

ARRAY BIOPHARMA INC  
Form 10-Q  
November 02, 2009

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)

**OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2009**

or

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

**For the transition period from      to**

**Commission File Number: 000-31979**

For the quarterly period ended September 30, 2009

## Array BioPharma Inc.

*(Exact Name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or Other Jurisdiction of  
Incorporation or Organization)*

**84-1460811**

*(I.R.S. Employer Identification No.)*

**3200 Walnut Street, Boulder, CO**

*(Address of Principal Executive Offices)*

**80301**

*(Zip Code)*

**(303) 381-6600**

*(Registrant's Telephone Number, Including Area Code)*

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

Yes      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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes      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  
Non-Accelerated Filer      (do not check if 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      No

As of October 29, 2009, the registrant had 49,309,333 shares of common stock outstanding.



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**ARRAY BIOPHARMA INC.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009**

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED FINANCIAL STATEMENTS****ARRAY BIOPHARMA INC.****Condensed Balance Sheets**

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

(Unaudited)

	<b>September 30, 2009</b>	<b>June 30, 2009</b>
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 54,701	\$ 33,202
Marketable securities	3,775	7,296
Prepaid expenses and other current assets	4,220	4,419
Total current assets	62,696	44,917
<b>Long-term assets</b>		
Marketable securities	18,798	16,990
Property and equipment, net	25,083	26,498
Other long-term assets	3,535	6,650
Total long-term assets	47,416	50,138
Total assets	\$ 110,112	\$ 95,055
<b>LIABILITIES AND STOCKHOLDERS DEFICIT</b>		
<b>Current liabilities</b>		
Accounts payable and other accrued expenses	\$ 6,993	\$ 8,421
Accrued outsourcing costs	5,423	4,759
Accrued compensation and benefits	8,747	7,848
Deferred rent	3,070	3,034
Deferred revenue	11,511	11,233
Current portion of long-term debt	-	15,000
Total current liabilities	35,744	50,295
<b>Long-term liabilities</b>		
Deferred rent	20,689	21,481
Deferred revenue	26,506	28,340
Long-term debt, net	108,161	68,170
Derivative liabilities	938	-
Other long-term liability	599	470
Total long-term liabilities	156,893	118,461
Total liabilities	192,637	168,756
<b>Commitments and contingencies</b>		
<b>Stockholders deficit</b>		

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Preferred stock, \$0.001 par value; 10,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock, \$0.001 par value; 120,000,000 shares authorized; 48,195,766 and 48,125,776 shares issued and outstanding, as of September 30, 2009 and June 30, 2008, respectively	48	48
Additional paid-in capital	314,002	312,349
Warrants	36,296	23,869
Accumulated other comprehensive income	5,132	3,234
Accumulated deficit	(438,003)	(413,201)
Total stockholders deficit	(82,525)	(73,701)
Total liabilities and stockholders deficit	\$ 110,112	\$ 95,055

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

Table of Contents**ARRAY BIOPHARMA INC.****Condensed Statements of Operations and Comprehensive Loss**

(Amounts in Thousands, Except Per Share Data)

(Unaudited)

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Revenue</b>		
Collaboration revenue	\$ 5,044	\$ 4,238
License and milestone revenue	2,846	1,510
Total revenue	7,890	5,748
<b>Operating expenses</b>		
Cost of revenue	5,923	5,120
Research and development for proprietary drug discovery	19,201	24,509
General and administrative	4,213	4,492
Total operating expenses	29,337	34,121
<b>Loss from operations</b>	(21,447)	(28,373)
<b>Other income (expense)</b>		
Impairment of marketable securities	(217)	(3,910)
Interest income	304	878
Interest expense	(3,442)	(2,280)
Total other income (expense)	(3,355)	(5,312)
<b>Net loss</b>	\$ (24,802)	\$ (33,685)
Change in unrealized gains and losses on marketable securities	1,898	1,957
<b>Comprehensive loss</b>	\$ (22,904)	\$ (31,728)
<b>Weighted average shares outstanding - basic and diluted</b>	48,137	47,573
<b>Net loss per share - basic and diluted</b>	\$ (0.52)	\$ (0.71)

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

Table of Contents**ARRAY BIOPHARMA INC.****Condensed Statement of Stockholders Equity (Deficit)**

(Amounts in Thousands)

(Unaudited)

	Preferred Stock Shares	Preferred Stock Amounts	Common Stock Shares	Common Stock Amounts	Additional Paid-in Capital	Warrants	Accumulated Other Comprehensive Income	Accumulated Deficit	Total
<b>Balance as of June 30, 2009</b>	-	\$ -	48,125	\$ 48	\$312,349	\$23,869	\$ 3,234	\$ (413,201)	\$(73,701)
Issuance of common stock under stock option and employee stock purchase plans	-	-	10	-	3	-	-	-	3
Issuance of common stock for cash, net of offering costs	-	-	60	-	128	-	-	-	128
Share-based compensation expense	-	-	-	-	1,522	-	-	-	1,522
Issuance of common stock warrants	-	-	-	-	-	12,427	-	-	12,427
Change in unrealized gains on marketable securities	-	-	-	-	-	-	1,898	-	1,898
Net loss	-	-	-	-	-	-	-	(24,802)	(24,802)
<b>Balance as of September 30, 2009</b>	-	\$ -	48,195	\$ 48	\$314,002	\$36,296	\$ 5,132	\$ (438,003)	\$(82,525)

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



Table of Contents**ARRAY BIOPHARMA INC.****Condensed Statements of Cash Flows**

(Amounts in Thousands)

(Unaudited)

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (24,802)	\$ (33,685)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization expense	1,683	1,619
Non-cash interest expense for the Deerfield Credit Facility	1,762	1,708
Share-based compensation expense	1,522	1,500
Impairment of marketable securities	217	3,910
Changes in operating assets and liabilities:		
Prepaid expenses and other current assets	907	662
Accounts payable and other accrued expenses	(1,428)	(411)
Accrued outsourcing costs	664	(2,684)
Accrued compensation and benefits	899	1,563
Deferred rent	(756)	(609)
Deferred revenue	(1,556)	4,540
Net cash used in operating activities	(20,888)	(21,887)
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(265)	(1,020)
Purchases of marketable securities	-	(10,522)
Proceeds from sales and maturities of marketable securities	3,521	15,000
Net cash provided by investing activities	3,256	3,458
<b>Cash flows from financing activities</b>		
Proceeds from exercise of stock options and shares issued under the employee stock purchase plan	3	247
Proceeds from the issuance of common stock for cash	128	-
Proceeds from the issuance of long-term debt and warrants	40,000	-
Payment of transaction fee	(1,000)	-
Net cash provided by financing activities	39,131	247
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>21,499</b>	<b>(18,182)</b>
Cash and cash equivalents as of beginning of period	33,202	56,448
<b>Cash and cash equivalents as of end of period</b>	<b>\$ 54,701</b>	<b>\$ 38,266</b>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 1,208	\$ 525
<b>Supplemental disclosure of non-cash information</b>		
Property and equipment acquisitions included in accounts payable	\$ -	\$ 454

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

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**ARRAY BIOPHARMA INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**For the quarter ended September 30, 2009**

**(Unaudited)**

**NOTE 1 - OVERVIEW AND BASIS OF PRESENTATION**

**Organization**

Array BioPharma Inc. (the Company) is a biopharmaceutical company focused on the discovery, development and commercialization of targeted small molecule drugs to treat patients afflicted with cancer, inflammatory and metabolic diseases. The Company's proprietary drug development pipeline includes clinical candidates that are designed to regulate therapeutically important target proteins. In addition, leading pharmaceutical and biotechnology companies partner with the Company to discover and develop drug candidates across a broad range of therapeutic areas.

**Basis of Presentation**

The Company follows the accounting guidance outlined in the Financial Accounting Standards Board Codification guidelines. The accompanying unaudited Condensed Financial Statements have been prepared without audit and do not include all of the disclosures required by the Financial Accounting Standards Board Codification guidelines, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC) for interim reporting. The unaudited Condensed Financial Statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary to present fairly the financial position of the Company as of September 30, 2009, its results of operations for the three months ended September 30, 2009 and 2008, respectively, and its cash flows of the Company for the three months ended September 30, 2009 and 2008, respectively. Operating results for the three months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the year ending June 30, 2010.

These unaudited Condensed Financial Statements should be read in conjunction with the Company's audited Financial Statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2009 filed with the SEC on August 18, 2009.

Additionally, the Company has evaluated subsequent events occurring through the filing date of this Quarterly Report on Form 10-Q and has determined there were no subsequent events to record or disclose in this report other than that discussed in Note 9 Subsequent Event. Certain fiscal 2009 amounts have been reclassified to conform to the current year presentation. Specifically, Accounts Payable and Other Accrued Expenses were aggregated into one line item, Accounts Payable and Other Accrued Expenses, in the accompanying Condensed Balance Sheets.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States ( U.S. ) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Although management bases these estimates on historical data and other assumptions believed to be reasonable under the circumstances, actual results could differ significantly from these estimates.

The Company believes the accounting estimates having the most significant impact on its financial statements relate to (i) estimating the fair value of the Company s auction rate securities ( ARS ); (ii) estimating accrued outsourcing costs for clinical trials and preclinical testing; and (iii) estimating the fair value of the Company s long-term debt that has associated warrants and embedded derivatives, which require separate valuation.

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**ARRAY BIOPHARMA INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

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**(Unaudited)**

**Liquidity**

The Company has incurred operating losses and has an accumulated deficit primarily as a result of ongoing research and development spending. As of September 30, 2009, the Company had an accumulated deficit of \$438.0 million. The Company had net losses of \$24.8 million and \$33.7 million for the three months ended September 30, 2009 and 2008, respectively. The Company had net losses of \$127.8 million, \$96.3 million and \$55.4 million for the fiscal years ended June 30, 2009, 2008 and 2007, respectively.

The Company has historically funded its operations through revenue from its collaborations, the issuance of equity securities and through debt provided by its credit facilities. Until the Company can generate sufficient levels of cash from its operations, which the Company does not expect to achieve in the foreseeable future, the Company will continue to utilize its existing cash, cash equivalents and marketable securities that were generated primarily from these sources.

The Company currently uses approximately \$21 million per quarter to fund its operations. The Company believes that its existing cash, cash equivalents and marketable securities, excluding the value of the ARS it holds, will enable it to continue to fund its operations at this level for the next 12 months assuming the Company obtains additional sources of funding as anticipated and/or reduces its current level of spending. Additional sources of funding may include up-front fees or research funding through new out-licensing transactions, sales of equity securities and/or issuances of additional debt. The Company is currently in active licensing discussions with a number of potential partners on select programs. The Company's current plan contemplates the receipt of significant upfront payments from new collaboration or licensing deals in the next 12 months. The Company also plans to satisfy its interest payment obligations under the credit facilities with Deerfield either through the issuance of shares of common stock to Deerfield in accordance with the facility agreements with Deerfield or with the proceeds from sales of its common stock pursuant to the Equity Distribution Agreement with Piper Jaffray & Co. discussed in Note 8 Equity Distribution Agreement.

If the Company is unable to obtain additional funding from these or other sources to the extent, or when needed, it will be necessary to significantly reduce its current rate of spending through further reductions in staff and delaying, scaling back or stopping certain research and development programs. Insufficient funds may also require the Company to relinquish greater, or all, rights to product candidates at an earlier stage of development or on less favorable terms to it or its stockholders than the Company would otherwise choose in order to obtain funding for further development and/or up-front license fees needed to fund its operations.

If the Company is unable to continue to fund its ongoing operations from such sources, its ability to continue as a going concern will be in substantial doubt. Moreover, if sufficient funds from up-front fees under new collaboration agreements are not received within

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approximately the next nine months, the Company will not be in compliance with certain covenants under its credit facilities with Deerfield and its loan with Comerica Bank, which require the Company to maintain certain levels of cash, cash equivalents and marketable securities, as described in Note 5 Long-Term Debt. In this event, Deerfield and Comerica would have the right to accelerate the Company's payment obligations to them, which it could not repay.

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**ARRAY BIOPHARMA INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**For the quarter ended September 30, 2009**

**(Unaudited)**

**Fair Value Measurements**

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

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

The Company discloses assets and liabilities measured at fair value based on their level in the hierarchy. In determining fair value for assets or liabilities for which there are no quoted prices in active markets, including ARS, warrants issued by the Company and the embedded derivatives associated with the Company's long-term debt, considerable judgment is required in interpreting market data to develop estimates of fair value. Accordingly, the fair value estimates disclosed by the Company may not be indicative of the amount that the Company or holders of the instruments could realize in a current market exchange. The use of different assumptions and/or estimation methodologies may have a material effect on their estimated fair value.

The Company periodically reviews the realizability of each investment when impairment indicators exist with respect to the investment. If an other-than-temporary impairment of the value of an investment is deemed to exist, the carrying value of the investment is written down to its estimated fair value.

**Cash and Cash Equivalents**

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

**Marketable Securities**

The Company has designated its marketable securities as of September 30, 2009 and June 30, 2009 as available-for-sale securities and accounts for them at their respective fair values. Marketable securities are classified as short-term or long-term based on the nature of these securities and the availability of these securities to meet current operating requirements. Marketable securities that are readily available for use in current operations are classified as short-term available-for-sale securities and are reported as a component of current assets in the accompanying Condensed Balance Sheets. Marketable securities that are not considered available for use in current operations are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying Condensed Balance Sheets.

Securities that are classified as available-for-sale are carried at fair value, including accrued interest, with temporary unrealized gains and losses reported as a component of Stockholders' Deficit until their disposition. The Company reviews all available-for-sale securities each period to determine if it is more likely than not that they will remain available-for-sale based on the Company's intent and ability to sell the



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**ARRAY BIOPHARMA INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**For the quarter ended September 30, 2009**

**(Unaudited)**

security if it is required to do so. The amortized cost of debt securities in this category is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included in Interest Income in the accompanying Condensed Statements of Operations and Comprehensive Loss. Realized gains and losses are reported in Interest Income and Interest Expense, respectively, in the accompanying Condensed Statements of Operations and Comprehensive Loss as incurred. Declines in value judged to be other-than-temporary are reported in Impairment of Marketable Securities in the accompanying Condensed Statements of Operations and Comprehensive Loss as recognized. The cost of securities sold is based on the specific identification method.

Under the fair value hierarchy, the Company's ARS are measured using Level 3, or unobservable inputs, as there is no active market for the securities. The most significant unobservable inputs used in this method are estimates of the amount of time until a liquidity event will occur and the discount rate, which incorporates estimates of credit risk and a liquidity premium (discount). Due to the inherent complexity in valuing these securities, the Company engaged a third-party valuation firm to perform an independent valuation of the ARS beginning with the first quarter of fiscal 2009 and continuing through the current fiscal quarter. While the Company believes that the estimates used in the fair value analysis are reasonable, a change in any of the assumptions underlying these estimates would result in different fair value estimates for the ARS and could result in additional adjustments to the ARS, either increasing or further decreasing their value, possibly by material amounts.

**Property and Equipment**

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

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

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

The Company depreciates leasehold improvements associated with operating leases on a straight-line basis over the shorter of the expected useful life of the improvements or the reasonably assured term of the leases.

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

### **Equity Investment**

The Company may enter into collaboration and licensing agreements in which it receives an equity interest in consideration for all or a portion of up-front, license or other fees under the terms of the agreement. The Company reports the value of equity securities received from non-publicly traded companies in which it does not exercise a significant controlling interest at cost as Other Long-term Assets in the accompanying Condensed Balance Sheets. The Company monitors its investment for impairment at least annually and makes appropriate reductions in the carrying value if it is determined that an impairment has occurred, based primarily on the financial condition and near term prospects of the issuer.

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**For the quarter ended September 30, 2009**

**(Unaudited)**

**Accrued Outsourcing Costs**

Substantial portions of the Company's preclinical studies and clinical trials are performed by third-party laboratories, medical centers, contract research organizations, and other vendors (collectively "CROs"). These CROs generally bill monthly or quarterly for services performed or bill based upon milestone achievement. For preclinical studies, the Company accrues expenses based upon estimated percentage of work completed and the contract milestones remaining. For clinical studies, expenses are accrued based upon the number of patients enrolled and the duration of the study. The Company monitors patient enrollment, the progress of clinical studies and related activities to the extent possible through internal reviews of data reported to it by the CROs, correspondence with the CROs and clinical site visits. The Company's estimates depend on the timeliness and accuracy of the data provided by its CROs regarding the status of each program and total program spending. The Company periodically evaluates the estimates to determine if adjustments are necessary or appropriate based on information it receives concerning changing circumstances, conditions or events that may affect such estimates.

**Deferred Revenue**

The Company records amounts received under its collaboration agreements, but not earned, as Deferred Revenue, which are then classified as current or long-term based on their expected recognition as revenue in the accompanying Condensed Balance Sheets.

**Long-term Debt and Embedded Derivatives**

The terms of the Company's long-term debt are discussed in detail in Note 5 Long-term Debt. The accounting for these arrangements is complex and is based upon significant estimates by management. The Company reviews all debt agreements to determine the appropriate accounting treatment when the agreement is entered into, and reviews all amendments to determine if the changes require accounting for the amendment as a modification, or extinguishment and new debt. The Company also reviews each long-term debt arrangement to determine if any feature of the debt requires bifurcation and/or separate valuation. These features include hybrid instruments, which are comprised of at least two components ((1) a debt host instrument and (2) one or more conversion features), other embedded derivatives, such as warrants and other rights of the debt holder. The initial fair value of the embedded derivatives recorded is reported as Derivative Liabilities and as Debt Discount in the Company's Condensed Balance Sheets. Any debt discount is amortized over the term of the underlying debt arrangement using the effective interest method and recorded as Interest Expense in the Condensed Statements of Operations and Comprehensive Loss.

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The Company currently has two embedded derivatives related to its long-term debt with Deerfield. The first is a variable interest rate structure that constitutes a liquidity-linked variable spread feature. The second derivative is a significant transaction contingent put option relating to the ability of Deerfield to accelerate the repayment of the debt in the event of certain changes in control of the Company. Collectively, they are referred to as the Embedded Derivatives. Under the fair value hierarchy, the Company's Embedded Derivatives are measured using Level 3, or unobservable, inputs as there is no active market for them. The fair value of the variable interest rate structure is based on the Company's estimate of the probable effective interest rate over the term of the credit facilities. The fair value of the put option is based on the Company's estimate of the probability that a change in control that triggers Deerfield's right to accelerate the debt will occur. With those inputs, the fair value of each Embedded Derivative is calculated as the difference between the fair value of the Deerfield credit facilities if the Embedded Derivatives are included, and the fair value of the Deerfield credit facilities if the Embedded Derivatives are excluded. Due to the inherent complexity in valuing the Deerfield credit facilities and the Embedded Derivatives, the Company engaged a third-party valuation firm to perform the valuation as of July 31, 2009 and September 30, 2009. The estimated fair value of the Embedded Derivatives was determined based on Management's judgment and assumptions. It is reasonably possible that the use of different assumptions could result in significantly different estimated fair values.

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**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**For the quarter ended September 30, 2009**

**(Unaudited)**

The fair value of the Embedded Derivatives is initially recorded as Derivative Liabilities and as Debt Discount in the Company's accompanying Condensed Balance Sheets. Any change in the value of the Embedded Derivatives will be adjusted quarterly as appropriate and recorded to Derivative Liabilities in the Condensed Balance Sheets and Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss. The Debt Discount is being amortized from the draw date of July 31, 2009 to the end of the term of the Deerfield credit facilities and recorded as Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

Warrants issued by the Company in connection with its long-term debt arrangements are reviewed to determine if they should be classified as liabilities or as equity. All outstanding warrants issued by the Company have been classified as equity. The Company values the warrants at issuance based on a Black-Scholes option pricing model and then allocates a portion of the proceeds under the debt to the warrants based upon their relative fair values.

Any transaction fees relating to the Company's long-term debt arrangements are recorded as Other Long-Term Assets in the Condensed Balance Sheets and amortized to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss using the effective interest method over the term of the underlying debt agreement.

**Income Taxes**

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

**Operating Leases**

The Company has negotiated certain landlord/tenant incentives, and rent holidays and escalations in the base price of rent payments under its operating leases. For purposes of determining the period over which these amounts are recognized or amortized, the initial term of an operating lease includes the "build-out" period of leases, where no rent payments are typically due

under the terms of the lease, and includes additional terms pursuant to any options to extend the initial term if it is more likely than not that the Company will exercise such options. The Company recognizes rent holidays and rent escalations on a straight-line basis over the initial lease term. The landlord/tenant incentives are recorded as an increase to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the initial lease term. The Company has also entered into two sale-lease back transactions for its facilities in Boulder and Longmont, Colorado, where the consideration received from the landlord is recorded as increases to Deferred Rent in the accompanying Condensed Balance Sheets and amortized on a straight-line basis over the initial lease term. Deferred Rent balances are classified as short-term or long-term in the accompanying Condensed Balance Sheets based upon when reversal of the liability is expected to occur.

### **Share-Based Compensation**

The Company uses the fair value method of accounting for share-based compensation arrangements which requires that compensation expense be recognized based on the grant date fair value of the arrangement. Share-based compensation arrangements include stock options granted under the

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**ARRAY BIOPHARMA INC.**

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**(Unaudited)**

Company's Amended and Restated Stock Option and Incentive Plan (the "Option Plan") and purchases of common stock by its employees at a discount to the market price under the Company's Employee Stock Purchase Plan (the "ESPP").

The estimated fair value of stock options is based on the Black-Scholes option pricing model and is expensed on a straight-line basis over the vesting term. Compensation expense for stock options is reduced for estimated forfeitures, which are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Compensation expense for purchases under the ESPP is recognized based on the estimated fair value of the common stock during each offering period and the percentage of the purchase discount.

**Revenue Recognition**

Most of the Company's revenue is in the form of research funding, up-front or license fees and milestone payments derived from designing, creating, optimizing, evaluating and developing drug candidates for the Company's collaborators. The Company's agreements with collaboration partners include fees based on contracted annual rates for full-time-equivalent employees working on a project, and may also include non-refundable license and up-front fees, non-refundable milestone payments that are triggered upon achievement of specific research or development goals, and future royalties on sales of products that result from the collaboration. A small portion of the Company's revenue comes from fixed fee agreements or from sales of compounds on a per-compound basis. The Company reports revenue for lead generation and lead optimization research, custom synthesis and process research, the development and sale of chemical compounds and the co-development of proprietary drug candidates the Company out-licenses, as Collaboration Revenue. License and Milestone Revenue is combined and consists of the current period's recognized up-front fees and ongoing milestone payments from collaborators.

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition* ("SAB 104"), which establishes four criteria, each of which must be met, in order to recognize revenue related to the performance of services or the shipment of products. Revenue is recognized when (a) persuasive evidence of an arrangement exists, (b) products are delivered or services are rendered, (c) the sales price is fixed or determinable, and (d) collectability is reasonably assured.

Collaboration agreements that include a combination of research funding, up-front or license fees, milestone payments and/or royalties are evaluated to determine whether each deliverable under the agreement has value to the customer on a stand-alone basis and whether reliable evidence of fair value for the deliverable exists. Deliverables in an arrangement that do not meet the separation criteria are treated as a single unit of accounting, generally applying applicable revenue recognition guidance for the final deliverable to the combined unit of accounting in accordance with SAB 104.

The Company recognizes revenue from non-refundable up-front payments and license fees on a straight-line basis over the term of performance under the agreement, which is generally the research term specified in the agreement. These advance payments are deferred and recorded as Deferred Revenue upon receipt, pending recognition, and are classified as a short-term or long-term liability in the accompanying Condensed Balance Sheets. When the performance period is not specifically identifiable from the agreement, the Company estimates the performance period based upon provisions contained within the agreement, such as the duration of the research term, the specific number of full-time-equivalent scientists working a defined number of hours per year at a stated price under the agreement, the existence, or likelihood of achievement, of development commitments, and other significant commitments of the Company.

Similarly to advance payments, for agreements that provide for milestone payments, a portion of each milestone payment is recognized as revenue when the specific milestone is achieved based on the applicable percentage of the estimated research or development term that has elapsed to the total estimated research term.



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The Company periodically reviews the expected performance periods under each of its agreements that provide for non-refundable up-front payments and license fees and milestone payments. To date, there has not been a significant change in an estimate or assumption of the expected period of performance that has had a material effect on the timing or amount of revenue recognized. Revenue recognition related to non-refundable license fees and up-front payments and to milestone payments could be accelerated in the event of early termination of programs.

**Cost of Revenue and Research and Development for Proprietary Drug Discovery Expenses**

The Company incurs costs in connection with performing research and development activities which consist mainly of compensation, associated fringe benefits, share-based compensation, preclinical and clinical outsourcing costs and other collaboration-related costs, including supplies, small tools, facilities, depreciation, recruiting and relocation costs and other direct and indirect chemical handling and laboratory support costs. The Company allocates these costs between Cost of Revenue and Research and Development for Proprietary Drug Discovery based upon the respective time spent on each by its scientists on development conducted for its collaborators and for its internal proprietary programs. Cost of Revenue represents the costs associated with research and development, including preclinical and clinical trials, conducted by the Company for its collaborators. Research and Development for Proprietary Drug Discovery Expenses consist of direct and indirect costs related to specific proprietary programs and related to programs under collaboration agreements which the Company has concluded it is likely to retain the rights to. The Company does not bear any risk of failure for performing these activities and the payments are not contingent on the success or failure of the research program. Accordingly, the Company expenses these costs when incurred.

Where the Company's collaboration agreements provide for it to conduct development of drug candidates, and for which the Company's partner has an option to obtain the right to conduct further development and to commercialize a product, the Company attributes a portion of its research and development costs to Cost of Revenue based on the percentage of total programs under the agreement that the Company concludes is likely to be selected by the partner. These costs may not be incurred equally across all programs. In addition, the Company continually evaluates the progress of development activities under these agreements and if events or circumstances change in future periods that the Company reasonably believes would make it unlikely that a collaborator would exercise an option with respect to the same percentage of programs, the Company will adjust the allocation accordingly.

For example, the Company granted Celgene Corporation an option to select up to two of four programs developed under its collaboration agreement with Celgene and concluded that Celgene was likely to exercise its option with respect to two of the four programs. Accordingly, the Company has reported costs associated with the Celgene collaboration as follows: 50% to Cost of Revenue, with the remaining 50% to Research and Development for Proprietary Drug Discovery. See Note 4, Deferred Revenue, for further information about the Company's collaboration with Celgene.

**Net Loss per Share**

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

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**(Unaudited)**

**Comprehensive Income (Loss)**

The Company's comprehensive income (loss) consists of the Company's net loss and unrealized gains and losses on investments in available-for-sale marketable securities. The Company had no other sources of comprehensive income (loss) for the fiscal periods presented.

**Recent Accounting Pronouncements**

*Collaborative Arrangements* - In the first quarter of fiscal 2010, new guidance relating to the accounting practices and disclosures for collaborative arrangements became effective. A collaborative arrangement is a contractual arrangement that involves a joint operating activity. These arrangements involve two (or more) parties who are both (a) active participants in the activity and (b) exposed to significant risks and rewards dependent on the commercial success of the activity. If the Company's collaboration agreements are determined to be collaborative arrangements, additional disclosures would be required beginning with this Quarterly Report on Form 10-Q. The Company determined that while certain agreements are collaborative arrangements, none of the current activities being performed under those arrangements would require a change to the accounting practices or disclosures made by the Company in its Quarterly Reports on Form 10-Q and Annual Reports on Form 10-K.

*Convertible Debt* - In the first quarter of fiscal 2010, guidance relating to the accounting for convertible debt became effective. The Company determined that none of its credit facilities are considered convertible debt as defined under this accounting guidance and therefore this pronouncement had no impact on its financial statements and disclosures.

*Fair Value Measurements* - In August 2009, new literature was issued giving companies additional guidance relating to the fair value measurements and disclosures of liabilities. The guidance was effective for the Company for the first quarter of fiscal 2010 and was adopted at that time. The effect of the guidance is reflected in the accompanying Condensed Financial Statements.

*Revenue Recognition for Multiple Deliverable Arrangements* - In October 2009, new guidance was issued related to multiple-deliverable revenue arrangements that are effective for the Company prospectively for revenue arrangements entered into or materially modified subsequent to July 1, 2010. The objective of this change is to address the accounting for multiple-deliverable arrangements to enable companies to account more easily for products or services (deliverables) separately rather than as a combined unit. The Company is currently evaluating the impact of this guidance on its financial statements.

**NOTE 2 SEGMENTS, GEOGRAPHIC INFORMATION AND SIGNIFICANT COLLABORATORS**

**Segments**

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

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For the quarter ended September 30, 2009

(Unaudited)

**Geographic Information**

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

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
North America	\$ 7,853	\$ 5,705
Europe	23	38
Asia Pacific	14	5
	\$ 7,890	\$ 5,748

**Significant Collaborators**

The following collaborators contributed greater than 10% of total revenue for the three months ended September 30, 2009 and 2008:

	<b>Three Months Ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Genentech, Inc.	64.1%	68.4%
Celgene Corporation	20.8%	24.9%
InterMune, Inc.	12.7%	0.0%
	97.6%	93.3%

The loss of one or more significant collaborators could have a material adverse effect on the Company's business, operating results or financial condition. The Company does not require collateral to secure the payment obligations of its collaborators. Although the Company is impacted by economic conditions in the biotechnology and pharmaceutical sectors, most collaborators pay in advance and management does not believe significant credit risk exists as of September 30, 2009.

**NOTE 3 - MARKETABLE SECURITIES**

The Company's investments in marketable securities include domestic public corporate debt securities, commercial paper issued by domestic public companies, obligations of U.S. federal government agencies and ARS. All of these investments are held in the name of the Company at a limited number of financial institutions. The Company's investments in marketable securities were all classified as available-for-sale as of September 30, 2009 and June 30, 2009.

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(Unaudited)

Marketable securities consisted of the following as of September 30, 2009 (dollars in thousands):

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Short-term available-for-sale securities:				
U.S. Government agency securities	\$ 3,510	\$ -	\$ -	\$ 3,510
Mutual fund securities	265	-	-	265
Sub-total	3,775	-	-	3,775
Long-term available-for-sale securities:				
Auction rate securities	13,067	5,132	-	18,199
Mutual fund securities	599	-	-	599
Sub-total	13,666	5,132	-	18,798
Total	\$ 17,441	\$ 5,132	\$ -	\$ 22,573

Marketable securities consisted of the following as of June 30, 2009 (dollars in thousands):

	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>
Short-term available-for-sale securities:				
U.S. Government agency securities	7,059	-	-	7,059
Mutual fund securities	237	-	-	237
Sub-total	7,296	-	-	7,296
Long-term available-for-sale securities:				
Auction rate securities	13,284	3,234	-	16,518
Mutual fund securities	472	-	-	472
Sub-total	13,756	3,234	-	16,990
Total	\$ 21,052	\$ 3,234	\$ -	\$ 24,286

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The fair value measurement categories of these marketable securities as of September 30, 2009 and June 30, 2009 were as follows (dollars in thousands):

	<b>September 30, 2009</b>	<b>June 30, 2009</b>
Quoted prices in active markets for identical assets (Level 1)	\$ 4,374	\$ 7,768
Significant unobservable inputs (Level 3)	18,199	16,518
	\$ 22,573	\$ 24,286



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The amortized cost and estimated fair value of available-for-sale securities by contractual maturity as of September 30, 2009 is as follows (dollars in thousands):

	<b>Amortized Cost</b>	<b>Fair Value</b>
Due in one year or less	\$ 3,775	\$ 3,775
Due in one year to three years	599	599
Due after 10 years or more	13,067	18,199
	<b>\$ 17,441</b>	<b>\$ 22,573</b>

**Auction Rate Securities**

During the fiscal year ended June 30, 2008, auctions for all of the ARS, amounting to seven securities with a par value of \$32.9 million and a current fair value of \$18.2 million, were unsuccessful. During the first quarter of fiscal 2009, auctions for the ARS that the Company holds were suspended. The lack of successful auctions resulted in the interest rate on these investments increasing to LIBOR plus additional basis points as stipulated in the auction rate agreements, ranging from 200 to 350 additional basis points, which has continued through the current fiscal quarter. While the Company now earns a higher contractual interest rate on these investments, the investments are not currently liquid and may not be liquid at a time when the Company needs to access these funds. In the event the Company needs to access these funds and liquidate the ARS prior to the time auctions of these investments are successful or the date on which the original issuers retire these securities, the Company may be required to sell them in a distressed sale in a secondary market, most likely for a lower value than their current fair value.

Under the fair value hierarchy, the Company's ARS are measured using Level 3, or unobservable inputs, as there is no active market for the securities. The most significant unobservable inputs used in this method are estimates of the amount of time until a liquidity event will occur and the discount rate, which incorporates estimates of credit risk and a liquidity premium (discount). Due to the inherent complexity in valuing these securities, the Company engaged a third-party valuation firm to perform an independent valuation of the ARS beginning with the first quarter of fiscal 2009 and continuing through the current fiscal quarter.

While the Company believes that the estimates used in the fair value analysis are reasonable, a change in any of the assumptions underlying these estimates would result in different fair value estimates for the ARS and could result in additional changes to the ARS values, either increasing or decreasing their value.



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Based on its fair value analysis and fair value estimates as of each quarter end, the Company recorded adjustments to the fair value of its ARS that are summarized below (dollars in thousands):

	<b>Three Months Ended September 30, 2009</b>	<b>Three Months Ended September 30, 2008</b>
Unrealized gains	\$ 1,898	\$ -
Losses attributable to the change in unrealized losses	\$ -	\$ (1,939)
Additional current period losses	(217)	(1,971)
	<b>\$ (217)</b>	<b>\$ (3,910)</b>

The Company has recorded cumulative net fair value adjustments to the ARS of \$(14.7) million as of September 30, 2009.

A rollforward of adjustments to the fair value of the ARS for the three months ended September 30, 2009 and 2008 follows (dollars in thousands):

	<b>Three Months Ended September 30, 2009</b>	<b>Three Months Ended September 30, 2008</b>
Balance as of prior year end	\$ 16,518	\$ 29,089
Add: Current period gains included in equity	1,898	-
Less: Current period losses included in earnings	(217)	(1,971)
Balance as of current quarter end	<b>\$ 18,199</b>	<b>\$ 27,118</b>

**NOTE 4 DEFERRED REVENUE**

In September 2007, the Company entered into a worldwide strategic collaboration with Celgene focused on the discovery, development and commercialization of novel therapeutics in cancer and inflammation. Under the agreement, Celgene made an

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up-front payment of \$40.0 million to the Company to provide research funding for activities conducted by the Company under the agreement. The Company is responsible for all discovery and clinical development through Phase 1 or Phase 2a. Celgene has an option to select a limited number of drugs developed under the collaboration that are directed to up to two of four mutually selected discovery targets and will receive exclusive worldwide rights to the drugs, except for limited co-promotional rights in the U.S. Celgene's option may be exercised with respect to drugs directed at any of the four targets at any time until the earlier of completion of Phase 1 or Phase 2a trials for the drug or September 2014. Additionally, the Company is entitled to receive, for each drug for which Celgene exercises an option, potential milestone payments of \$200.0 million, if certain discovery, development and regulatory milestones are achieved and an additional \$300.0 million if certain commercial milestones are achieved, as well as royalties on net sales. The Company retains all rights to the other programs. In June 2009, the parties amended the Celgene agreement to substitute a new discovery target in place of an existing target, and Celgene paid the Company \$4.5 million in

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consideration for the amendment. No other provisions of the agreement with Celgene were modified by the amendment.

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

**NOTE 5 LONG-TERM DEBT**

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

	September 30, 2009	June 30, 2009
Credit facility	\$ 126,762	\$ 86,286
Term loan	10,000	10,000
Equipment line of credit	5,000	5,000
<b>Long-term debt, gross</b>	141,762	101,286
Less: Unamortized discount on credit facility	(33,601)	(18,116)
<b>Long-term debt, net</b>	108,161	83,170
Less: Current portion	-	(15,000)
<b>Long-term debt</b>	\$ 108,161	\$ 68,170

**Deerfield Credit Facilities**

The Company has entered into two credit facilities (the "Credit Facilities") with Deerfield Private Design Fund, L.P. and Deerfield Private Design International Fund, L.P. (collectively "Deerfield"), health care investment funds. Under a Facility Agreement entered into with Deerfield in April 2008, the Company borrowed a total of \$80.0 million (the "2008 Loan"), which was funded in two \$40.0 million payments in June 2008 and December 2008. Certain terms of the 2008 Credit Facility, including the interest rate and

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payment terms applicable to the 2008 Loan and covenants relating to minimum cash and cash equivalent balances the Company must maintain, were amended in May 2009 when the Company entered into a new Facility Agreement with Deerfield, under which the Company borrowed \$40.0 million (the 2009 Loan ), which it drew down on July 31, 2009.

The outstanding principal and interest on the Credit Facilities is due on or before April 2014 and, at the Company's option, may be repaid at any time with shares of the Company's common stock that have been registered under the Securities Act of 1933, as amended, with certain restrictions, or in cash. The maximum number of shares that the Company can issue to Deerfield under the Credit Facilities is 9,622,220 shares, without obtaining stockholder approval.

The Company made quarterly interest payments under the 2008 Loan during fiscal 2009 and the first quarter of fiscal 2010 that accrued on the total \$80.0 million principal balance. Interest accrued at a 2.0% annual rate from the date of the Facility Agreement for the 2008 Loan through the July 31, 2009 disbursement of the 2009 Loan. In addition, compound interest accrued quarterly during this same period

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at an additional 6.5% annual rate on the total \$80.0 million principal loan balance, which was added to the amounts already accrued.

Simple interest began to accrue on the 2009 Loan when it was drawn down on July 31, 2009 at the rate of 7.5% per annum. This rate will continue to apply as long as the Company's total Cash and Cash Equivalents and Marketable Securities on the first business day of each month during which such principal amounts remain outstanding is at least \$60.0 million. If the Company's total Cash and Cash Equivalents and Marketable Securities in any month are less than \$60.0 million, the interest rate is adjusted to a rate between 8.5% per annum and 14.5% per annum for every \$10.0 million by which it is less than \$60.0 million as follows:

<b>Total Cash, Cash Equivalents and Marketable Securities</b>	<b>Applied Interest Rate</b>
\$60,000,000 or greater	7.50%
Between \$50,000,000 and \$59,999,999	8.50%
Between \$40,000,000 and \$49,999,999	9.50%
Between \$30,000,000 and \$39,999,999	12.00%
Between \$0 and \$29,999,999	14.50%

The 2009 Credit Facility amended the interest rate provisions of the 2008 Credit Facility. Effective as of July 31, 2009, interest began accruing on the \$80.0 million principal amount of the 2008 Loan, exclusive of interest that had been added to the principal amount, at the rates applicable to the 2009 Loan described above, and no additional compound interest will apply. In addition, as of the July 31, 2009 disbursement date of the 2009 Loan, interest became payable monthly on both Credit Facilities.

The variable interest rate structure under the Credit Facilities is considered an embedded derivative. Deerfield also has limited rights to accelerate the loan upon certain changes of control of the Company or an event of default. This change of control provision is considered a significant transaction contingent put option and is also an embedded derivative. These derivatives must be valued and reported separately in the Company's financial statements, and are collectively referred to as the Embedded Derivatives.

Under the fair value hierarchy, the Company measured the fair value of the Embedded Derivatives using Level 3, or unobservable, inputs. In order to estimate the fair value of the variable interest rate feature as of July 31, 2009, the Company projected its cash balances over the term of the agreement, including forecasts of up-front revenue from new collaboration arrangements, milestone payments, other revenue, funds to be provided from issuances of debt and/or equity, costs and expenses and other items. Such forecasts are inherently subjective and will likely not reflect actual results. Based on such projections, the Company estimated the

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effective interest rate based on projected cash balances from the draw date to the end of the term of the Credit Facilities to be 7.55% as of July 31, 2009. The Company also made assumptions as to interest rate behaviors and the impact of repaying the debt at maturity in cash and/or stock.

In order to estimate the fair value of the put right, the Company estimated the probability of a change in control that would trigger Deerfield's acceleration rights as specified in the loan provisions. The Company's evaluation of this probability was based on its expectations as to the size and financial strength of probable acquirers, including history of collaboration partners, the probability of an acquisition occurring during the term of the credit facility and other factors - all of which are inherently uncertain and difficult to predict. The Company estimated the probability of the change in control put being exercised to be 5% at July 31, 2009. The Company also made assumptions as to interest rate behaviors and the impact of repaying the debt at maturity in cash and/or stock.



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Based on these assumptions, the Embedded Derivatives were initially valued as of July 31, 2009 at \$1.1 million and recorded as Derivative Liabilities and as Debt Discount in the accompanying Condensed Balance Sheets.

As of September 30, 2009, the Company re-valued the effective interest rate and the change in control put. The assumptions used at July 31, 2009, described above, did not change at September 30, 2009, and the estimated fair value of the Embedded Derivatives was determined to be \$938 thousand as of September 30, 2009. This is a change in value of \$125 thousand from July 31, 2009 and was recorded as Interest Expense in the accompanying Statements of Operations and Comprehensive Loss for the three months ended September 30, 2009.

Management will re-assess these assumptions at each reporting date, and it is reasonably possible that future changes to these assumptions could materially change the estimated fair value of the Embedded Derivatives.

The Company estimated that the fair value of the Deerfield debt was \$86.6 million and \$48.7 million at September 30, 2009 and June 30, 2009, respectively. The primary reason for the difference in fair value is that the Company had drawn only \$80.0 million of the total \$120.0 million under the Credit Facilities as of June 30, 2009.

The Company paid Deerfield transaction fees totaling \$2.0 million when the Company drew the funds under the 2008 Loan, and \$500 thousand on July 10, 2009 and \$500 thousand when the funds were drawn on July 31, 2009 under the 2009 Credit Facility. The transaction fees are included in Other Long-term Assets in the accompanying Condensed Balance Sheets. The Company is amortizing these transaction fees to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss over the respective terms of each of the Credit Facilities. Other direct issuance costs in connection with the transactions were expensed as incurred and were not significant.

The Credit Facilities are secured by a second priority security interest in the Company's assets, including accounts receivable, equipment, inventory, investment property and general intangible assets, excluding copyrights, patents, trademarks, service marks and certain related intangible assets. This security interest and the Company's obligations under the Credit Facilities are subordinate to the Company's obligations to Comerica Bank, and to Comerica's security interest, under the Loan and Security Agreement between the Company and Comerica Bank dated June 28, 2005, as amended, discussed below.

The Facility Agreements for both Credit Facilities contain representations, warranties and affirmative and negative covenants that are customary for credit facilities of this type. The Facility Agreements restrict the Company's ability to, among other things, sell

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certain assets, engage in a merger or change in control transaction, incur debt, pay cash dividends and make investments. The Facility Agreements also contain events of default that are customary for credit facilities of this type, including payment defaults, covenant defaults, insolvency type defaults and events of default relating to liens, judgments, material misrepresentations and the occurrence of certain material adverse events. In addition, if the Company's total Cash, Cash Equivalents and Marketable Securities at the end of a fiscal quarter fall below \$20.0 million (which was reduced from \$40.0 million when the Company entered into the 2009 Credit Facility), all amounts outstanding under the Credit Facilities become immediately due and payable. The Company is also required, subject to certain exceptions and conditions, to make payments of principal equal to 15.0% of certain amounts it receives under collaboration, licensing, partnering, joint venture and other similar arrangements entered into after January 1, 2011.

### **Warrants Issued to Deerfield**

In consideration for providing the 2008 Credit Facility, the Company issued warrants to Deerfield to purchase 6,000,000 shares of common stock at a price of \$7.54 per share (the Prior Warrants ). In May

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2009, these warrants were exchanged for new warrants ( Exchange Warrants ) to purchase 6,000,000 shares of common stock at an exercise price of \$3.65 per share in connection with the execution of the Facility Agreement for the 2009 Loan, as described below.

Pursuant to the terms of the Facility Agreement for the 2009 Loan, the Company issued Deerfield warrants to purchase an aggregate of 6,000,000 shares of the Company's Common Stock (the "New Warrants" and collectively with the Exchange Warrants, the Warrants ) when the funds were disbursed on July 31, 2009.

The Exchange Warrants contain substantially the same terms as the Prior Warrants, except that the Exchange Warrants are not exercisable until six months from the July 31, 2009 disbursement date and have a per share exercise price equal to \$3.65, which was reduced from the \$7.54 exercise price of the Prior Warrants. The New Warrants have a per share exercise price equal to \$4.19. The Warrants are exercisable commencing six months after the July 31, 2009 issuance date and expire on April 29, 2014. All other provisions of the Exchange Warrants and the New Warrants are identical.

The Company allocated the \$80.0 million proceeds under the 2008 Loan between the debt and the Prior Warrants based upon their estimated relative fair values. The Company valued the Prior Warrants using the Black-Scholes option pricing model using the following assumptions:

- Risk-free interest rate of 3.3%;
- Volatility of 63.9%;
- Expected life of six years; and
- Dividend yield of zero.

The Company allocated \$20.6 million in value to equity and recorded it as Debt Discount in the accompanying Condensed Balance Sheets. Because the 2008 Loan was drawn down in two separate tranches, the Company is amortizing half of the Prior Warrant value from the first draw date and the remaining half from the second draw date, in both cases to the end of the credit facility term, to Interest Expense in the accompanying Condensed Statements of Operations and Comprehensive Loss.

The Company allocated the \$40.0 million proceeds under the 2009 Loan between the debt and the New Warrants based upon their estimated relative fair values. The Company valued t