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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2002

Commission File Number 000-31141

DISCOVERY PARTNERS INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-0655706**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. employer identification number)**
9640 Towne Centre Drive San Diego, California 92121	**(858) 455-8600**
(Address of principal executive offices and zip code)	**(Registrant's telephone number, Including area code)**

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

Yes [X] No [ ]

As of November 1, 2002 a total of 24,372,862 shares of the Registrant's Common Stock, $0.001 par value, were issued and outstanding.

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DISCOVERY PARTNERS INTERNATIONAL, INC.

PART I
FINANCIAL INFORMATION

Item 1. ***Financial Statements***

Discovery Partners International, Inc.
Condensed Consolidated Balance Sheets

	September 30, 2002	December 31, 2001
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,559,882	$ 50,915,481
Short-term investments	59,382,785	26,349,756
Accounts receivable	9,931,518	10,143,648
Inventories	4,638,431	8,174,755
Prepaid and other current assets	1,591,229	1,401,914
Total current assets	86,103,845	96,985,554
Restricted cash	898,426	861,352
Property and equipment, net	10,057,279	10,641,664
Goodwill, net	50,918,089	50,918,089
Patent, license rights and other intangible assets, net	7,637,256	6,400,268
Other assets, net	1,228,829	1,215,184
Total assets	$ 156,843,724	$ 167,022,111
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 4,182,216	$ 3,816,132
Contract loss accrual	1,426,870	—
Current portion of obligations under capital leases and line of credit	911,418	738,170
Deferred revenue	2,833,192	3,880,817
Total current liabilities	9,353,696	8,435,119
Obligations under capital leases, less current portion	421,198	1,082,257
Deferred rent	105,300	95,300
Minority interest in consolidated subsidiary	54,879	367,881
Stockholders' equity:		
Preferred stock, $.001 par value, 1,000,000 shares authorized, no shares issued and outstanding at September 30, 2002 and December 31, 2001	—	—
Common stock, $.001 par value, 99,000,000 shares authorized, 24,363,382 and 24,262,181 issued and outstanding at September 30, 2002 and December 31, 2001, respectively	24,363	24,262
Treasury stock, at cost, 35,000 shares	(119,250)	(119,250)
Additional paid-in capital	200,686,247	200,533,917
Deferred compensation	(372,643)	(882,964)
Note receivable from stockholder	(240,000)	(240,000)
Accumulated other comprehensive income	743,002	302,987
Accumulated deficit	(53,813,068)	(42,577,398)
Total stockholders' equity	146,908,651	157,041,554
Total liabilities and stockholders' equity	$ 156,843,724	$ 167,022,111

See accompanying notes.

Discovery Partners International, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Revenues	$ 10,544,241	$ 9,639,994	$ 28,959,962	$ 30,215,066
Cost of revenues:				
Cost of revenues before additional charges	6,975,814	4,972,156	19,158,799	14,931,706
Additional charges:				
Provision for discontinued products and obsolete inventory	—	4,396,795	5,781,262	4,396,795
Anticipated contract loss	—	—	1,485,000	—
Gross margin	3,568,427	271,043	2,534,901	10,886,565
Operating expenses:				
Research and development	1,301,095	3,088,128	5,147,479	9,956,053
Selling, general and administrative	3,523,720	2,663,773	9,832,908	8,178,164
Amortization of stock-based compensation	138,276	244,181	510,321	843,678
Amortization of goodwill	—	1,471,810	—	4,376,763
Total operating expenses	4,963,091	7,467,892	15,490,708	23,354,658
Loss from operations	(1,394,664)	(7,196,849)	(12,955,807)	(12,468,093)
Interest income, net	514,479	716,900	1,496,171	2,700,037
Foreign currency transaction gains (losses), net	(26,016)	(3,267)	(89,036)	60,088
Minority interest in consolidated subsidiary	97,278	60,793	313,002	196,583
Net loss	$ (808,923)	$ (6,422,423)	$ (11,235,670)	$ (9,511,385)
Net loss per share, basic and diluted	$ (0.03)	$ (0.27)	$ (0.46)	$ (0.40)
Weighted average shares outstanding, basic and diluted	24,328,208	24,134,645	24,306,838	23,968,537
The composition of stock-based compensation is as follows:				
Cost of revenues	$ 2,049	$ 3,671	$ 7,363	$ 12,228
Research and development	60,812	104,979	212,521	358,618
Selling, general and administrative	75,415	135,531	290,437	472,832
	$ 138,276	$ 244,181	$ 510,321	$ 843,678

See accompanying notes.

Discovery Partners International, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended	
	September 30, 2002	September 30, 2001
OPERATING ACTIVITIES		
Net loss	$ (11,235,670)	$ (9,511,385)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:		
Depreciation and amortization	3,846,561	4,262,287
Amortization of goodwill	—	4,376,763
Provision for discontinued products and obsolete inventory	5,781,262	4,396,795
Anticipated contract loss	1,485,000	—
Amortization of deferred compensation	510,321	843,678
Minority interest in consolidated subsidiary	(313,002)	(196,583)
Change in operating assets and liabilities:		
Accounts receivable	(268,869)	1,407,296
Inventories	(2,244,938)	(2,907,315)
Prepaid and other current assets	(175,300)	407,180
Accounts payable and accrued expenses	291,377	(2,677,934)
Contract loss accrual	(58,130)	—
Deferred revenue	(1,106,617)	(1,478,375)
Deferred rent	10,000	36,306
Restricted cash	(382)	200,000
Net cash used in operating activities	(3,478,387)	(841,287)
INVESTING ACTIVITIES		
Purchases of property and equipment	(1,989,833)	(2,589,094)
Other assets	62,838	447,875
Purchase of patents, license rights and other intangible assets	(2,080,590)	(2,114,283)
Additional cash consideration for acquisition of Discovery Technologies Ltd.	—	(894,300)
Purchases of short-term investments	(39,579,773)	(28,036,480)
Proceeds from maturity of short-term investments	6,546,744	—
Purchase of Systems Integration Drug Discovery Company, Inc., net of cash acquired	—	(12,011,297)
Purchase of Xenometrix, Inc., net of cash acquired	—	(1,795,077)
Net cash used in investing activities	(37,040,614)	(46,992,656)
FINANCING ACTIVITIES		
Proceeds from borrowings (principal payments) on capital leases and line of credit, net	(634,051)	985,438
Issuance of common stock, net of purchases	152,431	407,874
Net cash provided by (used in) financing activities	(481,620)	1,393,312
Effect of exchange rate changes	645,022	(254,992)
Net decrease in cash and cash equivalents	(40,355,599)	(46,695,623)
Cash and cash equivalents at beginning of period	50,915,481	97,690,236
Cash and cash equivalents at end of period	$ 10,559,882	$ 50,994,613
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 132,988	$ 105,601
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Fair value of assets acquired	$ —	$ 17,726,858
Cash paid for capital stock	—	(15,002,448)
Liabilities assumed	$ —	$ 2,724,410

See accompanying notes.

DISCOVERY PARTNERS INTERNATIONAL, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
SEPTEMBER 30, 2002

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The condensed consolidated balance sheet as of September 30, 2002, condensed consolidated statements of operations for the three and nine months ended September 30, 2002 and 2001, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2002 and 2001 are unaudited, but include all adjustments (consisting of normal recurring adjustments) which the Company considers necessary for a fair presentation of the financial position, results of operations and cash flows for the periods presented. The results of operations for the three and nine months ended September 30, 2002 shown herein are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For more complete financial information, these financial statements, and notes thereto, should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2001 included in the Company's Form 10-K filed with the Securities and Exchange Commission.

The consolidated financial statements include all the accounts of the Company and its wholly owned subsidiaries, IRORI Europe, Ltd., Discovery Partners International AG (DPI AG), ChemRx Advanced Technologies, Inc., Systems Integration Drug Discovery Company, Inc. and Xenometrix, Inc., and its majority owned subsidiary, Structural Proteomics, Inc. All intercompany accounts and transactions have been eliminated.

Certain prior period balances have been reclassified to conform to the current period presentation.

2. Net Loss Per Share

Basic and diluted net loss per common share are presented in conformity with Statement of Financial Accounting Standard (SFAS) No. 128, *Earnings per Share*. In accordance with SFAS No. 128, basic and diluted net loss per share has been computed using the weighted average number of shares of common stock outstanding during the period, less shares subject to repurchase. The Company has also excluded the effects of outstanding stock options and warrants from the calculation of diluted net loss per common share because all such securities are anti-dilutive for all applicable periods presented.

3. Comprehensive Loss

SFAS No. 130, *Reporting Comprehensive Income,* requires the Company to report, in addition to net loss, comprehensive income (loss) and its components. A summary follows:

Consolidated Statements of Comprehensive Loss
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2002	September 30, 2001	September 30, 2002	September 30, 2001
Comprehensive loss:				
Foreign currency translation adjustment	$ 30,710	$ 357,848	$ 471,074	$ (192,492)
Unrealized gain (loss) on investments	(69,723)	547,145	(31,059)	478,389
Net loss	(808,923)	(6,422,423)	(11,235,670)	(9,511,385)
Comprehensive loss	$ (847,936)	$ (5,517,430)	$ (10,795,655)	$ (9,225,488)

4. Inventory

Inventories are recorded at the lower of weighted average cost or market. Inventories consist of the following:

	September 30, 2002	December 31, 2001
	(Unaudited)	
Raw materials	$ 1,325,657	$ 1,304,113
Work-in-process	3,618,854	848,664
Finished goods	18,159,803	17,441,612
	23,104,314	19,594,389
Less reserves	(18,465,883)	(11,419,634)
	$ 4,638,431	$ 8,174,755

During the second quarter of 2002, the Company identified changes in the market for chemical compound libraries including a shift in demand from diverse purified compounds to purified targeted compounds and an increased demand to bring proprietary assets into drug discovery collaborations. As a result, the Company has made a decision to cease selling its chemical compounds on a stand-alone basis to third parties and, instead, will only make these compounds available as part of collaborations with future partners of the Company; however, there are no assurances that this strategy will be successful. Accordingly, the Company increased its inventory reserve by approximately $5.8 million to fully reserve for the chemical compound libraries as of June 30, 2002.

Although the Company will not market these compounds in the future, it will fulfill its current contractual obligations, which expire in June 2003, to supply chemical compounds. The Company estimated that it will incur a loss of approximately $1.5 million on the delivery of these compounds under this existing contract and, therefore, provided for this anticipated contract loss in the results of operations for the three months ended June 30, 2002. During the third quarter of 2002, the Company incurred a loss totaling $58,130 related to the sale of compounds under these contracts and the Company has, therefore, reduced the contract loss accrual by such amount to $1,426,870.

5. Deferred Stock Compensation

In conjunction with the Company's initial public offering completed in July 2000, the Company recorded deferred stock compensation totaling approximately $2.7 million and $1.0 million during the years ended December 31, 2000 and 1999, respectively, representing the difference at the date of grant between the exercise or purchase price and estimated fair value of the Company's common stock as estimated by the Company's management for financial reporting purposes in accordance with Accounting Principles Board (APB) No. 25 and its related interpretation. Deferred compensation is included as a reduction of stockholders' equity and is being amortized to expense on an accelerated basis in accordance with Financial Accounting Standards Board Interpretation No. 28 over the vesting period of the options and restricted stock. During the three months ended September 30, 2002 and 2001, the Company recorded amortization of stock-based compensation expense of approximately $138,000 and $244,000, respectively. During the nine months ended September 30, 2002 and 2001, the Company recorded amortization of stock-based compensation expense of approximately $510,000 and $844,000, respectively.

6. Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board (FASB) issued FASB Statements Nos. 141 and 142 (SFAS 141 and SFAS 142), *Business Combinations* and *Goodwill and Other Intangible Assets,* respectively. SFAS 141 replaces prior accounting standards and eliminates pooling-of-interests accounting prospectively. It also provides guidance on purchase accounting related to the recognition of intangible assets and accounting for negative goodwill. SFAS 142 changes the accounting for goodwill from an amortization method to an impairment write-off approach. Under SFAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired. SFAS 141 and SFAS 142 are effective for all business combinations completed after June 30, 2001. Additionally, effective January 1, 2002 amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 ceased, and intangible assets acquired prior to July 1, 2001 that do not meet the criteria for separate recognition under SFAS 141 have been reclassified to goodwill. The Company adopted SFAS 142 as of January 1, 2002. Accordingly, the Company ceased the amortization of goodwill and certain other intangibles resulting from acquisitions prior to July 1, 2001. The Company has determined that as of January 1, 2002 there was no impairment of goodwill. During the fourth quarter of 2002, the Company will perform its annual goodwill impairment analysis in accordance with SFAS 142 to test again for impairment. Since January 1, 2002, the market capitalization of companies in the biotechnology and pharmaceutical industries, including Discovery Partners, has significantly declined. The effects of these external market factors may contribute to a finding of goodwill impairment. Such a finding would require the impaired goodwill amount to be written off.

The following unaudited pro forma information reconciles the net loss and loss per share reported for the three and nine months ended September 30, 2001 to adjusted net loss and loss per share which reflects the adoption of SFAS 142 and compares the adjusted information to the current year results:

	Three Months Ended September 30		Nine Months Ended September 30	
	2002	2001	2002	2001
		(Pro Forma)		(Pro Forma)
Reported net loss	$(808,923)	$(6,422,423)	$(11,235,670)	$(9,511,385)
Goodwill and other intangible asset amortization	—	1,602,574	—	4,867,725
Adjusted net loss	$(808,923)	$(4,819,849)	$(11,235,670)	$(4,643,660
Basic and diluted loss per share:				
Reported net loss	$ (0.03)	$ (0.27)	$ (0.46)	$ (0.40)
Goodwill and other intangible asset amortization	—	0.07	—	0.20
Adjusted net loss per share	$ (0.03)	$ (0.20)	$ (0.46)	$ 0.20

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* which addresses financial reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of,* and the accounting and reporting provisions of APB No. 30, *Reporting the Results of Operations* for a disposal of a segment of a business. Adoption of SFAS No. 144, effective January 1, 2002, did not have a significant impact on the Company's financial condition or results of operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal.* SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and supersedes EITF Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The principal difference between SFAS 146 and Issue 94-3 relates to the requirements under SFAS 146 for recognition of a liability for a cost associated with an exit or disposal activity. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost as generally defined in Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. The provisions of SFAS 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. We do not expect that the adoption of SFAS 146 will have a material impact on the consolidated financial statements.

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

THIS FORM 10-Q CONTAINS CERTAIN STATEMENTS THAT ARE NOT STRICTLY HISTORICAL AND ARE "FORWARD-LOOKING" STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND INVOLVE A HIGH DEGREE OF RISK AND UNCERTAINTY. OUR ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE PROJECTED IN THE FORWARD-LOOKING STATEMENTS DUE TO RISKS AND UNCERTAINTIES THAT EXIST IN OUR OPERATIONS, DEVELOPMENT EFFORTS AND BUSINESS ENVIRONMENT, INCLUDING THOSE DESCRIBED BELOW UNDER THE HEADING "RISKS AND UNCERTAINTIES" AND THOSE DESCRIBED IN OUR FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2001 AND OTHER REPORTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION.

Overview

We sell a broad range of products and services to pharmaceutical and biotechnology companies to make the drug discovery process for our customers faster, less expensive and more effective at generating drug candidates. We focus on the portion of the drug discovery process that begins after identification of a drug target through when a drug candidate is ready for clinical trials. Our major products and services are as follows:

- We develop, produce and sell collections of chemical compounds in collaborations with pharmaceutical and biotechnology companies to be used to test for their potential use as new drugs or for use as the chemical starting point for new drugs.
- We develop, manufacture and sell proprietary instruments and the associated line of consumable supplies that are used by the pharmaceutical and biotechnology industries in their own in-house drug discovery chemistry operations.
- We provide assay development and screening services to our customers in which chemical compounds are tested for their biological activity as potential drugs.
- We provide access to computational software tools that guide the entire process of chemical compound design, development and testing.
- We license our proprietary gene profiling system that characterizes a cell's response upon exposure to compounds and other agents by the pattern of gene expression in the cell.

Business conditions in our industry have been difficult in 2002 and we expect them to continue to be difficult through at least 2003. We do not expect that we could achieve substantial internal growth through 2003, except with a sacrifice of profitability. We will not seek the sort of revenue growth which we think will be unprofitable, and we will try to manage our expenses accordingly.

Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates, and the estimates themselves might be different if we used different assumptions.

We believe the following critical accounting policies involve significant judgments and estimates that are used in the preparation of our financial statements.

Revenue recognition. Revenue from product sales, which include the sale of instruments, related consumables, and chemical compound libraries, is recorded as products are shipped if the costs of such shipments can be reasonably estimated and if all customer's acceptance criteria have been met. Currently, we are delivering compounds pursuant to a significant multi-year contract. Compounds are shipped to the customer as soon as they have met acceptance criteria even if this results in partial shipment of a production batch. As of September 30, 2002, we did not have sufficient historical production yield experience to estimate the costs of these partial shipments; therefore, we have deferred the recognition of revenue and cost of sales until all compounds expected to be

delivered in a specific production batch have been shipped to allow us to more accurately calculate the costs. Certain of our contracts for product sales include customer acceptance provisions that give our customers the right of replacement if the delivered product does not meet specified criteria; however, we have historically demonstrated that the products meet the specified criteria and we have no material history of customers exercising their right of replacement. Development contract revenues and high-throughput screening service revenues are recognized on a percentage of completion basis. Advances received under these development contracts and high-throughput screening service agreements are initially recorded as deferred revenue, which is then recognized as costs are incurred over the term of the contract. Certain of these contracts may allow the customer the right to reject acceptance of work performed; however, we have no material history of such rejections. Revenue from drug discovery and chemistry service agreements is recognized on a monthly basis and is based upon the number of full time equivalent (FTE) employees that actually worked on each agreement and the agreed-upon rate per FTE per month. Revenue due to us under the Xenometrix patent licensing agreements is recognized upon receipt of monies, provided we have no future obligation with respect to such payments. From time to time we receive requests from customers to bill and hold goods for them. In these cases, the customer accepts the risk of loss and the transfer of ownership of such goods prior to shipment. If the specific revenue recognition criteria under accounting principles generally accepted in the United States at the time of the bill and hold are met, the revenue is recognized.

Long-lived assets. We periodically assess the recoverability of our long-lived assets by determining whether the carrying value of such assets exceeds its fair value. If impairment is indicated, we reduce the carrying value of the asset to fair value. While our current and historical operating and cash flow losses are potential indicators of impairment, we believe the future cash flows to be received from our business and long-lived assets will exceed the assets' carrying value, and accordingly, we have not recognized any impairment losses through September 30, 2002.

Inventory. Inventories are recorded at the lower of cost or market. We write-down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than we have projected, additional inventory write-downs may be required. During the second quarter of 2002, we identified changes in the market for chemical compound libraries including a shift in demand from diverse purified compounds to purified targeted compounds and an increased demand to bring proprietary assets into drug discovery collaborations. As a result, we made a decision to cease selling our proprietary chemical compounds on a stand-alone basis to third parties and, instead, will make these compounds available only as part of collaborations with our future partners; however, there are no assurances that this strategy will be successful. We will expense the development and production of any compound that is created for exclusive use as part of collaborations with our future partners. A significant portion of our net inventory balance is work-in-process related primarily to two multi-year chemistry collaborations, for one of which we are not yet able to reasonably estimate the costs of partial shipments made under the contract. For this contract, we anticipated recording revenue on a percentage of completion method (units of delivery), however, we have deferred the recognition of revenue and cost of sales until all compounds expected to be delivered in a specific production batch have been shipped to allow us to more accurately calculate the costs. Estimated losses on any deliverables are recorded when they become apparent. During the third quarter, we have reserved approximately $273,000 against the work-in-process representing the anticipated loss on the sale of one of our chemical libraries.

Goodwill. In accordance with SFAS 142 we account for goodwill using an impairment write-off approach. Under SFAS 142, we will test goodwill annually (as of October 1) and whenever events or circumstances occur indicating that goodwill might be impaired. Goodwill is tested for impairment by comparing the fair value of each reporting unit with its carrying value. Fair value was initially determined based on a valuation performed by the Company which primarily considered the discounted cash flow, guideline company and similar transaction methods. We determined that as of January 1, 2002 there was no impairment of goodwill. During the fourth quarter of 2002, we will be performing our annual goodwill impairment analysis in accordance with SFAS 142 to test again for impairment. Since January 1, 2002, the market capitalization of companies in the biotechnology and pharmaceutical industries, as well as companies providing drug discovery tools like Discovery Partners, has significantly declined. Among the factors that can contribute to a determination that goodwill has been impaired are continuing operating losses by a reporting unit, and an enterprise market capitalization that is at or below cash/short-term investment position.

Results of Operations For The Three Months Ended September 30, 2002 and 2001

Revenue. Total revenues increased 9% from the three months ended September 30, 2001 to the three months ended September 30, 2002. The revenue increase was primarily due to the expected production ramp up of our long-term chemistry collaborations and an increase in chemistry license revenue offset by lower revenues from the sale of non-exclusive chemical compounds, lower instrumentation product and contract sales, lower screening revenues and lower grant revenues. It is expected that revenues will exceed $11.0 million in the fourth quarter of 2002.

Cost of revenues. Cost of revenues for the third quarter of 2001 includes a charge of $4.4 million of obsolete inventory reserves. During the third quarter of 2001, we experienced a shift in our mix of sales orders indicating a decrease in demand for certain of our inventoried chemical compound libraries, specifically large diversity libraries containing non-purified compounds. As a result of the changes in the marketplace, we assessed our ending inventory and increased our reserves for specifically identified obsolete inventory. No such charge was recorded in the third quarter 2002.

Gross margin. Gross margin as a percentage of revenues (excluding a charge of $4.4 million related to obsolete inventory taken in the third quarter of 2001) decreased from 48% for the three months ended September 30, 2001 to 34% for the three months ended September 30, 2002. The reduction in gross margin for the third quarter 2002 was due to previously anticipated changes in the product and services mix, which resulted in a redeployment of company funded research and development efforts and resources to direct revenue generating activities, as well as unabsorbed biology operations capacity. This decrease was partially offset by new chemistry license agreements entered into in the third quarter 2002 with higher margins. Gross margin as a percentage of revenues is unlikely to increase from third quarter 2002 due to the forecasted absence of new chemistry licensing revenues and due to potential production ramp-up inefficiencies.

Research and development expenses. Research and development expenses consist primarily of salaries and benefits, supplies and expensed development materials, and facilities costs and equipment depreciation. Research and development expenses decreased 58% ($1.8 million) from the three months ended September 30, 2001 to the three months ended September 30, 2002 primarily due to the redeployment of company funded research and development efforts and resources to direct revenue generating activities. The Company expects to reduce research and development expenditures to 10% of revenues.

Selling, general and administrative expenses. Selling, general and administrative expenses consist primarily of salaries and benefits for sales and marketing and administrative personnel, advertising and promotional expenses, professional services, and facilities costs. Selling, general and administrative expenses increased 32% ($860,000) from the three months ended September 30, 2001 to the three months ended September 30, 2002, due to additional personnel hired and relocation costs associated with the recent appointments of the Chief Operating Officer and the Chief Financial Officer.

Stock-based compensation. During 1999 and 2000, we granted stock options with exercise prices that were less than the estimated fair value of the underlying shares of common stock on the date of grant. As a result, we have recorded deferred stock-based compensation to be amortized over the period that these options vest. The deferred stock-based compensation expense for the three months ended September 30, 2002 was approximately $138,000, compared to approximately $244,000 for the three months ended September 30, 2001.

Amortization of goodwill. We recognized no goodwill amortization expense for the three months ended September 30, 2002 compared to approximately $1.5 million in goodwill amortization expense recognized during the three months ended September 30, 2001. This decrease is due to the adoption of SFAS 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002. SFAS 142 required that we cease the periodic amortization of goodwill and certain other intangibles resulting from acquisitions prior to July 1, 2001. However, SFAS 142 also requires that goodwill be reviewed periodically and written off to the extent that it is impaired. We will conduct a goodwill impairment review in the fourth quarter 2002. We believe that significant goodwill write offs are possible.

Interest income. We realized net interest income of approximately $515,000 for the three months ended September 30, 2002, as compared to net interest income of approximately $717,000 for the three months ended September 30, 2001. This decrease is primarily due to a decline in U.S. interest rates and a decrease in the average cash balance from the third quarter 2001 to the third quarter 2002.

Results of Operations For The Nine Months Ended September 30, 2002 and 2001

Revenue. Total revenues decreased 4% from the nine months ended September 30, 2001 to the nine months ended September 30, 2002. The revenue decline was primarily due to significantly lower revenues from the sale of non-exclusive chemical compounds, lower instrumentation product and contract sales, lower screening revenues and lower grant revenues. These decreases were partially offset by increased revenue related to collaboration agreements with large pharmaceutical companies and instrumentation services contracts.

Cost of Revenues. Cost of revenues for the nine months ended September 30, 2002 includes a charge of $5.8 million related to provisions for discontinued products. During the three months ended June 30, 2002, we identified changes in the market for chemical

compound libraries including a shift in demand from diverse purified compounds to purified targeted compounds and an increased demand to bring proprietary assets into drug discovery collaborations. As a result, we made a decision to cease selling our chemical compounds on a stand-alone basis to third parties and, instead, will make these compounds available only as part of collaborations with our future partners; however, there are no assurances that this strategy will be successful. Accordingly, we increased our inventory reserve by approximately $5.8 million to fully reserve for the chemical compound libraries as of September 30, 2002 and recorded this charge as an additional cost of revenue.

Additionally, the cost of revenues for the nine months ended September 30, 2002 includes a provision for contract losses estimated at approximately $1.5 million. The associated contracts obligate us to deliver compounds each quarter through the second quarter of 2003. The pricing of the compounds included in these contracts assumed that we would sell these compounds, under certain conditions, to multiple other customers. As a result of our decision to cease selling these compounds on a stand-alone basis, these secondary sales will not be realized and thus a loss is anticipated for these existing contacts. During the third quarter of 2002, we incurred a loss totaling $58,130 related to the sale of compounds under this contract and we have, therefore, reduced the contract loss accrual by such amount to $1,426,870.

Cost of revenues for the nine months ended September 30, 2001 includes a charge of $4.4 million of obsolete inventory reserves. During the third quarter of 2001, we experienced a shift in our mix of sales orders indicating a decrease in demand for certain of our inventoried chemical compound libraries, specifically large diversity libraries containing non-purified compounds. As a result of the changes in the marketplace, we assessed our ending inventory and increased our reserves for specifically identified obsolete inventory.

Gross margin. Gross margin as a percentage of revenues decreased from 51% for the nine months ended September 30, 2001 (excluding a $4.4 million charge for obsolete inventory) to 34% for the nine months ended September 30, 2002 (excluding a charge of $5.8 million related to discontinued products and $1.5 million of anticipated contract losses). The reduction in gross margin for the nine months ended September 30, 2002 was due to previously anticipated changes in the product and services mix, which resulted in a redeployment of company funded research and development efforts and resources to direct revenue generating activities, as well as unabsorbed biology operations capacity and non-recurring inefficiencies associated with ramping up our chemistry purification facility; partially offset by new chemistry license agreements entered into in the third quarter 2002 with higher margins.

Research and development expenses. Research and development expenses consist primarily of salaries and benefits, supplies and expensed development materials, and facilities costs and equipment depreciation. Research and development expenses decreased 48% ($4.8 million) from the nine months ended September 30, 2001 to the nine months ended September 30, 2002. Research and development expenses decreased primarily due to the redeployment of company funded research and development efforts and resources to direct revenue generating activities.

Selling, general and administrative expenses. Selling, general and administrative expenses consist primarily of salaries and benefits for sales and marketing and administrative personnel, advertising and promotional expenses, professional services, and facilities costs. Selling, general and administrative expenses increased 20% ($1.7 million) from the nine months ended September 30, 2001 to the nine months ended September 30, 2002, due to additional personnel hired and relocation costs associated with the recent appointments of the Chief Operating Officer and the Chief Financial Officer and to payments to a strategic consulting firm.

Stock-based compensation. During 1999 and 2000, we granted stock options with exercise prices that were less than the estimated fair value of the underlying shares of common stock on the date of grant. As a result, we have recorded deferred stock-based compensation to be amortized over the period that these options vest. The deferred stock-based compensation expense for the nine months ended September 30, 2002 was approximately $510,000, compared to approximately $844,000 for the nine months ended September 30, 2001.

Amortization of goodwill. We recognized no goodwill amortization expense for the nine months ended September 30, 2002 compared to approximately $4.4 million in goodwill amortization expense recognized during the nine months ended September 30, 2001. This decrease is due to the adoption of SFAS 142, *Goodwill and Other Intangible Assets,* effective January 1, 2002. SFAS 142 required that we cease the periodic amortization of goodwill and certain other intangibles resulting from acquisitions prior to July 1, 2001. However, SFAS 142 also requires that goodwill be reviewed periodically and written off to the extent that it is impaired. We will conduct a goodwill impairment review in the fourth quarter 2002. We believe that significant goodwill write offs are possible.

Interest income. We realized net interest income of approximately $1.5 million for the nine months ended September 30, 2002, as compared to net interest income of approximately $2.7 million for the nine months ended September 30, 2001. This decrease is primarily due to a decline in U.S. interest rates and a decrease in the average cash balance.

Liquidity and Capital Resources

Since inception of the Company, we have funded our operations principally with $39.0 million of private equity financings and $94.7 million of net proceeds from our initial public offering in July/August 2000.

At September 30, 2002, cash and cash equivalents and short-term investments totaled approximately $69.9 million, compared to $77.3 million at December 31, 2001.

We currently anticipate investing between $0.8 million and $1.4 million during the fourth quarter of 2002 for leasehold improvements and capital equipment necessary to support future revenue growth. Our actual future capital requirements will depend on a number of factors, including our success in increasing sales of both existing and new products and services, expenses associated with any unforeseen litigation, regulatory changes, competition and technological developments, and potential future merger and acquisition activity.

In April 2002, we paid $2 million in prepaid royalties as required under our exclusive Micro Arrayed Compound Screening (#ARCS) license agreement with Abbott Laboratories, which we carry on the balance sheet as other intangible assets. Expense will be recognized when royalties are earned. No other such license fees are payable for the remainder of 2002. If we elect to continue the exclusive license agreement with Abbott into 2003, a payment of $2 million will be due in April 2003.

RISKS AND UNCERTAINTIES

In addition to the other information contained herein, you should carefully consider the following risk factors in evaluating our company.

We derive a significant percentage of our revenues from a single customer and are contractually required to fulfill specific obligations. We need to continue to satisfy the customer or else we could lose the contract and its anticipated revenues.

We anticipate that a significant portion of our revenues for 2002 and beyond will be derived from our chemistry collaboration we entered into with Pfizer in December 2001. This collaboration requires us to deliver a large number of chemical compounds of guaranteed minimum purity with higher minimum weight quantity than we have historically been required to produce and deliver to other customers. We face the risk that, to the extent such minimum weight quantity and purity levels are not achieved in production, scheduled compound deliveries may be delayed, or additional costs may be required to reproduce or re-purify the compounds so that the minimum specifications are achieved, which could defer or eliminate revenues while increasing cost of revenues. We also may fail to deliver the minimum number of compounds required by Pfizer, which would increase the risk of Pfizer exercising its right to terminate the contract. In any event Pfizer has a contractual right to terminate the contract, with or without cause, upon six months notice beginning on January 1, 2003. During the three and nine months ended September 30, 2002, revenue from Pfizer represented 52% and 37%, respectively, of total revenue.

We may not achieve or sustain profitability in the future.

We have incurred operating and net losses since our inception. As of September 30, 2002, we had an accumulated deficit of $53.8 million. For the years ended December 31, 1999, 2000 and 2001 and for the nine months ended September 30, 2002, we had net losses of $3.4 million, $11.7 million, $11.1 million, and $11.2 million, respectively. We may also in the future incur operating and net losses and negative cash flow from operations. We may not be able to achieve or maintain profitability. Moreover, if we do achieve profitability, the level of any profitability cannot be predicted and may vary significantly from quarter to quarter.

We expect business conditions in our industry to be difficult in the near term.

Because we anticipate business conditions in the drug discover services business to be difficult through at least 2003, we are not seeking and do not anticipate sizable organic revenue growth in 2003.

Our success will depend on the prospects of the pharmaceutical and biotechnology industries and the extent to which these industries engage third parties to perform one or more aspects of their drug discovery process.

Our revenues depend to a large extent on research and development expenditures by the pharmaceutical and biotechnology industries and companies in these industries outsourcing research and development projects. These expenditures are based on a wide variety of factors, including the resources available for purchasing research equipment, the spending priorities among various types of research and policies regarding expenditures during recessionary periods. General economic downturns in our customers' industries or any decrease in research and development expenditures could harm our operations, as could increased popularity of management theories that counsel against outsourcing of critical business functions. In addition, the popularity of scientific thinking that disfavors expensive products (such as large diversity libraries) could negatively impact our revenues or our sales mix. Any decrease in drug discovery spending by pharmaceutical and biotechnology companies could cause our revenues to decline and adversely impact our profitability.

Our success will depend on technological improvements to the process of drug discovery and on improvements to our customers' expected return on investment (ROI) in the phases of the drug discovery and development process that we participate in.

The drug discovery and development process can be broadly separated into the following stages: Target identification; target validation; lead discovery; lead optimization; pre-clinical development; IND filing; clinical trials, phases I-III; new drug application (NDA); and post market surveillance. We currently participate in the areas of lead discovery and lead optimization. Current market studies indicate that, on average, less than one in fifty leads discovered ultimately results in an NDA. Moreover, based on current averages, for the isolated phases of lead discovery and lead optimization, the cost of acquiring a validated target plus the costs of lead discovery and lead optimization are greater than the expected proceeds of out-licensing a potential drug candidate during the pre-clinical phase of drug development. It is estimated that currently, a positive expected ROI on drug discovery and development does

not occur until the drug candidate has successfully passed through phase II of clinical trials. Such conditions make it difficult for us to solicit profitable business from collaboration partners who are unable to fund the development of drug candidates through phase II of clinical trials.

The concentration of the pharmaceutical industry and the current trend toward increasing consolidation could hurt our business prospects.

The pharmaceutical company side of the market for our products and services is highly concentrated, with approximately 50 large pharmaceutical companies conducting drug discovery research. The continuation of the current trend toward consolidation of the pharmaceutical industry may reduce the number of our potential customers even further. Accordingly, we expect that a relatively small number of customers will account for a substantial portion of our revenues.

Additional risks associated with a highly concentrated customer base include:

- fewer customers for our products and services;
- larger companies may develop and utilize in-house technology and expertise rather than using our products and services;
- larger customers may negotiate price discounts or other terms for our products and services that are unfavorable to us; and
- the market for our products and services may become saturated.

For example, because of the heavy concentration of the pharmaceutical industry and the high cost of our NanoKan System, we expect to place only a small number of NanoKan Systems before we saturate the market for this product. We have not filled an order for a NanoKan System since 2000. When we are no longer able to sell additional NanoKan Systems, we will be dependent upon the sale of consumables for revenue from this product line.

We may write off significant amounts of goodwill.

We are carrying $50.9 million of goodwill on our balance sheet arising from acquisitions. We intend to conduct a goodwill impairment review in the fourth quarter of 2002. The fact that our market capitalization recently has been approximately equal to our net cash position is considered an indicator of impairment. If the goodwill is impaired, we must write a portion or all of it off, which could result in a very significant reported net loss.

Our decision to discontinue the non-exclusive chemical compound supply product line places more emphasis on integrated drug discovery collaborations, an area of higher risk and complexity.

As a result of our decision to limit access to our proprietary chemistry compounds and capabilities solely to companies that enter into integrated drug discovery, chemistry or screening and optimization collaborations with us, we now rely on this relatively complex form of customer engagement to deliver value for the Company. As a result of the inherent complexity of such collaborations, we have an increased risk of being unable to reach agreement with the prospective customer for such collaborations or of structuring sub-optimal arrangements that fail to adequately compensate us for the risks inherent in such collaborations.

We may fail to expand customer relationships through integration of products and services.

We may not be successful in selling our offerings in combination across the range of drug discovery disciplines we serve because integrated combinations of our products and services may not achieve time and cost efficiencies for our customers, especially our large pharmaceutical company customers. On the other hand, biotechnology companies may desire our integrated offerings but are often not sufficiently financed to pay for these services. In addition, we may not succeed in further integrating our offerings. We may not be able to use existing relationships with customers in individual areas of our business to sell products and services in multiple areas of drug discovery. If we do not achieve integration of our products and services, we may not be able to take advantage of potential revenue opportunities and differentiate ourselves from competitors.

All our products and services have lengthy sales cycles and involve significant scientific risk of fulfillment, which could cause our operating results to fluctuate significantly from quarter to quarter.

Sales of all our products and services typically involve significant technical evaluation and commitment of expense or capital by our customers. Accordingly, the sales cycles, or the time from finding a prospective customer through closing the sale, associated with these products or collaborations, range from six to eighteen months. Sales of these products and the formation of these collaborations are subject to a number of significant risks, including customers' budgetary constraints and internal acceptance reviews that are beyond our control. Due to these lengthy and unpredictable sales cycles, our operating results could fluctuate significantly from quarter to quarter. We expect to continue to experience significant fluctuations in quarterly operating results due to a variety of factors, such as general and industry specific economic conditions, that may affect the research and development expenditures of pharmaceutical and biotechnology companies.

A large portion of our revenues rely upon the specific success, either on the customer's part in the form of delivering specified proteins for assay development or chemistry library design ideas of scientific projects for chemical compound development and production, or on our part in the form of assay or compound development or compound production,. To the extent that either we experience delays in receiving specific deliverables required for us to complete our objectives or we encounter delays in our ability meet our scientific obligations, we may be unable to receive and recognize revenues in accordance with our expectations.

A large portion of our expenses, including expenses for facilities, equipment and personnel, is relatively fixed. Accordingly, if revenues decline or do not grow as anticipated, we might not be able to correspondingly reduce our operating expenses. Failure to achieve anticipated levels of revenues could therefore significantly harm our operating results for a particular fiscal period.

Due to the possibility of fluctuations in our revenues (on an absolute basis and relative to our expenses), we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance.

If our products and services do not become widely used in the pharmaceutical and biotechnology industries, it is unlikely that we will succeed.

We have a limited history of offering our products and services, including our collections of chemical compounds, informatics tools, biology services, micro Arrayed Compound Screening, toxicology services and NanoKan Systems. It is uncertain whether our current customers will continue to use these products and services or whether new customers will use these products and services. In order to be successful, our products and services must meet the requirements of the pharmaceutical and biotechnology industries, and we must convince potential customers to use our products and services instead of competing technologies and offerings. Moreover, we cannot thrive unless we can achieve economies of scale on our various offerings. Market acceptance will depend on many factors, including our ability to:

- convince potential customers that our technologies are attractive alternatives to other technologies for drug discovery;
- manufacture products and conduct services in sufficient quantities with acceptable quality and at an acceptable cost;
- convince potential customers to purchase drug discovery products and services from us rather than developing them internally; and
- place and service sufficient quantities of our products.

Because of these and other factors, some of which are beyond our control, our products and services may not gain sufficient market acceptance.

The drug discovery industry is competitive and subject to technological change, and we may not have the resources necessary to compete successfully.

We compete with companies in the United States and abroad that engage in the development and production of drug discovery products and services. These competitors include companies engaged in the following areas of drug discovery:

- Assay, development and screening, including Cerep, Evotec Biosciences, Oncogene Sciences, Neogenesis, Pharmacopeia, Tripos and 3D Pharmaceuticals;
- Combinatorial chemistry instruments, including Argonaut and Mimotopes;
- Compound libraries and lead optimization, including Albany Molecular Research, Pharmacopeia, Array Biopharma and Arqule;
- Informatics, including Accelrys and Tripos; and
- Gene profiling, including Affymetrix and Gene Logic.

Academic institutions, governmental agencies and other research organizations also conduct research in areas in which we provide services, either on their own or through collaborative efforts. Also, essentially all of our pharmaceutical company customers have internal departments that provide some or all of the products and services we sell, so these customers may have limited needs for our products and services. Many of our competitors, including Pharmacopeia, have access to greater financial, technical, research, marketing, sales, distribution, service and other resources than we do. We may not yet be large enough to achieve satisfactory market recognition or operating efficiencies, particularly in comparison to some competitors.

Moreover, the pharmaceutical and biotechnology industries are characterized by continuous technological innovation. We anticipate that we will face increased competition in the future as new companies enter the market and our competitors make advanced technologies available. Technological advances or entirely different approaches that we or one or more of our competitors develop may render our products, services and expertise obsolete or uneconomical. For example, advances in informatics and virtual screening may render some of our technologies, such as our large compound libraries, obsolete. Additionally, the existing approaches of our competitors or new approaches or technologies that our competitors develop may be more effective than those we develop. We currently are investing in micro ARCS technology to improve screening processes. However, we may be unable to successfully develop this technology and sell it to customers and we may never recover the cost of our investment including the prepaid royalty to Abbott, which is carried on our balance sheet as other intangible assets in an amount equal to approximately $4.0 million and which could grow to over $6.0 million during 2003. We may not be able to compete successfully with existing or future competitors.

The intellectual property rights we rely on to protect the technology underlying our products and techniques may not be adequate, which could enable third parties to use our technology or very similar technology and could reduce our ability to compete in the market.

Our success will depend on our ability to obtain, protect and enforce patents on our technology and to protect our trade secrets. We also depend, in part, on patent rights that third parties license to us. Any patents we own or license may not afford meaningful protection for our technology and products. Others may challenge our patents or the patents of our licensors and, as a result, these patents could be narrowed, invalidated or rendered unenforceable. In addition, current and future patent applications on which we depend may not result in the issuance of patents in the United States or foreign countries. Competitors may develop products similar to ours that are not covered by our patents. Further, since there is a substantial backlog of patent applications at the U.S. Patent and Trademark Office, the approval or rejection of our or our competitors' patent applications may take several years.

Our European eukaryotic gene profiling patent is currently under opposition in the European Patent Office. Resolution of the opposition may not be reached for up to one year. In any event, such opposition could result in substantial cost to us, whether or not the result of such proceedings is favorable to us. There can be no assurance that this patent will ultimately be held valid or that any efforts to defend our patent will be successful. If we are unsuccessful in defending our European eukaryotic gene profiling patent we could be subject to impairment charges reducing the carrying value of our patent assets.

In addition to patent protection, we also rely on copyright protection, trade secrets, know-how, continuing technological innovation and licensing opportunities. In an effort to maintain the confidentiality and ownership of our trade secrets and proprietary information, we require our employees, consultants and advisors to execute confidentiality and proprietary information agreements. However, these agreements may not provide us with adequate protection against improper use or disclosure of confidential information, and there may not be adequate remedies in the event of unauthorized use or disclosure. Furthermore, like many technology companies, we may from time to time hire scientific personnel formerly employed by other companies involved in one or more areas similar to the activities conducted by us. In some situations, our confidentiality and proprietary information agreements may conflict with, or be subject to, the rights of third parties with whom our employees, consultants or advisors have prior employment or consulting relationships.

Although we require our employees and consultants to maintain the confidentiality of all confidential information of previous employers, their prior affiliations may subject us or these individuals to allegations of trade secret misappropriation or other similar claims. Finally, others may independently develop substantially equivalent proprietary information and techniques, or otherwise gain access to our trade secrets. Our failure to protect our proprietary information and techniques may inhibit or limit our ability to exclude certain competitors from the market.

The drug discovery industry has a history of intellectual property litigation and we may be involved in intellectual property lawsuits, which may be expensive.

In order to protect or enforce our patent rights, we may have to initiate legal proceedings against third parties. In addition, others may sue us for infringing their intellectual property rights, or we may find it necessary to initiate a lawsuit seeking a declaration from a court that we are not infringing the proprietary rights of others. The patent positions of pharmaceutical, biotechnology and drug discovery companies are generally uncertain. A number of pharmaceutical companies, biotechnology companies, independent researchers, universities and research institutions may have filed patent applications or may have been granted patents that cover technologies similar to the technologies owned by, or licensed to, us or our collaborators. A number of patents may have been issued or may be issued in the future that could cover certain aspects of our technology and that could prevent us from using technology that we use or expect to use. In addition, we are unable to determine all of the patents or patent applications that may materially affect our ability to make, use or sell any potential products. Legal proceedings relating to intellectual property would be expensive, take significant time and divert management's attention from other business concerns, no matter whether we win or lose. The cost of such litigation could affect our profitability.

Further, an unfavorable judgment in an infringement lawsuit brought against us, in addition to any damages we might have to pay, could require us to stop the infringing activity or obtain a license. Any required license may not be available to us on acceptable terms, or at all. In addition, some licenses may be nonexclusive, and therefore, our competitors may have access to the same technology that is licensed to us. If we fail to obtain a required license or are unable to design around a patent, we may be unable to sell some of our products or services.

Our stock price likely will be volatile.

The trading price of our common stock likely will be volatile and could be subject to fluctuations in price in response to various factors, many of which are beyond our control, including:

- actual or anticipated variations in quarterly operating results;
- goodwill impairment charges;
- announcements of technological innovations by us or our competitors;
- new products or services introduced or announced by us or our competitors;
- changes in financial estimates by securities analysts;
- conditions or trends in the pharmaceutical and biotechnology industries or in the drug discovery "tools" industry;
- announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- the implementation or wind-down of stock buyback programs;
- additions or departures of key personnel;
- economic and political factors; and
- sales of our common stock.

In addition, price and volume fluctuations in the stock market in general, and the Nasdaq National Market and the market for technology companies in particular, have often been unrelated or disproportionate to the operating performance of those companies. Further, the market prices of securities of life sciences companies have been particularly volatile. Conditions or trends in the pharmaceutical and biotechnology industries generally may cause further volatility in the trading price of our common stock, because the market may incorrectly perceive us as a pharmaceutical or biotechnology company. These broad market and industry factors may harm the market price of our common stock, regardless of our operating performance. In the past, plaintiffs have often instituted securities class action litigation following periods of volatility in the market price of a company's securities. A securities class action suit against us could result in potential liabilities, substantial costs and the diversion of management's attention and resources, regardless of whether we win or lose.

Our customers may restrict our use of scientific information, which could prevent us from using this information for additional revenue.

We plan to generate and use information that is not proprietary to our customers and which we derive from performing drug discovery services for our customers. However, our customers may not allow us to use information such as the general interaction between types of chemistries and types of drug targets that we generate when performing drug discovery services for them. Our current contracts typically restrict our use of certain scientific information we generate for our customers, such as the biological activity of chemical compounds with respect to drug targets, and future contracts also may restrict our use of additional scientific information. To the extent that our use of information is restricted, we may not be able to collect and aggregate scientific data and take advantage of potential revenue opportunities.

Our success will depend on our ability to attract and retain key executives, and experienced scientists and sales personnel.

Our future success will depend to a significant extent on our ability to attract, retain and motivate highly skilled scientists and sales personnel. In addition, our business would be significantly harmed if we lost the services of Riccardo Pigliucci, our chief executive officer. Our ability to maintain, expand or renew existing engagements with our customers, enter into new engagements and provide additional services to our existing customers depends, in large part, on our ability to hire and retain scientists with the skills necessary to keep pace with continuing changes in drug discovery technologies and sales personnel who are highly motivated. Additionally, it is difficult for us to find qualified sales personnel in light of the fact that our sales personnel generally hold Ph.D's. Our employees are "at will," which means that they may resign at any time, and we may dismiss them at any time. We believe that there is a shortage of, and significant competition for, scientists with the skills and experience in the sciences necessary to perform the services we offer. We compete with pharmaceutical companies, biotechnology companies, combinatorial chemistry companies, contract research companies and academic institutions for new personnel. We may not be successful in attracting new scientists or sales personnel or in retaining or motivating our existing personnel.

We have acquired several businesses and face risks associated with integrating these businesses and potential future acquisitions.

We completed the acquisitions of Systems Integration Drug Discovery Company, Inc. (SIDDCO) and Xenometrix last year and are in the process of integrating these businesses. We plan to continue to review potential acquisition candidates in the ordinary course of our business, and our strategy includes building our business through acquisitions. Acquisitions involve numerous risks, including, among others, difficulties and expenses incurred in the consummation of acquisitions and assimilation of the operations, personnel and services or products of the acquired companies, difficulties of operating new businesses, the diversion of management's attention from other business concerns and the potential loss of key employees of the acquired company. In addition, acquired businesses may have management structures incompatible with our own and may experience difficulties in maintaining their existing levels of business after joining us. If we do not successfully integrate and grow the businesses we have acquired or any businesses we may acquire in the future, our business will suffer. Additionally, acquisition candidates may not be available in the future or may not be available on terms and conditions acceptable to us. Acquisitions of foreign companies also may involve additional risks of assimilating different business practices, overcoming language and cultural barriers and foreign currency translation. We currently have no agreements or commitments with respect to any acquisition, and we may never successfully complete any additional acquisitions.

Our success will depend on our ability to manage growth and expansion.

Growth in our operations has placed and, if we grow in the future, will continue to place a significant strain on our operational, human and financial resources. In the past three years we have acquired five new businesses, and we intend to continue to grow our business internally and by acquisition. As and if we expand our operations we will not necessarily have in place infrastructure and

personnel sufficient to accommodate the increased size of our business. Our ability to effectively manage any growth through acquisitions or any internal growth will depend, in large part, on our ability to hire, train and assimilate additional management, professional, scientific and technical personnel and our ability to expand, improve and effectively use our operating, management, marketing and financial systems to accommodate our expanded operations. These tasks are made more difficult as we acquire businesses in geographically disparate locations, such as our acquisitions of Discovery Technologies Ltd. (now Discovery Partners International AG) in Switzerland, Axys Advanced Technologies (now part of ChemRx Advanced Technologies) in the San Francisco area, Structural Proteomics in New Jersey, Systems Integration Drug Discovery Company in Tucson, Arizona and Xenometrix in Boulder, Colorado.

Additionally, as a result of these acquisitions, we have a significant amount of goodwill and we may be subject to significant impairment charges in the future if goodwill pertaining to any acquisition becomes impaired.

Our operations could be interrupted by damage to our facilities.

Our results of operations are dependent upon the continued use of our highly specialized laboratories and equipment. Our operations are primarily concentrated in facilities in San Diego, California, near San Francisco, California, near Basel, Switzerland and in Tucson, Arizona. Natural disasters, such as earthquakes, or terrorist acts could damage our laboratories or equipment and these events may materially interrupt our business. We maintain business interruption insurance to cover lost revenues caused by such occurrences. However, this insurance would not compensate us for the loss of opportunity and potential adverse impact on relations with existing customers created by an inability to meet our customers' needs in a timely manner, and may not compensate us for the physical damage to our facilities.

We may incur exchange losses when foreign currency used in international transactions is converted into U.S. dollars.

Currency fluctuations between the U.S. dollar and the currencies in which we do business including the British pound, the Japanese yen, the Swiss franc and the Euro will cause foreign currency translation gains and losses. We cannot predict the effects of exchange rate fluctuations on our future operating results because of the number of currencies involved, changes in the percentage of our revenue that will be invoiced in foreign currencies, the variability of currency exposure and the potential volatility of currency exchange rates. We do not currently engage in foreign exchange hedging transactions to manage our foreign currency exposure; however, we may begin to hedge certain transactions between the Swiss franc and other currencies that are invoiced from our Swiss affiliate in order to minimize foreign exchange transaction gains and losses.

We may be subject to liability regarding hazardous materials.

Our products and services as well as our research and development processes involve the controlled use of hazardous materials. For example, we often use acids, bases, oxidants, and flammable materials. Acids include trifluoroacetic acid and hydrochloric acid, bases include sodium hydroxide and triethylamine, oxidants include peracids and potassium permanganate, and flammable solvents include methanol, hexane and tetrahydrofuran. We are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of such materials and certain waste products. We cannot completely eliminate the risk of accidental contamination or injury from these materials. In the event of such an accident, we could be held liable for any damages that result, and any such liability could exceed our resources and disrupt our business. In addition, we may have to incur significant costs to comply with environmental laws and regulations related to the handling or disposal of such materials or waste products in the future, which would require us to spend substantial amounts of money.

Because it is unlikely that we will pay dividends, our stockholders will only be able to benefit from holding our stock if the stock price appreciates.

We have never paid cash dividends on our capital stock and do not anticipate paying any cash dividends in the foreseeable future.

Anti-takeover provisions in our charter and bylaws could make a third-party acquisition of us difficult.

Our certificate of incorporation and bylaws contain provisions that could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions could limit the price that investors might be willing to pay in the future for shares of our common stock. In addition, as a result of our acquisition of Axys Advanced Technologies, we have a standstill

agreement with Axys Pharmaceuticals, which prevents Axys Pharmaceuticals (and prevents its subsequent acquirer, the Celera Genomics business of Applera Corporation) from making a hostile effort to acquire us.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Short-term investments. Our interest income is sensitive to changes in the general level of U.S. interest rates, particularly since a significant portion of our investments are and will be in short-term marketable securities, U.S. government securities and corporate bonds. Due to the nature and maturity of our short-term investments, we have concluded that there is no material market risk exposure to our principal. The average maturity of our investment portfolio is six months. A 1% change in interest rates would have an effect of approximately $365,000 on our income.

Foreign currency rate fluctuations. The functional currency for our Discovery Partners International AG (DPI AG) group is the Swiss franc. DPI AG accounts are translated from their local currency to the U.S. dollar using the current exchange rate in effect at the balance sheet date for the balance sheet accounts, and using the average exchange rate during the period for revenues and expense accounts. The effects of translation for our DPI AG group are recorded as a separate component of stockholders' equity (accumulated other comprehensive income (loss)). DPI AG conducts its business with customers in local currencies. Exchange gains and losses arising from these transactions are recorded using the actual exchange differences on the date of the transaction. We have not in the past taken any action to reduce our exposure to changes in foreign currency exchange rates, such as options or futures contracts, with respect to transactions with DPI AG or transactions with our worldwide customers, but anticipate that we could begin to hedge against foreign exchange transaction gains and losses resulting from non-Swiss franc invoices issued to customers by DPI AG in the near future. A 10% change in the value of the Swiss franc relative to the U.S. dollar throughout the first nine months of 2002 would have resulted in a 2% change in revenue for the nine months ended September 30, 2002.

Inflation. We do not believe that inflation has had a material impact on our business or operating results during the periods presented.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

We maintain disclosure controls and procedures, which we have designed to ensure that material information related to Discovery Partners International, Inc., including our consolidated subsidiaries, is made known to our disclosure committee on a regular basis. In response to recent legislation and proposed regulations, we reviewed our internal control structure and our disclosure controls and procedures. Although we believe our existing controls and procedures are adequate to enable us to comply with our disclosure obligations, as a result of such review, we implemented minor changes, primarily to formalize and document the procedures already in place. We also established a disclosure committee which consists of certain members of the Company's senior management.

After the formation of our disclosure committee and within 90 days prior to the filing of this quarterly report, a subset of the disclosure committee comprised of the Company's Chief Executive Officer, Mr. Pigliucci, and Chief Financial Officer, Mr. Kussman, carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based upon that evaluation, Mr. Pigliucci and Mr. Kussman concluded that the Company's disclosure controls and procedures are effective in causing material information to be collected, communicated and analyzed by management of the Company on a timely basis and to ensure that the quality and timeliness of the Company's public disclosures comply with its SEC disclosure obligations.

Changes in Controls and Procedures

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls after the date of our most recent evaluation.

PART II
OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not currently a party to any material legal proceedings.

Item 2. Changes in Securities and Use of Proceeds

On August 1, 2000, we closed the sale of 5,000,000 shares of our Common Stock, $0.001 par value, in our initial public offering (the "Offering"), and on August 30, 2000 we closed the sale of an additional 750,000 shares of Common Stock pursuant to the exercise of the underwriters' overallotment option in the Offering. The shares of Common Stock sold in the Offering were registered under the 1933 Act on a Registration Statement on Form S-1 (Reg. No. 333-36638) that was declared effective by the SEC on July 27, 2000.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

Exhibit Number	Exhibit Description
10.59†	Amendment No. 1 to the 2001 Agreement between us and Pfizer Inc. effective May 15, 2002
10.60†	Amendment No. 2 to the 2001 Agreement between us and Pfizer Inc. effective January 5, 2002
99.1	Certifications under Section 906 of the Sarbanes-Oxley Act of 2002

† Certain confidential portions of this Exhibit were omitted by means of redacting a portion of the text (the "Mark"). This Exhibit has been filed separately with the Secretary of the Commission without the Mark pursuant to the Company's Application Requesting Confidential Treatment under Rule 24b-2 under the Securities Exchange Act of 1934.

(b) Reports on Form 8-K:

None.

SIGNATURES

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

DISCOVERY PARTNERS INTERNATIONAL, INC.

Date: November 14, 2002

By: /s/ Riccardo Pigliucci

Riccardo Pigliucci
Chief Executive Officer
(Duly Authorized Officer)

Date: November 14, 2002

By: /s/ Craig Kussman

Craig Kussman
Chief Financial Officer, Vice President Finance
and Administration and Secretary
(Principal Financial and Accounting Officer)

CERTIFICATIONS

I, Riccardo Pigliucci, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Discovery Partners International, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officer and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Riccardo Pigliucci

Riccardo Pigliucci
Chief Executive Officer

I, Craig Kussman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Discovery Partners International, Inc.

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ Craig Kussman

Craig Kussman
Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description
10.59†	Amendment No. 1 to the 2001 Agreement between us and Pfizer Inc. effective May 15, 2002
10.60†	Amendment No. 2 to the 2001 Agreement between us and Pfizer Inc. effective January 5, 2002
99.1	Certification under Section 906 of the Sarbanes-Oxley Act of 2002

† Certain confidential portions of this Exhibit were omitted by means of redacting a portion of the text (the "Mark"). This Exhibit has been filed separately with the Secretary of the Commission without the Mark pursuant to the Company's Application Requesting Confidential Treatment under Rule 24b-2 under the Securities Exchange Act of 1934.

EXHIBIT 10.59

AMENDMENT NO. 1 TO THE 2001 AGREEMENT BETWEEN DISCOVERY PARTNERS INTERNATIONAL, INC AND PFIZER INC

Execution of this letter amendment ("Amendment No. 1") between PFIZER INC ("Pfizer") and DISCOVERY PARTNERS INTERNATIONAL, INC. ("DPI"), will serve to amend an agreement between the parties, effective as of May 15, 2002 (the "2002 Agreement").

WHEREAS, the 2002 Agreement provides for a four (4) year program between DPI and Pfizer to design and provide Pfizer with protocols and procedures useful in the production of pharmacologically relevant compounds, and to prosecute said protocols and procedures to synthesize libraries of Pfizer exclusive compounds for Pfizer's chemical files; and

WHEREAS, the parties now wish to amend the 2002 Agreement, and

NOW THEREFORE, the Parties agree as follows:

1 Scope of Amendment No. 1. Amendment No. 1 modifies and amends the 2002 Agreement only to the extent expressly specified herein. Otherwise, the terms and conditions of the 2002 Agreement shall remain unchanged and shall continue to be full force and effect.

2 Definitions. For purposes of this Amendment, capitalized terms in this Amendment have the same meaning as in the 2002 Agreement unless modified below. The following definition will be added as follows:

2.1 "Compound Resynthesis Services" means work performed by DPI under a Request for Service to re-synthesis compounds according to pre-existing protocols directed by a Request for Services form. Such pre-existing protocols shall come from those developed under that *** Agreement between *** *** and *** and dated *** (as amended hereto) (the " *** Agreement"). Technology used to complete Compound Resynthesis Services shall be Confidential Information for this Agreement and ownership and all other rights and restrictions shall be determined in accordance with the terms of the *** Agreement.

Additionally, the following definitions will be modified as set out below; the term "Protocol Services" should read in its entirety as follows

2.2 "Protocol Services" shall mean work performed by FTEs at DPI toward the generation of *** ideas and / or development and refinement of Protocols for synthesis and purification of Compounds of interest to Pfizer, as directed by a Pfizer approved Request for Services.

3 The following changes shall be made to Section 2, Scope of Work.

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

Section 2.1, Scope of Work, third line. The following phrase shall be deleted "Attention *** with a copy to *** *** , *** , Discovery Partners International, Inc., 9640 Towne Centre Drive, San Diego, CA 92121."

Section 2.2 the first sentence shall be deleted and replaced with: "Upon receipt of a Request for Service, with the *** , DPI will promptly conduct a search of its *** ."

Section 2.4 shall be added. "From time to time, DPI will submit *** *** representing a *** of Compounds to Pfizer during the weekly

teleconference or electronically. This structure submission indicates DPI's willingness to perform Services. If Pfizer approves of the *** proposed, a Request for Services will be generated. The Request for Services will request either Protocol Services, *** basis, or Compound Services, invoiced to Pfizer on a *** or *** basis (the "Services"). A Request for Services shall be sent to ChemRx Advanced Technologies, 385 Oyster Point Blvd. Suite 1, South San Francisco, California 94080, Attention *** (Pfizer Project Leader) "

Section 2.5 shall be added: "With regard to Section 2, when Pfizer authorizes DPI to perform the Service a copy of the Request for Service shall be sent to *** , *** , Discovery Partners International, Inc., 9640 Towne Centre Drive, San Diego, CA 92121."

4 The following changes shall be made to Section 3 and Section 4 relating to Payment and Payment for Production of Compound Libraries.

Section 3.1.4, the last sentence shall be deleted and replaced as follows: "DPI's invoices shall be sent to: Pfizer Global Research and Development, 50 Pequot Avenue, New London, Connecticut 06320, Attention *** ."

Section 4.1, to the last sentence the following shall be added: "The minimum and the maximum compounds comprise compounds from both Compound Service and Compound Resynthesis Service."

Section 4.1.1 shall be deleted in its entirety and the following shall be added: "The parties agree that the production and purification of Compounds with the criteria set forth in Schedule 4.1 affixed hereto shall be calculated on a *** *** basis, in accordance with the table below:

***
***
***

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

***

The parties agree that compounds produced that meet all of the criteria set forth in Schedule 4.1 except that there is less than *** but at least *** *** of such compounds shall be deemed to be *** . DPI shall have the right to deliver to Pfizer *** up to *** of the number of Compounds delivered in any individual Library and Pfizer shall accept and pay for such *** at the rate of *** . Should DPI produce *** in excess of *** of the number of Compounds in any individual Library, DPI shall not provide Pfizer *** in excess of such *** without the prior written consent of Pfizer. *** shall not count toward the calculation of the *** but shall count towards the calculation of the *** at the rate of a *** being deemed as *** of *** .

For point of clarity, the calculated cost, based on the table in Section 4.1.1, to produce *** Compounds is *** *** For further clarity in the same example, if *** were delivered in addition to the *** , the cost would be increased by *** for a total of *** . In case of such example *** Compounds would be counted towards the *** *** and *** Compounds would be counted toward the *** *** *** *** .

On an individual library basis, following endorsement by the Steering Committee, and approval by DPI and Pfizer, the parties may agree to a rate different from that set forth above."

The last sentence of Section 4.1.6 will be deleted and the following will be added: "DPI's invoices shall be sent to: Pfizer Global Research and Development, 50 Pequot Avenue, New London, Connecticut 06320, Attention *** ."

5 The following changes shall be made to Section 6, Project Program.

Section 6.4, third line. The following DPI Appointee " *** " shall be deleted and replaced with the following DPI Appointee, " *** ".

Section 6.5, third line. The following phrase "DPI co-chairman shall initially be *** *** " shall be deleted and replaced with the following phrase "DPI co-chairman shall be *** ".

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

Section 6.6.2, the second sentence shall be modified to read: "All communication pertaining to Compound Services, Compound Resynthesis Services and Protocol Services shall be the sole responsibility of the Steering Committee or the Research Contacts."

6 The following changes shall be made to Section 7, Reports and Materials.

Section 7.2.2, the second from last sentence, shall be deleted and the following shall be added "Materials shall be delivered to *** , according to Exhibit D Sample and Data Delivery, in a format agreed upon by the Steering Committee."

7 The following changes shall be made to Section 10, Key Investigators.

Section 10.1 the first sentence shall be deleted and replaced with the following " During the Agreement Period, *** , or some other nominee of DPI, acceptable to Pfizer acting reasonably, ("Key Investigator") shall commit *** of his time each week to the Project Program."

8. The following changes shall be made to Section 15, Ownership and Intellectual Property.

Section 15.2, the first sentence shall be deleted and replaced with: "Subject to Section 15.1 and 15.3.2, *** *** , to *** and the results of the *** ."

The 2002 Agreement, as amended by this letter, is and shall continue to be in full force and effect without lapse and is hereby in all respect ratified and confirmed.

If you agree to the terms and provisions hereof, please evidence your agreement by countersigning one of the two duplicate original copies of this letter and returning it to us. This letter shall become effective as of February 1, 2002, when executed by DPI and received by Pfizer.

Agreed: Pfizer Inc International	Agreed: Discovery Partners
By: /s/ Edward D. Pagani	By: /s/ Riccardo Pigliucci
Name:	Name: Riccardo Pigliucci
Title:	Title: Chairman and CEO
Date: 6/12/02	Date: 6/20/02

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

EXHIBIT 10.60

AMENDMENT NO. 2 TO THE 2001 AGREEMENT BETWEEN DISCOVERY PARTNERS INTERNATIONAL, INC AND PFIZER INC

Execution of this letter amendment ("Amendment No. 2") between PFIZER INC ("Pfizer") and DISCOVERY PARTNERS INTERNATIONAL, INC. ("DPI"), will serve to amend an agreement between the parties, effective as of January 15, 2002 (the "2002 Agreement") as amended on June 20, 2002 ("Amendment No. 1").
WHEREAS, the 2002 Agreement provides for a four (4) year program between DPI and Pfizer to design and provide Pfizer with protocols and procedures useful in the production of pharmacologically relevant compounds, and to prosecute said protocols and procedures to synthesize libraries of Pfizer exclusive compounds for Pfizer's chemical files; and

WHEREAS, the parties now wish to further amend the 2002 Agreement, and

NOW THEREFORE, the Parties agree as follows:

1 Title of Amendment No. 1 shall be deleted and replaced with "Amendment No. 1 to the 2002 Agreement between Discovery Partners International, Inc. and Pfizer Inc

2 Preamble of Amendment No. 1 the date "May 15, 2002" shall be deleted and replaced with "January 15, 2002".

3 Scope of Amendment No. 2. Amendment No. 2 modifies and amends the 2002 Agreement, and the Amendment No. 1 only to the extent expressly specified herein. Otherwise, the terms and conditions of the 2002 Agreement and Amendment No. 1 shall remain unchanged and shall continue to be full force and effect.

Definitions. For purposes of this Amendment, capitalized terms in this Amendment No. 2 have the same meaning as in the 2002 Agreement and the Amendment No. 1.

4 The following changes shall be made to Section 3, Payments.

Section 3.1, Funding of *** for *** , the range of *** commitment table shall be deleted and replaced with the following table:

***
***
***

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

Section 3.1.6 in sentence one, the annual funding payment for Commitment Year 1 of " *** " shall be deleted and replaced by " *** ."

5 The following table shall replace the corresponding table in Exhibit A, such that the Annual Project Plan depicts the modifications to Section 3.1 and 3.1.6 identified in this Amendment 2.

***
***
***

The 2002 Agreement, as amended by this letter, is and shall continue to be in

full force and effect without lapse and is hereby in all respect ratified and confirmed.

If you agree to the terms and provisions hereof, please evidence your agreement by countersigning one of the two duplicate original copies of this letter and returning it to us. This letter shall become effective as of February 1, 2002, when executed by DPI and received by Pfizer.

Agreed: Discovery Partners International	Agreed: Pfizer Inc
By: /s/ Riccardo Pigliucci	By: /s/ Edward D. Pagani
Name: Riccardo Pigliucci	Name: Dr. Edward D. Pagani
Title: Chairman and CEO	Title: Site Head, Strategic Alliances
Date: 8/13/02	Date: 8/12/02

*** Portions of this page have been omitted pursuant to a request for Confidential Treatment and filed separately with the Commission.

EXHIBIT 99.1

CERTIFICATION UNDER SECTION 906 OF THE SABARNES-OXLEY ACT OF 2002

Riccardo Pigliucci and Craig Kussman hereby certify that:

1. They are the Chief Executive Officer and Chief Financial Officer, respectively, of Discovery Partners International, Inc.

2. The Form10-Q report of Discovery Partners International, Inc., which accompanies this certification, fully complies with the requirements of section 13(a) of the Securities Exchange Act of 1934.

3. The information contained in the Form 10-Q report of Discovery Partners International, Inc., which accompanies this certification, fairly presents, in all material respects, the financial condition and results of operations of Discovery Partners International, Inc.

/s/Riccardo Pigliucci	/s/Craig Kussman
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Riccardo Pigliucci	Craig Kussman
Chief Executive Officer	Chief Financial Officer

Date: November 14, 2002