ARENA PHARMACEUTICALS INC
Form 10-Q
May 02, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2012

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File Number: 000-31161

ARENA PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**23-2908305**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6166 Nancy Ridge Drive, San Diego, CA	**92121**
(Address of principal executive offices)	**(Zip Code)**

858.453.7200

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

The number of shares of common stock outstanding as of the close of business on May 1, 2012:

Class	**Number of Shares Outstanding**
Common Stock, $0.0001 par value	182,500,778

Table of Contents

ARENA PHARMACEUTICALS, INC.

INDEX

In this report, Arena Pharmaceuticals, Arena, we, us and our refer to Arena Pharmaceuticals, Inc., and our wholly owned subsidiaries, unless context otherwise provides.

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Arena Pharmaceuticals, Inc.

Condensed Consolidated Balance Sheets

(In thousands)

	March 31, 2012 (Unaudited)	December 31, 2011 [1]
Assets		
Current assets:		
Cash and cash equivalents	$ 88,193	$ 57,632
Accounts receivable	1,003	607
Prepaid expenses and other current assets	2,779	2,021
Total current assets	91,975	60,260
Land, property and equipment, net	80,864	82,066
Acquired technology and other intangibles, net	11,312	11,032
Other non-current assets	3,648	3,771
Total assets	$ 187,799	$ 157,129
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 3,540	$ 5,294
Accrued compensation	3,736	4,280
Current portion of deferred revenues	3,510	3,473
Current portion of lease financing obligations	1,397	1,313
Total current liabilities	12,183	14,360
Deferred rent	180	225
Deferred revenues, less current portion	40,350	41,209
Derivative liabilities	3,992	1,617
Note payable to Deerfield[2]	12,182	14,698
Lease financing obligations, less current portion	74,086	74,458
Commitments and contingencies and subsequent events		
Stockholders equity:		
Common stock	18	15
Additional paid-in capital	1,167,775	1,108,625
Treasury stock, at cost	(23,070)	(23,070)
Accumulated other comprehensive income	6,431	4,743
Accumulated deficit	(1,106,328)	(1,079,751)
Total stockholders equity	44,826	10,562
Total liabilities and stockholders equity	$ 187,799	$ 157,129

[1] The balance sheet data at December 31, 2011, has been derived from audited financial statements at that date. It does not include, however, all of the information and notes required by US generally accepted accounting principles for complete financial statements.

[2] The outstanding principal balance of the note payable to Deerfield was $17.3 million at March 31, 2012, and $22.3 million at December 31, 2011. See Notes 5 and 12.

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Arena Pharmaceuticals, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(In thousands, except per share data)

(Unaudited)

	Three months ended March 31,	
	2012	**2011**
Revenues:		
Manufacturing services	$ 1,292	$ 1,408
Collaborative agreements	897	2,517
Total revenues	2,189	3,925
Operating Expenses:		
Cost of manufacturing services	791	2,381
Research and development	14,470	15,935
General and administrative	6,355	6,890
Restructuring charges	0	3,467
Amortization of acquired technology and other intangibles	176	436
Total operating expenses	21,792	29,109
Loss from operations	(19,603)	(25,184)
Interest and Other Income (Expense):		
Interest income	15	49
Interest expense	(3,031)	(4,694)
Gain (Loss) from valuation of derivative liabilities	(2,375)	439
Loss on extinguishment of debt	(1,670)	(10,514)
Other	87	6
Total interest and other expense, net	(6,974)	(14,714)
Net loss	(26,577)	(39,898)
Deemed dividend related to beneficial conversion feature of convertible preferred stock	(2,824)	(2,260)
Net loss allocable to common stockholders	$ (29,401)	$ (42,158)
Net loss per share allocable to common stockholders:		
Basic	$ (0.18)	$ (0.35)
Diluted	$ (0.18)	$ (0.35)
Shares used in calculating net loss per share allocable to common stockholders:		
Basic	164,213	121,654
Diluted	164,213	121,654

Comprehensive Loss:		
Net loss	$ (26,577)	$ (39,898)
Foreign currency translation gain	1,688	383
Comprehensive loss	$ (24,889)	$ (39,515)

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

Arena Pharmaceuticals, Inc.

Condensed Consolidated Cash Flow Statements

(In thousands)

(Unaudited)

	Three months ended March 31,	
	2012	**2011**
Operating Activities		
Net loss	$ (26,577)	$ (39,898)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,405	2,560
Amortization of acquired technology and other intangibles	176	436
Share-based compensation	1,407	1,330
(Gain) Loss from valuation of derivative liabilities	2,375	(439)
Amortization of prepaid financing costs	85	283
Accretion of note payable to Deerfield	814	1,599
Accretion of note payable to Siegfried	0	126
Loss on extinguishment of debt	1,670	10,514
Changes in assets and liabilities:		
Accounts receivable	(353)	524
Prepaid expenses and other assets	(748)	(85)
Accounts payable and accrued liabilities	(2,637)	(384)
Deferred revenues	(822)	(928)
Deferred rent	(45)	(42)
Net cash used in operating activities	(22,250)	(24,404)
Investing Activities		
Purchases of land, property and equipment	(274)	(90)
Other non-current assets	50	3
Net cash used in investing activities	(224)	(87)
Financing Activities		
Principal payments on lease financing obligations	(288)	(213)
Principal payments on note payable to Deerfield	(5,000)	(37,739)
Repayment on note payable to Siegfried	0	(3,430)
Proceeds from issuance of common stock	41,283	17,662
Proceeds from issuance of preferred stock	16,463	17,750
Net cash provided by (used in) financing activities	52,458	(5,970)
Effect of exchange rate changes on cash	577	(346)
Net increase (decrease) in cash and cash equivalents	30,561	(30,807)
Cash and cash equivalents at beginning of period	57,632	150,669
Cash and cash equivalents at end of period	$ 88,193	$ 119,862

See accompanying notes to unaudited condensed consolidated financial statements.

3

Table of Contents

Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation and Recent Events

The accompanying unaudited condensed consolidated financial statements of Arena Pharmaceuticals, Inc., which include our wholly owned subsidiaries, should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission, or SEC, from which we derived our balance sheet as of December 31, 2011. The accompanying financial statements have been prepared in accordance with US generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of our management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

In June 2011, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2011-05, Presentation of Comprehensive Income, which amends the presentation requirements for comprehensive income. Under ASU 2011-05, we have the option to present the components of net income and comprehensive income as one single continuous statement or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present other comprehensive income in the statement of stockholders equity, but it does not change the items that must be reported in comprehensive income. We adopted ASU 2011-05 in the first quarter of 2012 by using a single-statement approach.

The preparation of financial statements in accordance with GAAP requires our management to make estimates and assumptions that affect amounts reported in the financial statements and notes thereto. The amounts reported could differ under different estimates and assumptions.

2. Fair Value Disclosures

We measure our financial assets and liabilities at fair value, which is defined as the exit price, or the amount that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We use the following three-level valuation hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs to value our financial assets and liabilities:

Level 1 - Observable inputs such as unadjusted quoted prices in active markets for identical instruments.

Level 2 - Quoted prices for similar instruments in active markets or inputs that are observable for the asset or liability, either directly or indirectly.

Level 3 - Significant unobservable inputs based on our assumptions.

The following table presents our valuation hierarchy for our financial assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2012, in thousands:

		Fair Value Measurements at March 31, 2012		
	Balance at March 31, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds and cash equivalents[1]	$ 71,646	$ 71,646	$ 0	$ 0
Liabilities:				
Warrants and other derivative instruments	$ 3,992	$ 0	$ 0	$ 3,992

[1] Included in cash and cash equivalents on our condensed consolidated balance sheet.

Table of Contents

The following table presents our valuation hierarchy for our financial assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2011, in thousands:

		Fair Value Measurements at December 31, 2011		
	Balance at December 31, 2011	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds and cash equivalents[1]	$ 35,307	$ 35,307	$ 0	$ 0
Liabilities:				
Warrants and other derivative instruments	$ 1,617	$ 0	$ 0	$ 1,617

[1] Included in cash and cash equivalents on our consolidated balance sheet.

The following table presents the activity for our derivative liabilities during the three months ended March 31, 2012, in thousands:

	Significant Unobservable Inputs (Level 3)
Balance at December 31, 2011	$ 1,617
Loss from valuation of derivative liabilities	2,375
Balance at March 31, 2012	$ 3,992

3. Accounts Payable and Other Accrued Liabilities

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

	March 31, 2012	December 31, 2011
Accounts payable	$ 1,449	$ 2,363
Accrued expenses	1,302	1,046
Accrued clinical and preclinical study fees	147	430
Loss provision (see Note 4)	533	1,203
Other accrued liabilities	109	252
Total accounts payable and other accrued liabilities	$ 3,540	$ 5,294

4. Agreements with Siegfried Ltd

In January 2008, Arena Pharmaceuticals GmbH, or Arena GmbH, our wholly owned subsidiary, acquired from Siegfried Ltd, or Siegfried, certain drug product facility assets, including manufacturing facility production licenses, fixtures, equipment, other personal property and real estate assets in Zofingen, Switzerland, under an asset purchase agreement. These assets are being used to manufacture lorcaserin and certain drug products for Siegfried. In connection with this transaction, Arena GmbH and Siegfried also entered into a long-term supply agreement for the active pharmaceutical ingredient of lorcaserin, a manufacturing services agreement and a technical services agreement. These agreements have since been amended.

Among other changes, under the amended manufacturing services agreement, Siegfried has agreed to order 80% of its requirements of certain drug products from Arena GmbH for the calendar year 2012 at agreed upon prices in exchange for Arena GmbH providing further reductions to the prices for certain of the manufacturing services provided to Siegfried.

At December 31, 2011, we recorded a $1.2 million estimated contract loss provision related to the amount that the costs to manufacture drug product are expected to exceed the related revenues through December 31, 2012, under the amended manufacturing services agreement. In the three months ended March 31, 2012, we reduced this estimated loss provision by (i) $0.5 million primarily due to a decrease in our manufacturing costs as a result of operational efficiencies and (ii) $0.2 million to reflect the loss incurred on the services rendered in the quarter. At March 31, 2012, we estimated our loss provision, which is recorded in accounts payable and other accrued liabilities on our condensed consolidated balance sheet, to be $0.5 million at March 31, 2012. See Note 3.

Table of Contents

5. Note Payable to Deerfield

In July 2009, pursuant to a Facility Agreement we entered into in June 2009, or the Facility Agreement, with Deerfield Private Design Fund, L.P., Deerfield Private Design International, L.P., Deerfield Partners, L.P., Deerfield International Limited, Deerfield Special Situations Fund, L.P., and Deerfield Special Situations Fund International Limited, or collectively Deerfield, Deerfield provided us with a $100.0 million secured loan. We received net proceeds of $95.6 million from this loan. At any time, we may prepay any or all of the outstanding principal at par. In connection with the funding of this loan, we issued Deerfield warrants to purchase an aggregate of 28,000,000 shares of our common stock, which were exercisable until June 17, 2013, and at an exercise price of $5.42 per share.

As of the July 2009 issuance date of the loan, we separately valued four components under the Facility Agreement as follows: (i) the $100.0 million loan was valued at $47.9 million on a relative fair value basis and recorded as a liability on our condensed consolidated balance sheet, (ii) the original warrants to purchase 28,000,000 shares of our common stock were valued at $39.1 million on a relative fair value basis and recorded as additional paid-in capital on our condensed consolidated balance sheet, and the resulting debt discount is being accreted to interest expense, (iii) Deerfield s former right to loan us up to an additional $20.0 million under the Facility Agreement was valued at $9.5 million and classified as a liability on our condensed consolidated balance sheet and (iv) Deerfield s ability to accelerate principal payments under the loan under certain circumstances, including upon certain changes of control was valued at $0.5 million and classified as a liability on our condensed consolidated balance sheet. As Deerfield s right to loan us additional funds has terminated, such right is no longer recorded on our condensed consolidated balance sheet.

Subsequent to the funding of the Deerfield loan, we have amended the terms of the Facility Agreement, repaid certain of the debt and, as part of various equity financings, exchanged all of the original warrants for a lesser number of warrants at lower exercise prices. In addition to other equity financings with Deerfield, we exchanged certain of their warrants as part of our financings in June 2010, March 2011 and January 2012, as described below. Other than the exercise period, the exercise price and certain provisions related to cashless exercise and early termination of the warrants, all of the warrants issued in exchange contained substantially the same terms as the original warrants.

In June 2010, we entered into a purchase and exchange agreement with Deerfield, pursuant to which we (i) sold Deerfield 11,000,000 shares of our common stock, resulting in net proceeds to us of $35.5 million, and (ii) exchanged Deerfield s warrants to purchase 16,200,000 shares of our common stock for new warrants to purchase the same number of shares of our common stock at an exercise price of $3.45 per share and an expiration date of June 17, 2013.

In March 2011, we and Deerfield entered into a securities purchase agreement, an exchange agreement and a second amendment to the Facility Agreement. Under this securities purchase agreement, Deerfield purchased 12,150,000 shares of our common stock and 12,150 shares of our Series C Convertible Preferred Stock, or Series C Preferred, resulting in net proceeds to us of $17.6 million, after prepayment of $17.7 million of loan principal under the second amendment to the Facility Agreement. In April 2011, Deerfield converted all of the Series C Preferred into a total of 12,150,000 shares of common stock. The fair value of the common stock into which the Series C Preferred was convertible on the date of issuance exceeded the proceeds allocated to the Series C Preferred on a relative fair value basis by $2.3 million, resulting in a beneficial conversion feature that we recognized as a decrease to additional paid-in capital and a deemed dividend to the Series C Preferred stockholders in the three months ended March 31, 2011. Under this exchange agreement, we exchanged 14,368,590 of Deerfield s warrants with an exercise price of $3.45 per share for new warrants to purchase the same number of shares of our common stock at an exercise price of $1.68 per share and an expiration date of June 17, 2015.

In January 2012, we and Deerfield entered into a securities purchase agreement, an exchange agreement and a third amendment to the Facility Agreement.

Under this securities purchase agreement, Deerfield purchased 9,953,250 shares of our common stock for a purchase price of $1.65775 per share and approximately 9,953 shares of our Series D Convertible Preferred Stock, or Series D Preferred, for a purchase price of $1,657.75 per share. In February 2012, Deerfield converted all of the Series D Preferred into a total of 9,953,250 shares of common stock. The fair value of the common stock into which the Series D Preferred was convertible on the date of issuance exceeded the proceeds allocated to the Series D Preferred on a relative fair value basis by $2.8 million, resulting in a beneficial conversion feature that we recognized as a decrease to additional paid-in capital and a deemed dividend to the Series D Preferred stockholders in the three months ended March 31, 2012.

Under this exchange agreement, we issued Deerfield warrants to purchase 8,631,410 shares of our common stock at an exercise price of $1.745 per share in exchange for the cancellation of outstanding warrants to purchase 11,800,000 shares of our common stock at an exercise price of $5.42 per share and outstanding warrants to purchase 1,831,410 shares of our common stock at an exercise price of $3.45 per share. These new warrants are exercisable until June 17, 2015. We

Table of Contents

determined that the incremental value of these new warrants was $4.5 million, which was recorded as a component of the stock issuance and warrant exchange in the stockholders equity section of our condensed consolidated balance sheet. See Note 7 for a breakdown of the 23,000,000 Deerfield warrants outstanding as of March 31, 2012.

Under the third amendment to the Facility Agreement, we prepaid $5.0 million of the principal amount that was originally scheduled to be repaid to Deerfield in June 2013. After deducting such prepayment, net proceeds to us under this financing were approximately $27.9 million. In connection with the $5.0 million prepayment, we retired a proportional share of the debt discount and issuance costs directly related to the repaid debt and recognized a non-cash loss on extinguishment of debt of $1.7 million in the three months ended March 31, 2012.

The following table summarizes the principal repayments made on our Deerfield loan from its inception through March 31, 2012, in thousands:

	Loan Principal
Original loan principal	$ 100,000
July 2009 repayment	(10,000)
August 2010 repayment	(30,000)
January 2011 repayment	(20,000)
March 2011 repayment	(17,739)
January 2012 repayment	(5,000)
Outstanding principal balance at March 31, 2012	$ 17,261

See Note 12 regarding the reduction to the outstanding principal balance subsequent to March 31, 2012.

The outstanding principal balance on the Deerfield loan is due on June 17, 2013. The difference between the $12.2 million recorded value and the $17.3 million outstanding principal balance of the loan as of March 31, 2012, represents the remaining debt discount, which we will accrete over the term of the loan or until paid. The outstanding principal accrues interest at the contractual rate of 7.75% per annum, payable quarterly in arrears. Total interest expense of $1.2 million, including accretion of the debt discount attributable to the warrants and the other derivative financial instruments and amortization of capitalized issuance costs, was recognized in connection with this loan in the three months ended March 31, 2012, compared to $2.7 million in the three months ended March 31, 2011. The current effective annual interest rate on the loan is 38.4%.

6. Derivative Liabilities

In June 2006 and August 2008, we issued seven-year warrants, which we refer to as the Series B Warrants, to purchase 829,856 and 1,106,344 shares of our common stock, respectively, at an exercise price of $15.49 and $7.71 per share, respectively. The Series B Warrants are related to our Series B Convertible Preferred Stock, which we redeemed in 2008 and is no longer outstanding. The warrants contain an anti-dilution provision and, as a result of certain subsequent equity issuances at prices below the adjustment price of $6.72 defined in the warrants, as of March 31, 2012, the number of shares issuable upon exercise of the outstanding June 2006 and August 2008 Series B Warrants was increased to 1,467,405 and 1,965,418, respectively, and the exercise price was reduced to $8.76 and $4.34 per share, respectively. The Series B Warrants are classified as a liability on our condensed consolidated balance sheets.

In accordance with relevant guidance, we have revalued these warrants on each subsequent balance sheet date, and will continue to do so until they are exercised or expire, with any changes in the fair value between reporting periods recorded as other income or expense. The June 2006 and August 2008 Series B Warrants were valued at March 31, 2012, and 2011, using an option pricing model and the following assumptions:

	March 31, 2012		March 31, 2011	
	June 2006 Series B Warrants	August 2008 Series B Warrants	June 2006 Series B Warrants	August 2008 Series B Warrants
Risk-free interest rate	0.2%	0.7%	1.0%	2.0%

Dividend yield	0%	0%	0%	0%
Expected volatility	87%	99%	90%	82%
Expected life (years)	1.25	3.37	2.25	4.37

We separately valued Deerfield s right to require us to accelerate payments under the loan under certain circumstances, including upon certain changes of control, at $0.5 million as of the July 2009 issuance date of the Deerfield loan (see Note 5). The value of this

Table of Contents

acceleration right is classified as a liability on our condensed consolidated balance sheet and, accordingly, will be revalued on each subsequent balance sheet date until it is exercised or expires, with any changes in the fair value between reporting periods recorded as other income or expense. At each reporting date, this acceleration right was valued using a discounted cash flow model.

Our derivative liabilities, which are recorded as a long-term liability on our condensed consolidated balance sheet, consisted of the following as of March 31, 2012, and December 31, 2011, in thousands:

	March 31, 2012	December 31, 2011
Series B Warrants	$ 3,992	$ 1,562
Deerfield acceleration right	0	55
Total derivative liabilities	$ 3,992	$ 1,617

The change in the fair value of our derivative liabilities is recorded in the interest and other income (expense) section of our condensed consolidated statements of operations and comprehensive loss. Following is the gain (loss) we recognized in the three months ended March 31, 2012, and 2011, in thousands:

	Three months ended March 31, 2012	2011
Series B Warrants	$ (2,430)	$ 259
Deerfield acceleration right	55	180
Total gain (loss) from valuation of derivative liabilities	$ (2,375)	$ 439

7. Warrants

As part of our January 2012 sale of common stock to Deerfield (see Note 5), we exchanged outstanding warrants to purchase 11,800,000 shares of our common stock at an exercise price of $5.42 per share and outstanding warrants to purchase 1,831,410 shares of our common stock at an exercise price of $3.45 per share for new warrants to purchase 8,631,410 shares of our common stock at an exercise price of $1.745 per share. We determined that the incremental value of the $1.745 warrants was $4.5 million as of their issuance date.

The following table summarizes our outstanding warrants as of March 31, 2012:

	Balance Sheet Classification	Number of Warrants	Exercise Price	Expiration Date
Deerfield $1.68 warrants	Equity	14,368,590	$ 1.68	June 17, 2015
Deerfield $1.745 warrants	Equity	8,631,410	$ 1.745	June 17, 2015
August 2008 Series B Warrants	Liability	1,965,418	$ 4.34	August 14, 2015
June 2006 Series B Warrants	Liability	1,467,405	$ 8.76	June 30, 2013
Total number of warrants outstanding		26,432,823		

See Note 12 regarding the exercise of certain of these warrants subsequent to March 31, 2012.

8. Stockholders Equity

Equity Financings

In January 2012, we issued Deerfield 9,953,250 shares of our common stock and approximately 9,953 shares of our Series D Preferred and, as described in Note 5, exchanged certain of Deerfield s warrants to purchase shares of our common stock. After deducting a $5.0 million prepayment of loan principal, net proceeds to us from this transaction were approximately $27.9 million. In February 2012, Deerfield converted all of the Series D Preferred into a total of 9,953,250 shares of our common stock.

In March 2012, we issued 14,414,370 shares of our common stock under an equity line of credit agreement with Azimuth Opportunity, L.P., resulting in net proceeds to us of approximately $24.7 million.

Table of Contents

Share-based Compensation

We recognized share-based compensation expense as follows, in thousands, except per share data:

	Three months ended March 31,	
	2012	2011
Research and development	$ 167	$ 525
General and administrative	1,240	711
Restructuring charges	0	94
Total share-based compensation expense and impact on net loss allocable to common stockholders	$ 1,407	$ 1,330
Impact on net loss per share allocable to common stockholders, basic and diluted	$ 0.01	$ 0.01

Share-based Award Activity

The following table summarizes our stock option activity during the three months ended March 31, 2012:

	Options	Weighted-Average Exercise Price
Outstanding at January 1, 2012	10,309,972	$ 5.63
Granted	4,669,400	1.81
Exercised	(10,688)	1.49
Forfeited/cancelled/expired	(644,588)	7.45
Outstanding at March 31, 2012	14,324,096	$ 4.31

We granted 1,690,500 and 371,800 performance-based restricted stock unit awards in February 2007 and March 2008, respectively. The awards provided employees until February 26, 2012, to achieve four specific drug development and strategic performance goals. No compensation expense has been recognized to date related to these awards. None of these performance goals was achieved by February 26, 2012, and, consequently, all of the 1,171,250 then outstanding awards expired on such date without any vesting.

9. Concentration of Credit Risk and Major Customers

Financial instruments, which potentially subject us to concentrations of credit risk, consist primarily of cash, cash equivalents and short-term investments. We limit our exposure to credit loss by holding our cash in US dollars or placing our cash and investments in US government, agency and government-sponsored enterprise obligations and in corporate debt instruments that are rated investment grade, in accordance with our board-approved investment policy.

We manufacture drug products for Siegfried under a manufacturing services agreement, and all of our manufacturing services revenues are attributable to Siegfried.

Percentages of our total revenues derived from our manufacturing services agreement and our most significant collaborators for the periods presented are as follows:

Source of Revenue	Three months ended March 31, 2012	2011
Manufacturing services agreement with Siegfried	59.0%	35.9%
Collaboration with Eisai Inc.	39.2%	50.9%
Former collaboration with Ortho-McNeil-Janssen Pharmaceuticals, Inc.	0.0%	12.9%
Others	1.8%	0.3%
Total percentage of revenues	100.0%	100.0%

Table of Contents

10. Net Loss Per Share

We calculate basic and diluted net loss per share allocable to common stockholders using the weighted-average number of shares of common stock outstanding during the period, less any shares subject to repurchase or forfeiture. There were no shares of our common stock subject to repurchase or forfeiture for the three months ended March 31, 2012, or 2011.

Because we are in a net loss position, we have excluded any outstanding unvested performance-based restricted stock unit awards (which were subject to forfeiture), warrants, stock options and convertible preferred stock, as well as unvested restricted stock in our deferred compensation plan, from our calculation of diluted net loss per share because including these securities in the calculation would be antidilutive for the periods presented. The table below presents our securities that would have been included in our diluted net loss per share allocable to common stockholders if they were not antidilutive at March 31, 2012, and 2011.

	Three months ended March 31,	
	2012	2011
Warrants	26,432,823	30,868,111
Stock options	14,324,096	10,603,879
Performance-based restricted stock unit awards	0	1,332,700
Unvested restricted stock	79,169	79,169
Series C Preferred	0	12,150,000
Total	40,836,088	55,033,859

11. Legal Proceedings

Beginning on September 20, 2010, a number of complaints were filed in the US District Court for the Southern District of California against us and certain of our current and former employees and directors on behalf of certain purchasers of our common stock. The complaints have been brought as purported stockholder class actions, and, in general, include allegations that we and certain of our current and former employees and directors violated federal securities laws by making materially false and misleading statements regarding our lorcaserin program, thereby artificially inflating the price of our common stock. The plaintiffs are seeking unspecified monetary damages and other relief. On November 19, 2010, eight prospective lead plaintiffs filed motions to consolidate, appoint a lead plaintiff, and appoint lead counsel. The Court took the motions to consolidate under submission on January 14, 2011. On August 8, 2011, the Court consolidated the actions and appointed a lead plaintiff and lead counsel. On November 1, 2011, the lead plaintiff filed a consolidated amended complaint. On December 30, 2011, we filed a motion to dismiss the consolidated amended complaint. The motion to dismiss has been fully briefed and the Court took the motion to dismiss under submission on April 13, 2012. In addition to the class actions, a complaint involving similar legal and factual issues has been brought by at least one individual stockholder and is pending in federal court. On December 30, 2011, we filed a motion to dismiss the stockholder s complaint. The motion to dismiss has been fully briefed and the Court took the motion to dismiss under submission on April 13, 2012. We intend to defend against the claims advanced and to seek dismissal of these complaints. Due to the early stage of these proceedings, we are not able to predict or reasonably estimate the ultimate outcome or possible losses relating to these claims.

On September 24, 2010, a stockholder derivative complaint was filed in the Superior Court of California for the County of San Diego against certain of our current and former employees and directors, and other stockholder derivative complaints were subsequently filed in state court. On October 19, 2010, the Superior Court ordered that the pending state derivative actions be consolidated. The Superior Court also ordered that later filed, related state derivative actions be consolidated as well. We refer to the consolidated state derivative actions as the State Derivative Action. In November 2010, plaintiffs in the State Derivative Action filed a consolidated stockholder derivative complaint. We filed a demurrer to the consolidated stockholder derivative complaint on February 15, 2011. On October 6, 2010, a stockholder derivative complaint was filed in the US District Court for the Southern District of California. Thereafter, a number of other stockholder derivative complaints were also filed in federal court. On March 3, 2011, the federal court ordered that the pending federal derivative actions be consolidated. The federal court also ordered that later filed, related federal derivative actions be consolidated as well. We refer to the consolidated federal derivative actions as the Federal Derivative Action. We refer to the State Derivative Action and the Federal Derivative Action collectively as the Derivative Actions. The Derivative Actions allege breaches of fiduciary duties by the defendants and other violations of law. In general, the Derivative Actions allege that certain of our current and former employees and directors caused or allowed for the dissemination of materially false and misleading statements regarding our lorcaserin program, thereby artificially inflating the price of our common stock. On September 9, 2011, we and lead counsel for the plaintiffs in the Derivative Actions entered into a stipulation of settlement to resolve the Derivative Actions. The current and former employees and directors named as individual defendants in the Derivative Actions have also entered into the stipulation of settlement. On

October 19, 2011, the Superior Court of California entered an order preliminarily approving the proposed settlement. On December 16, 2011, the Superior Court of California issued its final order and judgment approving the settlement and dismissing the State Derivative Action with prejudice. On December 29, 2011, the US District Court issued an order dismissing the Federal

Table of Contents

Derivative Action with prejudice. In accordance with the terms of the settlement, and in exchange for a release of all claims by the plaintiffs, among others, we agreed to adopt certain corporate governance measures and cause our insurers to pay the plaintiffs attorneys a total of $1.1 million. The time for appeals of the settlement of the Derivative Actions has lapsed without any appeal.

12. Subsequent Events

We have evaluated subsequent events after the balance sheet date of March 31, 2012, and up to the date we filed this report.

Additional Lease Obligation

In May 2007, pursuant to an agreement that was originally with BioMed Realty, L.P., a Maryland limited partnership, or BioMed, and later assigned by BioMed to one of its subsidiaries, BMR-6114-6154 Nancy Ridge Drive LLC, a Delaware limited liability company, or BMR, we sold to BMR three of our US properties and our right, title and interest in the option to purchase a fourth US property, which we were leasing from another lessor. In connection with this transaction, we also (i) entered into agreements with BMR to lease back the properties under 20-year leases, and (ii) agreed that, upon the exercise of the option, we would continue to lease the fourth property, but with BMR for a term that is concurrent with the leases for the other three properties.

In April 2012, BMR exercised its option and purchased the fourth property. As a result of the purchase, we are obligated to lease this property through May 2027, which results in an additional future obligation of approximately $14.1 million over the term of this lease. In addition, subject to certain restrictions, we have the option to repurchase this property, as well as the other three properties, on the 10th, 15th or 20th anniversary of the May 2007 execution date of the leases, and earlier if the leases are terminated under certain circumstances.

Deerfield Warrant Exercise

In April 2012, Deerfield exercised a portion of its warrants to purchase 2,000,000 shares of our common stock at $1.68 per share, and elected to pay the exercise price for the warrants by canceling a portion of the outstanding principal balance of our Deerfield loan. Accordingly, after such reduction, the outstanding principal balance on the Deerfield loan was $13.9 million.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

This discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this quarterly report on Form 10-Q, or Quarterly Report, and the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2011, or 2011 Annual Report, as filed with the Securities and Exchange Commission, or SEC. Operating results are not necessarily indicative of results that may occur in future periods.

This Quarterly Report includes forward-looking statements, which involve a number of risks and uncertainties. These forward-looking statements can generally be identified as such because the context of the statement will include words such as may, will, intend, plan, believe, anticipate, expect, estimate, predict, potential, continue, likely, or opportunity, the negative of these words or other similar words. S statements that describe our future plans, strategies, intentions, expectations, objectives, goals or prospects and other statements that are not historical facts are also forward-looking statements. For such statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. Readers of this Quarterly Report are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the time this Quarterly Report was filed with the SEC. These forward-looking statements are based largely on our expectations and projections about future events and future trends affecting our business, and are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. These risks and uncertainties include, without limitation, the risk factors identified in our SEC reports, including this Quarterly Report. In addition, past financial or operating performance is not necessarily a reliable indicator of future performance, and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. Except as required by law, we undertake no obligation to update publicly or revise our forward-looking statements.

OVERVIEW AND RECENT DEVELOPMENTS

We are a clinical-stage biopharmaceutical company focused on discovering, developing and commercializing oral drugs that target G protein-coupled receptors, or GPCRs, an important class of validated drug targets, in four major therapeutic areas: cardiovascular, central nervous system, inflammatory and metabolic diseases. We are seeking to advance multiple drug candidates, all of which we discovered

internally, through the development process.

We have submitted regulatory applications for US and EU approval of our most advanced drug candidate, lorcaserin, which is intended for weight management. In December 2011, we resubmitted the lorcaserin New Drug Application, or NDA, to the US Food and Drug Administration, or FDA, and the FDA has assigned a new Prescription Drug User Fee Act, or PDUFA, target date of June 27, 2012. The FDA s Endocrinologic and Metabolic Drugs Advisory Committee is scheduled to meet on May 10, 2012, to discuss the lorcaserin NDA. In March 2012, the European Medicines Agency, or EMA, accepted a marketing authorization application, or MAA, for lorcaserin, which we filed through the centralized procedure.

Our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH, has granted Eisai Inc., or Eisai, exclusive rights to commercialize lorcaserin in the United States and its territories and possessions, subject to FDA approval of the lorcaserin NDA. Also subject to applicable regulatory approval, we intend to commercialize lorcaserin in the European Union and in other areas outside of the United States with one or more collaborators or independently.

Table of Contents

Our recent and first quarter 2012 developments include:

- Filed an MAA for lorcaserin through the centralized procedure with the EMA, and the EMA has accepted the MAA for review.