ACADIA PHARMACEUTICALS INC
Form 10-K
March 06, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2011

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: 000-50768

ACADIA PHARMACEUTICALS INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**06-1376651**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification Number)**
3911 Sorrento Valley Boulevard San Diego, California	**92121**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s telephone number, including area code:

(858) 558-2871

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.0001 per share	**The NASDAQ Global Market**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes ¨ No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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 definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Securities Exchange Act of 1934:

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 Securities Exchange Act of 1934). Yes ¨ No x

As of June 30, 2011, the last business day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the registrant s common stock held by non-affiliates of the registrant was approximately $85.7 million, based on the closing price of the registrant s common stock on the NASDAQ Global Market on June 30, 2011 of $1.63 per share.

As of March 1, 2012, 52,903,450 shares of the registrant s common stock, $0.0001 par value, were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement to be filed with the Securities and Exchange Commission by April 30, 2012 are incorporated by reference into Part III of this report.

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PART I

FORWARD-LOOKING STATEMENTS

This report and the information incorporated herein by reference contain forward-looking statements that involve a number of risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. Although our forward-looking statements reflect the good faith judgment of our management, these statements can only be based on facts and factors currently known by us. Consequently, forward-looking statements are inherently subject to risks and uncertainties, and actual results and outcomes may differ materially from results and outcomes discussed in the forward-looking statements.

Forward-looking statements can be identified by the use of forward-looking words such as believes, expects, hopes, may, will, plans, in estimates, could, should, would, continue, seeks, aims, projects, predicts, pro forma, anticipates, potential or other simil use in the negative), or by discussions of future matters such as the development of product candidates or products, technology enhancements, possible changes in legislation, and other statements that are not historical. These statements include but are not limited to statements under the captions Business, Risk Factors, and Management s Discussion and Analysis of Financial Condition and Results of Operations as well as other sections in this report. You should be aware that the occurrence of any of the events discussed under the caption Risk Factors and elsewhere in this report could substantially harm our business, results of operations and financial condition. If any of these events occurs, the trading price of our common stock could decline and you could lose all or a part of the value of your shares of our common stock.

The cautionary statements made in this report are intended to be applicable to all related forward-looking statements wherever they may appear in this report. We urge you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report.

Item 1. *Business.*

Overview

We are a biopharmaceutical company focused on innovative small molecule drugs that address unmet medical needs in neurological and related central nervous system disorders. We have four product candidates in clinical development led by pimavanserin, which is in Phase III development as a potential first-in-class treatment for Parkinson s disease psychosis. We hold worldwide commercialization rights to pimavanserin. In addition, we have a product candidate in Phase II development for chronic pain and a product candidate in Phase I development for glaucoma, both in collaboration with Allergan, Inc., and a product candidate in Phase I development for schizophrenia in collaboration with Meiji Seika Pharma Co., Ltd. All of the product candidates in our pipeline emanate from discoveries made using our proprietary drug discovery platform.

Our pipeline of product candidates addresses diseases that are not well served by currently available therapies and that represent large potential commercial market opportunities. We believe our product candidates offer innovative therapeutic approaches and may provide significant advantages relative to current therapies. Our clinical-stage product candidates are as follows:

Pimavanserin. Pimavanserin is a new chemical entity that we discovered and have advanced to Phase III development as a potential first-in-class treatment for Parkinson s disease psychosis. Parkinson s disease psychosis is a debilitating disorder that develops in up to 60 percent of patients with Parkinson s disease. This disorder deeply affects the quality of life of patients with Parkinson s disease and is associated with increased caregiver distress and burden, nursing home placement, and increased mortality. The U.S. Food and Drug Administration, or FDA, has not approved any drug to treat Parkinson s disease psychosis. Pimavanserin provides an innovative approach to treating this disorder by selectively blocking a key serotonin receptor that plays an important role in psychosis. We believe pimavanserin has the potential to be the first safe and effective drug that will treat Parkinson s disease psychosis without compromising motor control, thereby significantly improving the quality of life for patients with Parkinson s disease.

We are currently conducting several clinical trials in our Phase III program with pimavanserin for Parkinson s disease psychosis, including a pivotal Phase III efficacy, tolerability and safety study, and open-label safety extension studies. We believe that pimavanserin also has the potential to address a range of other neurological and psychiatric disorders, including Alzheimer s disease psychosis and schizophrenia, which are underserved by currently marketed antipsychotic drugs. We have completed a Phase II trial with pimavanserin as a co-therapy in schizophrenia and have established plans for a future Phase II feasibility study to explore the use of pimavanserin as a treatment for Alzheimer s disease psychosis.

Alpha Adrenergic Agonists. In collaboration with Allergan, we have discovered and are developing small molecule product candidates for the treatment of chronic pain. Chronic pain is a common form of persistent pain that may be related to a number of medical conditions and is often resistant to treatment. Allergan has conducted several Phase II trials in this program and has reported preliminary results, including positive proof-of-concept in a human visceral pain trial and efficacy signals in two chronic pain trials in the areas of fibromyalgia and irritable bowel syndrome. Allergan has announced that it is seeking a partner for the further development of this program and for commercialization in areas predominantly served by general practitioners.

Muscarinic Agonist. We have discovered and, in collaboration with Allergan, are developing a small molecule product candidate for the treatment of glaucoma. Glaucoma is a chronic eye disease and is the second leading cause of blindness in the world. Our selective muscarinic agonist has demonstrated a promising preclinical profile, including robust efficacy and a long duration of action. This program has reached Phase I development.

AM-831. We have discovered and, in collaboration with Meiji Seika Pharma, are developing AM-831, a small molecule product candidate for the treatment of schizophrenia. Currently prescribed treatments do not effectively address or may exacerbate cognitive disturbances associated with schizophrenia. We believe that AM-831 provides the potential for a new class of pro-cognitive antipsychotic drugs. AM-831 has reached Phase I development.

In addition to our clinical-stage product candidates, we have used our proprietary drug discovery platform to discover additional product candidates. These include two preclinical programs that we believe provide the potential for innovative disease-modifying therapies for Parkinson s disease and other neurological disorders. We have demonstrated that our platform can be used to rapidly discover new compounds that may serve as potential treatments for significant unmet medical needs. Currently, we have focused our resources on our most advanced product candidates, including pimavanserin.

We have assembled a management team with significant industry experience to lead the discovery and development of our product candidates. We complement our management team with a group of scientific and clinical advisors that includes recognized experts in the fields of Parkinson s disease psychosis, schizophrenia, and other central nervous system disorders.

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We maintain a website at *www.acadia-pharm.com*, to which we regularly post copies of our press releases as well as additional information about us. Our filings with the Securities and Exchange Commission, or SEC, are available free of charge through our website as soon as reasonably practicable after being electronically filed with or furnished to the SEC. Interested persons can subscribe on our website to email alerts that are sent automatically when we issue press releases, file our reports with the SEC or post certain other information to our website. Information contained in our website does not constitute a part of this report or our other filings with the SEC.

Our Strategy

Our goal is to become a leader in the discovery, development, and commercialization of innovative small molecule drugs that address unmet medical needs in neurological and related central nervous system disorders. Key elements of our strategy are to:

Develop and commercialize our lead product candidate, pimavanserin, for Parkinson s disease psychosis. We have selected Parkinson s disease psychosis as our lead indication for pimavanserin and we are focused on advancing our Phase III program toward registration for this indication. We plan to complete the development in this program independently or in collaboration with partners, and position pimavanserin as a potential first-in-class treatment for patients with Parkinson s disease psychosis. If successful, we intend to participate in the commercialization of pimavanserin for this indication in the United States by establishing a small specialty sales force that calls on a focused group of neurologists. We plan to commercialize pimavanserin in markets outside of the United States by establishing one or more strategic alliances in the future.

Maximize the commercial potential of pimavanserin by expanding to additional neurological and psychiatric disorders. We intend to use our Phase III Parkinson s disease psychosis program as a foundation to develop and commercialize pimavanserin for additional neurological and psychiatric indications that are underserved by currently available antipsychotics and represent large unmet medical needs. This may include development of pimavanserin as a treatment for psychoses associated with other neurological disorders, including Alzheimer s disease, and as a co-therapy for schizophrenia. In therapeutic areas that involve an extensive development program or require large specialty or primary care sales forces, we intend to complete late-stage development and commercialization through, or in collaboration with, partners. We may elect to retain commercialization rights in selected areas where we feel pimavanserin can be sold by a specialty sales force that calls on a focused group of physicians.

Continue to develop our other product candidates for the treatment of central nervous system and related disorders. We plan to continue developing our other product candidates, including our collaborative clinical programs with Allergan and Meiji Seika Pharma, and our internal preclinical programs. While our resources are currently focused on our most advanced clinical-stage product candidates, most notably pimavanserin, we may choose to pursue additional product candidates in the future. These may be directed at neurological and related central nervous system disorders and may be developed independently or in partnerships. We believe that a diversified pipeline will mitigate risks inherent in drug development and increase the likelihood of commercial success.

Opportunistically in-license or acquire complementary product candidates. Although all of the product candidates currently in our pipeline emanate from discoveries made using our proprietary platform, in the future, we may elect to in-license or acquire preclinical assets, and clinical-stage product candidates or products to augment our pipeline and to leverage any sales force that we may establish in the future.

Disease and Market Overview

Our product candidates address diseases that are not well served by currently available therapies and that represent large potential commercial market opportunities. Background information on the diseases and related commercial markets that may be addressed by our product candidates is set forth below.

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Parkinson s Disease Psychosis

Parkinson s disease is a chronic and progressive neurological disorder that involves malfunction and death of neurons in a region of the brain that controls movement. This neurodegeneration creates a shortage of an important brain signaling chemical, or neurotransmitter, known as dopamine, thereby rendering patients less able to direct or control their movements in a normal manner. Parkinson s disease is characterized by well-known motor symptoms including tremors, limb stiffness, slowness of movements, and difficulties with posture and balance, as well as by non-motor symptoms, which often include psychosis. Parkinson s disease progresses slowly in most people and the severity of symptoms tends to worsen over time.

Parkinson s disease is the second most common neurological disorder after Alzheimer s disease. According to the National Parkinson Foundation, about one million people in the United States and from four to six million people worldwide suffer from this disease. Parkinson s disease is more common in people over 60 years of age, and the prevalence of this disease is expected to increase significantly as the average age of the population increases. Parkinson s disease patients are currently treated with dopamine replacement therapies such as levodopa, commonly referred to as L-dopa, which is metabolized to dopamine, and dopamine agonists, which are molecules that mimic the action of dopamine.

Studies have suggested that up to 60 percent of patients with Parkinson s disease will develop psychotic symptoms, commonly consisting of visual hallucinations and delusions. The development of psychosis in patients with Parkinson s disease substantially contributes to the burden of Parkinson s disease and deeply affects their quality of life. Parkinson s disease psychosis is associated with increased caregiver stress and burden, nursing home placement, and increased mortality.

Treatment of Parkinson s disease psychosis poses a challenge to physicians. The FDA has not approved any therapy for Parkinson s disease psychosis. Physicians may attempt to address this disorder initially by decreasing the dose of the dopamine replacement drugs, which are administered to manage the motor symptoms of Parkinson s disease. However, this approach is generally not effective in alleviating psychotic symptoms and is often associated with a significant worsening of motor function in these patients. Despite substantial limitations, currently marketed antipsychotic drugs are used off-label to treat patients with Parkinson s disease psychosis. Because antipsychotic drugs block dopamine receptors, and thereby may counteract the dopamine replacement therapy, these drugs often worsen motor symptoms in patients with Parkinson s disease when used at doses required to achieve antipsychotic effects. Nevertheless, physicians frequently resort to off-label use of antipsychotic medications, including Seroquel and the generic drug clozapine, to treat Parkinson s disease psychosis.

The only current antipsychotic drug that has demonstrated efficacy in reducing psychosis in patients with Parkinson s disease without further impairing motor function is clozapine when given at low doses. Studies suggest that this unique clinical utility of low-dose clozapine arises from its potent blocking of a key serotonin receptor, a protein that responds to the neurotransmitter serotonin, known as the 5-HT2A receptor. The use of low-dose clozapine has been approved in Europe, but not in the United States, for the treatment of psychotic disorders in Parkinson s disease. However, routine use of clozapine is limited by its potential to cause a rare blood disorder that necessitates stringent blood monitoring.

Current antipsychotic drugs are associated with a number of side effects, which can be problematic for elderly patients with Parkinson s disease. In addition, all current antipsychotic drugs have a black box warning for use in elderly patients with dementia-related psychosis due to increased mortality and morbidity. Currently, there is a large unmet medical need for new therapies that will effectively treat psychosis in patients with Parkinson s disease without compromising motor control or causing other serious side effects in this fragile, elderly patient population.

Schizophrenia

Schizophrenia is a severe chronic mental illness that involves disturbances in cognition, perception, emotion, and other aspects of behavior. The positive symptoms of schizophrenia include hallucinations and

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delusions, while the negative symptoms may manifest as loss of interest and emotional withdrawal. Schizophrenia is associated with persistent impairment of a patient s social functioning and productivity. Cognitive disturbances often prevent patients with schizophrenia from readjusting to society. As a result, patients with schizophrenia are normally required to be under medical care for their entire lives.

According to the National Institute of Mental Health, approximately one percent of the U.S. population suffers from this disease. Worldwide sales of antipsychotic drugs used to treat schizophrenia and other psychiatric conditions exceeded $25 billion in 2010. These drugs have been increasingly used by physicians to address a range of disorders in addition to schizophrenia, including bipolar disorder and a variety of psychoses and related conditions in elderly patients. Despite their commercial success, current antipsychotic drugs have substantial limitations, including inadequate efficacy and severe side effects.

The first-generation, or typical, antipsychotics that were introduced in the late-1950s block dopamine receptors. While typical antipsychotics are effective against positive symptoms of schizophrenia in many patients, these drugs often induce disabling motor disturbances, and they fail to address or worsen most of the negative symptoms and cognitive disturbances associated with schizophrenia.

Most schizophrenia patients in the United States today are treated with second-generation, or atypical, antipsychotics, which induce fewer motor disturbances than typical antipsychotics, but still fail to address most of the negative symptoms of schizophrenia. In addition, currently prescribed treatments do not effectively address or may exacerbate cognitive disturbances associated with schizophrenia. It is believed that the efficacy of atypical antipsychotics is due to their interactions with dopamine and 5-HT2A receptors. The side effects induced by the atypical agents may include weight gain, non-insulin dependent (type II) diabetes, cardiovascular side effects, and motor disturbances. We believe that these side effects generally arise either from non-essential receptor interactions or from excessive dopamine blockade.

The limitations of currently available antipsychotics result in poor patient compliance. A study conducted by the National Institute of Mental Health, which was published in *The New England Journal of Medicine* in September 2006, found that 74 percent of patients taking typical or atypical antipsychotics discontinued treatment within 18 months because of side effects or lack of efficacy. We believe there is a large unmet medical need for new therapies that have an improved side effect and efficacy profile.

Alzheimer s Disease Psychosis

Alzheimer s disease is a progressive neurodegenerative disorder that slowly destroys memory and thinking skills, and eventually even the ability to carry out simple tasks. Its symptoms include cognitive dysfunction, memory abnormalities, progressive impairment in activities of daily living, and a host of behavioral and neuropsychiatric symptoms. Alzheimer s disease primarily affects older people and, in most cases, symptoms first appear after age 60. Alzheimer s disease gets worse over time and is fatal.

According to the Alzheimer s Association, 5.4 million people in the Unites States are living with Alzheimer s disease and it is currently the fifth leading cause of death for people age 65 and older. While the diagnostic criteria for Alzheimer s disease mostly focus on the related cognitive deficits, it is often the behavioral and psychiatric symptoms that are most troublesome for caregivers and lead to poor quality of life for patients. These symptoms include agitation, aggressive behaviors, and psychosis. Studies have suggested that approximately 25 to 50 percent of Alzheimer s disease patients may develop psychosis, commonly consisting of hallucinations and delusions. The diagnosis of Alzheimer s disease psychosis is associated with more rapid cognitive and functional decline and institutionalization.

There is no proven safe and effective therapy for Alzheimer s disease psychosis. As symptoms progress and become more severe, physicians often resort to off-label use of antipsychotic medications in these patients. Current antipsychotic drugs are associated with a number of side effects, which can be problematic for elderly patients with Alzheimer s disease. In addition, antipsychotic drugs may exacerbate the cognitive disturbances associated with Alzheimer s disease. Current antipsychotic drugs also have a black box warning for use in elderly patients with dementia-related psychosis due to increased mortality and morbidity. There is a large unmet medical need for a safe and effective therapy to treat the psychosis in patients with Alzheimer s disease.

Chronic Pain

Chronic pain is a common form of pain that persists or progresses over a long period of time. In contrast to acute pain that usually arises suddenly in response to an identifiable injury and is transient, chronic pain persists over time and is often resistant to medical treatments. Chronic pain may be related to a number of different medical conditions, including diabetes, arthritis, migraine, fibromyalgia, irritable bowel syndrome, cancer, shingles, and previous trauma or injury.

Hypersensitivity is a common feature of many chronic pain disorders, including fibromyalgia and irritable bowel syndrome. Fibromyalgia is a common and complex chronic pain disorder characterized by chronic widespread muscle pain, stiffness and tenderness of muscles, tendons and joints without detectable inflammation. It also is often associated with fatigue, sleep disorders, anxiety, depression and disturbances in bowel function. Fibromyalgia affects an estimated 10 million people in the United States, predominately women over the age of 30. Irritable bowel syndrome is one of the most common ailments of the intestines and affects an estimated 15 percent of the U.S. population.

There are a variety of drugs used to treat patients with chronic pain, including anticonvulsants, selective serotonin and norepinephrine reuptake inhibitors, or SNRIs, tricyclic antidepressants, opioid painkillers, and non-steroidal anti-inflammatory agents. Currently, the leading drugs include Lyrica, an anticonvulsant approved for postherpetic neuralgia, diabetic neuropathic pain and fibromyalgia, and Cymbalta, an SNRI indicated for treatment of diabetic peripheral neuropathic pain, fibromyalgia, and major depressive disorder. Lyrica and Cymbalta had worldwide sales of $3.7 billion and $4.2 billion, respectively, in 2011. Lyrica is the successor to Neurontin, which was the first product to be approved by the FDA for the treatment of neuropathic pain and is now generic.

Only a portion of patients with chronic pain get meaningful relief from anticonvulsants and antidepressants. Side effects of anticonvulsants may include dizziness, somnolence, dry mouth, blurred vision, weight gain, and concentration or attention difficulties. Side effects of SNRIs may include nausea, vomiting, dizziness, sleep disturbances, constipation, dry mouth, anxiety, abnormal vision, headache and sexual dysfunction. Tricyclic antidepressants have long been used to treat depression and these agents may have pain-relieving effects in some patients. Common side effects of these agents include dry mouth, blurred vision, constipation, difficulty with urination, impaired thinking and tiredness.

Drugs such as opioid painkillers and non-steroidal anti-inflammatory agents that are effective in treating inflammatory and acute pain usually are not effective in treating chronic pain. Opioid painkillers also have significant adverse side effects that limit their usefulness, and prolonged use of these drugs can lead to the need for increasing dosage and potentially to addiction.

Due to these shortcomings of current therapies, we believe that there is a large unmet medical need for new chronic pain therapies with improved efficacy and side effect profiles.

Glaucoma

Glaucoma is a chronic eye disease that, if left untreated, can lead to blindness. According to the World Health Organization, glaucoma is the second leading cause of blindness in the world. Loss of vision is caused by degeneration of the optic nerve, which is responsible for carrying images from the eye to the brain. A frequent symptom of glaucoma is increased fluid pressure within the eye, referred to as intraocular pressure. In the early stages of the disease, there may be no symptoms. It is estimated that over four million people in the United States have glaucoma but only half of those know they have it. Older people are at a higher risk for glaucoma and the disease is more common in people over 60 years of age. The prevalence of glaucoma is expected to increase as the average age of the population increases.

Currently there are a variety of options available to treat glaucoma, including eye medications, laser procedures and surgery. These treatment options are intended to decrease intraocular pressure and, thereby, protect the optic nerve. Physicians often treat glaucoma with multiple classes of drugs to optimize therapy and minimize side effects. Drugs used to treat glaucoma include prostaglandin analogs such as Xalatan and Lumigan, beta blockers such as timolol, and alpha agonists such as Alphagan, as well as combined medications. Xalatan, a leading glaucoma treatment with worldwide sales of $1.3 billion in 2011, is now generic. While Xalatan is an effective anti-glaucoma agent, it frequently causes increased pigmentation of the iris that may lead to a change in iris color, and may cause other side effects, including blurred vision and burning and stinging sensations in the eye. We believe there is a need for new and more effective drugs that can treat glaucoma with fewer side effects and help patients reduce the risk of losing their vision.

Our Product Candidates and Preclinical Programs

Our pipeline includes four product candidates in clinical development and two additional programs in preclinical testing. We believe that our product candidates offer innovative therapeutic approaches and may provide significant advantages relative to current therapies. The following table summarizes our clinical-stage product candidates and preclinical programs:

Product Candidate/Program	Indication	Stage of Development	Commercialization Rights
Pimavanserin	Parkinson s disease psychosis	Phase III	ACADIA
	Schizophrenia	Phase II (1)	ACADIA
	Alzheimer s disease psychosis	Phase II (2)	ACADIA
Alpha adrenergic agonists	Chronic Pain	Phase II	Allergan
Muscarinic agonist	Glaucoma	Phase I	Allergan
AM-831	Schizophrenia	Phase I	Meiji Seika Pharma Asia ACADIA Rest of World
ER_{β} program	Neuroprotection/ Chronic Pain	Preclinical	ACADIA
Nurr-1 program	Parkinson s Disease	Preclinical	ACADIA

(1) Completed Phase II schizophrenia co-therapy trial.
(2) We have established a protocol for a future Phase II feasibility study in Alzheimer s disease psychosis.

Pimavanserin

Overview

Pimavanserin is a new chemical entity that we discovered and have advanced to Phase III development as a potential first-in-class treatment for Parkinson s disease psychosis. Pimavanserin is a small molecule that can be taken orally as a tablet once-a-day. Pimavanserin selectively blocks the activity of the 5-HT2A receptor, a drug target that plays an important role in psychosis. We hold worldwide rights to pimavanserin and have established a patent portfolio, which includes numerous issued patents covering pimavanserin in the United States, Europe and several additional countries.

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We have selected Parkinson s disease psychosis as our lead indication for pimavanserin and we are focused on advancing our Phase III program toward registration for this indication. We believe that pimavanserin also has the potential to address a range of other neurological and psychiatric indications that are underserved by currently marketed antipsychotics. We have completed a Phase II trial with pimavanserin as a co-therapy in schizophrenia and have established a protocol for a future Phase II feasibility study to explore the potential of pimavanserin as a treatment for Alzheimer s disease psychosis. In the future, we intend to use our Phase III Parkinson s disease psychosis program as a foundation to develop and commercialize pimavanserin for these and other potential neurological and psychiatric indications independently or in collaboration with strategic partners.

Pimavanserin as a Treatment for Parkinson s Disease Psychosis

We are in Phase III development with pimavanserin as a potential first-in-class treatment for Parkinson s disease psychosis. Currently, there are no therapies approved to treat Parkinson s disease psychosis in the United States. Pimavanserin offers an innovative non-dopaminergic approach to treating Parkinson s disease psychosis. We believe that pimavanserin has the potential to be the first safe and effective drug that will treat the psychosis in patients with Parkinson s disease without compromising motor control, thereby significantly improving the quality of life for these patients. As a result, we believe that, if approved, pimavanserin will offer significant advantages relative to current antipsychotics used off-label for the treatment of Parkinson s disease psychosis.

We are currently conducting several clinical trials in our Phase III program with pimavanserin for Parkinson s disease psychosis, including a pivotal Phase III study, referred to as the -020 Study, designed to evaluate the efficacy, tolerability and safety of pimavanserin as a treatment for patients with Parkinson s disease psychosis. The -020 Study is a multi-center, double-blind, placebo-controlled trial expected to enroll about 200 patients at clinical centers located in North America. Patients are randomized to two study arms and receive oral doses of either 40 mg of pimavanserin or placebo once-daily for six weeks. Patients also continue to receive stable doses of their existing dopamine replacement therapy used to manage the motor symptoms of Parkinson s disease. The primary endpoint of the -020 Study is antipsychotic efficacy as measured using nine items from the hallucinations and delusions domains of the Scale for the Assessment of Positive Symptoms, or SAPS. We are using an independent group of centralized raters to assess the primary endpoint in the -020 Study. Motoric tolerability is a key secondary endpoint in the study and is measured using Parts II and III of the Unified Parkinson s Disease Rating Scale, or UPDRS. The -020 Study builds on the signals of efficacy observed in our earlier studies and incorporates several study design enhancements guided by the previous data and experience we have gained in our Parkinson s disease program. We expect to report top-line results from the -020 Study near the end of the third quarter of 2012. If successful, the -020 Study would represent the first of two required pivotal Phase III trials in our Parkinson s disease psychosis program.

In addition to the -020 Study, we are continuing to conduct an open-label safety extension trial, referred to as the -015 Study, involving patients with Parkinson s disease psychosis who have completed our earlier Phase III studies as well as patients who complete the -020 Study. Patients are eligible to participate in the -015 Study if, in the opinion of the treating physician, the patient may benefit from continued treatment with pimavanserin. The -015 Study, together with a similar extension trial that is ongoing from our earlier Phase II Parkinson s disease psychosis trial, has generated a considerable amount of long-term safety data on pimavanserin. A total of over 200 patients have now been treated with pimavanserin for over one year and our longest single-patient exposure is greater than seven years. We believe that our experience to date suggests that long-term administration of pimavanserin is generally safe and well tolerated in this fragile, elderly patient population.

In September 2009, we announced top-line results from an initial Phase III trial with pimavanserin in patients with Parkinson s disease psychosis, referred to as the -012 Study. While the -012 Study was impacted by a larger than expected placebo response and did not meet its primary endpoint, signals of antipsychotic efficacy were consistently observed in the pimavanserin 40 mg study arm. These signals were most prominent in the United States portion of the study, which comprised nearly one-half of the patients in the study. The -012 Study met the key secondary endpoint of motoric tolerability and pimavanserin was generally safe and well tolerated in

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the study. On the basis of data from the -012 Study, during 2010 we concluded a second Phase III trial, referred to as the -014 Study, early and analyzed this study in order to use the findings to support our design of the -020 Study. In the -014 Study, the 20 mg pimavanserin arm showed a signal of antipsychotic efficacy on the primary assessment scale and a statistically significant difference from placebo on a secondary outcome measure. The -014 Study met the key secondary endpoint of motoric tolerability and pimavanserin was generally safe and well tolerated in the study.

In 2006, we announced top-line results from a multi-center, double-blind, placebo-controlled Phase II trial with pimavanserin in patients with Parkinson s disease psychosis. The trial met the primary endpoint, which was to demonstrate that administration of pimavanserin did not result in deterioration of the motoric function of these patients as measured by the UPDRS. Pimavanserin also showed antipsychotic effects in secondary endpoints using two different rating scales, including SAPS. Pimavanserin was generally safe and well tolerated in the study.

Pimavanserin as a Co-Therapy for Schizophrenia

By combining pimavanserin with a low dose of an antipsychotic drug such as risperidone, a commonly prescribed atypical antipsychotic drug that is now generic, we believe that the optimal relationship between 5-HT2A receptor blockade and partial dopamine receptor blockade can be achieved. Therefore, we believe co-therapy with pimavanserin may result in enhanced efficacy and fewer side effects relative to existing treatments, thereby providing an improved therapy for patients with schizophrenia.

We reported positive results in 2007 from a multi-center, double-blind, placebo-controlled Phase II trial designed to evaluate pimavanserin as a co-therapy in patients with schizophrenia. The trial results showed several advantages of co-therapy with pimavanserin and a 2 mg, or low, dose of risperidone in patients with schizophrenia. These advantages included enhanced efficacy comparable to that of a 6 mg, or standard, dose of risperidone, a faster onset of antipsychotic action, and an improved side effect profile, including significantly less weight gain, compared to the standard dose of risperidone. If we elect to pursue further development for this indication in the future, we currently expect that it will be through, or in collaboration with, a partner.

Pimavanserin as a Treatment for Alzheimer s Disease Psychosis

Patients with Alzheimer s disease psychosis and Parkinson s disease psychosis share many common characteristics. They are typically elderly and frail, and often exhibit similar psychiatric symptoms associated with their respective underlying neurodegenerative disease. In preclinical models of Alzheimer s disease psychosis, we have shown that pimavanserin attenuates psychosis-related behaviors. In addition, pimavanserin has been shown to positively interact with muscarinic agonists and cholinesterase inhibitors to enhance their pro-cognitive and antipsychotic actions in preclinical models. Because of its mechanism of action and the favorable safety profile observed to date in studies conducted in elderly patients with Parkinson s disease psychosis, we believe that pimavanserin also may be ideally suited to address the need for a new treatment for Alzheimer s disease psychosis that is safe, effective and well tolerated.

We have established a protocol for a Phase II feasibility study to evaluate the potential of pimavanserin as a treatment for Alzheimer s disease psychosis. While our resources are currently focused on our Phase III program in Parkinson s disease psychosis, we intend to pursue our planned feasibility study in Alzheimer s disease psychosis in the future independently or in collaboration with a partner.

Alpha Adrenergic Agonists

In collaboration with Allergan, we have discovered and are developing small molecule product candidates for the treatment of chronic pain. Our novel alpha adrenergic agonists provide pain relief in a range of preclinical models, without the side effects of current pain therapies, including sedation and cardiovascular and respiratory effects.

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Allergan has conducted several Phase II trials in this program and has reported preliminary results, including positive proof-of-concept in a visceral pain trial in patients that had hypersensitivity of the esophagus, and efficacy signals in two chronic pain trials in the areas of fibromyalgia and irritable bowel syndrome. Allergan has announced that it is seeking a partner for the further development of this program and for commercialization in areas predominantly served by general practitioners.

Muscarinic Agonist

We have discovered and, in collaboration with Allergan, are developing a small molecule product candidate for the treatment of glaucoma. Using our proprietary drug discovery platform, we identified a subtype of the muscarinic receptors that controls intraocular pressure and discovered lead compounds that selectively activate this target. In preclinical models, our product candidate has demonstrated a promising preclinical profile, including robust efficacy and a long duration of action. This program has reached Phase I development.

AM-831

We have discovered and, in collaboration with Meiji Seika Pharma, are developing AM-831, a small molecule product candidate for the treatment of schizophrenia. AM-831 is a novel and orally available small molecule that combines muscarinic m1 partial agonism with both dopamine D2 and serotonin 5-HT2A receptor antagonism. AM-831 has demonstrated robust effects in preclinical models of psychosis and pro-cognitive effects in preclinical behavioral models. AM-831 has reached Phase I development.

We intend to co-develop AM-831 in collaboration with Meiji Seika Pharma through completion of proof-of-concept clinical studies, at which point Meiji Seika Pharma will be solely responsible for continued development and commercialization in the licensed Asian territory. We plan to seek a strategic partner to pursue development and commercialization of AM-831 in the rest of the world.

Preclinical Programs

In addition to our four clinical-stage product candidates, we have used our proprietary drug discovery platform to discover additional product candidates. These include two preclinical programs that we believe provide the potential for innovative disease-modifying therapies for treating Parkinson s disease and other neurological disorders. In our ER-beta program, we have discovered compounds that exhibit anti-inflammatory and neuroprotective properties in preclinical models and may have the ability to slow down the progression of Parkinson s disease. These compounds also may address symptoms of chronic, inflammatory and neuropathic pain while avoiding the side effects associated with activating ER-alpha receptors. Our initial research studies in the ER-beta program have been supported by grants from The Michael J. Fox Foundation, and we were awarded another grant from the National Institute of Neurological Disorders and Stroke, a division of the National Institutes of Health. In the second preclinical program, we discovered compounds that selectively activate Nurr1-RXR complexes and promote viability of dopamine-containing neurons. We are conducting studies to examine the effects of these compounds on neuroprotection and neuroregeneration in preclinical models of Parkinson s disease pursuant to a separate grant from The Michael J. Fox Foundation.

Currently, our resources are focused on our most advanced product candidates, including pimavanserin, and we are not devoting significant resources to earlier-stage programs that are not directly funded. However, we may elect to pursue the development of additional product candidates in the future independently or in partnerships.

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Our Drug Discovery Platform and Capabilities

Overview

All of our product candidates that are currently in clinical trials and earlier stages of discovery and development emanate from discoveries made using our proprietary drug discovery platform. We have demonstrated that our platform can be used to rapidly identify drug-like, small molecule chemistries for a wide range of drug targets. We believe that our expertise combined with our proprietary platform has allowed us to discover product candidates more efficiently than traditional approaches.

Our Drug Discovery Approach

Our drug discovery approach is designed to introduce chemistry at an early stage in the drug discovery process and enable selection of the most attractive, drug-like chemistries for desired targets. A key to our discovery approach has been our set of proprietary functional test systems, or assays, that we developed for a large number of targets predominantly in the G-protein coupled receptor and nuclear receptor gene families. We believe that these gene families represent the most relevant and feasible targets for small molecule drug discovery focused on central nervous system indications. We have used our proprietary assays in conjunction with our proprietary receptor selection and amplification technology, a cell-based assay system which we refer to as R-SAT, to validate drug targets, and to discover novel small molecules that are specific for these targets.

Collaboration Agreements

We have established three separate collaboration agreements with Allergan, a collaboration agreement with Meiji Seika Pharma and a technology license agreement with Aventis to leverage our drug discovery platform and related assets, and to advance development of and commercialize selected product candidates. Our collaborations have typically included upfront payments at initiation of the collaboration, research support during the research term, if applicable, milestone payments upon successful completion of specified development objectives, and royalties based upon future sales, if any, of drugs developed under the collaboration. Our current agreements are as follows:

Allergan

In March 2003, we entered into a collaboration agreement with Allergan to discover, develop and commercialize new therapeutics for ophthalmic and other indications. The agreement originally provided for a three-year research term, which has been extended by the parties through March 2013. As of December 31, 2011, we had received an aggregate of $18.5 million under the agreement, consisting of an upfront payment, and research funding and related fees. During the extended research term, Allergan is entitled to exclusively license specified chemistry and related assets for development and commercialization. If we grant Allergan such an exclusive license, we would be eligible to receive license fees and milestone payments upon the successful achievement of agreed-upon clinical and regulatory objectives as well as royalties on future product sales, if any, worldwide. Assuming the license and successful development of a product in the area of eye care, we could receive up to approximately $13.5 million in aggregate license fees and milestone payments per product under the agreement, as well as royalties on future product sales worldwide, if any.

In July 1999, we entered into a collaboration agreement with Allergan to discover, develop and commercialize selective muscarinic drugs for the treatment of glaucoma. Under this agreement, we provided our chemistry and discovery expertise to enable Allergan to select a compound for development. We granted Allergan exclusive worldwide rights to commercialize products based on this compound for the treatment of ocular disease. As of December 31, 2011, we had received an aggregate of $9.5 million in payments under the agreement, consisting of upfront fees, research funding and milestone payments. We are eligible to receive additional milestone payments of up to $15 million in the aggregate as well as royalties on future product sales worldwide, if any. Allergan may terminate this agreement upon 90 days notice. However, if terminated, Allergan s rights to the selected compound would revert to us.

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In September 1997, we entered into a collaboration agreement with Allergan focused primarily on the discovery and development of new therapeutics for pain and ophthalmic indications. This agreement was amended in conjunction with the execution and subsequent amendments of the March 2003 collaboration agreement, and provides for the continued development of product candidates for one target area. We are restricted from conducting competing research in that target area. Pursuant to the agreement, we granted Allergan exclusive worldwide rights to commercialize products resulting from the collaboration. We had received an aggregate of $10.5 million in research funding and milestone payments through December 31, 2011 under this agreement. We are eligible to receive additional milestone payments of up to $10.0 million in the aggregate as well as royalties on future product sales worldwide, if any. In connection with the execution of the collaboration agreement in 1997, Allergan made a $6.0 million equity investment in us.

The general terms of our collaboration agreements with Allergan continue until the later of the expiration of the last to expire patent covering a product licensed under the collaboration and at least 10 years from the date of first commercial sale of a product. In addition, each of our Allergan collaboration agreements includes a research term that is shorter but may be renewed if agreed to by the parties.

Meiji Seika Pharma

In March 2009, we entered into a collaboration agreement with Meiji Seika Pharma to develop and commercialize a novel class of pro-cognitive drugs to treat patients with schizophrenia and related disorders in Japan and several other Asian countries. Under the agreement, we are eligible to receive up to $25 million in aggregate payments, consisting of $3 million in license fees and up to $22 million in payments upon the achievement of development and regulatory milestones in the licensed Asian territory. In addition, we are eligible to receive royalties on future product sales, if any, in the Asian territory. Meiji Seika Pharma also is responsible for the first $15 million of development expenses and we and Meiji Seika Pharma will share remaining expenses through clinical proof-of-concept, subject to possible adjustment in the event we further license the program outside of the Asian territory. Meiji Seika Pharma is responsible for all costs associated with the development, manufacturing and commercialization of the product candidate in the Asian territory, and is eligible to share a portion of any product-related revenues received by us in the rest of the world. As of December 31, 2011, we had received an aggregate of $4.3 million in payments under the agreement, including $3 million in license fees and reimbursement of initial development expenses. Our agreement with Meiji Seika Pharma is subject to early termination upon specified events.

Aventis

In July 2002, we entered into an agreement with Aventis under which we have licensed a portion of our technology for their use in a specified area that we are not pursuing presently.

Intellectual Property

We currently hold 48 issued U.S. patents and 236 issued foreign patents. All of these patents originated from us. In addition, we have 20 provisional and utility U.S. patent applications and 98 foreign patent applications.

Patents or other proprietary rights are an essential element of our business. Our strategy is to file patent applications in the United States and any other country that represents an important potential commercial market to us. In addition, we seek to protect our technology, inventions and improvements to inventions that are important to the development of our business. Our patent applications claim proprietary technology, including methods of screening and chemical synthetic methods, novel drug targets and novel compounds identified using our technology.

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We also rely upon trade secret rights to protect other technologies that may be used to discover and validate targets and that may be used to identify and develop novel drugs. We protect our trade secrets in part through confidentiality and proprietary information agreements. We have entered into a license agreement, dated as of November 30, 2006, for certain intellectual property rights from the Ipsen Group in order to expand and strengthen the intellectual property portfolio for our serotonin platform. We are a party to various other license agreements that give us rights to use certain technologies in our research and development.

Pimavanserin

Ten U.S. patents have been issued to us that provide coverage for pimavanserin, comprising three that cover the compound generically and seven that specifically cover pimavanserin, polymorphs thereof, the use thereof for treating Parkinson s disease psychosis, schizophrenia and sleep disorders, or the method of producing pimavanserin. The generic coverage expires in 2021. The pimavanserin specific patent and the Parkinson s disease psychosis treatment patent provide protection until June 2027 and 2026, respectively. The patent that covers polymorphs of pimavanserin provides protection until June 2028. We have 50 issued foreign patents that specifically cover pimavanserin, including patents in 39 European countries, Australia, Hong Kong, India, Mexico, New Zealand, Russia, Singapore and South Africa, which provide patent protection through 2024. We continue to prosecute patent applications directed to pimavanserin and to methods of treating various diseases using pimavanserin, either alone or in combination with other agents, worldwide.

Alpha Adrenergic Agonists

We have not been issued, and are not pursuing, patents covering the compounds being pursued by Allergan under this collaboration as the compounds are covered by Allergan patents.

Muscarinic Agonist

We have two U.S. patents that have been issued to us providing coverage for the compounds covered by our collaboration with Allergan for the treatment of glaucoma. These U.S. patents will expire in 2023. We have 45 issued foreign patents and 15 pending foreign applications that cover these compounds. The issued foreign patents for this program will expire in 2022 and 2025.

AM-831

Two U.S. patents have been issued to us that provide coverage for the compounds covered by our collaboration with Meiji Seika Pharma. These patents expire in 2024 and 2026. We have 40 issued foreign patents that cover these compounds. These patents provide protection through 2024.

Other Product Candidates

We have 14 issued U.S. patents and 15 issued foreign patents with claims for other product candidates that are at earlier stages of development.

Our Drug Discovery Platform

Our core R-SAT technology is protected by eight issued U.S. patents and 17 foreign patents. Our U.S. patents for R-SAT will expire over the range of 2013 to 2025. The foreign patents covering R-SAT will expire over the range of 2014 to 2024.

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Competition

We face, and will continue to face, intense competition from pharmaceutical and biotechnology companies, as well as numerous academic and research institutions and governmental agencies, both in the United States and abroad. We compete or will compete, as applicable, with existing and new products being developed by our competitors. Some of these competitors are pursuing the development of pharmaceuticals that target the same diseases and conditions that our research and development programs target.

Even if we and our collaborators are successful in developing our product candidates, the resulting products would compete with a variety of established drugs in the areas of Parkinson s disease psychosis, schizophrenia, Alzheimer s disease psychosis, chronic pain, and glaucoma. For example, our potential product for the treatment of Parkinson s disease psychosis will compete with off-label use of antipsychotic drugs, including Seroquel, marketed by Astra-Zeneca, and clozapine, a generic drug.

Our potential products for the treatment of schizophrenia would compete with Zyprexa, marketed by Eli Lilly, Risperdal, marketed by Johnson & Johnson, Abilify, marketed jointly by Bristol-Myers Squibb and Otsuka Pharmaceutical, Seroquel, and clozapine. Zyprexa, Risperdal, and clozapine are now generic in the United States. Our potential product for Alzheimer s disease psychosis would compete with off-label use of antipsychotic drugs.

Our potential products for the treatment of chronic pain would compete with Neurontin and Lyrica, each marketed by Pfizer, and Cymbalta, marketed by Eli Lilly, as well as with a variety of generic or proprietary opioids. Currently, the leading drugs approved for chronic pain indications include Lyrica, the successor to Neurontin, and Cymbalta.

Our potential products for the treatment of glaucoma would compete with Xalatan, marketed by Pfizer, and Lumigan and Alphagan, marketed by Allergan. Xalatan is a leading glaucoma treatment that is now generic.

In addition, the companies described above and other competitors may have a variety of drugs in development or awaiting FDA approval that could reach the market and become established before we have a product to sell. Our competitors may also develop alternative therapies that could further limit the market for any drugs that we may develop. Many of our competitors are using technologies or methods different or similar to ours to identify and validate drug targets and to discover novel small molecule drugs. Many of our competitors and their collaborators have significantly greater experience than we do in the following:

- identifying and validating targets;
- screening compounds against targets;
- preclinical and clinical trials of potential pharmaceutical products; and
- obtaining FDA and other regulatory clearances.

In addition, many of our competitors and their collaborators have substantially greater advantages in the following areas:

- capital resources;
- research and development resources;
- manufacturing capabilities; and

sales and marketing.

Smaller companies also may prove to be significant competitors, particularly through proprietary research discoveries and collaborative arrangements with large pharmaceutical and established biotechnology companies.

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Many of our competitors have products that have been approved or are in advanced development. We face competition from other companies, academic institutions, governmental agencies and other public and private research organizations for collaborative arrangements with pharmaceutical and biotechnology companies, in recruiting and retaining highly qualified scientific and management personnel and for licenses to additional technologies. Our competitors, either alone or with their collaborators, may succeed in developing technologies or drugs that are more effective, safer, and more affordable or more easily administered than ours and may achieve patent protection or commercialize drugs sooner than us. Developments by others may render our product candidates or our technologies obsolete. Our failure to compete effectively could have a material adverse affect on our business.

Government Regulation

The manufacturing and marketing of our potential products and our ongoing research and development activities are subject to extensive regulation by numerous governmental authorities in the United States and other countries. Before marketing in the United States, any new drug developed by us must undergo rigorous preclinical testing, clinical trials and an extensive regulatory clearance process implemented by the FDA under the federal Food, Drug, and Cosmetic Act, as amended. The FDA regulates, among other things, the development, testing, manufacture, safety, efficacy, record keeping, labeling, storage, approval, advertising, promotion, sale and distribution of biopharmaceutical products. None of our product candidates has been approved for sale in the United States or any foreign market. The regulatory review and approval process, which includes preclinical testing and clinical trials of each product candidate, is lengthy, expensive and uncertain.

In the United States, product candidates are tested in animals until adequate proof of safety is established. Clinical trials for new product candidates are typically conducted in three sequential phases that may overlap. Phase I trials involve the initial introduction of the product candidate into healthy human volunteers. The emphasis of Phase I trials is on testing for safety or adverse effects, dosage, tolerance, metabolism, distribution, excretion and clinical pharmacology. Phase II involves studies in a limited patient population to determine the initial efficacy of the compound for specific targeted indications, to determine dosage tolerance and optimal dosage and to identify possible adverse side effects and safety risks. Once a compound shows evidence of effectiveness and is found to have an acceptable safety profile in Phase II evaluations, Phase III trials are undertaken to more fully evaluate clinical outcomes. Before commencing clinical investigations in humans, we or our collaborators must submit to the FDA an Investigational New Drug Application, or IND.

Regulatory authorities may require additional data before allowing the clinical studies to commence or proceed from one phase to another, and could demand that the studies be discontinued or suspended at any time if there are significant safety issues. We have in the past and may in the future rely on some of our collaborators to file INDs and generally direct the regulatory approval process for many of our potential products. Clinical testing must also meet requirements for clinical trial registration, institutional review board oversight, informed consent, health information privacy, and good clinical practices.

To establish a new product candidate s safety and efficacy, the FDA requires companies seeking approval to market a drug product to submit extensive preclinical and clinical data, along with other information, for each indication. The data and information are submitted to the FDA in the form of a New Drug Application, or NDA. Generating the required data and information for an NDA takes many years and requires the expenditure of substantial resources. Information generated in this process is susceptible to varying interpretations that could delay, limit or prevent regulatory approval at any stage of the process. The failure to demonstrate adequately the quality, safety and efficacy of a product candidate under development would delay or prevent regulatory approval of the product candidate. We cannot assure you that, even if clinical trials are completed, either our collaborators or we will submit applications for required authorizations to manufacture and/or market potential products or that any such application will be reviewed and approved by the appropriate regulatory authorities in a timely manner, if at all. Under applicable laws and FDA regulations, each NDA submitted for FDA approval is usually given an internal administrative review within 60 days following submission of the NDA. If deemed sufficiently complete to permit a substantive review, the FDA will file the NDA. The FDA can refuse to file any NDA that it deems incomplete or not properly reviewable. The FDA has established internal goals of six months for priority review for NDAs that cover product candidates that offer major advances in treatment or provide a treatment where no adequate therapy exists, and 10 months for the standard review of non-priority NDAs. However, the FDA is not legally required to complete its review within these periods, these performance goals may change over time and the review is often extended by FDA requests for additional information or clarification. Moreover, the outcome of the review, even if generally favorable, may not be an actual approval but a complete response letter that describes additional work that must be done before the NDA can be approved. Before approving an NDA, the FDA will inspect the facilities at which the product is manufactured and will not approve the product unless the manufacturing facility complies with cGMPs. The FDA s review of an NDA may also involve review and recommendations by an independent FDA advisory committee, particularly for novel indications, such as Parkinson s disease psychosis.

In addition, delays or rejections may be encountered based upon changes in regulatory policy for product approval during the period of product development and regulatory agency review. Changes in regulatory approval policy, regulations or statutes or the process for regulatory review during products development or approval periods may cause delays in the approval or rejection of an application.

Before receiving FDA approval to market a potential product, we or our collaborators must demonstrate through adequate and well-controlled clinical studies that the potential product is safe and effective on the patient population that will be treated. If regulatory approval of a potential product is granted, this approval will be limited to those disease states and conditions for which the product is approved. Marketing or promoting a drug for an unapproved indication is generally prohibited. Furthermore, FDA approval may entail ongoing requirements for risk management, including post-marketing studies. Even if approval is obtained, a marketed product, its manufacturer and its manufacturing facilities are subject to continuing review and periodic inspections by the FDA. Discovery of previously unknown problems with a product, manufacturer or facility may result in restrictions on the product or manufacturer, including labeling changes, warning letters, costly recalls or withdrawal of the product from the market.

Any drug is likely to produce some toxicities or undesirable side effects in animals and in humans when administered at sufficiently high doses and/or for sufficiently long periods of time. Unacceptable toxicities or side effects may occur at any dose level at any time in the course of studies in animals designed to identify unacceptable effects of a product candidate, known as toxicological studies, or during clinical trials of our potential products. The appearance of any unacceptable toxicity or side effect could cause us or regulatory authorities to interrupt, limit, delay or abort the development of any of our product candidates. Further, such unacceptable toxicity or side effects could ultimately prevent a potential product s approval by the FDA or foreign regulatory authorities for any or all targeted indications or limit any labeling claims, even if the product is approved.

Any trade name that we intend to use for a potential product must be approved by the FDA irrespective of whether we have secured a formal trademark registration from the U.S. Patent and Trademark Office. The FDA conducts a rigorous review of proposed product names, and may reject a product name if it believes that the name inappropriately implies medical claims or if it poses the potential for confusion with other product names. The FDA will not approve a trade name until the NDA for a product is approved. If the FDA determines that the trade names of other products that are approved prior to the approval of our potential products may present a risk of confusion with our proposed trade name, the FDA may elect to not approve our proposed trade name. If our trade name is rejected, we will lose the benefit of any brand equity that may already have been developed for this trade name, as well as the benefit of our existing trademark applications for this trade name. If the FDA does not approve our proposed trade name, we may be required to launch a potential product candidate without a brand name, and our efforts to build a successful brand identity for, and commercialize, this product candidate may be adversely impacted.

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We and our collaborators and contract manufacturers also are required to comply with the applicable FDA current good manufacturing practice regulations. Good manufacturing practice regulations include requirements relating to quality control and quality assurance as well as the corresponding maintenance of records and documentation. Manufacturing facilities are subject to inspection by the FDA. These facilities must be approved before we can use them in commercial manufacturing of our potential products. The FDA may conclude that we or our collaborators or contract manufacturers are not in compliance with applicable good manufacturing practice requirements and other FDA regulatory requirements.

If the product is approved, we must also comply with post-marketing requirements, including, but not limited to, compliance with advertising and promotion regulations enforced by FDA s Office of Prescription Drug Promotion, the Prescription Drug Marketing Act, anti-fraud and abuse laws, healthcare information privacy laws, post-marketing safety surveillance, and disclosure of payments or transfers of value to healthcare professionsals. In addition, we are subject to other federal and state regulation including, but not limited to, implementation of corporate compliance programs and reporting of payments and transfers of value to healthcare professionals.

Outside of the United States, our ability to market a product is contingent upon receiving a marketing authorization from the appropriate regulatory authorities. The requirements governing the conduct of clinical trials, marketing authorization, pricing and reimbursement vary widely from country to country. At present, foreign marketing authorizations are applied for at a national level, although within the European Community, or EC, registration procedures are available to companies wishing to market a product in more than one EC member state. If the regulatory authority is satisfied that adequate evidence of safety, quality and efficacy has been presented, marketing authorization will be granted. This foreign regulatory approval process involves all of the risks associated with FDA marketing approval discussed above. In addition, foreign regulations may include applicable post-marketing requirements, including safety surveillance, anti-fraud and abuse laws, and implementation of corporate compliance programs and reporting of payments or transfers of value to healthcare professionals.

Drugs for Serious or Life-Threatening Illnesses

The Federal Food, Drug and Cosmetic Act, as amended, and FDA regulations provide certain mechanisms for the accelerated Fast Track approval of potential products intended to treat serious or life-threatening illnesses which have been studied for safety and effectiveness and which demonstrate the potential to address unmet medical needs. These procedures permit early consultation and commitment from the FDA regarding the preclinical and clinical studies necessary to gain marketing approval. Provisions of this regulatory framework also permit, in certain cases, NDAs to be approved on the basis of valid surrogate markers of product effectiveness, thus accelerating the normal approval process. Certain potential products employing our technology might qualify for this accelerated regulatory procedure. Even if the FDA agrees that these potential products qualify for accelerated approval procedures, the FDA may deny approval of our drugs or may require that additional studies be required before approval. The FDA may also require us to perform post-approval, or Phase IV, studies as a condition of such early approval. In addition, the FDA may impose restrictions on distribution and/or promotion in connection with any accelerated approval, and may withdraw approval if post-approval studies do not confirm the intended clinical benefit or safety of the potential product.

Other U.S. Regulatory Requirements

In the United States, the research, manufacturing, distribution, sale, and promotion of drug products are potentially subject to regulation by various federal, state and local authorities in addition to the FDA, including the Centers for Medicare & Medicaid Services (formerly the Health Care Financing Administration), other divisions of the United States Department of Health & Human Services, including, for example, the Office of Inspector General, and state and local governments. For example, if a drug product is reimbursed by Medicare, Medicaid or other federal or state health care programs, sales, marketing and scientific/educational grant programs must comply with the Medicare-Medicaid Anti-Fraud and Abuse Act, as amended, the False Claims Act, also as amended, and similar state laws. If a drug product is reimbursed by Medicare or Medicaid, pricing and rebate programs must comply with, as applicable, the Medicaid rebate requirements of the Omnibus Budget Reconciliation Act of 1990, as amended, and the Medicare Prescription Drug Improvement and Modernization Act of 2003. Additionally, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or collectively the PPACA, enacted in March 2010, substantially changes the way healthcare is financed by both governmental and private insurers. Among other cost containment measures, the PPACA establishes: an annual, nondeductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents; a new Medicare Part D coverage gap discount program; and a new formula that increases the rebates a manufacturer must pay under the Medicaid Drug Rebate Program. In the future, there may continue to be additional proposals relating to the reform of the U.S. healthcare system, some of which could further limit coverage and reimbursement of drug products. If drug products are made available to authorized users of the Federal Supply Schedule of the General Services Administration, additional laws and requirements apply. All of these activities are also potentially subject to federal and state consumer protection and unfair competition laws.

Marketing, Sales and Distribution

We currently have no marketing, sales or distribution capabilities. In order to commercialize any of our product candidates, we must develop these capabilities internally or through collaboration with third parties. In selected therapeutic areas where we feel that our product candidates can be commercialized by a specialty sales force that calls on a limited and focused group of physicians, we plan to participate in the commercialization of our product candidates in the United States. In therapeutic areas that require a large sales force selling to a large and diverse prescribing population, we plan to partner our product candidates for commercialization. We plan to commercialize our products in markets outside of the United States by establishing one or more strategic alliances in the future.

Manufacturing

We outsource and plan to continue to outsource manufacturing responsibilities for our existing and future product candidates for development and commercial purposes. The production of pimavanserin employs small molecule synthetic organic chemistry procedures that are standard in the pharmaceutical industry. Our collaboration agreements provide for our partners to arrange for the production of our product candidates for use in clinical trials and potential commercialization.

Employees

At December 31, 2011, we had 24 employees, of whom 12 hold Ph.D. or other advanced degrees. Of our total workforce, 14 are engaged in research and development activities and 10 are engaged in executive, finance, and administration activities. None of our employees is represented by a collective bargaining agreement, nor have we experienced work stoppages. We believe that our relations with our employees are good.

Research and Development Expenses

Our research and development expenses were $17.3 million in 2011, $20.6 million in 2010, and $41.6 million in 2009.

Long-Lived Assets

Our long-lived assets located in the United States totaled $151,000, $282,000 and $738,000 as of December 31, 2011, 2010 and 2009, respectively. Our only other long-lived assets were located in Europe and totaled $0, $144,000 and $324,000 as of December 31, 2011, 2010 and 2009, respectively.

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Item 1A. ***Risk Factors.***

You should consider carefully the following information about the risks described below, together with the other information contained in this Annual Report and in our other public filings in evaluating our business. If any of the following risks actually occurs, our business, financial condition, results of operations and future growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock would likely decline.

Risks Related to Our Business

We expect our net losses to continue for at least several years and are unable to predict the extent of future losses or when we will become profitable, if ever.

We have experienced significant net losses since our inception. As of December 31, 2011, we had an accumulated deficit of approximately $346.9 million. We expect to incur net losses over the next several years as we advance our programs and incur significant clinical development costs.

We have not received, and do not expect to receive for at least the next several years, any revenues from the commercialization of our product candidates. Substantially all of our revenues for the year ended December 31, 2011 were from our collaborations with Allergan and Meiji Seika Pharma as well as our agreements with other parties. We anticipate that collaborations, which provide us with research funding and potential milestone payments and royalties, will continue to be our primary source of revenues for the next several years.

We cannot be certain that the milestones required to trigger payments under our existing collaborations will be reached or that we will secure additional collaboration agreements. To obtain revenues from our product candidates, we must succeed, either alone or with others, in developing, obtaining regulatory approval for, and manufacturing and marketing drugs with significant market potential. We may never succeed in these activities, and may never generate revenues that are significant enough to achieve profitability.

We depend on collaborations with third parties to develop and commercialize selected product candidates and to provide substantially all of our revenues.

A key aspect of our strategy is to selectively enter into collaboration agreements with third parties. We currently rely, and will continue to rely, on our collaborators for financial resources and for development, regulatory, and commercialization expertise for selected product candidates. The ongoing research term of our agreements with Allergan will end in March 2013, unless extended, and additional payments from our agreements with Allergan and Meiji Seika Pharma are dependent on successful advancement of our applicable product candidates. There is no guarantee that revenues from our ongoing collaborations will continue at current or past levels. Given the current economic environment, it is possible that our existing collaborators may elect to reduce their external spending.

Our collaborators may fail to develop or effectively commercialize products using our product candidates or technologies because they:

- do not have sufficient resources or decide not to devote the necessary resources due to internal constraints such as limited cash or human resources or a change in strategic focus;
- decide to pursue a competitive product developed outside of the collaboration; or
- cannot obtain the necessary regulatory approvals.

For example, Allergan has announced that it is seeking a partner for further development and commercialization of drug candidates in our chronic pain program. If Allergan is unable to successfully partner this program, it may elect to not pursue further development. In addition, any partner that Allergan does identify may devote substantially less resources than Allergan has devoted to our chronic pain program to date.

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Each of Meiji Seika Pharma and Allergan can terminate our existing collaborations under specific circumstances, including in some cases the right to terminate without cause upon prior notice. We may not be able to renew our existing collaborations on acceptable terms, if at all. We also face competition in our search for new collaborators, if we seek a new partner for our pimavanserin program. Given the current economic environment, it is possible that competition for new collaborators may increase. If we are unable to renew any existing collaboration or find new collaborations, we may not be able to continue advancing our programs alone.

If we fail to obtain the capital necessary to fund our operations, we will be unable to successfully develop products.

We have consumed substantial amounts of capital since our inception. Our cash, cash equivalents and investment securities totaled approximately $31.0 million at December 31, 2011. While we believe that our existing cash resources and anticipated payments from our existing collaborations will be sufficient to fund our cash requirements at least into the second quarter of 2013, we will require significant additional financing in the future to continue to fund our operations. Our future capital requirements will depend on, and could increase significantly as a result of, many factors including:

- progress in, and the costs of, our preclinical studies and clinical trials and other research and development programs;
- the scope, prioritization and number of our research and development programs;
- the ability of our collaborators and us to reach the milestones, and other events or developments, triggering payments under our collaboration agreements or to otherwise make payments under these agreements;
- the extent to which we are obligated to reimburse our collaborators or our collaborators are obligated to reimburse us for clinical trial costs under our collaboration agreements;
- the costs involved in filing, prosecuting, enforcing and defending patent claims and other intellectual property rights;
- the costs of securing manufacturing arrangements for clinical or commercial production;
- the costs of preparing applications for regulatory approvals for our product candidates;
- the costs of establishing or contracting for sales and marketing capabilities if we obtain regulatory clearances to market our product candidates; and
- the costs associated with litigation.

Until we can generate significant continuing revenues, we expect to satisfy our future cash needs through our existing cash, cash equivalents and investment securities, strategic collaborations, private or public sales of our securities, debt financings, grant funding, or by licensing all or a portion of our product candidates or technology. Turmoil and volatility in the financial markets have adversely affected the market capitalizations of many biotechnology companies, and generally made equity and debt financing more difficult to obtain. This, coupled with other factors, may limit our access to additional financing over the near-term future. This could have a material adverse effect on our ability to access sufficient funding. We cannot be certain that additional funding will be available to us on acceptable terms, if at all. If funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our research or development programs or our commercialization efforts. Additional funding, if obtained, may significantly dilute existing stockholders.

We do not have a partner for the development of our lead product candidate, pimavanserin, and are solely responsible for the advancement of this program.

Following the September 2010 merger of Biovail Corporation with Valeant, we entered into an agreement with Biovail, in October 2010, to end our collaboration regarding North American rights to pimavanserin. This agreement allowed us to regain the rights that we had licensed to Biovail and receive a one-time payment of $8.75 million. Pursuant to the collaboration, Biovail had been responsible for funding development of pimavanserin, and seeking regulatory approval for and any future marketing of pimavanserin in North America. Following the end of the collaboration, we now have full responsibility for the pimavanserin program. We expect our research and development costs for the continued development of pimavanserin to continue to be substantial. While we are continuing to run the ongoing trials for pimavanserin, we would need to add resources and raise additional funds in the future in order to take this product candidate to market, if we do not secure another partner.

Our most advanced product candidates are in clinical trials, which are long, expensive and unpredictable, and there is a high risk of failure.

Preclinical testing and clinical trials are long, expensive and unpredictable processes that can be subject to delays. It may take several years to complete the preclinical testing and clinical development necessary to commercialize a drug, and delays or failure can occur at any stage. Interim results of clinical trials do not necessarily predict final results, and success in preclinical testing and early clinical trials does not ensure that later clinical trials will be successful. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in advanced clinical trials even after promising results in earlier trials.

Our drug development programs are at various stages of development and the historical rate of failures for product candidates is extremely high. In fact, we previously had an unsuccessful Phase III trial with our product candidate, pimavanserin. We are currently conducting the -020 Study, a Phase III trial with pimavanserin for the treatment of Parkinson s disease psychosis that we initiated in the third quarter of 2010. An unfavorable outcome in the -020 Study would be a major set-back for the program and for us, generally. In particular, an unfavorable outcome in this or other studies in our pimavanserin program may require us to delay, reduce the scope of, or eliminate this program and could have a material adverse effect on us and the value of our common stock. In addition to our pimavanserin program, we also have clinical programs in collaboration with Allergan for the treatment of chronic pain and glaucoma, which are in Phase II and Phase I development, respectively, and a clinical program for the treatment of schizophrenia in Phase I development with Meiji Seika Pharma.

In connection with clinical trials, we face risks that:

- a product candidate may not prove to be efficacious;
- patients may die or suffer other adverse effects for reasons that may or may not be related to the product candidate being tested;
- the results may not confirm the positive results of earlier trials; and
- the results may not meet the level of statistical significance required by the FDA or other regulatory agencies.

If we do not successfully complete preclinical and clinical development, we will be unable to market and sell products derived from our product candidates and to generate product revenues. Even if we do successfully complete clinical trials, those results are not necessarily predictive of results of additional trials that may be needed before an NDA may be submitted to the FDA. Of the large number of drugs in development, only a small percentage result in the submission of an NDA to the FDA and even fewer are approved for commercialization.

Delays, suspensions and terminations in our clinical trials could result in increased costs to us and delay our ability to generate product revenues.

The commencement of clinical trials can be delayed for a variety of reasons, including delays in:

- demonstrating sufficient safety and efficacy to obtain regulatory approval to commence a clinical trial;
- reaching agreement on acceptable terms with prospective contract research organizations and clinical trial sites;

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- manufacturing sufficient quantities of a product candidate;
- obtaining clearance from the FDA to commence clinical trials pursuant to an IND;
- obtaining institutional review board approval to conduct a clinical trial at a prospective clinical trial site; and
- patient enrollment, which is a function of many factors, including the size of the patient population, the nature of the protocol, the proximity of patients to clinical trial sites, the availability of effective treatments for the relevant disease and the eligibility criteria for the clinical trial.

Once a clinical trial has begun, it may be delayed, suspended or terminated due to a number of factors, including:

- ongoing discussions with regulatory authorities regarding the scope or design of our clinical trials or requests by them for supplemental information with respect to our clinical trial results;
- failure to conduct clinical trials in accordance with regulatory requirements;
- lower than anticipated screening or retention rates of patients in clinical trials;
- serious adverse events or side effects experienced by participants; and
- insufficient supply or deficient quality of product candidates or other materials necessary for the conduct of our clinical trials.

Many of these factors may also ultimately lead to denial of regulatory approval of a current or potential product candidate. If we experience delays, suspensions or terminations in a clinical trial, the commercial prospects for the related product candidate will be harmed, and our ability to generate product revenues will be delayed.

If conflicts arise with our collaborators, they may act in their self interests, which may be adverse to our interests.

Conflicts may arise in our collaborations due to one or more of the following:

- disputes or breaches with respect to payments that we believe are due under the applicable agreements, particularly in the current economic environment when companies, including large established ones, may be seeking to reduce external payments;
- disputes on strategy as to what development or commercialization activities should be pursued under the applicable agreements;
- disputes as to the responsibility for conducting development and commercialization activities pursuant to the applicable collaboration, including the payment of costs related thereto;
- disagreements with respect to ownership of intellectual property rights;

- unwillingness on the part of a collaborator to keep us informed regarding the progress of its development and commercialization activities, or to permit public disclosure of these activities;

- delay of a collaborator s development or commercialization efforts with respect to our product candidates; or

- termination or non-renewal of the collaboration.

Conflicts arising with our collaborators could impair the progress of our product candidates, harm our reputation, result in a loss of revenues, reduce our cash position, and cause a decline in our stock price.

In addition, in our collaborations, we generally have agreed not to conduct independently, or with any third party, any research that is directly competitive with the research conducted under the applicable program. Our collaborations may have the effect of limiting the areas of research that we may pursue, either alone or with others. Our collaborators, however, may develop, either alone or with others, products in related fields that are competitive with the products or potential products that are the subject of these collaborations. Competing products, either developed by our collaborators or to which our collaborators have rights, may result in the allocation of resources by our competitors to competing products and their withdrawal of support for our product candidates or may otherwise result in lower demand for our potential products.

We have collaborations with Allergan for the development of product candidates related to chronic pain and ophthalmic diseases, including glaucoma. Allergan currently markets therapeutic products to treat glaucoma and is engaged in other research programs related to glaucoma and other ophthalmic products that are independent from our development program in this therapeutic area. Allergan is also pursuing other research programs related to pain management that are independent from our collaboration in this therapeutic area.

Our collaboration with Meiji Seika Pharma is initially focused on the development of AM-831 as a treatment for schizophrenia and related disorders. While Meiji Seika Pharma has rights to AM-831 in the Asian territory, we have the right to pursue the development and commercialization of AM-831, alone or with a partner, in the rest of the world. Meiji Seika Pharma is also pursuing other research and development programs related to schizophrenia that are independent from our collaboration in this therapeutic area.

We rely on third parties to conduct our clinical trials and perform data collection and analysis, which may result in costs and delays that prevent us from successfully commercializing product candidates.

Although we design and manage our current preclinical studies and clinical trials, we currently do not have the ability to conduct clinical trials for our product candidates on our own. In addition to our collaborators, we rely on contract research organizations, medical institutions, clinical investigators, and contract laboratories to perform data collection and analysis and other aspects of our clinical trials. In addition, we also rely on third parties to assist with our preclinical studies, including studies regarding biological activity, safety, absorption, metabolism, and excretion of product candidates.

Our preclinical activities or clinical trials may be delayed, suspended, or terminated if:

- these third parties do not successfully carry out their contractual duties or fail to meet regulatory obligations or expected deadlines;
- these third parties need to be replaced; or
- the quality or accuracy of the data obtained by these third parties is compromised due to their failure to adhere to our clinical protocols or regulatory requirements or for other reasons.

Failure to perform by these third parties may increase our development costs, delay our ability to obtain regulatory approval, and delay or prevent the commercialization of our product candidates. We currently use several contract research organizations to perform services for our preclinical studies and clinical trials. While we believe that there are numerous alternative sources to provide these services, in the event that we seek such alternative sources, we may not be able to enter into replacement arrangements without delays or additional expenditures.

Even if we or our collaborators successfully complete the clinical trials of product candidates, the product candidates may fail for other reasons.

Even if we or our collaborators successfully complete the clinical trials of product candidates, the product candidates may fail for other reasons, including the possibility that the product candidates will:

- fail to receive the regulatory clearances required to market them as drugs;
- be subject to proprietary rights held by others requiring the negotiation of a license agreement prior to marketing;

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- be difficult or expensive to manufacture on a commercial scale;
- have adverse side effects that make their use less desirable; or
- fail to compete with product candidates or other treatments commercialized by competitors.

Our product candidates may not gain acceptance among physicians, patients, and the medical community, thereby limiting our potential to generate revenues.

Even if our product candidates are approved for commercial sale by the FDA or other regulatory authorities, the degree of market acceptance of any approved product candidate by physicians, healthcare professionals and third-party payors, and our profitability and growth will depend on a number of factors, including:

- the ability to provide acceptable evidence of safety and efficacy;
- relative convenience and ease of administration;
- the prevalence and severity of any adverse side effects;
- availability of alternative treatments;
- pricing and cost effectiveness, which may be subject to regulatory control;
- effectiveness of our or our collaborators sales and marketing strategy; and
- our ability to obtain sufficient third-party insurance coverage or reimbursement.

If any product candidate that we discover and/or develop does not provide a treatment regimen that is as beneficial as the current standard of care or otherwise does not provide patient benefit, that product will not achieve market acceptance and we will not generate sufficient revenues to achieve or maintain profitability.

If we are unable to attract, retain, and motivate key management and research and development staff, our drug development programs and our research and discovery efforts may be delayed and we may be unable to successfully develop or commercialize our product candidates.

Our success depends on our ability to attract, retain, and motivate highly qualified management and scientific personnel. In particular, our development programs depend on our ability to attract and retain highly skilled development personnel, especially in the fields of central nervous system disorders, including neuropsychiatric and related disorders. In the future, we may need to hire additional personnel if we expand our research and development efforts from our current levels. We face competition for experienced scientists, clinical operations personnel, and other technical personnel from numerous companies and academic and other research institutions. Competition for qualified personnel is particularly intense in the San Diego, California area. If we are unable to attract and retain the necessary personnel, this will significantly impede the achievement of our research and development objectives and our ability to meet the demands of our collaborators in a timely fashion.

All of our employees are at will employees, which means that any employee may quit at any time and we may terminate any employee at any time. We do not carry key person insurance covering members of senior management.

We do not know whether our drug discovery platform will lead to the discovery or development of commercially viable product candidates.

Our drug discovery platform uses new and unproven methods to identify and develop product candidates. We have never successfully completed clinical development of any of our product candidates, and there are no drugs on the market that have been discovered using our drug discovery platform.

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Our research and development focuses on small molecule drugs for the treatment of central nervous system disorders. Due to our limited resources, we may have to forego potential opportunities with respect to discovering product candidates to treat diseases or conditions in other therapeutic areas. If we are not able to use our technologies to discover and develop product candidates that can be commercialized, we may not achieve profitability. In the future, we may find it necessary to license the technology of others or acquire additional product candidates to augment the results of our internal discovery activities. If we are unable to identify new product candidates using our drug discovery platform, we may be unable to establish or maintain a clinical development pipeline or generate product revenues.

We may not be able to continue or fully exploit our collaborations with outside scientific and clinical advisors, which could impair the progress of our clinical trials and our research and development efforts.

We work with scientific and clinical advisors at academic and other institutions who are experts in the field of central nervous system disorders. They assist us in our research and development efforts and advise us with respect to our clinical trials. These advisors are not our employees and may have other commitments that would limit their future availability to us. Although our scientific and clinical advisors generally agree not to engage in competing work, if a conflict of interest arises between their work for us and their work for another entity, we may lose their services, which may impair our reputation in the industry and delay the development or commercialization of our product candidates.

We will need to continue to manage our organization and we may encounter difficulties with our reduced staffing and any future transitions, which could adversely affect our results of operations.

We will need to effectively manage our operations and facilities in order to advance our drug development programs, including those covered by our collaborations with Allergan and Meiji Seika Pharma, achieve milestones under our collaboration agreements, facilitate additional collaborations, and pursue other development activities. It is possible that our infrastructure may be inadequate to support our future efforts and growth. In particular, we may have to develop internal sales, marketing, and distribution capabilities if we decide to market any drug that we may successfully develop. We may not successfully manage our operations and, accordingly, may not achieve our research, development, and commercialization goals.

We expect that our results of operations will fluctuate, which may make it difficult to predict our future performance from period to period.

Our quarterly operating results have fluctuated in the past and are likely to do so in the future. Some of the factors that could cause our operating results to fluctuate from period to period include:

- the status of development of pimavanserin and our other product candidates, including compounds being developed under our collaborations;
- whether we generate revenues or reimbursements by achieving specified research, development or commercialization milestones under any agreements or otherwise receive potential payments under these agreements;
- whether we are required to make payments due to achieving specified milestones under any licensing or similar agreements or otherwise make potential payments under these agreements;
- the incurrence of preclinical or clinical expenses that could fluctuate significantly from period to period, including reimbursement obligations pursuant to our collaboration agreements;
- the initiation, termination, or reduction in the scope of our collaborations or any disputes regarding these collaborations;
- the timing of our satisfaction of applicable regulatory requirements;

the rate of expansion of our clinical development and other internal research and development efforts;

- the effect of competing technologies and products and market developments;
- the costs associated with litigation; and
- general and industry-specific economic conditions.

We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as indications of our future performance.

Relying on third-party manufacturers may result in delays in our clinical trials and product introductions.

We have no manufacturing facilities and have no experience in the manufacturing of drugs or in designing drug-manufacturing processes. We have contracted with third-party manufacturers to produce, in collaboration with us, our product candidates for clinical trials. If any of our product candidates are approved by the FDA or other regulatory agencies for commercial sale, we may need to contract with a third party to manufacture them in larger quantities. We currently use third-party manufacturers to produce clinical supplies of our compounds for us, including pimavanserin. While we believe that there are alternative sources available to manufacture our product candidates, in the event that we seek such alternative sources, we may not be able to enter into replacement arrangements without delays or additional expenditures. We cannot estimate these delays or costs with certainty but, if they were to occur, they could cause a delay in our development and commercialization efforts.

The manufacturers of our product candidates are obliged to operate in accordance with FDA-mandated current good manufacturing practices, or cGMPs. A failure of any of our contract manufacturers to establish and follow cGMPs and to document their adherence to such practices may lead to significant delays in clinical trials or in obtaining regulatory approval of product candidates or the ultimate launch of products based on our product candidates into the market. Failure by our third-party manufacturers or us to comply with applicable regulations could result in sanctions being imposed on us, including fines, injunctions, civil penalties, failure of the government to grant pre-market approval of drugs, delays, suspension or withdrawal of approvals, seizures or recalls of products, operating restrictions, and criminal prosecutions.

Our management has broad discretion over the use of our cash and we may not use our cash effectively, which could adversely affect our results of operations.

Our management has significant flexibility in applying our cash resources and could use these resources for corporate purposes that do not increase our market value, or in ways with which our stockholders may not agree. We may use our cash resources for corporate purposes that do not yield a significant return or any return at all for our stockholders, which may cause our stock price to decline.

We have incurred, and expect to continue to incur, significant costs as a result of laws and regulations relating to corporate governance and other matters.

Laws and regulations affecting public companies, including provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act that was enacted in July 2010, the provisions of the Sarbanes-Oxley Act of 2002, or SOX, and rules adopted or proposed by the SEC and by The Nasdaq Global Market, have resulted in, and will continue to result in, significant costs to us as we evaluate the implications of these rules and respond to their requirements. We issued an evaluation of our internal control over financial reporting under Section 404 of SOX with our Annual Report. In the future, if we are not able to issue an evaluation of our internal control over financial reporting as required or we or our independent registered public accounting firm determine that our internal control over financial reporting is not effective, this shortcoming could have an adverse effect on our business and financial results and the price of our common stock could be negatively affected. New rules could make it more difficult or more costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially

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higher costs to obtain the coverage that is the same or similar to our current coverage. The impact of these events could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors and board committees, and as our executive officers. We cannot predict or estimate the total amount of the costs we may incur or the timing of such costs to comply with these rules and regulations.

Healthcare legislation may make it more difficult to receive revenues, if we have products that are approved.

In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or collectively, PPACA, became law in the United States. PPACA substantially changes the way healthcare is financed by both governmental and private insurers and significantly affects the healthcare industry. Among the provisions of PPACA of importance to our potential product candidates are the following:

- expansion of health care fraud and abuse laws, including the False Claims Act and the Anti-Kickback Statute, new government investigative powers, and enhanced penalties for noncompliance;
- a new Medicare Part D coverage gap discount program, in which manufacturers must agree to offer 50% point-of-sale discounts off negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer s outpatient drugs to be covered under Medicare Part D;
- extension of manufacturers Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations;
- expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals beginning in 2014 and by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level, thereby potentially increasing manufacturers Medicaid rebate liability;
- expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program;
- new requirements to report certain financial arrangements with physicians, including reporting any payments or transfers of value made or distributed to prescribers, teaching hospitals and other healthcare providers, beginning March 31, 2013, and reporting any investment interests held by physicians and their immediate family members during the preceding calendar year;
- a new requirement to annually report drug samples that manufacturers and distributors provide to physicians, effective April 1, 2012; and
- a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research.

We expect that PPACA, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria and in additional downward pressure on the price that we receive for any approved product, and could seriously harm our future revenues. Any reduction in reimbursement from Medicare or other government programs may result in a similar reduction in payments from private payors.

If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to sell and market any products we may develop, we may not be able to generate product revenue.

We do not currently have an organization for the sales, marketing and distribution of pharmaceutical products. In order to market any products that may be approved by the FDA, we must build our sales, marketing, managerial, and related capabilities or make arrangements with third parties to perform these services. If we are unable to establish adequate sales, marketing, and distribution capabilities, whether independently or with third parties, we may not be able to generate product revenue and may not become profitable.

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If we engage in any acquisition, we will incur a variety of costs and may never realize the anticipated benefits of the acquisition.

We may attempt to acquire businesses, technologies, services, or products or license in technologies that we believe are a strategic fit with our business. We have limited experience in identifying acquisition targets, successfully completing proposed acquisitions and integrating any acquired businesses, technologies, services or products into our current infrastructure. The process of integrating any acquired business, technology, service, or product may result in unforeseen operating difficulties and expenditures and may divert significant management attention from our ongoing business operations. As a result, we will incur a variety of costs in connection with an acquisition and may never realize its anticipated benefits.

Earthquake or fire damage to our facilities could delay our research and development efforts and adversely affect our business.

Our headquarters and research and development facilities in San Diego are located in a seismic zone, and there is the possibility of an earthquake, which could be disruptive to our operations and result in delays in our research and development efforts. In addition, while our facilities have not been adversely impacted by local wildfires, there is the possibility of future fires in the area. In the event of an earthquake or fire, if our facilities or the equipment in our facilities is significantly damaged or destroyed for any reason, we may not be able to rebuild or relocate our facilities or replace any damaged equipment in a timely manner and our business, financial condition, and results of operations could be materially and adversely affected. We do not have insurance for damages resulting from earthquakes. While we do have fire insurance for our property and equipment located in San Diego, any damage sustained in a fire could cause a delay in our research and development efforts and our results of operations could be materially and adversely affected.

Risks Related to Our Intellectual Property

Our ability to compete may decline if we do not adequately protect our proprietary rights.

Our commercial success depends on obtaining and maintaining proprietary rights to our product candidates and technologies and their uses, as well as successfully defending these rights against third-party challenges. We will only be able to protect our product candidates, proprietary technologies, and their uses from unauthorized use by third parties to the extent that valid and enforceable patents, or effectively protected trade secrets, cover them. Although we have filed numerous patent applications worldwide with respect to pimavanserin, we have not been issued patents with respect to each of our filings.

Our ability to obtain patent protection for our product candidates and technologies is uncertain due to a number of factors, including:

- we may not have been the first to make the inventions covered by our pending patent applications or issued patents;
- we may not have been the first to file patent applications for our product candidates or the technologies we rely upon;
- others may independently develop similar or alternative technologies or duplicate any of our technologies;
- our disclosures in patent applications may not be sufficient to meet the statutory requirements for patentability;
- any or all of our pending patent applications may not result in issued patents;
- we may not seek or obtain patent protection in all countries that will eventually provide a significant business opportunity;

any patents issued to us or our collaborators may not provide a basis for commercially viable products, may not provide us with any competitive advantages or may be challenged by third parties;

- our proprietary technologies may not be patentable;
- others may design around our patent claims to produce competitive products which fall outside of the scope of our patents;
- others may identify prior art which could invalidate our patents; or
- changes to patent laws that limit the exclusivity rights of patent holders.

Even if we have or obtain patents covering our product candidates or technologies, we may still be barred from making, using and selling our product candidates or technologies because of the patent rights of others. Others have or may have filed, and in the future are likely to file, patent applications covering compounds, assays, genes, gene products or therapeutic products that are similar or identical to ours. There are many issued U.S. and foreign patents relating to genes, nucleic acids, polypeptides, chemical compounds or therapeutic products, and some of these may encompass reagents utilized in the identification of candidate drug compounds or compounds that we desire to commercialize. Numerous U.S. and foreign issued patents and pending patent applications owned by others exist in the area of central nervous system disorders and the other fields in which we are developing products. These could materially affect our ability to develop our product candidates or sell our products. Because patent applications can take many years to issue, there may be currently pending applications, unknown to us, that may later result in issued patents that our product candidates or technologies may infringe. These patent applications may have priority over patent applications filed by us.

We regularly conduct searches to identify patents or patent applications that may prevent us from obtaining patent protection for our proprietary compounds or that could limit the rights we have claimed in our patents and patent applications. Disputes may arise regarding the ownership or inventorship of our inventions. It is difficult to determine how such disputes would be resolved. Others may challenge the validity of our patents. If our patents are found to be invalid, we will lose the ability to exclude others from making, using or selling the inventions claimed therein.

Some of our academic institutional licensors, research collaborators and scientific advisors have rights to publish data and information to which we have rights. If we cannot maintain the confidentiality of our technology and other confidential information in connection with our collaborations, then our ability to receive patent protection or protect our proprietary information will be impaired. Additionally, employees whose positions were eliminated in connection with restructurings may seek future employment with our competitors. Although each of our employees is required to sign a confidentiality agreement with us at the time of hire, we cannot guarantee that the confidential nature of our proprietary information will be maintained in the course of such future employment. In addition, technology that we may license in may become important to some aspects of our business. We generally will not control the patent prosecution, maintenance or enforcement of in-licensed technology.

Confidentiality agreements with employees and others may not adequately prevent disclosure of our trade secrets and other proprietary information and may not adequately protect our intellectual property, which could limit our ability to compete.

Because we operate in the highly technical field of drug discovery and development of small molecule drugs, we rely in part on trade secret protection in order to protect our proprietary technology and processes. However, trade secrets are difficult to protect. We enter into confidentiality and intellectual property assignment agreements with our corporate partners, employees, consultants, outside scientific collaborators, sponsored researchers, and other advisors. These agreements generally require that the other party keep confidential and not disclose to third parties all confidential information developed by the party or made known to the party by us during the course of the party s relationship with us. These agreements also generally provide that inventions conceived by the party in the course of rendering services to us will be our exclusive property. However, these agreements may not be honored and may not effectively assign intellectual property rights to us. Enforcing a

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claim that a party illegally obtained and is using our trade secrets is difficult, expensive and time consuming and the outcome is unpredictable. In addition, courts outside the United States may be less willing to protect trade secrets. The failure to obtain or maintain trade secret protection could adversely affect our competitive position. In addition, we have not entered into any noncompete agreements with any of our employees.

A dispute concerning the infringement or misappropriation of our proprietary rights or the proprietary rights of others could be time consuming and costly, and an unfavorable outcome could harm our business.

There is significant litigation in our industry regarding patent and other intellectual property rights. While we are not currently subject to any pending intellectual property litigation, and are not aware of any such threatened litigation, we may be exposed to future litigation by third parties based on claims that our product candidates, technologies or activities infringe the intellectual property rights of others. In particular, there are many patents relating to specific genes, nucleic acids, polypeptides or the uses thereof to identify product candidates. Some of these may encompass genes or polypeptides that we utilize in our drug development activities. If our drug development activities are found to infringe any such patents, we may have to pay significant damages or seek licenses to such patents. A patentee could prevent us from using the patented genes or polypeptides for the identification or development of drug compounds. There are also many patents relating to chemical compounds and the uses thereof. If our compounds are found to infringe any such patents, we may have to pay significant damages or seek licenses to such patents. A patentee could prevent us from making, using or selling the patented compounds. We may need to resort to litigation to enforce a patent issued to us, protect our trade secrets or determine the scope and validity of third-party proprietary rights. From time to time, we may hire scientific personnel formerly employed by other companies involved in one or more areas similar to the activities conducted by us. Either we or these individuals may be subject to allegations of trade secret misappropriation or other similar claims as a result of their prior affiliations. If we become involved in litigation, it could consume a substantial portion of our managerial and financial resources, regardless of whether we win or lose. We may not be able to afford the costs of litigation. Any legal action against us or our collaborators could lead to:

- payment of damages, potentially treble damages, if we are found to have willfully infringed a party s patent rights;

- injunctive or other equitable relief that may effectively block our ability to further develop, commercialize, and sell products; or

- we or our collaborators having to enter into license arrangements that may not be available on commercially acceptable terms, if at all.

As a result, we could be prevented from commercializing current or future products.

The patent applications of pharmaceutical and biotechnology companies involve highly complex legal and factual questions, which, if determined adversely to us, could negatively impact our patent position.

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions. For example, some of our patent applications will cover gene sequences and products and the uses of those gene sequences and products. Public disclosures and patent applications related to the Human Genome Project and other genomics efforts may limit the scope of our claims or make unpatentable subsequent patent applications. No consistent policy regarding the breadth of claims allowed in biotechnology patents has emerged to date. The United States Patent and Trademark Office s standards are uncertain and could change in the future. Consequently, the issuance and scope of patents cannot be predicted with certainty. Patents, if issued, may be challenged, invalidated or circumvented. U.S. patents and patent applications may also be subject to interference proceedings, and U.S. patents may be subject to reexamination proceedings in the United States Patent and Trademark Office (and foreign patents may be subject to opposition or comparable proceedings in the corresponding foreign patent office), which proceedings could result in either loss of the patent or denial of the patent application or loss or reduction in the scope of one or more of the claims of the

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patent or patent application. In addition, such interference, reexamination and opposition proceedings may be costly. Accordingly, rights under any issued patents may not provide us with sufficient protection against competitive products or processes.

In addition, changes in or different interpretations of patent laws in the United States and foreign countries may permit others to use our discoveries or to develop and commercialize our technology and products without providing any compensation to us or may limit the number of patents or claims we can obtain. In particular, there have been proposals to shorten the exclusivity periods available under U.S. patent law that, if adopted, could substantially harm our business. The product candidates that we are developing are protected by intellectual property rights, including patents and patent applications. If any of our product candidates becomes a marketable product, we will rely on our exclusivity under patents to sell the compound and recoup our investments in the research and development of the compound. If the exclusivity period for patents is shortened, then our ability to generate revenues without competition will be reduced and our business could be materially adversely impacted. The laws of some countries do not protect intellectual property rights to the same extent as U.S. laws and those countries may lack adequate rules and procedures for defending our intellectual property rights. For example, some countries, including many in Europe, do not grant patent claims directed to methods of treating humans and, in these countries, patent protection may not be available at all to protect our product candidates. In addition, U.S. patent laws may change which could prevent or limit us from filing patent applications or patent claims to protect our products and/or technologies or limit the exclusivity periods that are available to patent holders. For example, the Leahy-Smith America Invents Act, or the Leahy-Smith Act, was recently signed into law and includes a number of significant changes to U.S. patent law. These include changes to transition from a first-to-invent system to a first-to-file system and to the way issued patents are challenged. These changes may favor larger and more established companies that have more resources to devote to patent application filing and prosecution. The U.S. Patent and Trademark Office is currently developing regulations and procedures to administer the Leahy-Smith Act, and many of the substantive changes to patent law associated with the Leahy-Smith Act will not become effective until one year or 18 months after its enactment. Accordingly, it is not clear what, if any, impact the Leahy-Smith Act will ultimately have on the cost of prosecuting our patent applications, our ability to obtain patents based on our discoveries and our ability to enforce or defend our issued patents.

If we fail to obtain and maintain patent protection and trade secret protection of our product candidates, proprietary technologies and their uses, we could lose our competitive advantage and competition we face would increase, reducing our potential revenues and adversely affecting our ability to attain or maintain profitability.

Risks Related to Our Industry

We will be subject to stringent regulation in connection with the marketing of any products derived from our product candidates, which could delay the development and commercialization of our products.

The pharmaceutical industry is subject to stringent regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in other countries. Neither we nor our collaborators can market a pharmaceutical product in the United States until it has completed rigorous preclinical testing and clinical trials and an extensive regulatory clearance process implemented by the FDA. Satisfaction of regulatory requirements typically takes many years, depends upon the type, complexity and novelty of the product, and requires substantial resources. Even if regulatory approval is obtained, it may impose significant restrictions on the indicated uses, conditions for use, labeling, advertising, promotion, and/or marketing of such products, and requirements for post-approval studies, including additional research and development and clinical trials. These limitations may limit the size of the market for the product or result in the incurrence of additional costs. Any delay or failure in obtaining required approvals could have a material adverse effect on our ability to generate revenues from the particular product candidate.

Outside the United States, the ability to market a product is contingent upon receiving approval from the appropriate regulatory authorities. The requirements governing the conduct of clinical trials, marketing authorization, pricing, and reimbursement vary widely from country to country. Only after the appropriate regulatory authority is satisfied that adequate evidence of safety, quality, and efficacy has been presented will it grant a marketing authorization. Approval by the FDA does not automatically lead to the approval by regulatory authorities outside the United States and, similarly, approval by regulatory authorities outside the United States will not automatically lead to FDA approval.

In addition, U.S. and foreign government regulations control access to and use of some human or other tissue samples in our research and development efforts. U.S. and foreign government agencies may also impose restrictions on the use of data derived from human or other tissue samples. Accordingly, if we fail to comply with these regulations and restrictions, the commercialization of our product candidates may be delayed or suspended, which may delay or impede our ability to generate product revenues.

If our competitors develop and market products that are more effective than our product candidates, they may reduce or eliminate our commercial opportunity.

Competition in the pharmaceutical and biotechnology industries is intense and expected to increase. We face competition from pharmaceutical and biotechnology companies, as well as numerous academic and research institutions and governmental agencies, both in the United States and abroad. Some of these competitors have products or are pursuing the development of drugs that target the same diseases and conditions that are the focus of our drug development programs.

For example, our potential product for Parkinson s disease psychosis would compete with off-label use of antipsychotic drugs, including Seroquel, marketed by Astra-Zeneca, and with the generic drug clozapine. Our potential products for the treatment of schizophrenia would compete with Zyprexa, marketed by Eli Lilly, Fanapt marketed by Novartis Pharmaceuticals, Risperdal, marketed by Johnson & Johnson, Abilify, marketed jointly by Bristol-Myers Squibb and Otsuka Pharmaceutical, Seroquel, and clozapine. Our potential product for Alzheimer s disease psychosis would compete with off-label use of antipsychotic drugs. In the area of chronic pain, potential products would compete with Neurontin and Lyrica, marketed by Pfizer, and Cymbalta, marketed by Eli Lilly, as well as a variety of generic or proprietary opioids. Our potential products for the treatment of glaucoma would compete with Xalatan, marketed by Pfizer, and Lumigan and Alphagan, marketed by Allergan.

Many of our competitors and their collaborators have significantly greater experience than we do in the following:

- identifying and validating targets;
- screening compounds against targets;
- preclinical studies and clinical trials of potential pharmaceutical products; and
- obtaining FDA and other regulatory approvals.

In addition, many of our competitors and their collaborators have substantially greater capital and research and development resources, manufacturing, sales and marketing capabilities, and production facilities. Smaller companies also may prove to be significant competitors, particularly through proprietary research discoveries and collaboration arrangements with large pharmaceutical and established biotechnology companies. Many of our competitors have products that have been approved or are in advanced development and may develop superior technologies or methods to identify and validate drug targets and to discover novel small molecule drugs. Our competitors, either alone or with their collaborators, may succeed in developing drugs that are more effective, safer, more affordable, or more easily administered than ours and may achieve patent protection or commercialize drugs sooner than us. Our competitors may also develop alternative therapies that could further limit the market for any drugs that we may develop. Our failure to compete effectively could have a material adverse affect on our business.

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Any claims relating to improper handling, storage, or disposal of biological, hazardous, and radioactive materials used in our business could be costly and delay our research and development efforts.

Our research and development activities involve the controlled use of potentially harmful hazardous materials, including volatile solvents, biological materials such as blood from patients that has the potential to transmit disease, chemicals that cause cancer, and various radioactive compounds. Our operations also produce hazardous waste products. We face the risk of contamination or injury from the use, storage, handling or disposal of these materials. We are subject to federal, state and local laws and regulations governing the use, storage, handling, and disposal of these materials and specified waste products. The cost of compliance with these laws and regulations could be significant, and current or future environmental regulations may impair our research, development, or production efforts. If one of our employees were accidentally injured from the use, storage, handling, or disposal of these materials, the medical costs related to his or her treatment would be covered by our workers compensation insurance policy. However, we do not carry specific biological or hazardous waste insurance coverage and our general liability insurance policy specifically excludes coverage for damages and fines arising from biological or hazardous waste exposure or contamination. Accordingly, in the event of contamination or injury, we could be subject to criminal sanctions or fines or be held liable for damages, our operating licenses could be revoked, or we could be required to suspend or modify our operations and our research and development efforts.

Consumers may sue us for product liability, which could result in substantial liabilities that exceed our available resources and damage our reputation.

Researching, developing, and commercializing drug products entails significant product liability risks. Liability claims may arise from our and our collaborators use of products in clinical trials and the commercial sale of those products. Consumers may make these claims directly and our collaborators or others selling these products may seek contribution from us if they receive claims from consumers. Although we currently have product liability insurance that covers our clinical trials, we will need to increase and expand this coverage as we commence larger scale trials and if our product candidates are approved for commercial sale. This insurance may be prohibitively expensive or may not fully cover our potential liabilities. Inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or inhibit the commercialization of products that we or our collaborators develop. Product liability claims could have a material adverse effect on our business and results of operations. Our liability could exceed our total assets if we do not prevail in a lawsuit from any injury caused by our drug products.

Risks Related to Our Common Stock

Our stock price may be particularly volatile because we are a drug discovery and development company.

The market prices for securities of biotechnology companies in general, and drug discovery and development companies in particular, have been highly volatile and may continue to be highly volatile in the future. The following factors, in addition to other risk factors described in this section, may have a significant impact on the market price of our common stock:

- the development status of our product candidates, including results of our clinical trials for our pimavanserin program or our schizophrenia, chronic pain or glaucoma collaborations;
- the initiation, termination, or reduction in the scope of our collaborations or any disputes or developments regarding our collaborations;
- market conditions or trends related to biotechnology and pharmaceutical industries, or the market in general;
- announcements of technological innovations, new commercial products, or other material events by our competitors or us;
- disputes or other developments concerning our proprietary rights;

changes in, or failure to meet, securities analysts or investors expectations of our financial performance;

our failure to meet applicable Nasdaq listing standards and the possible delisting of our common stock from the Nasdaq Global Market;

additions or departures of key personnel;

discussions of our business, products, financial performance, prospects, or stock price by the financial and scientific press and online investor communities such as blogs and chat rooms;

public concern as to, and legislative action with respect to, genetic testing or other research areas of biopharmaceutical companies, the pricing and availability of prescription drugs, or the safety of drugs and drug delivery techniques;

regulatory developments in the United States and in foreign countries;

the announcement of, or developments in, any litigation matters; and

economic and political factors, including but not limited to economic and financial crises, wars, terrorism, and political unrest.

In particular, our development program with pimavanserin encompasses a number of studies, including Phase III efficacy trials, open-label safety extension trials and a range of supporting studies, including carcinogenicity studies, and drug-drug interaction studies. Another unfavorable outcome in one or more of the studies in the development of pimavanserin could be a major set-back for our company, generally. Such an unfavorable outcome could have a material adverse effect on our company and the value of our common stock.

In the past, following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. We may become subject to this type of litigation, which is often extremely expensive and diverts management s attention.

If we or our stockholders sell substantial amounts of our common stock, the market price of our common stock may decline.

A significant number of shares of our common stock are held by a small number of stockholders. Sales of a significant number of shares of our common stock, or the expectation that such sales may occur, could significantly reduce the market price of our common stock. We filed a registration statement in connection with a private financing that we concluded in January 2011, which registration covers approximately 17.0 million shares of our common stock. We also have effective registration statements to sell shares of our common stock on our own behalf, and may elect to sell shares pursuant to such registrations from time to time, as we did, in April 2011, pursuant to the termination agreement we entered into regarding the lease of a facility in Sweden. Our stock price may decline as a result of the sale of the shares of our common stock included in any of these registration statements.

If the price of our common stock trades below $1.00 per share for a sustained period or we do not meet other continued listing requirements, our common stock may be delisted from the Nasdaq Global Market.

The Nasdaq Global Market imposes, among other requirements, listing maintenance standards as well as minimum bid and public float requirements. In particular, Nasdaq rules require us to maintain a minimum bid price of $1.00 per share of our common stock and to have a specified level of stockholder equity. If the closing bid price of our common stock is below $1.00 per share for 30 consecutive trading days, which was the case in 2010, or we do not meet other requirements, which was the case in 2010 when we failed to meet the minimum market value listing requirement, we would fail to be in compliance with Nasdaq s continued listing standards and, if we are unable to cure the non-compliance within 180 days, our common stock may be delisted from the

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Nasdaq Global Market and we may not be able to maintain the continued listing of our common stock on the Nasdaq Global Market. Delisting could adversely affect the market liquidity of our common stock and the market price of our common stock could decrease. Such delisting could also adversely affect our ability to obtain financing for the continuation of our operations.

If our officers, directors, and largest stockholders choose to act together, they may be able to significantly influence our management and operations, acting in their best interests and not necessarily those of our other stockholders.

Our directors, executive officers and holders of five percent or more of our outstanding common stock and their affiliates beneficially own a substantial portion of our outstanding common stock. As a result, these stockholders, acting together, have the ability to significantly influence all matters requiring approval by our stockholders, including the election of all of our board members, amendments to our certificate of incorporation, going-private transactions, and the approval of mergers or other business combination transactions. The interests of this group of stockholders may not always coincide with the company s interests or the interests of other stockholders and they may act in a manner that advances their best interests and not necessarily those of our other stockholders.

Anti-takeover provisions in our charter documents and under Delaware law may make an acquisition of us more complicated and may make the removal and replacement of our directors and management more difficult.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may delay or prevent a change in control, discourage bids at a premium over the market price of our common stock and adversely affect the market price of our common stock and the voting and other rights of the holders of our common stock. These provisions may also make it difficult for stockholders to remove and replace our board of directors and management. These provisions:

- establish that members of the board of directors may be removed only for cause upon the affirmative vote of stockholders owning at least a majority of our capital stock;
- authorize the issuance of blank check preferred stock that could be issued by our board of directors to increase the number of outstanding shares and prevent or delay a takeover attempt;
- limit who may call a special meeting of stockholders;
- establish advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon at stockholder meetings;
- prohibit our stockholders from making certain changes to our amended and restated certificate of incorporation or amended and restated bylaws except with 66 $^{2}/_{3}$ percent stockholder approval; and
- provide for a board of directors with staggered terms.

We are also subject to provisions of the Delaware corporation law that, in general, prohibit any business combination with a beneficial owner of 15 percent or more of our common stock for three years unless the holder s acquisition of our stock was approved in advance by our board of directors. Although we believe these provisions collectively provide for an opportunity to receive higher bids by requiring potential acquirors to negotiate with our board of directors, they would apply even if the offer may be considered beneficial by some stockholders.

Adverse securities and credit market conditions may significantly affect our ability to raise capital.

Turmoil and volatility in the financial markets have adversely affected the market capitalizations of many biotechnology companies, and generally made equity and debt financing more difficult to obtain. This, coupled

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with other factors, may limit access to financing over the near-term future. This could have a material adverse effect on our ability to access funding on acceptable terms, or at all, and our stock price may suffer further as a result.

Item 1B. ***Unresolved Staff Comments.***

This item is not applicable.

Item 2. ***Properties.***

Our primary facility consists of approximately 29,000 square feet of leased research and office space located in San Diego, California, which is leased through the end of 2012 with an option to extend. We also lease another facility in San Diego that covers approximately 8,000 square feet of laboratory, office, and other space. That lease runs through November 2012, with an option to extend. We believe that our existing facilities are adequate for our current needs.

Item 3. ***Legal Proceedings.***

This item is not applicable.

Item 4. ***Mine Safety Disclosures.***

This item is not applicable.

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PART II

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

(a) Our common stock is traded on the NASDAQ Global Market under the symbol ACAD . The following table sets forth the high and low sale prices for our common stock as reported on the NASDAQ Global Market for the periods indicated.

2011	**High**	**Low**
First Quarter	$ 1.88	$ 1.12
Second Quarter	$ 3.30	$ 1.48
Third Quarter	$ 1.90	$ 0.99
Fourth Quarter	$ 1.35	$ 0.90
2010		
First Quarter	$ 1.75	$ 1.21
Second Quarter	$ 2.00	$ 1.00
Third Quarter	$ 1.42	$ 0.91
Fourth Quarter	$ 1.50	$ 0.65

As of March 1, 2012, there were approximately 48 stockholders of record of our common stock. We have not paid any cash dividends to date and do not anticipate any being paid in the foreseeable future.

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Item 6. ***Selected Financial Data.***

The following data has been derived from our audited financial statements, including the consolidated balance sheets at December 31, 2011 and 2010 and the related consolidated statements of operations for the three years ended December 31, 2011 and related notes appearing elsewhere in this report. The statement of operations data for the years ended December 31, 2008 and 2007 and the balance sheet data as of December 31, 2009, 2008 and 2007 are derived from our audited consolidated financial statements that are not included in this report. You should read the selected financial data set forth below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and related notes included elsewhere in this report.

	Years Ended December 31,				
	2011	**2010 (1)**	**2009**	**2008**	**2007**
	(In thousands, except per share data)				
Consolidated Statement of Operations Data:					
Revenues:					
Collaborative revenues	$ 2,067	$ 42,135	$ 6,399	$ 1,590	$ 7,555
Operating expenses:					
Research and development	17,309	20,579	41,585	56,750	57,942
General and administrative	7,610	6,462	10,282	11,818	12,267
Total operating expenses	24,919	27,041	51,867	68,568	70,209
Income (loss) from operations	(22,852)	15,094	(45,468)	(66,978)	(62,654)
Interest income, net	87	45	323	2,734	6,264
Net income (loss)	$ (22,765)	$ 15,139	$ (45,145)	$ (64,244)	$ (56,390)
Net income (loss) per common share, basic	$ (0.44)	$ 0.39	$ (1.20)	$ (1.73)	$ (1.60)
Net income (loss) per common share, diluted	$ (0.44)	$ 0.39	$ (1.20)	$ (1.73)	$ (1.60)
Weighted average shares used in computing net income (loss) per common share, basic	52,183	38,593	37,476	37,113	35,211
Weighted average shares used in computing net income (loss) per common share, diluted	52,183	38,720	37,476	37,113	35,211

(1) As described in Note 6 of the notes to our consolidated financial statements appearing elsewhere in this report, in October 2010 we ended a collaboration agreement with Biovail and recognized all remaining revenues related to this collaboration agreement, resulting in net income for us for the year ended December 31, 2010.

	At December 31,				
	2011	**2010**	**2009**	**2008**	**2007**
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash, cash equivalents and investment securities	$ 31,048	$ 37,087	$ 47,060	$ 60,083	$ 126,858
Working capital	25,784	31,890	33,766	51,331	111,966
Total assets	32,114	38,394	49,680	64,677	134,584
Long-term debt, less current portion		32	98	430	1,156
Total stockholders equity	23,362	29,688	12,114	52,992	113,934

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

The following discussion and analysis of our consolidated financial condition and results of operations should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report. Past operating results are not necessarily indicative of results that may occur in future periods. This discussion contains forward-looking statements, which involve a number of risks and uncertainties. Such forward-looking statements include statements about our strategies, objectives, expectations, discoveries, collaborations, clinical trials, proprietary and external programs, products or product candidates, and other statements that are not historical facts, including statements which may be preceded by the words believes, expects, hopes, may, will, plans, intends, estimates, could, should, would, contin projects, predicts, pro forma, anticipates, potential or similar words. For forward-looking statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. Readers of this report are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date on which they are made. We undertake no obligation to update or revise publicly any forward-looking statements. Forward-looking statements are not guarantees of performance. Actual results or events may differ materially from those anticipated in our forward-looking statements as a result of various factors, including those set forth under the section captioned Risk Factors elsewhere in this report. Information in the following discussion for a yearly period means for the year ended December 31 of the indicated year.

Overview

Background

We are a biopharmaceutical company focused on innovative small molecule drugs that address unmet medical needs in neurological and related central nervous system disorders. We have four product candidates in clinical development led by pimavanserin, which is in Phase III development as a potential first-in-class treatment for Parkinson s disease psychosis. We hold worldwide commercialization rights to pimavanserin. In addition, we have a product candidate in Phase II development for chronic pain and a product candidate in Phase I development for glaucoma, both in collaboration with Allergan, and a product candidate in Phase I development for schizophrenia in collaboration with Meiji Seika Pharma. All of the product candidates in our pipeline emanate from discoveries made using our proprietary drug discovery platform.

We have incurred substantial operating losses since our inception due in large part to expenditures for our research and development activities. As of December 31, 2011, we had an accumulated deficit of $346.9 million. We expect to continue to incur operating losses for at least the next several years as we pursue the clinical development of our product candidates.

Revenues

We have not generated any revenues from product sales to date and we do not expect to generate revenues from product sales for at least the next several years, if at all. Our revenues to date have been generated substantially from payments under our current and past collaboration agreements. As of December 31, 2011, we had received an aggregate of $112.5 million in payments under these agreements, including upfront payments, research funding, milestone payments and reimbursed development expenses. We expect our revenues for the next several years to consist primarily of revenues derived from payments under our current agreements with Allergan and Meiji Seika Pharma and potential additional collaborations, as well as grant funding.

We currently are a party to three separate collaboration agreements with Allergan. Pursuant to our March 2003 collaboration agreement with Allergan, we had received an aggregate of $18.5 million in payments as of December 31, 2011, consisting of an upfront payment, research funding and related fees. This collaboration agreement is currently focused on the discovery of new therapeutics for ophthalmic indications and originally provided for a three-year research term, which has been extended by the parties through March 2013. Our two other collaboration agreements with Allergan involve the development of product candidates in the areas of

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chronic pain and glaucoma. We are eligible to receive payments upon achievement of development and regulatory milestones, as well as royalties on future product sales, if any, under each of our three collaboration agreements with Allergan. Each of our agreements with Allergan is subject to early termination upon specified events, including, in the case of one of our agreements, if we have a change in control. Upon the conclusion of the research term under each agreement, Allergan may terminate the agreement by notice.

In March 2009, we entered into a collaboration agreement with Meiji Seika Pharma. Under the agreement, we are eligible to receive up to $25 million in aggregate payments, consisting of $3 million in license fees and up to $22 million in payments upon achievement of development and regulatory milestones in the licensed Asian territory. In addition, we are eligible to receive royalties on future product sales, if any, in the Asian territory. Meiji Seika Pharma also is responsible for the first $15 million of designated development expenses and we will share the remaining expenses through clinical proof-of-concept, subject to possible adjustment in the event we further license the program outside of the Asian territory. As of December 31, 2011, we had received an aggregate of $4.3 million in payments from Meiji Seika Pharma, consisting of license fees and reimbursed research and development expenses. Our agreement with Meiji Seika Pharma is subject to early termination upon specified events.

In May 2009, we entered into a collaboration agreement with Biovail, pursuant to which we received a non-refundable $30 million upfront payment. Under this collaboration, we also were eligible to receive potential development, regulatory and sales milestones as well as royalties on future net sales of pimavanserin. In October 2010, we entered an agreement with Biovail to regain all rights to pimavanserin and conclude our collaboration. In connection with this agreement, we recorded all remaining revenues related to our collaboration Biovail, which totaled $34.7 million during the fourth quarter of 2010. We recognized aggregate revenues relating to the Biovail collaboration of $39.5 million during the year ended December 31, 2010. We have no future obligations to Biovail.

Research and Development Expenses

Our research and development expenses have consisted primarily of fees paid to external service providers, salaries and related personnel expenses, facilities and equipment expenses, and other costs. We charge all research and development expenses to operations as incurred. Our research and development activities are primarily focused on our most advanced product candidates, including pimavanserin. We currently are responsible for all costs incurred in the development of pimavanserin as well as for the costs associated with our other internal programs.

Pursuant to our collaboration, Meiji Seika Pharma is responsible for the first $15 million of designated development expenses for the product candidate, AM-831, and we and Meiji Seika Pharma will share remaining expenses through clinical proof-of-concept, subject to possible adjustment. As of December 31, 2011, approximately $2.8 million of the designated development expenses had been incurred. We expect to coordinate a significant portion of the planned external development services and, accordingly, we may incur the related development costs for these external services and receive reimbursement of Meiji Seika Pharma s portion of these costs pursuant to the agreement. Meiji Seika Pharma is responsible for all costs associated with the development of AM-831 in the Asian territory. We are not responsible for, nor have we incurred, development expenses in our clinical programs for chronic pain and glaucoma, which we are pursuing in collaboration with Allergan.

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We use external service providers to manufacture our product candidates to be used in clinical trials and for the majority of the services performed in connection with the preclinical and clinical development of our product candidates. We have used our internal research and development resources, including our employees and discovery infrastructure, across several projects and many of our costs have not been attributable to a specific project but were directed to broadly applicable research activities. Accordingly, we have not reported our internal research and development costs on a project basis. To the extent that external expenses are not attributable to a specific project, they are included in other external costs. The following table summarizes our research and development expenses for the years ended December 31, 2011, 2010, and 2009 (in thousands):

	Years Ended December 31,		
	2011	2010	2009
Costs of external service providers:			
Pimavanserin	$ 10,373	$ 12,506	$ 27,079
AM-831 and other	1,438	1,087	822
Subtotal	11,811	13,593	27,901
Internal costs	4,986	6,387	12,810
Stock-based compensation	512	599	874
Total research and development	$ 17,309	$ 20,579	$ 41,585

At this time, due to the risks inherent in the clinical trial process and given the stage of development of our programs, we are unable to estimate with any certainty the costs we will incur for the continued development of our product candidates for potential commercialization. Due to these same factors, we are unable to determine the anticipated completion dates for our current research and development programs. Clinical development timelines, probability of success, and development costs vary widely. While our current focus is primarily on advancing the clinical development of pimavanserin, we anticipate that we will make determinations as to which programs to pursue and how much funding to direct to each program on an ongoing basis in response to the scientific and clinical success of each product candidate, as well as an ongoing assessment of each product candidate s commercial potential and our financial position. We cannot forecast with any degree of certainty which product candidates will be subject to future collaborative or licensing arrangements, when such arrangements will be secured, if at all, and to what degree such arrangements would affect our development plans and capital requirements.

We expect our external research and development expenses to continue to be substantial as we pursue the development of pimavanserin and our other product candidates, including AM-831. The lengthy process of completing clinical trials and seeking regulatory approval for our product candidates requires the expenditure of substantial resources. Any failure by us or delay in completing clinical trials, or in obtaining regulatory approvals could cause our research and development expenses to increase and, in turn, have a material adverse effect on our results of operations.

General and Administrative Expenses

Our general and administrative expenses have consisted primarily of salaries and other costs for employees serving in executive, finance, business development, and business operations functions, as well as professional fees associated with legal and accounting services, and costs associated with patents and patent applications for our intellectual property.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based on our consolidated financial statements. We have identified the accounting policies that we believe require application of management s most subjective judgments, often requiring the need to make estimates about the effect of matters

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that are inherently uncertain and may change in subsequent periods. Our actual results may differ substantially from these estimates under different assumptions or conditions. While our significant accounting policies are described in more detail in the notes to consolidated financial statements included in this report, we believe that the following accounting policies require the application of significant judgments and estimates.

Revenue Recognition

We recognize revenues in accordance with authoritative guidance established by U.S. Generally Accepted Accounting Principles, or GAAP. Our revenues are primarily related to our collaboration agreements, which may provide for various types of payments to us, including upfront payments, funding of research and development, milestone payments, and licensing fees. Our collaboration agreements also include potential payments for product royalties; however, we have not received any product royalties to date.

We consider a variety of factors in determining the appropriate method of accounting under our collaboration agreements, including whether the various elements can be separated and accounted for individually as separate units of accounting. Where there are multiple deliverables identified within a collaboration agreement that are combined into a single unit of accounting, revenues are deferred and recognized over the expected period of performance. The specific methodology for the recognition of the revenue is determined on a case-by-case basis according to the facts and circumstances of the applicable agreement.

Upfront, non-refundable payments that do not have stand-alone value are recorded as deferred revenue once received and recognized as revenues over the expected period of performance. Revenues from non-refundable license fees are recognized upon receipt of the payment if the license has stand-alone value, we do not have ongoing involvement or obligations, and we can determine the best estimate of the selling price for any undelivered items. When non-refundable license fees do not meet all of these criteria, the license revenues are recognized over the expected period of performance. Non-refundable payments for research funding are generally recognized as revenues over the period as the related research activities are performed. Payments for reimbursement of external development costs are generally recognized as revenues using a contingency-adjusted performance model over the expected period of performance. Payments received from grants are recognized as revenues as the related research and development is performed and when collectability has been reasonably assured.

We evaluate milestone payments on an individual basis and recognize revenues from non-refundable milestone payments when the earnings process is complete and the payment is reasonably assured. Non-refundable milestone payments related to arrangements under which we have continuing performance obligations are recognized as revenues upon achievement of the associated milestone, provided that (i) the milestone event is substantive and its achievability was not reasonably assured at the inception of the agreement and (ii) the amount of the milestone payment is reasonable in relation to the effort expended or th**$(0.26)** $(0.10) **$(0.72)** $(0.68)

(Loss) income from discontinued operations

(0.03) 0.19 **0.46** 0.22

Net (loss) income				
	$(0.29)	$0.09	**$(0.26)**	$(0.46)

Basic earnings (loss) per share is computed as net income (loss) available to common shareholders divided by the weighted average basic shares outstanding. The outstanding shares used to calculate the weighted average basic shares excludes 115,969 of restricted shares at December 31, 2011 and 246,391 of restricted shares and

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performance shares (including reinvested dividends) at December 31, 2010, as these shares were issued but were not vested and, therefore, not considered outstanding for purposes of computing basic earnings per share at the balance sheet dates. When a loss is reported, the denominator of diluted earnings per share cannot be adjusted for the dilutive impact of share-based compensation awards because doing so would be anti-dilutive to the loss per share. In addition, when a loss from continuing operations is reported, adjusting the denominator of diluted earnings per share would also be anti-dilutive to the loss per share, even if an entity has net income after adjusting for a discontinued operation. Therefore, for each of the three and nine months ended December 31, 2011 and 2010, basic weighted-average shares outstanding were used in calculating the diluted net loss per share.

For each of the three and nine months ended December 31, 2011, stock options and SSARs on 2.0 million common shares were not included in computing diluted earnings per share because their effects were anti-dilutive. For each of the three and nine months ended December 31, 2010, stock options and SSARs on 2.8 million common shares were not included in computing diluted earnings per share because their effects were anti-dilutive.

10. Commitments and Contingencies

The Company is the subject of various threatened or pending legal actions and contingencies in the normal course of conducting its business. The Company provides for costs related to these matters when a loss is probable and the amount can be reasonably estimated. The effect of the outcome of certain of these matters on the Company s future results of operations and liquidity cannot be predicted because any such effect depends on future results of operations and the amount or timing of the resolution of such matters. While it is not possible to predict with certainty, management believes that the ultimate resolution of such individual or aggregated matters will not have a material adverse effect on the consolidated financial position, results of operations, or cash flows of the Company.

As of December 31, 2011, the Company has reached its minimum purchase commitments from a vendor of $20.0 million per year through fiscal 2012. The total commitment to this vendor was $330.0 million as disclosed in the Company s Annual Report on Form 10-K for the year ended March 31, 2011. The majority of this obligation was assumed by OnX upon the completion of the TSG divestiture.

In September 2011, the Company entered into a 74-month lease for a new corporate facility located in Alpharetta, Georgia. The lease term commenced in January 2012 upon the completion of certain agreed-upon improvements. In October 2011, the Company entered into an agreement to terminate the lease on its previous corporate facility located in Solon, Ohio effective March 31, 2012 in consideration of a one-time termination payment of $2.0 million plus associated brokerage fees of approximately $0.1 million.

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11. Additional Balance Sheet Information

Additional information related to the Company s Condensed Consolidated Balance Sheets is as follows:

	December 31, 2011		March 31, 2011	
Other current assets:				
Marketable securities restricted in Rabbi Trust	**$**	**8,447**	$	5,791
Other		**77**		553
Total	**$**	**8,524**	$	6,344
Other non-current assets:				
Corporate-owned life insurance policies	**$**	**3,171**	$	3,323
Marketable securities restricted in Rabbi Trust				7,950
Other		**610**		436
Total	**$**	**3,781**	$	11,709
Accrued liabilities:				
Salaries, wages, and related benefits	**$**	**4,468**	$	4,943
SERP obligations		**3,212**		5,675
BEP obligations		**3,343**		
Restructuring liabilities		**4,075**		475
Accrued income tax provision		**2,460**		
Other taxes payable		**1,866**		1,226
Other		**1,464**		2,275
Total	**$**	**20,888**	$	14,594
Other non-current liabilities:				
BEP obligations	**$**		$	5,629
Other employee benefit obligations		**184**		305
Income taxes payable/Uncertain tax positions		**2,834**		4,337
Deferred rent		**1,445**		712
Restructuring liabilities		**696**		258
Other		**974**		731
Total	**$**	**6,133**	$	11,972

The marketable securities included in the table above within Other current assets and Other non-current assets are maintained in a Rabbi Trust to informally fund the Company s obligations with respect to employee benefit plan obligations under the SERP and Benefits Equalization Plan (BEP), which are included within Accrued liabilities and Other non-current liabilities.

The corporate-owned life insurance policies included in the table above within Other non-current assets represent split-dollar endorsement life insurance policies for which the related benefit obligation is included within Other non-current liabilities. The Company presents these contracts at their cash surrender value (which is considered fair value), net of policy loans. The Company adjusts the carrying value of these contracts to the cash surrender value at the end of each reporting period. Such periodic adjustments are included in Other expenses (income), net within the accompanying Condensed Consolidated Statements of Operations.

Additional information with respect to the Company s marketable securities, corporate-owned life insurance policies, and employee benefit plans obligations is provided in the Company s Annual Report on Form 10-K for the year ended March 31, 2011.

The accrued income tax provision in the table above reflects the tax effect on the gain on the sale of TSG, which was computed in accordance with the FASB s authoritative guidance on income tax accounting and recorded in the third quarter of fiscal 2012.

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12. Business Segments

Description of Business Segments

The Company has two reportable business segments: HSG and RSG. The reportable segments are each managed separately and are supported by various practices as well as Company-wide functional departments. These functional support departments include general accounting, tax, and information technology and a portion of these costs are reported in Corporate/Other. Corporate/Other is not a reportable business segment as defined by GAAP. As a result of the sale of the Company s TSG business, and the TSA with OnX, which is disclosed in Note 3, Corporate/Other costs have been adjusted for all prior periods presented to remove the portion of the functional support department costs that were transferred to OnX.

HSG is a leading technology provider of software, hardware and services to the hospitality industry, offering industry leading enterprise solutions for property management, point of sale, inventory and procurement, document management, and mobility-enabled guest engagement. HSG solutions allow customers in the gaming, hotel and resort, cruise line, foodservice management, higher education, and sports and entertainment markets to enhance guest services, increase revenue opportunities, and reduce operational expenses.

RSG is a leader in designing solutions that help make retailers more productive and provide their customers with an enhanced shopping experience. RSG solutions help improve operational efficiency, technology utilization, customer satisfaction, and in-store profitability, including mobility and wireless, customized pricing, inventory, and customer relationship management systems. The group also provides implementation plans and supplies the complete package of hardware needed to operate the systems, including servers, receipt printers, point-of-sale terminals, and wireless devices for in-store use by the retailer s store associates.

Measurement of Segment Operating Results and Segment Assets

The Company s President and Chief Executive Officer, who is the Chief Operating Decision Maker (CODM), evaluates performance and allocates resources to its reportable segments based on operating income. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies found in the Company s Annual Report on Form 10-K for the year ended March 31, 2011. Intersegment sales are recorded at pre-determined amounts to allow for inter-company profit to be included in the operating results of the individual reportable segments. Such inter-company profit is eliminated for consolidated financial reporting purposes.

The CODM does not evaluate a measurement of segment assets when evaluating the performance of the Company s reportable segments. As such, financial information relating to segment assets is not provided in the table below.

The following table presents segment profit and related information for each of the Company s reportable segments and Corporate/Other. Please refer to Note 5 to Condensed Consolidated Financial Statements for further information on the fiscal 2012 and fiscal 2011 restructuring charges.

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	Reportable segments HSG	RSG	Corporate/ Other	Consolidated
Three months ended December 31, 2011				
Total sales	$ 21,680	$ 30,127	$	$ 51,807
Elimination of intersegment sales		(225)		(225)
Sales from external customers	$ 21,680	$ 29,902	$	$ 51,582
Gross margin	$ 13,956	$ 5,976	$	$ 19,932
Gross margin percentage	*64.4%*	*20.0%*		*38.6%*
Operating income (loss)	$ 1,680	$ 1,323	$ (10,052)	$ (7,049)
Other expenses, net			(22)	(22)
Interest expense, net			(56)	(56)
Income (loss) from continuing operations before income taxes	$ 1,680	$ 1,323	$ (10,130)	$ (7,127)
Three months ended December 31, 2010				
Total sales	$ 24,666	$ 34,458	$	$ 59,124
Elimination of intersegment sales	(3)	(124)		(127)
Sales from external customers	$ 24,663	$ 34,334	$	$ 58,997
Gross margin	$ 13,346	$ 5,795	$	$ 19,141
Gross margin percentage	*54.1%*	*16.9%*		*32.4%*
Operating income (loss)	$ 1,955	$ 1,042	$ (8,260)	$ (5,263)
Other income, net			321	321
Interest expense, net			(295)	(295)
Income (loss) from continuing operations before income taxes	$ 1,955	$ 1,042	$ (8,234)	$ (5,237)

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	Reportable segments HSG	RSG	Corporate/ Other	Consolidated
Nine months ended December 31, 2011				
Total sales	$ 63,491	$ 93,987	$	$ 157,478
Elimination of intersegment sales		(620)		(620)
Sales from external customers	$ 63,491	$ 93,367	$	$ 156,858
Gross margin	$ 40,187	$ 18,833	$	$ 59,020
Gross margin percentage	*63.3%*	*20.2%*		*37.6%*
Operating income (loss)	$ 2,036	$ 5,090	$ (28,367)	$ (21,241)
Other expenses, net			(293)	(293)
Interest expense, net			(883)	(883)
Income (loss) from continuing operations before income taxes	$ 2,036	$ 5,090	$ (29,543)	$ (22,417)
Nine months ended December 31, 2010				
Total sales	$ 68,964	$ 87,132	$	$ 156,096
Elimination of intersegment sales	(66)	(305)		(371)
Sales from external customers	$ 68,898	$ 86,827	$	$ 155,725
Gross margin	$ 38,848	$ 17,013	$	$ 55,861
Gross margin percentage	*56.4%*	*19.6%*		*35.9%*
Operating income (loss)	$ 4,408	$ 3,889	$ (24,752)	$ (16,455)
Other income, net			2,281	2,281
Interest expense, net			(819)	(819)
Income (loss) from continuing operations before income taxes	$ 4,408	$ 3,889	$ (23,290)	$ (14,993)

13. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or would be paid to transfer a liability in an orderly transaction between market participants on the measurement date. The fair value of financial assets and liabilities are measured on a recurring or non-recurring basis. Financial assets and liabilities measured on a recurring basis are those that are adjusted to fair value each time a financial statement is prepared. Financial assets and liabilities measured on a non-recurring basis are those that are adjusted to fair value when a significant event occurs. In determining fair value of financial assets and liabilities, the Company uses various valuation techniques. For many financial instruments, pricing inputs are readily observable in the market, the valuation methodology used is widely accepted by market participants, and the valuation does not require significant management discretion. For other financial instruments, pricing inputs are less observable in the market and may require management judgment. The availability of pricing inputs observable in the market varies from instrument to instrument and depends on a variety of factors including the type of instrument, whether the instrument is actively traded, and other characteristics particular to the transaction.

The Company estimates the fair value of financial instruments using available market information and generally accepted valuation methodologies. The Company assesses the inputs used to measure fair value using a three-tier hierarchy. The hierarchy indicates the extent to which pricing inputs used in measuring fair value are

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observable in the market. Level 1 inputs include unadjusted quoted prices for identical assets or liabilities and are the most observable. Level 2 inputs include unadjusted quoted prices for similar assets and liabilities that are either directly or indirectly observable, or other observable inputs such as interest rates, foreign currency exchange rates, commodity rates, and yield curves. Level 3 inputs are not observable in the market and include the Company s own judgments about the assumptions market participants would use in pricing the asset or liability. The use of observable and unobservable inputs is reflected in the hierarchy assessment disclosed in the tables below.

Additional information with respect to the Company s fair value measurements is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2011.

There were no transfers between Levels 1, 2, and 3 during the three- and nine-month periods ended December 31, 2011 and 2010.

The following tables present information about the Company s financial assets and liabilities measured at fair value on a recurring basis and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value:

		Fair value measurement used		
	Recorded value as of December 31, 2011	Active markets for identical assets or liabilities (Level 1)	Quoted prices in similar instruments and observable inputs (Level 2)	Active markets for unobservable inputs (Level 3)
Assets:				
Available for sale restricted marketable securities current	**$ 8,447**	**$ 8,447**	**$**	**$**
Available for sale unrestricted marketable securities current	**$ 39,994**	**$ 39,994**	**$**	**$**
Corporate-owned life insurance non-current	**3,171**			**3,171**
Liabilities:				
BEP current	**$ 3,343**	**$**	**$ 3,343**	**$**

		Fair value measurement used		
	Recorded value as of March 31, 2011	Active markets for identical assets or liabilities (Level 1)	Quoted prices in similar instruments and observable inputs (Level 2)	Active markets for unobservable inputs (Level 3)
Assets:				
Available for sale restricted marketable securities current	$ 5,791	$ 5,791	$	$
Available for sale restricted marketable securities non-current	7,950	7,950		
Corporate-owned life insurance non-current	3,323			3,323
Liabilities:				
BEP non-current	$ 5,629	$	$ 5,629	$

The Company maintains an investment in available for sale marketable securities in which cost approximates fair value. The recorded value of the Company s investment in available for sale marketable securities is based on quoted prices in active markets and, therefore, is classified within Level 1 of the fair value hierarchy. As of December 31, 2011, the Company has approximately $0.1 million of unrealized losses related to this investment, which is recorded within Accumulated other comprehensive loss in the Condensed Consolidated Balance Sheets.

The recorded value of the Corporate-owned life insurance policies is adjusted to the cash surrender value of the policies which are not observable in the market, and therefore, are classified within Level 3 of the fair value hierarchy. Changes in the cash surrender value of these policies are recorded within Other expenses (income), net in the Condensed Consolidated Statements of Operations. Although corporate-owned life insurance policies are exempt from such disclosure requirements, management believes the disclosures are useful to financial statement users.

The recorded value of the BEP obligation is measured as employee deferral contributions and Company matching contributions less distributions made from the plan, and adjusted for the returns on the hypothetical

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investments selected by the participants, which are indirectly observable and therefore, classified within Level 2 of the fair value hierarchy.

The following table presents a summary of changes in the fair value of the Level 3 assets and liabilities related to the Company s continuing operations for the nine months ended December 31, 2011 and 2010:

	Nine months ended December 31	
	2011	2010
Corporate-owned life insurance:		
Balance on April 1	**$ 3,323**	$ 16,095
Realized gains		2,065
Unrealized gain (loss)	**83**	(247)
Purchases and settlements, net	**(235)**	(3,141)
Balance on December 31	**$ 3,171**	$ 14,772

Realized gains recorded during the first nine months of fiscal 2012 represent the amounts recognized for the increase in the cash surrender value of Corporate-owned life insurance policies and are recorded within Other expenses (income), net in the accompanying Condensed Consolidated Statements of Operations. Realized gains recorded during the first nine months of fiscal 2011 represent the amounts recognized on the redemption of certain Corporate-owned life insurance policies, net of amounts recognized for the decrease in the cash surrender value of these policies, and are recorded within Other expenses (income), net in the accompanying Condensed Consolidated Statements of Operations.

The following tables present information about the Company s financial and nonfinancial assets and liabilities measured at fair value on a nonrecurring basis and indicate the fair value hierarchy of the valuation techniques utilized to determine such fair value:

	00000	00000	00000	00000
		Fair value measurement used		
	Recorded value as of December 31, 2011	Active markets for identical assets or liabilities (Level 1)	Quoted prices in similar instruments and observable inputs (Level 2)	Active markets for unobservable inputs (Level 3)
Assets:				
Goodwill	**$ 15,084**	**$**	**$**	**$ 15,084**
Intangible assets	**21,611**			**21,611**
Liabilities:				
SERP obligations current	**$ 3,212**	**$**	**$**	**$ 3,212**
Other employee benefit plans obligations current	**116**			**116**
BEP current	**3,343**			**3,343**
Restructuring liabilities current	**4,075**			**4,075**
Restructuring liabilities non-current	**696**			**696**
Other employee benefit plans obligations non-current	**184**			**184**

		Fair value measurement used		
	Recorded value as of March 31, 2011	Active markets for identical assets or liabilities (Level 1)	Quoted prices in similar instruments and observable inputs (Level 2)	Active markets for unobservable inputs (Level 3)
Assets:				
Goodwill	$ 15,211	$	$	$ 15,211
Intangible assets	22,535			22,535
Liabilities:				

SERP obligations current	$ 5,675	$	$	$ 5,675
Other employee benefit plans obligations current	116			116
Restructuring liabilities current	475			475
Restructuring liabilities non-current	258			258
Other employee benefit plans obligations non-current	305			305

Goodwill of the Company s reporting units is measured for impairment on an annual basis, or in interim periods if indicators of potential impairment exist, using a combination of an income approach and a market approach.

The Company s intangible assets are valued at their estimated fair value at time of acquisition. The Company evaluates the fair value of its finite-lived intangible assets when impairment indicators are present and its indefinite-lived intangible assets on an annual basis, or in interim periods if indicators of potential impairment exist. The same approach described above for the goodwill valuation is also used to value indefinite-lived intangible assets.

The recorded value of the Company s SERP and other benefit plans obligations is based on estimates developed by management by evaluating actuarial information and includes assumptions such as discount rates, future compensation increases, expected retirement dates, payment forms, and mortality. The recorded value of these obligations is measured on an annual basis, or upon the occurrence of a plan curtailment or settlement.

The Company s restructuring liabilities primarily consist of one-time termination benefits to former employees and ongoing costs related to long-term operating lease obligations. The recorded value of the termination benefits to employees is adjusted to the expected remaining obligation for each period based on the arrangements made with the former employees. The recorded value of the ongoing lease obligations is based on the remaining lease term and payment amount, net of sublease income plus interest, discounted to present value. Changes in subsequent periods resulting from a revision to either the timing or the amount of estimated cash flows over the future period are measured using the credit-adjusted, risk-free rate that was used to measure the restructuring liabilities initially.

The inputs used to value the Company s goodwill, intangible assets, SERP obligations, other employee benefit plans obligations, and restructuring liabilities are not observable in the market and therefore, these amounts are classified within Level 3 in the fair value hierarchy.

The following table presents a summary of changes in the fair value of the Level 3 assets and liabilities related to the Company s continuing operations for the nine months ended December 31, 2011 and 2010:

	Nine months ended December 31, 2011				
	Goodwill	Intangible assets	SERP obligations	Other employee benefit plans obligations	Restructuring liabilities
Balance at April 1, 2011	$ 15,211	$ 22,535	$ 5,675	$ 421	$ 733
Unrealized losses relating to instruments still held at the reporting date	(127)				
Purchases		1,373	92		7,954
Settlements			(2,555)	(121)	(3,916)
Amortization		(2,297)			
Balance at December 31, 2011	$ 15,084	$ 21,611	$ 3,212	$ 300	$ 4,771

	Nine months ended December 31, 2010				
	Goodwill	Intangible assets	SERP obligations	Other employee benefit plans obligations	Restructuring liabilities
Balance at April 1, 2010	$ 15,010	$ 23,755	$ 8,412	$ 454	$ 1,938
Realized losses		(59)	383		
Unrealized gains relating to instruments still held at the reporting date	82		(596)		
Purchases		2,015	890		403
Settlements			(2,504)	(35)	(1,240)
Amortization		(2,139)			
Balance at December 31, 2010	$ 15,092	$ 23,572	$ 6,585	$ 419	$ 1,101

Realized losses on the Company s SERP obligation were primarily comprised of the actuarial losses recognized due to the settlement of a SERP obligation to a former executive and are recorded within Restructuring

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charges in the accompanying Condensed Consolidated Statements of Operations. Additional information regarding the Company s restructuring actions is included in Note 5 to Condensed Consolidated Financial Statements.

Unrealized gains related to goodwill represent fluctuations due to the movement of foreign currencies relative to the U.S. dollar. Cumulative currency translation adjustments are recorded within Accumulated other comprehensive loss in the accompanying Condensed Consolidated Balance Sheets. Unrealized losses related to the Company s SERP obligation represent the unamortized actuarial losses, net of taxes, and are recorded within Accumulated other comprehensive loss in the accompanying Condensed Consolidated Balance Sheets.

14. Subsequent Events

In January 2012, the Company made a payment of $1.2 million to OnX for a working capital adjustment as part of the sale, which is described in Note 3 to Condensed Consolidated Financial Statements.

Subsequent to December 31, 2011 and through February 3, 2012, the Company made additional repurchases of 129,044 of its common shares for an aggregate of $1.0 million, representing an average purchase price of $8.10 per common share. This completes the repurchase of shares authorized under the current common share repurchase authorization, which is described in Note 7 to Condensed Consolidated Financial Statements.

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

In Management s Discussion and Analysis of Financial Condition and Results of Operations, (MD&A), management explains the general financial condition and results of operations for Agilysys, Inc. and its subsidiaries (Agilysys or the Company) including:

- *what factors affect the Company s business;*
- *what the Company s earnings and costs were;*
- *why those earnings and costs were different from the year before;*
- *where the earnings came from;*
- *how the Company s financial condition was affected; and*
- *where the cash will come from to fund future operations.*

The MD&A analyzes changes in specific line items in the Condensed Consolidated Statements of Operations and Condensed Consolidated Statements of Cash Flows and provides information that management believes is important to assessing and understanding the Company s consolidated financial condition and results of operations. This Quarterly Report on Form 10-Q (Quarterly Report) updates information included in the Company s Annual Report on Form 10-K (Annual Report) for the fiscal year ended March 31, 2011, filed with the Securities and Exchange Commission (SEC). This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and related Notes that appear in Item 1 of this Quarterly Report as well as the Company s Annual Report for the year ended March 31, 2011. Information provided in the MD&A may include forward-looking statements that involve risks and uncertainties. Many factors could cause actual results to be materially different from those contained in the forward-looking statements. Additional information concerning forward-looking statements is contained in Forward-Looking Information below and in Risk Factors included in Part I, Item 1A of the Company s Annual Report for the fiscal year ended March 31, 2011. Management believes that this information, discussion, and disclosure is important in making decisions about investing in the Company. Table amounts are in thousands.

Introduction

Agilysys is a leading developer and marketer of proprietary enterprise software, services, and solutions to the hospitality and retail industries. The Company develops technology solutions including hardware, software, and services to help customers resolve their most complicated hospitality and retail business systems needs. Agilysys hospitality and retail business systems solutions include: property management systems, inventory and procurement solutions, point-of-sale solutions, and document management software. Proprietary services include expertise in mobility and wireless solutions for retailers, and resold hardware, software, and services. A significant portion of the point-of-sale related revenue is recurring from software support and hardware maintenance agreements. Agilysys corporate facilities are located in Alpharetta, Georgia. Agilysys also operates extensively throughout North America, with additional sales and support offices in the United Kingdom and Asia. Agilysys has two reportable segments: Hospitality Solutions Group (HSG) and Retail Solutions Group (RSG). See Note 12 to Condensed Consolidated Financial Statements titled, *Business Segments*, which is included in Item 1, for additional information.

The primary objective of the Company s ongoing strategic planning process is to create shareholder value by exploiting growth opportunities and strengthening its competitive position within the specific technology solutions and in the end markets its services. The plan builds on the Company s existing strengths and targets industry leading growth and peer beating financial and operating results driven by new technology trends and market opportunities. The Company s strategic plan specifically focuses on:

- Growing sales of its proprietary offerings, both software and services.

Diversifying its customer base across geographies and industries.

Capitalizing on the Company s intellectual property and emerging technology trends.

Optimizing the Company s facilities footprint and corporate expense while locating corporate services closer to the operating businesses.

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The Company s top priorities include improving operating performance and financial results, profitably growing the business, and returning capital to shareholders. To that end, the Company will use its cash, including the proceeds from the recent TSG sale, to fund working capital needs, make select investments in the businesses, and return excess cash to shareholders as prudently as possible. The Company intends to achieve its objectives through a tighter coupling and management of the operating expenses of the businesses and sharpening the focus of our investments to concentrate on growth opportunities with the highest return by seeking the highest margin revenue opportunities in the markets in which it competes.

Revenues - Defined

As required by the SEC, the Company separately presents revenues earned as either product revenues or services revenues in its Condensed Consolidated Statements of Operations. In addition to the SEC requirements, the Company may, at times, also refer to revenues as defined below. The terminology, definitions, and applications of terms the Company uses to describe its revenues may be different from those used by other companies and caution should be used when comparing these financial measures to those of other companies. The Company uses the following terms to describe revenues:

Revenues The Company presents revenues net of sales returns and allowances.

Product revenues The Company defines product revenues as revenues earned from the sales of hardware equipment and proprietary and remarketed software.

Services revenues The Company defines services revenues as revenues earned from the sales of proprietary and remarketed services and support.

General Company Overview

Total net sales rose $1.1 million or 0.7% in the nine months ended December 31, 2011 compared with the nine months ended December 31, 2010. Gross margin as a percentage of sales increased 170 basis points to 37.6% for the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011.

While the Company s revenues and gross margin have improved in the first nine months of fiscal 2012 compared with the same prior year period, market conditions still reflect uncertainty regarding the overall business environment and demand for technology products and services. The Company continues to believe that it is well-positioned to capitalize on future growth in technology-related spending across its customer base in the global hospitality and general and specialty retail markets, which will allow for the further leveraging of its business model and earnings growth.

Matters Affecting Comparability

On August 1, 2011, the Company completed the previously announced sale of its Technology Solutions Group (TSG) business to OnX Enterprise Solutions Limited and its subsidiary OnX Acquisition LLC (together OnX). For financial reporting purposes, TSG s operating results for fiscal 2012 through the completion of the sale and for the fiscal 2011 periods presented were classified within discontinued operations. Accordingly, the discussion and analysis presented below, including comparisons to prior year periods, reflects the continuing business of Agilysys.

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Results of Operations Third Fiscal 2012 Quarter Compared to Third Fiscal 2011 Quarter

Net Sales and Operating (Loss) Income

The following table presents the Company s consolidated revenues and results from continuing operations for the three months ended December 31, 2011 and 2010:

	Three months ended December 31		Increase (decrease)	
(Dollars in thousands)	**2011**	2010	$	%
Net Sales:				
Products	**$ 25,721**	$ 33,970	$ (8,249)	(24.3)%
Services	**25,861**	25,027	834	3.3%
Total	**51,582**	58,997	(7,415)	(12.6)%
Cost of goods sold:				
Products	**20,109**	26,777	(6,668)	(24.9)%
Services	**11,541**	13,079	(1,538)	(11.8)%
Total	**31,650**	39,856	(8,206)	(20.6)%
Gross margin:				
Products	**5,612**	7,193	(1,581)	(22.0)%
Services	**14,320**	11,948	2,372	19.9%
Total	**19,932**	19,141	791	4.1%
Gross margin percentage:				
Products	***21.8%***	*21.2%*		
Services	***55.4%***	*47.7%*		
Total	***38.6%***	*32.4%*		
Operating expenses:				
Selling, general, and administrative expenses	**23,743**	24,401	(658)	(2.7)%
Restructuring charges	**3,238**	3	3,235	nm
Total	**26,981**	24,404	2,577	10.6%
Operating loss from continuing operations:				
Operating loss	**$ (7,049)**	$ (5,263)	$ (1,786)	(33.9)%
Operating loss percentage	***(13.7)%***	*(8.9)%*		

nm - not meaningful

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The following table presents the Company s results from continuing operations by business segment for the three months ended December 31, 2011 and 2010:

(Dollars in thousands)	Three months ended December 31 2011	2010	Increase (decrease) $	%
Hospitality				
Total sales from external customers	**$ 21,680**	$ 24,663	$ (2,983)	(12.1)%
Gross margin	**$ 13,956**	$ 13,346	$ 610	4.6%
	64.4%	*54.1%*		
Operating income	**$ 1,680**	$ 1,955	$ (275)	(14.1)%
Retail				
Total sales from external customers	**$ 29,902**	$ 34,334	$ (4,432)	(12.9)%
Gross margin	**$ 5,976**	$ 5,795	$ 181	3.1%
	20.0%	*16.9%*		
Operating income	**$ 1,323**	$ 1,042	$ 281	27.0%
Corporate and Other				
Operating loss	**$ (10,052)**	$ (8,260)	$ (1,792)	(21.7)%
Consolidated				
Total sales from external customers	**$ 51,582**	$ 58,997	$ (7,415)	(12.6)%
Gross margin	**$ 19,932**	$ 19,141	$ 791	4.1%
	38.6%	*32.4%*		
Operating loss	**$ (7,049)**	$ (5,263)	$ (1,786)	(33.9)%

Net sales. Total sales decreased $7.4 million or 12.6% for the three months ended December 31, 2011. Product sales decreased $8.2 million while services sales increased $0.8 million for the comparable periods.

HSG s sales decreased $3.0 million in the third quarter of fiscal 2012 compared to the same prior year period. These decreases were seen throughout the Company s product and service lines due to the increased concentration in selling higher quality product offerings in fiscal 2012 as compared to prior year and lower volumes period over period. RSG s sales decreased $4.4 million due mainly to a decrease in hardware sales, which was partially offset by an increase in service sales and in software sales. The prior year quarter for RSG included some hardware sales that did not repeat in the current quarter.

Gross margin. The Company s total gross margin increased $0.8 million or 4.1% and total gross margin percentage increased 620 basis points for the three months ended December 31, 2011 compared to the same period in 2010. Products gross margin decreased $1.6 million although the gross margin percentage increased 60 basis points and services gross margin increased $2.4 million and the gross margin percentage increased 770 basis points for the comparable periods. RSG services sales comprised 36.1% of the sales in the current quarter, an increase of 7.8% over third quarter 2011.

From a business segment perspective, HSG s gross margins increased 1,030 basis points, primarily due to the mix in overall revenue shifting to higher margin services sales comprising 69.5% of overall revenue in the current quarter compared to 62.1% in the same period last year. Additionally, improved services gross margins were due to more efficient use of labor in our services projects. RSG s gross margins increased 310 basis points, primarily attributable to the change in mix of products and services sold during the current year period.

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Selling, general and administrative expenses. The Company s selling, general and administrative (SG&A) expenses decreased by $0.7 million, or 2.7%, during the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011.

SG&A expenses increased $0.9 million in HSG, decreased $0.1 million in RSG and decreased $1.4 million in Corporate/Other SG&A in the third quarter of the current year compared with the third quarter of the prior year. The increase in HSG s expenses was primarily driven by a shift in headcount focusing on support and maintenance to research and development activities. The decrease in Corporate/Other expenses was primarily due to lower outside service costs with significant spend in the prior period associated with the implementation of Oracle Enterprise Resource Planning (ERP) software that did not repeat in fiscal 2012 and the decrease in Solon, Ohio staff prior to the buildup of the new corporate support team in Alpharetta, Georgia. The decrease is partially offset by approximately $1.3 million of additional depreciation expense related to the accelerated depreciation of property and equipment located at the Company s previous corporate office in Solon, Ohio. Due to relocating the corporate services, the Company changed its useful life estimate for the property and equipment located at its Alpharetta, Georgia location.

Restructuring charges. Under the fiscal 2012 restructuring plan, the Company recorded $3.2 million in restructuring charges, primarily comprised of lease termination of $2.1 million and severance and related benefits of $1.0 million in Corporate/Other. The Company expects to incur approximately $8.0 million in additional restructuring charges for severance and related benefits and facilities related to these restructuring actions during the remainder of fiscal 2012 and the first quarter of fiscal 2013. As a result of taking these restructuring actions, the Company expects to realize between approximately $14.0 million and $16.0 million in cost savings, of which approximately half has been recognized in the third quarter fiscal 2012 run rate. The remaining savings are expected to be primarily realized during fiscal 2013.

During the third quarter of fiscal 2011, the Company recorded insignificant additional restructuring charges primarily associated with ongoing lease obligations for the Company s former corporate headquarters in Boca Raton, Florida, which was part of the previously disclosed restructuring actions taken in fiscal 2009. Additional information regarding the Company s respective restructuring plans is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2011.

Other Expenses (Income)

	Three months ended December 31		(Unfavorable) favorable	
(Dollars in thousands)	**2011**	2010	$	%
Other expenses (income):				
Other expenses (income), net	**$ 22**	$ (321)	$ (343)	(106.9)%
Interest income	**(4)**	(21)	(17)	
Interest expense	**60**	316	256	81.0%
Total other expenses (income), net	**$ 78**	$ (26)	$ (104)	(400.0)%

Other expenses (income), net. The $22,000 of other expense in the third quarter of fiscal 2012 primarily consists of losses recognized as a result of movements in foreign currencies relative to the U.S. dollar.

The $0.3 million of other income in the third quarter of fiscal 2011 primarily represents increases in the cash surrender value of BEP and SERP of $0.2 million, gains recognized as a result of movements in foreign currencies relative to the U.S. dollar of $0.1 million.

Interest income. Interest income decreased during the quarter ended December 31, 2011 compared to the same prior year quarter. In fiscal 2009, management changed to a more conservative investment strategy and continued to maintain this strategy through fiscal 2012.

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Interest expense. Interest expense consists of costs associated with the interest expense on borrowings against certain Company-owned life insurance policies and capital leases, and in prior year includes costs associated with the Company s Credit Facility and the amortization of deferred financing fee. Interest expense decreased $0.3 million during the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011. The Company terminated its existing Credit Facility on July 29, 2011.

Income Taxes

	Three Months Ended December 31	
	2011	2010
Effective income tax rate	**19.0%**	56.3%

Income tax expense is based on the Company s estimate of the effective tax rate expected to be applicable for the respective full year. For the third quarter of fiscal 2012, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations and recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance. Other items effecting the rate in the current year quarter include foreign and state taxes and a discrete item related to a decrease in unrecognized tax benefits. For the third quarter of fiscal 2011, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations and recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance. Other items effecting the rate include foreign and state taxes and a discrete item related to unrecognized tax benefits.

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Results of Operations First Nine Months of Fiscal 2012 Compared to First Nine Months of Fiscal 2011

Net Sales and Operating Income (Loss)

The following table presents the Company s consolidated revenues and operating results from continuing operations for the nine months ended December 31, 2011 and 2010:

(Dollars in thousands)	Nine months ended December 31 2011	2010	Increase (decrease) $	%
Net Sales:				
Products	**$ 80,371**	$ 81,653	$ (1,282)	(1.6)%
Services	**76,487**	74,072	2,415	3.3%
Total	**156,858**	155,725	1,133	0.7%
Cost of goods sold:				
Products	**63,536**	63,326	210	0.3%
Services	**34,302**	36,538	(2,236)	(6.1)%
Total	**97,838**	99,864	(2,026)	(2.0)%
Gross margin:				
Products	**16,835**	18,327	(1,492)	(8.1)%
Services	**42,185**	37,534	4,651	12.4%
Total	**59,020**	55,861	3,159	5.7%
Gross margin percentage:				
Products	***20.9%***	*22.4%*		
Services	***55.2%***	*50.7%*		
Total	***37.6%***	*35.9%*		
Operating expenses:				
Selling, general, and administrative expenses	**72,307**	71,851	456	0.6%
Asset impairment charges		59	(59)	nm
Restructuring charges	**7,954**	406	7,548	nm
Total	**80,261**	72,316	7,945	11.0%
Operating loss from continuing operations:				
Operating loss	**$ (21,241)**	$ (16,455)	$ (4,786)	(29.1)%
Operating loss percentage	***(13.5)%***	*(10.6)%*		

nm - not meaningful

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The following table presents the Company s operating results from continuing operations by business segment for the nine months ended December 31, 2011 and 2010:

(Dollars in thousands)	Nine months ended December 31 2011	2010	(Decrease) increase $	%
Hospitality				
Total sales from external customers	**$ 63,491**	$ 68,898	$ (5,407)	(7.8)%
Gross margin	**$ 40,187**	$ 38,848	$ 1,339	3.4%
	63.3%	*56.4%*		
Operating income	**$ 2,036**	$ 4,408	$ (2,372)	(53.8)%
Retail				
Total sales from external customers	**$ 93,367**	$ 86,827	$ 6,540	7.5%
Gross margin	**$ 18,833**	$ 17,013	$ 1,820	10.7%
	20.2%	*19.6%*		
Operating income	**$ 5,090**	$ 3,889	$ 1,201	30.9%
Corporate and Other				
Operating loss	**$ (28,367)**	$ (24,752)	$ (3,615)	(14.6)%
Consolidated				
Total sales from external customers	**$ 156,858**	$ 155,725	$ 1,133	0.7%
Gross margin	**$ 59,020**	$ 55,861	$ 3,159	5.7%
	37.6%	*35.9%*		
Operating loss	**$ (21,241)**	$ (16,455)	$ (4,786)	(29.1)%

Net sales. Total sales increased $1.1 million or 0.7% for the nine months ended December 31, 2011. Product sales decreased $1.3 million while services sales increased $2.4 million for the comparable periods.

HSG s sales decreased $5.4 million in the first nine months of fiscal 2012 compared to the same prior year period primarily due a decrease in product sales of $6.2 million, partially offset by an increase in services sales of $0.8 million. In the prior year period, HSG recognized a large hardware sale that did not repeat in the current year period. In addition, the revisions to our prior period financial statements as discussed in Note 2 to the Condenses Consolidated Financial Statements, which is included in Item 1 of this Quarterly Report on Form 10-Q, resulted in a reduction in the HSG revenues of approximately $1.8 million.

RSG sales increased $6.5 million due to increases in both product and services offerings of $4.9 million and $1.6 million, respectively. The increases in RSG s revenues in the first nine months of the current year compared to the first nine months of the prior year were attributable to higher volumes and improving pricing on hardware in the first nine months of the current year compared to the prior year. This increase was partially offset by the impact of the revisions to our prior period financial statements of approximately $0.4 million.

Gross margin. The Company s total gross margin increased $3.2 million or 5.7% and total gross margin percentage increased 170 basis points for the nine months ended December 31, 2011. This overall improvement is primarily the result of the shift to more profitable services from product sales. Products gross margin decreased $1.5 million and the gross margin percentage decreased 150 basis points while services gross margin increased $4.7 million and the gross margin percentage increased 450 basis points for the comparable period.

HSG s gross margins increased 690 basis points, which was primarily attributable to product mix and more efficient use of labor in our services projects. RSG s gross margin percentage for the nine months ended

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December 31, 2011 increased slightly by 60 basis points compared to the same prior year period.

Selling, general and administrative expenses. The Company s selling, general and administrative (SG&A) expenses increased $0.5 million, or 0.6%, during the first nine months of fiscal 2012 compared with the first nine of fiscal 2011.

SG&A expenses increased $3.0 million and $0.2 million in HSG and RSG, respectively while Corporate/Other SG&A expenses decreased $2.7 million in the first nine months of the current year compared to the first nine months of the prior year. The increase in HSG s SG&A expense was primarily driven by the shift in focus of existing headcount to work on research and development projects from support and maintenance initiatives and the acceleration of stock compensation expense as a result of the announcement of the TSG sale. The increase in RSG s SG&A costs were driven by increased incentive costs as well as the accelerated stock compensation expense. The decrease in Corporate/Other SG&A expense was primarily due to higher outside service costs incurred in the first nine months of fiscal 2011 associated with the implementation of the Oracle ERP software for its North American operations that did not occur in fiscal 2012. This benefit was offset by the additional depreciation and amortization expense of $2.7 million recorded during the current period for the accelerated depreciation of property and equipment located at the Company s previous corporate offices in Solon, Ohio.

Asset impairment charges. The Company tests its goodwill and long-lived assets for impairment upon identification of impairment indicators, or at least annually. The asset impairment charges recorded during the first nine months of fiscal 2011 related to certain capitalized intangible software assets that management determined were no longer being sold by the business.

Restructuring charges. Under the fiscal 2012 restructuring plan, the Company recorded a total of $8.0 million in restructuring charges during the first nine months of fiscal 2012, primarily comprised of severance and related benefits, with $0.8 million, $0.4 million, and $6.8 million related to HSG and RSG, and Corporate/Other, respectively. Included in the $6.8 million restructuring charge for Corporate/Other is a $2.1 million one-time lease termination fee for the Solon, Ohio facility. The Company expects to incur approximately $8.0 million in additional restructuring charges for severance and related benefits, relocation, and facilities related to these restructuring actions during the remainder of fiscal 2012 and the first quarter of fiscal 2013. As a result of taking these restructuring actions, the Company expects to realize between approximately $14.0 million and $16.0 million in cost savings, of which approximately half has been recognized in the third quarter fiscal 2012 run rate. The remaining savings are expected to be primarily realized during fiscal 2013.

The Company recorded a total of $0.4 million in additional restructuring charges during the first nine months of fiscal 2011, primarily comprised of non-cash settlement costs related to the payment of an obligation to a former executive under the Company s SERP and other ongoing lease obligations. The additional restructuring charges recorded in fiscal 2011 related to the previously disclosed restructuring actions taken in fiscal 2009. Additional information regarding the Company s respective restructuring plans is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2011.

Other Expenses (Income)

(Dollars in thousands)	Nine months ended December 31 **2011**	2010	(Unfavorable) favorable $	%
Other expenses (income):				
Other expenses (income), net	**$ 294**	$ (2,281)	$ (2,575)	(112.9)%
Interest income	**(54)**	(61)	(7)	(11.5)%
Interest expense	**937**	880	(57)	(6.5)%
Total other expenses (income), net	**$ 1,177**	$ (1,462)	$ (2,639)	(180.5)%

Other expenses (income), net. The $0.3 million of other expense in the first nine months of fiscal 2012 primarily consists of losses recognized as a result of movements in foreign currencies relative to the U.S. dollar.

The $2.3 million of other income in the first nine months of fiscal 2011 primarily represents a gain of $2.1 million recorded on the $2.2 million in proceeds received as a death benefit from certain Company-owned life insurance policies, gains recognized as a result of the movement of foreign currencies relative to the U.S. dollar of $0.3 million, and a gain of $0.1 million recorded for the proceeds received as a distribution of The Reserve Fund investment. These proceeds were partially offset by decreases in the cash surrender value of Company-owned life insurance policies, BEP and SERP of $0.2 million.

Interest income. Interest income decreased slightly during the nine months ended December 31, 2011 compared to the same prior year period. In fiscal 2009, management changed to a more conservative investment strategy and maintained this strategy through fiscal 2012.

Interest expense. Interest expense consists of costs associated with the Company s Credit Facility, the amortization of deferred financing fees, interest expense on borrowings against certain Company-owned life insurance policies, and capital leases. Interest expense increased $57,000 during the first nine months of fiscal 2012 compared to the first nine months of fiscal 2011. The Company terminated its Credit Facility on July 29, 2011 and immediately expensed approximately $0.4 million in unamortized deferred financing fees related to the former Credit Facility.

Income Taxes

	Nine months ended December 31	
	2011	2010
Effective income tax rate	**27.7%**	(3.4)%

Income tax expense is based on the Company s estimate of the effective tax rate expected to be applicable for the respective full year. For the first nine months of fiscal 2012, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations and recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance. For the first nine months of fiscal 2011, the effective tax rate was different than the statutory rate due primarily to the intra-period tax allocation rules associated with the discontinued operations and recognition of net operating losses as deferred tax assets, which were offset by increases in the valuation allowance. In addition, an increase in the valuation allowance was recorded due to the correction of an error, as more fully described in Note 1 to the Condensed Consolidated Financial Statements.

Discontinued Operations

On May 28, 2011, the Company entered into a definitive agreement to sell its TSG business for an aggregate purchase price of $64.0 million in cash, subject to a possible downward adjustment based on final working capital, to OnX. On July 28, 2011, the Company s shareholders approved this sale and the transaction closed on August 1, 2011, the date on which certain other contingencies specified in the agreement were satisfied. Upon the close of the transaction, the aggregate purchase price of $64.0 million was reduced by the payment of agreed-upon fees of $3.3 million for severance costs and $1.2 million for third-party services in support of the transition, resulting in net proceeds received by the Company of $59.5 million. In December 2011, the Company entered into a settlement agreement with OnX for a working capital adjustment of $1.2 million that was paid to OnX in January 2012.

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Components of Results of Discontinued Operations

For the three and nine months ended December 31, 2011 and 2010 the income from discontinued operations was comprised of the following:

(In thousands)	Three months ended December 31, 2011	Three months ended December 31, 2010	Nine months ended December 31, 2011	Nine months ended December 31, 2010
Discontinued operations:				
Net sales	**$**	$ 158,325	**$ 123,807**	$ 376,907
Income (loss) from operations of TSG	**$**	$ 7,124	**$ (1,781)**	$ 8,963
(Loss) gain on sale of TSG	**(1,200)**		**19,486**	
	(1,200)	7,124	**17,705**	8,963
Income tax (benefit) expense	**(465)**	2,836	**7,302**	3,933
(Loss) income from discontinued operations	**$ (735)**	$ 4,288	**$ 10,403**	$ 5,030

Recently Adopted and Recently Issued Accounting Standards

A description of recently adopted and recently issued accounting pronouncements is included in Note 2 to Condensed Consolidated Financial Statements, which is included in Item 1 of this Quarterly Report on Form 10-Q. Management continually evaluates the potential impact, if any, on its financial position, results of operations, and cash flows, of all recent accounting pronouncements and, if significant, makes the appropriate disclosures. During the nine months ended December 31, 2011, no material changes resulted from the adoption of recent accounting pronouncements.

Liquidity and Capital Resources

Overview

The Company s operating cash requirements consist primarily of working capital needs, operating expenses, capital expenditures, and payments of principal and interest on indebtedness outstanding, which were comprised of lease and rental obligations at December 31, 2011. The Company believes that cash flow from operating activities, cash on hand, and access to capital markets will provide adequate funds to meet its short-term and long-term liquidity requirements.

Prior to July 29, 2011, the Company maintained a $50.0 million asset-based revolving Credit Facility with Bank of America, N.A., as lender, which had the ability to be increased to $75.0 million by a $25.0 million accordion feature for borrowings and letters of credit, that was due to mature on May 5, 2012. The Company s obligations under the Credit Facility were secured by significantly all of the Company s assets. The Credit Facility contained mandatory repayment provisions, representations, warranties, and covenants customary for a secured credit facility of its type. The Company terminated the Credit Facility on July 29, 2011 in conjunction with the sale of TSG. Additional information with respect to the Credit Facility is contained in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2011.

We will use the proceeds of the TSG Sale to fund our working capital needs, make select investments in the HSG and RSG Businesses, and return excess cash as prudently as possible to our shareholders. We will be able to focus more acutely on the growth of our HSG and RSG Businesses in the higher-margin and higher-growth hospitality and retail markets. We will also investigate possibilities for enhancing our HSG and RSG Businesses that may have been less available to us, due to competitive factors, resource issues, or otherwise, when we operated both the TSG Business and our HSG and RSG Businesses together. We may use a portion of the net cash proceeds from the TSG Sale for future acquisitions complementary to our HSG and RSG Businesses. However, at this time, no specific acquisition targets have been identified.

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As of December 31, 2011 and March 31, 2011, the Company s total debt was approximately $1.3 million and $1.9 million, respectively, comprised of capital lease obligations in both periods.

Additional information regarding the Company s financing arrangements is included in its Annual Report for the fiscal year ended March 31, 2011.

As of December 31, 2011, 100% of the Company s cash and cash equivalents were deposited in bank accounts. Short-term investments are deposited in Treasury notes. Therefore, the Company believes that credit risk is limited with respect to its cash and cash equivalents and short-term investment balances.

Cash Flow

(Dollars in thousands)	Nine months ended December 31 **2011**	2010	Increase (decrease) $
Net cash (used for) provided by continuing operations:			
Operating activities	**$ (9,769)**	$ (16,254)	$ 6,485
Investing activities	**21,602**	(3,334)	24,936
Financing activities	**(14,068)**	(260)	(13,808)
Effect of foreign currency fluctuations on cash	**(135)**	218	(353)
Cash flows used for continuing operations	**(2,370)**	(19,630)	17,260
Net operating, investing, and financing cash flows used for discontinued operations	**(24,128)**	(1,463)	(22,665)
Net decrease in cash and cash equivalents	**$ (26,498)**	$ (21,093)	$ (5,405)

Cash flow used for operating activities. The $9.8 million in cash used for operating activities during the first nine months of fiscal 2012 consisted of a net loss from continuing operations of $16.2 million, $17.1 million in non-cash adjustments to the net loss from continuing operations, and a negative $10.7 million of changes in operating assets and liabilities. Significant changes in operating assets and liabilities included a $10.7 million decrease in deferred revenue due to the Company recognizing amounts for services performed during the nine months ended December 31, 2011. The $16.3 million in cash used for operating activities during the nine months ended December 31, 2010 consisted of a $15.5 million loss from continuing operations, $13.1 million in non-cash adjustments to the loss from continuing operations, and a negative $13.9 million of changes in operating assets and liabilities. Significant changes in operating assets and liabilities included a $18.7 million increase in accounts receivable, a $0.8 million increase in inventories, and a $3.3 million decrease in accrued liabilities, offset by a $6.2 million increase in accounts payable and a $2.5 million increase in deferred revenue. The change in accounts receivable is reflective of an increase in the volume of sales that occurred in December 2010 (i.e., the last month of the fiscal quarter) compared to March 2010. The increases in accounts payable and in inventories were a result of the higher sales volume in December 2010 compared to March 2010.

Cash flow provided by (used for) investing activities. The $21.6 million in cash provided by investing activities during the nine months ended December 31, 2011 was primarily driven by the $59.5 million in net proceeds received from the sale of the TSG business and $5.0 million in proceeds from the Company s investments in marketable securities, which were used to settle employee benefit plan obligations, offset by $40.0 million for funds invested in Treasury notes and $3.1 million used for the purchase of software, property, and equipment. The $3.3 million in cash used for investing activities during the nine months ended December 31, 2010 resulted from the receipt of $4.3 million in proceeds as a redemption of certain Company-owned life insurance policies and $0.1 million in proceeds received as a partial distribution of the Company s previously disclosed claim on its investment in the Primary Fund, partially offset by $2.1 million used for additional investments in Company-owned life insurance policies and $4.7 million used for the purchase of software, property, and equipment.

Cash flow used for financing activities. During the nine months ended December 31, 2011, the Company used $14.1 million for financing activities, which was comprised of $12.1 million for repurchases of the Company s common shares, $1.1 million for repurchases of the Company s common shares to satisfy employee tax withholding on the vesting or exercise of stock based compensation awards, and $0.8 million for payments on

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capital lease obligations. During the nine months ended December 31, 2010, the Company used $0.3 million in cash for financing activities. This amount was comprised of $0.3 million for payments on capital lease obligations.

Contractual Obligations

As of December 31, 2011, the Company has reached its minimum purchase commitments from a vendor of $20.0 million per year through fiscal 2012, The total commitment to this vendor was $330.0 million as disclosed in the Company s Annual Report on Form 10-K for the year ended March 31, 2011. The majority of this obligation was assumed by OnX upon the completion of the TSG divestiture.

In September 2011, the Company entered into a 74-month lease for a new corporate facility located in Alpharetta, Georgia. The lease term commenced in January 2012 upon the completion of certain agreed-upon improvements. In October 2011, the Company entered into an agreement to terminate the lease on its previous corporate facility located in Solon, Ohio effective March 31, 2012 in consideration of a one-time termination payment of $2.0 million plus associated brokerage fees of approximately $0.1 million. The Company expects these actions to result in a net reduction of the operating lease obligations disclosed as contractual obligations in its Annual Report for the fiscal year ended March 31, 2011 of approximately $0.6 million per year in rental payments between fiscal 2013 and fiscal 2017.

As of December 31, 2011, there were no other significant changes to the Company s contractual obligations as presented in its Annual Report for the year ended March 31, 2011.

Off-Balance Sheet Arrangements

The Company has not entered into any off-balance sheet arrangements that have had or are reasonably likely to have a current or future effect on the Company s financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Critical Accounting Policies

A detailed description of the Company s significant accounting policies is included in the Company s Annual Report for the year ended March 31, 2011. There have been no material changes in the Company s significant accounting policies and estimates since March 31, 2011.

Forward-Looking Information

This Quarterly Report contains certain management expectations, which may constitute forward-looking information within the meaning of Section 27A of the Securities Act of 1933, Section 21E of the Securities and Exchange Act of 1934, and the Private Securities Reform Act of 1995. Forward-looking information speaks only as to the date of this Quarterly Report and may be identified by use of words such as may, will, believes, anticipates, plans, expects, estimates, projects, targets, forecasts, continues, seeks, or the negative of those terms or s Many important factors could cause actual results to be materially different from those in forward-looking information including, without limitation, competitive factors, disruption of supplies, changes in market conditions, pending or future claims or litigation, or technology advances. No assurances can be provided as to the outcome of cost reductions, expected benefits and outcomes from our recent ERP implementation, business strategies, future financial results, unanticipated downturns to our relationships with customers and macroeconomic demand for IT products and services, unanticipated difficulties integrating acquisitions, new laws and government regulations, interest rate changes, consequences related to the concentrated ownership of our outstanding shares by MAK Capital, unanticipated deterioration in economic and financial conditions in the United States and around the world, consequences associated with the sale of the Company s TSG business, and uncertainties regarding restructuring actions and/or the relocation of the Company s corporate facilities. The Company does not undertake to update or revise any forward-looking information even if events make it clear that any projected results, actions, or impact, express or implied, will not be realized.

Other potential risks and uncertainties that may cause actual results to be materially different from those in forward-looking information are described in Risk Factors, which is included in Part I, Item 1A of the Company s Annual Report for the fiscal year ended March 31, 2011.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about market risk affecting the Company, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, contained in the Company s Annual Report for the fiscal year ended March 31, 2011. There have been no material changes in the Company s market risk exposures since March 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision of and with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), management evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report. Based on that evaluation, the CEO and CFO concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

Change in Internal Control over Financial Reporting

None.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

There have been no material changes in the risk factors included in our Annual Report for the fiscal year ended March 31, 2011 that may materially affect the Company s business, results of operations, or financial condition.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans
August 1-31	397,061	$ 7.97	397,061	1,202,939
September 1-30	402,939	$ 8.57	800,000	800,000
October 1-31	294,000	$ 8.32	1,094,000	506,000
November 1-30	241,461	$ 8.26	1,335,461	264,539
December 1-31	135,495	$ 7.89	1,470,956	129,044
Total	1,470,956	$ 8.24	1,470,956	129,044

Item 3. Defaults Upon Senior Securities

None.

Item 4. [Removed and Reserved]

Item 5. Other Information

(b) Reference is made to the Form 8-K filed by the Company on January 31, 2012 disclosing advance notice procedures under Article II, Section I of the Company s Amended Code of Regulations that shareholders must comply with when nominating a Director candidate.

Item 6. Exhibits

3(ii) Amended Code of Regulations of Agilysys, Inc., which is incorporated by reference to Exhibit 3(ii) to the Company s Current Report on Form 8-K filed on January 31, 2012 (File No. 000-05734).

31.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer.

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

32.2 Certification of Vice President Controller pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

101 The following materials from the Company s quarterly report on Form 10-Q for the quarter ended December 31, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2011 and 2010, (ii) Condensed Consolidated Balance Sheets at December 31, 2011 and March 31, 2011, (iii) Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2011 and 2010, and (iv) Notes to Condensed Consolidated Financial Statements for the nine months ended December 31, 2011 tagged as blocks of text.

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 (the Exchange Act), or otherwise subject to the liability of that section, and shall not be part of any registration statement or other document filed under the Securities Act of 1933 or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report to be signed on its behalf by the undersigned thereunto duly authorized.

AGILYSYS, INC.

Date: February 9, 2012

/s/ Janine K. Seebeck
Janine K. Seebeck
Vice President Controller
(Principal Accounting Officer and Duly Authorized Officer)