2.2 million, $0.5 million and $0.2 million for the years ending December 31, 2008, 2009 and 2010, respectively.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(7) REDEEMABLE CONVERTIBLE PREFERRED STOCK AND WARRANTS (Continued)

At the option of any holder of Series B Preferred, any Series B Preferred held by such holder may be converted into common stock based on the applicable conversion price then in effect for such shares. If the Company is permitted to satisfy a portion of a redemption by using shares of its common stock, and if the Company elects to do so, the number of shares to be issued to holders of Series B Preferred will be determined by dividing such holder's cash redemption price by the lesser of the fixed conversion price or 95% of the arithmetic average of the volume weighted-average price of the Company's common stock for, depending on the specified circumstances, 10 or 15 consecutive trading days prior to the delivery of the redemption notice or date of the triggering event.

If the Company is required to redeem all or some of the currently outstanding shares of its Series B Preferred, the Company may be able to pay all or a portion of the redemption price using shares of its common stock if certain enumerated conditions are satisfied, including: (i) the Company has sufficient number of shares of common stock available for issuance; (ii) the shares of common stock to be issued are registered under an effective registration statement or are otherwise available for sale under Rule 144(k) under the Securities Act; (iii) the Company's common stock is listed on the NASDAQ Global Market or other eligible market; (iv) the shares to be issued can be issued without violating the rules of the NASDAQ Global Market or any applicable trading market or a provision of the Company's Certificate of Designations governing the Company's Series B Preferred, or Series B Certificate of Designations; and (v) no bankruptcy event has occurred.

Also, the holders of the Series B-2 Preferred may require the Company to redeem their shares if the Company issues common stock or common stock equivalents for an effective net price of less than $5.33 per share (excluding, among other things, certain common stock and common stock equivalents issued or issuable (i) to the Company's officers, directors, employees or consultants, (ii) in connection with certain strategic partnerships or joint ventures, and (iii) in connection with certain mergers and acquisitions). "Effective net price" is not defined in the Series B Certificate of Designations. The holders of the Company's Series B-2 Preferred may assert that effective net price should be calculated as the amount the Company receives after paying any discounts and other expenses related to any such issuance.

In addition to the foregoing redemption rights, at any time following the occurrence of a "Triggering Event," a holder of the Series B Preferred may require the Company to repurchase all or any portion of the Series B Preferred then held by such holder at a price per share equal to the greater of 115% of the stated value (as calculated under the Series B Certificate of Designations) of such shares plus all accrued but unpaid dividends thereon to the date of payment. "Triggering Event" is specifically defined in the Series B Certificate of Designations, and includes any of the following events: (i) immediately prior to a bankruptcy event; (ii) the Company fails for any reason to timely deliver a certificate evidencing any securities to a purchaser or the exercise or conversion rights of the holders are otherwise suspended for other than a permissible reason; (iii) any of certain events of default (as set forth in the Registration Rights Agreement with the Series B Preferred holders) occur and remain uncured for 60 days; (iv) the Company fails to make any cash payment required under the Series B Preferred transaction documents and such failure is not timely cured; (v) the issuance of a going concern opinion by the Company's independent registered public accounting firm that is not timely cured; (vi) the Company breaches a section of the Series B Preferred purchase agreement relating to indebtedness and subordination; or (vii) the Company defaults in the timely performance of any other obligation under the Series B Preferred transaction documents and such default is not timely cured.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(7) REDEEMABLE CONVERTIBLE PREFERRED STOCK AND WARRANTS (Continued)

If the closing price of the Company's common stock is equal to or above $14.00 per share for 30 consecutive trading days, upon 10 trading days' prior written notice, the Company has the right to, and the warrant holders will have the right to require the Company to, call and cancel any unexercised portion of the warrants. Upon exercise of a warrant following such call notice and prior to the warrant cancellation date, the Company will be obligated to issue to the warrant holder an exchange warrant entitling the holder to purchase shares of the Company's common stock equal to the amount of the holder's warrant that was called. This exchange warrant would contain the same terms and conditions as the original warrant, except that the maturity date would be seven years from the date of issuance of such exchange warrant and the exercise price would be equal to 130% of the average of the volume weighted-average price of the Company's common stock for the five trading days preceding the original warrant cancellation date.

On March 31, 2006, following the Company's call notice to one of the two warrant holders, Smithfield Fiduciary LLC, such holder exercised its warrants to purchase 829,856 shares of the Company's common stock, resulting in gross proceeds of $8.3 million. In connection with this exercise in full of its warrants, Smithfield claimed that it was entitled to receive exchange warrants that would include a provision that could require the Company to issue additional exchange warrants in the future. The Company disagreed with this interpretation. On June 30, 2006, the Company entered into a Settlement Agreement and Release with Smithfield. As part of the Settlement Agreement and Release, (a) Smithfield and the Company provided each other with a release of any claims relating to (i) Smithfield's demand for, and the Company's non-issuance of, exchange warrants, and (ii) any breach or default under certain of the agreements on account of the foregoing, (b) the Company issued Smithfield a seven-year warrant to purchase 829,856 shares of the Company's common stock at an initial exercise price of $15.49 per share, and (c) the Company filed a registration statement covering the sale of the shares of common stock issuable under their new warrant. The new warrant does not contain any right for the Company, or for the holder to require the Company, to call the warrant, nor does it provide the holder the right to receive any exchange warrants in the future. The Company recorded a non-cash charge of $4.6 million related to the warrant settlement in the second quarter of 2006. The Company does not know whether it will have a similar dispute with its other warrant holder, Mainfield Enterprises, or, if it does, the likely outcome of the dispute. As such, the Company has not recorded any charges related to the Mainfield warrant.

Each investor agrees that for so long as it holds Series B-1 Preferred and Series B-2 Preferred, it shall vote its shares of Series B-1 Preferred, Series B-2 Preferred and common stock on all matters in which such investor is entitled to vote and on which holders of common stock have the right to vote, in the manner recommended by the Company's board of directors to all of its stockholders unless the Company's board of directors elects to permit the investors to vote such shares in their own discretion.

(8) STOCKHOLDERS' EQUITY

Preferred Stock

In October 2002, and in conjunction with the stockholders' rights plan (see "Stockholders' Rights Plan" below in this note), the Company's board of directors created a series of preferred stock, consisting of 350,000 shares with a par value of $.0001 per share, designated as Series A Junior Participating Preferred Stock, or the Series A Preferred Stock. Such number of shares may be increased or decreased by the Company's board of directors, provided that no decrease shall reduce the number

of shares of Series A Preferred Stock to a number less than the number of shares then outstanding, plus the number of shares reserved for issuance upon the exercise of outstanding options, rights or warrants or upon the conversion of any outstanding securities issued by the Company convertible into Series A Preferred Stock. As of December 31, 2007, no shares of Series A Preferred Stock were issued or outstanding.

Treasury Stock

In October 2003, Biotechnology Value Fund, L.P. and certain of its affiliates accepted the Company's offer of $23.1 million to purchase from them 3,000,000 shares of the Company's common stock at a cash price of $7.69 per share.

Equity Compensation Plans

In June 2006, the Company's stockholders approved the Company's 2006 Long-Term Incentive Plan, as amended, or the 2006 LTIP, which provides for the grant of up to a total of 6,000,000 shares of common stock (subject to certain adjustments described in the 2006 LTIP) to designated employees, certain consultants and advisors who perform services for the Company, and non-employee members of the Company's board of directors as stock options, stock appreciation rights, restricted stock awards, restricted stock unit awards and performance awards. Effective in June 2006, the Company's Amended and Restated 1998 Equity Compensation Plan, Amended and Restated 2000 Equity Compensation Plan and 2002 Equity Compensation Plan, or the Prior Plans, were terminated. However, notwithstanding such termination, all outstanding awards under the Prior Plans will continue to be governed under the terms of the Prior Plans. The 6,000,000 shares of common stock authorized for issuance under the 2006 LTIP is increased by the number of shares subject to any stock awards under the Prior Plans that are forfeited, expire or otherwise terminate without the issuance of such shares and as otherwise provided in the 2006 LTIP. As of December 31, 2007, a total of 2,610,858 shares of common stock were available for future grant under the 2006 LTIP.

Stock options generally vest 25% per year over four years and are exercisable for up to 10 years from the date of grant. Restricted common stock generally vests over a two, three or four-year period and the recipient, at the date of grant, has all rights of a stockholder, subject to certain restrictions on transferability and a risk of forfeiture. The Company issues new shares of common stock upon the exercise of stock options, for purchases made under the Purchase Plan and for grants of restricted stock.

In the event of termination of service, unvested restricted stock is subject to forfeiture and restricted common stock issued from the exercise of unvested stock options is subject to repurchase at the original purchase price. In the event the Company elects to not buy back any such unvested shares, any related compensation will be expensed immediately. In accordance with SFAS No. 128, the Company has excluded all unvested restricted stock and restricted common stock issued from the exercise of unvested stock options from its calculation of basic and diluted net loss per share.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

In 2003, the Company set up a deferred compensation plan for its executive officers, whereby executive officers elected to contribute their shares of restricted stock into the plan. At December 31, 2007, 2006 and 2005, a total of 107,919, 114,169 and 134,169 shares of restricted stock were contributed to the plan, respectively.

The following table summarizes the Company's stock option activities under the Prior Plans and the 2006 LTIP, or collectively, the Equity Compensation Plans, for the years ended December 31, 2007, 2006 and 2005:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2004	2,780,399	$ 8.66		
Granted	1,201,635	6.73		
Exercised	(75,790)	5.34		
Forfeited/cancelled/expired	(253,413)	9.08		
Outstanding at December 31, 2005	3,652,831	8.07		
Granted	1,139,384	13.51		
Exercised	(180,364)	6.56		
Forfeited/cancelled/expired	(89,470)	10.81		
Outstanding at December 31, 2006	4,522,381	9.44		
Granted	1,437,787	13.04		
Exercised	(206,571)	5.96		
Forfeited/cancelled/expired	(239,595)	11.25		
Outstanding at December 31, 2007	5,514,002	$ 10.43	6.90	$ 4,304
Vested and expected to vest at December 31, 2007	5,255,585	$ 10.34	6.81	$ 4,249
Vested and exercisable at December 31, 2007	2,984,227	$ 9.18	5.54	$ 3,516

The aggregate intrinsic value in the above table is calculated as the difference between the closing price of the Company's common stock at December 31, 2007 of $7.83 per share and the exercise price of stock options that had strike prices below the closing price. The intrinsic value of all stock options exercised during the years ended December 31, 2007, 2006 and 2005 was $1.2 million, $1.7 million and $0.4 million, respectively.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

The following table summarizes outstanding and exercisable stock options as of December 31, 2007:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life (in years)	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
$0.20 - $5.99	342,700	4.70	$ 3.24	305,138	$ 3.02
$6.00 - $6.01	669,312	5.89	6.00	566,486	6.00
$6.12 - $6.16	763,846	6.83	6.16	488,155	6.16
$6.30 - $10.14	572,698	5.99	8.34	435,199	8.37
$10.21 - $11.31	720,346	7.50	10.58	357,589	10.62
$11.37 - $13.39	584,625	6.15	12.17	356,440	12.21
$13.50 - $13.50	1,037,587	9.15	13.50	75,737	13.50
$13.60 - $31.34	822,888	6.50	17.23	399,483	18.18
$0.20 - $31.34	5,514,002	6.90	$ 10.43	2,984,227	$ 9.18

Stock options exercisable pursuant to the terms of the Prior Plans can be exercised prior to vesting; however, unvested shares are subject to repurchase at the original purchase price if a grantee terminates employment prior to vesting. At December 31, 2007, 2006 and 2005, 312, 924 and 1,537 shares of common stock issued upon the exercise of stock options were subject to repurchase at the original purchase price at a weighted-average price of $6.16, $6.11 and $6.10 per share, respectively.

In February 2007, the Company granted 1,690,500 performance-based restricted stock unit awards under the 2006 LTIP. The awards provide employees until February 26, 2012 to achieve four key drug development and strategic performance goals. A fixed number of awards will be earned for each goal that is successfully achieved. Once earned, the awards will remain unvested until the performance period is complete. The awards that have been earned at February 26, 2012 will vest and be settled in shares of the Company's common stock, with the holder receiving one share of common stock for each award earned and vested. Termination of employment prior to vesting will result in the forfeiture of any earned (as well as unearned) awards, except for in limited circumstances such as termination due to death, disability or a change in control. No compensation expense was recognized related to these awards during the year ended December 31, 2007 as management believes achievement of the performance goals is not probable at December 31, 2007. The following table summarizes activity with respect to such awards during the year ended December 31, 2007:

Performance Units	Weighted-Average Grant-Date Fair Value

	Performance Units	Weighted-Average Grant-Date Fair Value
Outstanding at January 1, 2007		$
Granted	1,690,500	13.50
Vested		
Forfeited/cancelled	(54,900)	13.50
Outstanding at December 31, 2007	1,635,600	$ 13.50
Vested at December 31, 2007		

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

The following table summarizes the Company's unvested restricted stock activity, excluding shares contributed to the Company's deferred compensation plan, during the years ended December 31, 2007, 2006 and 2005:

Unvested Restricted Stock	Shares	Weighted-Average Grant-Date Fair Value
Unvested at December 31, 2004	249,497	$ 6.45
Granted	8,000	6.78
Vested	(187,001)	6.46
Forfeited		
Unvested at December 31, 2005	70,496	6.47
Granted	81,000	16.80
Vested	(51,997)	6.44
Forfeited		
Unvested at December 31, 2006	99,499	14.89
Granted		
Vested	(41,499)	13.19
Forfeited		
Unvested at December 31, 2007	58,000	$ 16.11

The total grant-date fair value of restricted stock vested during the years ended December 31, 2007, 2006 and 2005 was $0.5 million, $0.3 million and $1.2 million, respectively.

Share-based Compensation

The Company uses the Black-Scholes option pricing model to estimate the grant-date fair value of share-based awards in determining the share-based compensation expense recognized under SFAS No. 123R. The table below sets forth the weighted-average assumptions and estimated fair value of stock options granted under the Equity Compensation Plans during the years ended December 31, 2007 and 2006:

	December 31,	
	2007	2006
Risk-free interest rate	4.6%	4.6%
Dividend yield	0%	0%
Expected volatility	64%	70%
Expected life (years)	5.39	5.19
Weighted-average estimated fair value of stock options granted	$ 7.82	$ 8.35

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

The table below sets forth the weighted-average assumptions and estimated fair value of the options to purchase stock granted under the Purchase Plan for multiple offering periods during the years ended December 31, 2007 and 2006:

	December 31,	
	2007	2006
Risk-free interest rate	3.8% - 5.3%	1.7% - 5.3%
Dividend yield	0%	0%
Expected volatility	66% - 72%	65% - 75%
Expected life (years)	0.25 - 2.0	0.25 - 2.0
Weighted-average estimated fair value of options granted under the Purchase Plan	$2.18 to $5.46	$1.99 to $7.29

Expected volatility for awards granted after adoption of SFAS No. 123R is based on a combination of 75% historical volatility of the Company's common stock and 25% market-based implied volatilities from traded options on its common stock, with historical volatility being more heavily weighted due to low volume of traded options on its common stock. Prior to adoption of SFAS No. 123R, the Company's computation of expected volatility was based only on historical volatility of its common stock. The expected life of options granted under SFAS No. 123R is determined based on historical experience of similar awards, giving consideration to the contractual terms of the share-based awards, vesting schedules and post-vesting terminations. Prior to the adoption of SFAS No. 123R, an average expected life of five years was used in determining the fair value of option grants based on the vesting period of the options due to the short period of time the Company's stock had been publicly traded. The risk-free interest rates are based on the US Treasury yield curve, with a remaining term approximately equal to the expected term used in the option pricing model.

SFAS No. 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures of unvested stock options were estimated to be 5.4% and 6.7% for the years ended December 31, 2007 and 2006 based on historical experience. As a result, the Company reduced its share-based compensation expense by $0.4 million for each of the years ended December 31, 2007 and 2006. If actual forfeitures vary from these estimates, the Company will recognize the difference in compensation cost in the period the actual forfeitures occur or when stock options vest. Prior to the adoption of SFAS No. 123R, the Company accounted for forfeitures as they occurred in the pro forma disclosure required under SFAS No. 123.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

The Company recognized share-based compensation expense in accordance with SFAS No. 123R as follows (in thousands, except per share data):

	December 31,	
	2007	**2006**
Research and development	$ 4,190	$ 2,901
General and administrative	4,626	2,149
Total share-based compensation expense and impact on net loss allocable to common stockholders	$ 8,816	$ 5,050
Impact on net loss per share allocable to common stockholders, basic and diluted	$ 0.14	$ 0.11

At December 31, 2007, total unrecognized estimated compensation cost, excluding estimated forfeitures, related to unvested stock options was $13.6 million, which is expected to be recognized over a weighted-average remaining requisite service period of 2.44 years. At December 31, 2007, total unrecognized estimated compensation cost related to restricted stock was $0.5 million, which is expected to be recognized over a weighted-average remaining requisite service period of 1.09 years.

Cash of $1.2 million was received from stock option exercises during the year ended December 31, 2007. Cash of $1.9 million was received from stock purchases under the Purchase Plan during the year ended December 31, 2007. Tax benefits recognized related to share-based compensation and related cash flow impacts were not material during the year ended December 31, 2007 because the Company is in a net operating loss position.

Employee Stock Purchase Plan

The Purchase Plan qualifies under Section 423 of the Internal Revenue Service and permits substantially all employees to purchase shares of the Company's common stock at a discount to market. Under the Purchase Plan, employees can choose to have up to 15% of their annual compensation withheld to purchase shares of common stock, subject to certain limitations. The shares of common stock may be purchased over an offering period with a maximum duration of two years at 85% of the lower of the fair market value of the common stock on the first day of the applicable offering period or on the last day of the three-month purchase period. In June 2006, the Company's stockholders approved an increase in the aggregate number of shares of common stock that may be issued pursuant to the Purchase Plan from 1,000,000 to 1,500,000. During the years ended December 31, 2007, 2006 and 2005, 235,726, 307,086 and 197,862 shares, respectively, were purchased under to the Purchase Plan. As of December 31, 2007, a total of 1,050,406 shares has been issued under the Purchase Plan.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(8) STOCKHOLDERS' EQUITY (Continued)

Common Shares Reserved for Future Issuance

The following shares of common stock are reserved for future issuance at December 31, 2007:

Equity Compensation Plans	9,760,460
Deferred compensation plan	107,919
Warrants	1,936,200
Series B-1 Preferred	5,481,740
Series B-2 Preferred	1,829,909
Payment of dividends	1,935,084
Purchase Plan	449,594
Total	21,500,906

Stockholders' Rights Plan

In October 2002, the Company's board of directors adopted a stockholders' rights plan, or the Rights Agreement, under which all stockholders of record as of November 13, 2002 received rights to purchase shares of the Series A Preferred Stock, or the Rights. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of the Series A Preferred Stock at an initial exercise price of $36.00 per share, subject to adjustment. The Rights are not exercisable until the 10th day after such time as a person or group acquires beneficial ownership of 10% or more, or announces a tender offer for 10% or more, of the Company's common stock. At such time, all holders of the Rights, other than the acquiror, will be entitled to purchase shares of the Company's common stock at a 50% discount to the then current market price.

The Rights will trade with the Company's common stock, unless and until they are separated due to a person or group acquiring beneficial ownership of 10% or more, or announcing a tender offer for 10% or more, of the Company's common stock. The Company's board of directors may terminate the Rights Agreement at any time or redeem the Rights prior to the time a person acquires 10% or more of the common stock.

In November 2006, the Rights Agreement was amended to provide, among other things, that the triggering percentage for when a Beneficial Owner (as defined in the Rights Agreement) of the Company's common stock would be an Acquiring Person (as further defined in the Amendment) increased from 10% to 15%.

(9) EMPLOYEE BENEFIT PLAN

The Company has a defined contribution retirement plan that complies with Section 401(k) of the Internal Revenue Code. All employees of the Company are eligible to participate in the plan. The Company matches 100% of each participant's voluntary contributions, subject to a maximum Company contribution of 6% of the participant's compensation. The Company's matching portion, which totaled $1.4 million in each of the years ended December 31, 2007 and 2006 and $1.1 million in the year ended December 31, 2005, vests over a five-year period from the date of hire.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(10) INCOME TAXES

In July 2006, the FASB issued FASB Interpretation No., or FIN, 48, "Accounting for Uncertainty in Income Taxes An Interpretation of SFAS No. 109," which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Under FIN 48, the impact of an uncertain income tax position on the income tax return must be recognized at the largest amount that is more-likely-than-not to be sustained upon audit by the relevant taxing authority. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006.

The Company adopted the provisions of FIN 48 on January 1, 2007. The total amount of unrecognized tax benefits as of the date of adoption was $8.6 million. Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of the Company's net operating loss and credit carryforwards could be limited in the event of cumulative changes in ownership of more than 50%. Such a change occurred in prior years, and the Company is currently undergoing a Section 382/383 analysis. Until this analysis has been completed, the Company has removed the deferred tax assets for net operating losses of $131.3 million and research and development credits of $36.5 million from its deferred tax asset schedule. As such, the Company has recorded a corresponding decrease to its valuation allowance.

A rollforward of changes in the Company's unrecognized tax benefits is shown below, in thousands:

Balance at January 1, 2007	$ (8,566)
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	8,566
Settlements	
Balance at December 31, 2007	$

Due to the existence of the valuation allowance, future changes in the Company's unrecognized tax benefits will not likely impact the effective tax rate.

The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company did not have any accrued interest or penalties included in its consolidated balance sheets at December 31, 2007 or 2006, and did not recognize any interest and/or penalties in its consolidated statement of operations during the year ended December 31, 2007.

The Company is subject to income taxation in the United States at the federal and state levels. The Company's tax years for 1997 and later are subject to examination by the United States and California tax authorities due to the carryforward of unutilized net operating losses and research and development credits. The Company is currently not under examination by any taxing authorities.

The adoption of FIN 48 did not impact the Company's financial condition, results of operations or cash flows. At December 31, 2007, the Company had net deferred tax assets of $13.9 million. The deferred tax assets are primarily comprised of deferred revenues,

SFAS No. 123R expense, depreciation

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(10) INCOME TAXES (Continued)

and capitalized research and development costs. Due to uncertainties surrounding the Company's ability to generate future taxable income to realize these assets, the Company has not recognized these assets and a full valuation allowance has been established to offset the Company's net deferred tax assets. The future utilization of the Company's NOL and R&D credit carryforwards to offset future taxable income may be subject to a substantial annual limitation as a result of ownership changes that may have occurred previously or that could occur in the future. The Company has not yet determined when such an ownership change occurred; however, the Company is in the process of completing a Section 382/383 analysis regarding the limitation of the NOL and R&D credit carryforwards. Until this analysis has been completed, the Company has removed the deferred tax assets associated with these carryforwards from its deferred tax asset schedule and has recorded a corresponding decrease to their valuation allowance. When the Section 382/383 analysis is completed, the Company plans to update its unrecognized tax benefits under FIN 48. The Company expects the Section 382/383 analysis to be completed within the next twelve months.

Significant components of the Company's deferred tax assets at December 31, 2007 and 2006 are shown below, in thousands. A valuation allowance of $13.9 million and $137.0 million has been recognized to offset the net deferred tax assets as of December 31, 2007 and 2006, respectively, as realization of such assets is uncertain. The valuation allowance decreased by $123.1 million in 2007 compared to 2006, primarily due to the removal of the net operating losses and research and development credits from the Company's deferred tax assets.

	December 31,	
	2007	2006
Deferred tax assets:		
Net operating loss carryforwards	$	$ 99,913
Research and development credits		27,846
Capitalized R&D (state)	1,920	2,330
Deferred revenues	7,426	5,200
Depreciation	2,030	1,518
SFAS No. 123R expense	2,383	830
Other, net	2,065	1,900
Total deferred tax assets	15,824	139,537
Deferred tax liabilities:		
Acquired intangible amortization	(1,942)	(2,554)
Total deferred tax liabilities	(1,942)	(2,554)
Net deferred tax assets	13,882	136,983
Valuation allowance	(13,882)	(136,983)
Net deferred tax assets	$	$

At December 31, 2007, the Company had Federal tax net operating loss carryforwards of $345.0 million that will begin to expire in 2017 unless previously utilized. At the same

date, the Company had state tax net operating loss carryforwards of $302.9 million, which does not include $12.8 million which expired in 2007. The California net operating loss carryforwards will begin to expire in 2012. At December 31, 2007, $9.1 million of net operating loss carryforwards related to stock option

(10) INCOME TAXES (Continued)

exercises, which will result in an increase to additional paid-in capital and a decrease in income taxes payable at the time when the tax loss carryforwards are utilized. The Company also had Federal and California research and development tax credit carryforwards of $25.3 million and $17.0 million, respectively. The Federal research and development credit carryforwards will begin to expire in 2012 unless previously utilized. The California research and development credit carryforwards carry forward indefinitely.

The provision for income taxes on earnings subject to income taxes differs from the statutory Federal rate at December 31, 2007, 2006 and 2005, due to the following, in thousands:

	December 31,		
	2007	2006	2005
Statutory Federal rate	$ (49,395)	$ (30,014)	$ (26,209)
State income tax, net of Federal benefit	(6,391)	(5,146)	(4,494)
Permanent items and other	3,053	739	(183)
SFAS No. 123R expense	1,589	1,208	
Deferred compensation			175
Foreign losses	12,125		
Research and development credit	(8,321)	(5,353)	(5,074)
Dividends and accretion on preferred stock	842	809	3,658
Removal of NOL's and R&D credits	169,599		
Valuation allowance and other	(123,101)	37,757	32,127
Provision for income taxes	$	$	$

(11) SUBSEQUENT EVENT

On January 9, 2008, the Company acquired from Siegfried Ltd, or Siegfried, certain drug product facility assets, including fixtures, equipment, other personal property and real estate assets under an Asset Purchase Agreement, between Siegfried and the Company's wholly owned Swiss subsidiary, Arena Pharmaceuticals GmbH. The purchase price under such agreement, in Swiss francs, was CHF 31.8 million in cash and 1,488,482 shares of the Company's common stock, which were issued to Siegfried on January 8, 2008. The Company paid CHF 21.8 million, or $19.8 million, of the cash purchase price at the closing of such transaction, and will pay the remaining CHF 10.0 million in three equal installments in the third, fourth and fifth years after closing. In connection with this transaction, the Company and Siegfried also entered into a long-term supply agreement for the active pharmaceutical ingredient of lorcaserin, a contract manufacturing agreement and a technical services agreement.

ARENA PHARMACEUTICALS, INC.

Notes to Consolidated Financial Statements (Continued)

(12) QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table presents quarterly data for the years ended December 31, 2007 and 2006, in thousands, except per share data:

2007	Quarter ended December 31	Quarter ended September 30	Quarter ended June 30	Quarter ended March 31	Year ended December 31
Revenues	$ 4,569	$ 5,041	$ 4,811	$ 4,911	$ 19,332
Net loss	(40,386)	(32,278)	(38,608)	(31,895)	(143,166)
Net loss allocable to common stockholders	(40,926)	(32,813)	(39,132)	(32,409)	(145,280)
Net loss per share allocable to common stockholders, basic and diluted	$ (0.60)	$ (0.54)	$ (0.64)	$ (0.53)	$ (2.31)

2006	Quarter ended December 31	Quarter ended September 30	Quarter ended June 30	Quarter ended March 31	Year ended December 31
Revenues	$ 4,699	$ 4,416	$ 9,328	$ 12,126	$ 30,569
Net loss	(35,889)	(19,624)	(18,509)	(12,226)	(86,248)
Net loss allocable to common stockholders	(36,409)	(20,138)	(19,013)	(12,719)	(88,279)
Net loss per share allocable to common stockholders, basic and diluted	$ (0.73)	$ (0.43)	$ (0.40)	$ (0.30)	$ (1.89)

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, or the Exchange Act. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this annual report.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining for us adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our CEO and VP, Finance and Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of December 31, 2007.

The registered public accounting firm that audited the financial statements included in this Annual Report on Form 10-K has issued an attestation report on our internal control over financial reporting, and such report is included below.

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during the fourth quarter of the period covered by this Annual Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders of Arena Pharmaceuticals, Inc.

We have audited Arena Pharmaceuticals, Inc.'s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Arena Pharmaceuticals, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Arena Pharmaceuticals, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2007 of Arena Pharmaceuticals, Inc. and our report dated February 29, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California
February 29, 2008

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

We have adopted a Code of Business Conduct and Ethics that applies to our directors and employees (including our principal executive officer, principal financial officer, principal accounting officer and controller), and have posted the text of the policy on our website (*www.arenapharm.com*) in connection with "Investor" materials. In addition, we intend to promptly disclose (i) the nature of any amendment to the policy that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions and (ii) the nature of any waiver, including an implicit waiver, from a provision of the policy that is granted to one of these specified individuals, the name of such person who is granted the waiver and the date of the waiver on our website in the future.

The other information required by this item is incorporated herein by reference from the information under the captions "Election of Directors," "Compensation and Other Information Concerning Executive Officers, Directors and Certain Stockholders" and "Section 16(a) Beneficial Ownership Reporting Compliance" contained in our proxy statement for the annual meeting of stockholders to be held in June 2008, or the Proxy Statement.

Item 11. Executive Compensation.

The information required by this item is incorporated herein by reference from the information under the captions "Compensation and Other Information Concerning Executive Officers, Directors and Certain Stockholders," "Compensation Committee Interlocks and Insider Participation" and "Compensation Committee Report" contained in the Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information relating to securities authorized for issuance under our equity compensation plans is set forth in "Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" above in this Annual Report. The other information required by this item is incorporated herein by reference from the information under the caption "Security Ownership of Certain Beneficial Owners and Management" contained in the Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this item is incorporated herein by reference from the information under the captions "Certain Relationships and Related Transactions" and "Election of Directors" contained in the Proxy Statement.

Item 14. Principal Accountant Fees and Services.

The information required by this item is incorporated herein by reference from the information under the captions "Independent Auditors' Fees" and "Pre-Approval Policies and Procedures" contained in the Proxy Statement.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) 1. **FINANCIAL STATEMENTS.**

Reference is made to the Index to Financial Statements under Item 8, Part II hereof.

2. **FINANCIAL STATEMENT SCHEDULES.**

The Financial Statement Schedules have been omitted either because they are not required or because the information has been included in the financial statements or the notes thereto included in this annual report.

3. **EXHIBITS**

EXHIBIT NO.	DESCRIPTION
2.1*	Agreement of Purchase and Sale, dated as of March 21, 2007, by and between Arena and BMR-6114-6154 Nancy Ridge Drive LLP (as assignee of BioMed Realty, L.P.) (incorporated by reference to Exhibit 2.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on May 8, 2007, Commission File No. 000-31161)
3.1	Fifth Amended and Restated Certificate of Incorporation of Arena (incorporated by reference to Exhibit 3.1 to Arena's quarterly report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 14, 2002, Commission File No. 000-31161)
3.2	Certificate of Amendment of the Fifth Amended and Restated Certificate of Incorporation of Arena (incorporated by reference to Exhibit 4.2 to Arena's registration statement on Form S-8, filed with the Securities and Exchange Commission on June 28, 2006, Commission File No. 333-135398)
3.3	Amended and Restated Bylaws of Arena (incorporated by reference to Exhibit 3.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on October 4, 2007, Commission File No. 000-31161)
3.4	Certificate of Designations of Series A Junior Participating Preferred Stock of Arena, dated November 4, 2002 (incorporated by reference to Exhibit 3.3 to Arena's quarterly report on Form 10-Q for the quarter ended September 30, 2002, filed with the Securities and Exchange Commission on November 14, 2002, Commission File No. 000-31161)
3.5	Certificate of Designations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Arena, dated December 24, 2003 (incorporated by reference to Exhibit 3.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
4.1	Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on November 1, 2002, Commission File No. 000-31161)
4.2	

EXHIBIT NO.	DESCRIPTION
	Amendment No. 1, dated December 24, 2003, to Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)

4.3	Amendment No. 2, dated November 16, 2006, to Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.3 to Amendment No. 2 to Arena's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on November 16, 2006, Commission File No. 000-31161)
4.4	Form of common stock certificates (incorporated by reference to Exhibit 4.2 to Arena's registration statement on Form S-1, as amended, filed with the Securities and Exchange Commission on July 19, 2000, Commission File No. 333-3594)
10.1**	1998 Equity Compensation Plan (incorporated by reference to Exhibit 10.1 to Arena's registration statement on Form S-1, as amended, filed with the Securities and Exchange Commission on June 22, 2000, Commission File No. 333-3594)
10.2**	Amended and Restated 2000 Equity Compensation Plan (incorporated by reference to Exhibit 10.2 to Arena's annual report on Form 10-K for the year ended December 31, 2001, filed with the Securities and Exchange Commission on March 15, 2002, Commission File No. 000-31161)
10.3	2001 Arena Employee Stock Purchase Plan, as amended (incorporated by reference to Exhibit 10.5 to Arena's quarterly report on Form 10-Q for the quarter ended June 30, 2006, filed with the Securities and Exchange Commission on August 4, 2006, Commission File No. 000-31161)
10.4**	2002 Equity Compensation Plan (incorporated by reference to Exhibit A to Arena's Proxy Statement regarding Arena's June 11, 2002, Annual Stockholders Meeting, filed with the Securities and Exchange Commission on April 23, 2002, Commission File No. 000-31161)
10.5+	Research Collaboration and License Agreement, dated effective as of October 21, 2002, by and between Arena and Merck & Co., Inc. (incorporated by reference to Exhibit 10.20 to Arena's annual report on Form 10-K for the year ended December 31, 2002, filed with the Securities and Exchange Commission on March 28, 2003, Commission File No. 000-31161)
10.6+	First Amendment to Research Collaboration and License Agreement, dated as of October 20, 2004, by and between Arena and Merck (incorporated by reference to Exhibit 10.19 to Arena's annual report on Form 10-K for the year ended December 31, 2004, filed with the Securities and Exchange Commission on March 2, 2005, Commission File No. 000-31161)
10.7	Second Amendment to Research Collaboration and License Agreement, dated as of February 20, 2007, by and between Arena and Merck
10.8**	Form of Termination Protection Agreement, dated December 20, 2002, by and among Arena and the employees listed on Schedule 1 thereto (incorporated by reference to Exhibit 10.1 to Arena's quarterly report on Form 10-Q for quarter ended June 30, 2003, filed with the Securities and Exchange Commission on August 13, 2003, Commission File No. 000-31161)
10.9	Securities Purchase Agreement for Arena's Series B Convertible Preferred Stock and warrants dated December 24, 2003, among Arena and the investor signatories thereto (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
10.10	

	Registration Rights Agreement dated December 24, 2003, among Arena and the investor signatories thereto (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)

10.11	Form of Warrant dated December 24, 2003 (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
10.12	Settlement Agreement and Release, dated as of June 30, 2006, between Arena and Smithfield Fiduciary LLC. (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)
10.13	Amendment to Registration Rights Agreement, dated as of June 30, 2006, between Arena and Smithfield Fiduciary LLC. (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)
10.14	Amendment to Registration Rights Agreement, dated as of June 30, 2006, between Arena and Mainfield Enterprises, Inc. (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)
10.15	Purchase and Sale Agreement and Joint Escrow Instructions, dated December 22, 2003, between Arena and ARE Nancy Ridge No. 3, LLC (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Securities and Exchange Commission on January 6, 2004, Commission File No. 000-31161)
10.16	Lease Agreement, dated December 30, 2003, between Arena and ARE Nancy Ridge No. 3, LLC (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2004, Commission File No. 000-31161)
10.17**	Arena's Deferred Compensation Plan, effective November 11, 2003, between Arena and participating executive officers (incorporated by reference to Exhibit 10.29 to Arena's annual report on Form 10-K for the year ended December 31, 2003, filed with the Securities and Exchange Commission on March 1, 2004, Commission File No. 000-31161)
10.18+	Collaboration and License Agreement, dated as of December 20, 2004, by and between Arena and Ortho-McNeil Pharmaceutical, Inc. (incorporated by reference to Exhibit 10.20 to Arena's annual report on Form 10-K for the year ended December 31, 2004, filed with the Securities and Exchange Commission on March 2, 2005, Commission File No. 000-31161)
10.19**	Form of stock option grant for non-employee directors under Arena's 2002 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 21, 2005, Commission File No. 000-31161)
10.20**	Severance Benefit Plan, providing benefits for specified executive officers, dated effective January 20, 2006 (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 24, 2006, Commission File No. 000-31161)
10.21**	2006 Long-Term Incentive Plan, as Amended (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on April 13, 2007, Commission File No. 000-31161)
10.22**	Form of Stock Option Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006,

Commission File No. 000-31161)
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10.23**	Form of Stock Option Grant Agreement Director under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.24**	Form of Incentive Stock Option Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.25**	Form of Restricted Stock Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.4 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.26**	Form of Restricted Stock Unit Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.5 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.27	Form of Performance-Based Restricted Stock Grant Agreement for non-executive employees under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on March 1, 2007, Commission File No. 000-31161)
10.28**	Form of Performance-Based Restricted Stock Grant Agreement for executive officers under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on March 1, 2007, Commission File No. 000-31161)
10.29**	Form of Indemnification Agreement between Arena and its directors (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on June 18, 2007, Commission File No. 000-31161)
10.30**	Form of Indemnification Agreement between Arena and its executive officers (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on June 18, 2007, Commission File No. 000-31161)
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32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 and Rule 13a-14(B) promulgated under the Securities Exchange Act of 1934

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Confidential treatment has been granted for portions of this document.

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Exhibits and schedules to this agreement have been omitted pursuant to the rules of the Securities and Exchange Commission. We will submit copies of such exhibits and schedules to the Securities and Exchange Commission upon request.

**
Management contract or compensatory plan or arrangement.

(b) **EXHIBITS**

See Item 15(a)(3) above.

(c) **FINANCIAL STATEMENT SCHEDULES**

See Item 15(a)(2) above.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 4, 2008.

Arena Pharmaceuticals, Inc.,
a Delaware corporation

By: /s/ JACK LIEF

Jack Lief
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 4, 2008.

	Signatures	Title
By:	/s/ JACK LIEF Jack Lief	President, Chief Executive Officer and Director
By:	/s/ ROBERT E. HOFFMAN Robert E. Hoffman, CPA	Vice President, Finance and Chief Financial Officer (principal financial and accounting officer)
By:	/s/ DOMINIC P. BEHAN Dominic P. Behan, Ph.D.	Director
By:	/s/ DONALD D. BELCHER Donald D. Belcher	Director
By:	/s/ SCOTT H. BICE Scott H. Bice	Director
By:	/s/ HARRY F. HIXSON Harry F. Hixson, Jr., Ph.D.	Director
By:	/s/ J. CLAYBURN LA FORCE, JR. J. Clayburn La Force, Jr., Ph.D.	Director

By:	/s/ TINA NOVA BENNETT	Director
	Tina Nova Bennett, Ph.D.	
By:	/s/ PHILLIP M. SCHNEIDER	Director
	Phillip M. Schneider	
By:	/s/ CHRISTINE A. WHITE, M.D.	Director
	Christine A. White, M.D.	
By:	/s/ RANDALL E. WOODS	Director
	Randall E. Woods	

EXHIBIT INDEX

EXHIBIT NO.	DESCRIPTION
2.1*	Agreement of Purchase and Sale, dated as of March 21, 2007, by and between Arena and BMR-6114-6154 Nancy Ridge Drive LLP (as assignee of BioMed Realty, L.P.) (incorporated by reference to Exhibit 2.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on May 8, 2007, Commission File No. 000-31161)
3.1	Fifth Amended and Restated Certificate of Incorporation of Arena (incorporated by reference to Exhibit 3.1 to Arena's quarterly report on Form 10-Q for the quarter ended June 30, 2002, filed with the Securities and Exchange Commission on August 14, 2002, Commission File No. 000-31161)
3.2	Certificate of Amendment of the Fifth Amended and Restated Certificate of Incorporation of Arena (incorporated by reference to Exhibit 4.2 to Arena's registration statement on Form S-8, filed with the Securities and Exchange Commission on June 28, 2006, Commission File No. 333-135398)
3.3	Amended and Restated Bylaws of Arena (incorporated by reference to Exhibit 3.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on October 4, 2007, Commission File No. 000-31161)
3.4	Certificate of Designations of Series A Junior Participating Preferred Stock of Arena, dated November 4, 2002 (incorporated by reference to Exhibit 3.3 to Arena's quarterly report on Form 10-Q for the quarter ended September 30, 2002, filed with the Securities and Exchange Commission on November 14, 2002, Commission File No. 000-31161)
3.5	Certificate of Designations of Series B-1 Convertible Preferred Stock and Series B-2 Convertible Preferred Stock of Arena, dated December 24, 2003 (incorporated by reference to Exhibit 3.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
4.1	Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on November 1, 2002, Commission File No. 000-31161)
4.2	Amendment No. 1, dated December 24, 2003, to Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
4.3	Amendment No. 2, dated November 16, 2006, to Rights Agreement, dated October 30, 2002, between Arena and Computershare Trust Company, Inc. (incorporated by reference to Exhibit 4.3 to Amendment No. 2 to Arena's Registration Statement on Form 8-A filed with the Securities and Exchange Commission on November 16, 2006, Commission File No. 000-31161)
4.4	Form of common stock certificates (incorporated by reference to Exhibit 4.2 to Arena's registration statement on Form S-1, as amended, filed with the Securities and

EXHIBIT NO.	DESCRIPTION
	Exchange Commission on July 19, 2000, Commission File No. 333-3594)
10.1**	1998 Equity Compensation Plan (incorporated by reference to Exhibit 10.1 to Arena's registration statement on Form S-1, as amended, filed with the Securities and Exchange Commission on June 22, 2000, Commission File No. 333-3594)

10.2**	Amended and Restated 2000 Equity Compensation Plan (incorporated by reference to Exhibit 10.2 to Arena's annual report on Form 10-K for the year ended December 31, 2001, filed with the Securities and Exchange Commission on March 15, 2002, Commission File No. 000-31161)
10.3	2001 Arena Employee Stock Purchase Plan, as amended (incorporated by reference to Exhibit 10.5 to Arena's quarterly report on Form 10-Q for the quarter ended June 30, 2006, filed with the Securities and Exchange Commission on August 4, 2006, Commission File No. 000-31161)
10.4**	2002 Equity Compensation Plan (incorporated by reference to Exhibit A to Arena's Proxy Statement regarding Arena's June 11, 2002, Annual Stockholders Meeting, filed with the Securities and Exchange Commission on April 23, 2002, Commission File No. 000-31161)
10.5+	Research Collaboration and License Agreement, dated effective as of October 21, 2002, by and between Arena and Merck & Co., Inc. (incorporated by reference to Exhibit 10.20 to Arena's annual report on Form 10-K for the year ended December 31, 2002, filed with the Securities and Exchange Commission on March 28, 2003, Commission File No. 000-31161)
10.6+	First Amendment to Research Collaboration and License Agreement, dated as of October 20, 2004, by and between Arena and Merck (incorporated by reference to Exhibit 10.19 to Arena's annual report on Form 10-K for the year ended December 31, 2004, filed with the Securities and Exchange Commission on March 2, 2005, Commission File No. 000-31161)
10.7	Second Amendment to Research Collaboration and License Agreement, dated as of February 20, 2007, by and between Arena and Merck
10.8**	Form of Termination Protection Agreement, dated December 20, 2002, by and among Arena and the employees listed on Schedule 1 thereto (incorporated by reference to Exhibit 10.1 to Arena's quarterly report on Form 10-Q for quarter ended June 30, 2003, filed with the Securities and Exchange Commission on August 13, 2003, Commission File No. 000-31161)
10.9	Securities Purchase Agreement for Arena's Series B Convertible Preferred Stock and warrants dated December 24, 2003, among Arena and the investor signatories thereto (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
10.10	Registration Rights Agreement dated December 24, 2003, among Arena and the investor signatories thereto (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
10.11	Form of Warrant dated December 24, 2003 (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Securities and Exchange Commission on December 30, 2003, Commission File No. 000-31161)
10.12	Settlement Agreement and Release, dated as of June 30, 2006, between Arena and Smithfield Fiduciary LLC. (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)

10.13	Amendment to Registration Rights Agreement, dated as of June 30, 2006, between Arena and Smithfield Fiduciary LLC. (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)
10.14	Amendment to Registration Rights Agreement, dated as of June 30, 2006, between Arena and Mainfield Enterprises, Inc. (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on July 6, 2006, Commission File No. 000-31161)
10.15	Purchase and Sale Agreement and Joint Escrow Instructions, dated December 22, 2003, between Arena and ARE Nancy Ridge No. 3, LLC (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Securities and Exchange Commission on January 6, 2004, Commission File No. 000-31161)
10.16	Lease Agreement, dated December 30, 2003, between Arena and ARE Nancy Ridge No. 3, LLC (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 6, 2004, Commission File No. 000-31161)
10.17**	Arena's Deferred Compensation Plan, effective November 11, 2003, between Arena and participating executive officers (incorporated by reference to Exhibit 10.29 to Arena's annual report on Form 10-K for the year ended December 31, 2003, filed with the Securities and Exchange Commission on March 1, 2004, Commission File No. 000-31161)
10.18+	Collaboration and License Agreement, dated as of December 20, 2004, by and between Arena and Ortho-McNeil Pharmaceutical, Inc. (incorporated by reference to Exhibit 10.20 to Arena's annual report on Form 10-K for the year ended December 31, 2004, filed with the Securities and Exchange Commission on March 2, 2005, Commission File No. 000-31161)
10.19**	Form of stock option grant for non-employee directors under Arena's 2002 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 21, 2005, Commission File No. 000-31161)
10.20**	Severance Benefit Plan, providing benefits for specified executive officers, dated effective January 20, 2006 (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on January 24, 2006, Commission File No. 000-31161)
10.21**	2006 Long-Term Incentive Plan, as Amended (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on April 13, 2007, Commission File No. 000-31161)
10.22**	Form of Stock Option Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.23**	Form of Stock Option Grant Agreement Director under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.24**	Form of Incentive Stock Option Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.3 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1,

2006, Commission File No. 000-31161)

10.25**	Form of Restricted Stock Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.4 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.26**	Form of Restricted Stock Unit Grant Agreement under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.5 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on August 1, 2006, Commission File No. 000-31161)
10.27	Form of Performance-Based Restricted Stock Grant Agreement for non-executive employees under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.1 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on March 1, 2007, Commission File No. 000-31161)
10.28**	Form of Performance-Based Restricted Stock Grant Agreement for executive officers under the Arena 2006 Long-Term Incentive Plan (incorporated by reference to Exhibit 10.2 to Arena's report on Form 8-K filed with the Securities and Exchange Commission on March 1, 2007, Commission File No. 000-31161)
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QuickLinks