

NEKTAR THERAPEUTICS

Form 10-Q

November 07, 2008

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2008**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 0-24006**

**NEKTAR THERAPEUTICS  
(Exact name of registrant as specified in its charter)**

**Delaware  
(State or other jurisdiction of  
incorporation or organization)**

**94-3134940  
(IRS Employer  
Identification No.)**

**201 Industrial Road  
San Carlos, California 94070  
(Address of principal executive offices)**

**650-631-3100**

**(Registrant's telephone number, including area code)**

**(Former name, former address and former fiscal year, if changed since last report)**

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

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

The number of outstanding shares of the registrant's Common Stock, \$0.0001 par value, was 92,445,985 on October 31, 2008.



**NEKTAR THERAPEUTICS  
INDEX**

**PART I: FINANCIAL INFORMATION**

Item 1. Condensed Consolidated Financial Statements – Unaudited:

Condensed Consolidated Balance Sheets – September 30, 2008 and December 31, 2007 4

Condensed Consolidated Statements of Operations for the three month and nine month periods ended September 30, 2008 and 2007 5

Condensed Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2008 and 2007 6

Notes to Condensed Consolidated Financial Statements 7

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations 13

Item 3. Quantitative and Qualitative Disclosures About Market Risk 21

Item 4. Controls and Procedures 22

**PART II: OTHER INFORMATION**

Item 1. Legal Proceedings 22

Item 1A. Risk Factors 22

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 34

Item 3. Defaults Upon Senior Securities 34

Item 4. Submission of Matters to a Vote of Security Holders 34

Item 5. Other Information 34

Item 6. Exhibits 35

Signatures 36

Exhibit 31.1

Exhibit 31.2

Exhibit 32.1

**Table of Contents**

**Forward-Looking Statements**

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the 1933 Act ), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ). All statements other than statements of historical fact are forward-looking statements for purposes of this Quarterly Report on Form 10-Q, including any projections of earnings, revenue or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance any statements regarding the closing of the proposed sale of assets to Novartis as well as expected benefits there from, and any statements of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, potential or continue, or the neg other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, but not limited to, the risk factors set forth in Part II, Item 1A Risk Factors below and for the reasons described elsewhere in this Quarterly Report on Form 10-Q. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof and we do not intend to update any forward-looking statements except as required by law or applicable regulations. Except where the context otherwise requires, in this Quarterly Report on Form 10-Q, the Company, Nektar, we, us and our refer to Nektar Therapeutics, a Delaware corporation, and, where appropriate, its subsidiaries.

**Trademarks**

All Nektar brand and product names, including, but not limited to, Nektar®, contained in this document are trademarks, registered trademarks or service marks of Nektar Therapeutics in the United States (U.S.) and certain other countries. This document also contains references to trademarks, registered trademarks and service marks of other companies that are the property of their respective owners.

**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements Unaudited**

**NEKTAR THERAPEUTICS**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except per share information)

	<b>September 30, 2008 Unaudited</b>	<b>December 31, 2007 (1)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 63,713	\$ 76,293
Short-term investments	280,803	406,060
Accounts receivable, net of allowance of \$92 and \$33 at September 30, 2008 and December 31, 2007, respectively	8,515	21,637
Inventory	9,861	12,187
Assets held for sale	42,975	
Other current assets	4,420	7,106
 Total current assets	 \$ 410,287	 \$ 523,283
Property and equipment, net	73,641	114,420
Goodwill	78,431	78,431
Other intangible assets, net	1,971	2,680
Other assets	4,022	6,289
 Total assets	 \$ 568,352	 \$ 725,103
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,113	\$ 3,589
Accrued compensation	14,723	14,680
Accrued expenses to contract manufacturers		40,444
Accrued expenses	15,715	12,446
Interest payable	85	2,638
Capital lease obligations, current portion	1,401	2,335
Deferred revenue, current portion	11,970	19,620
Other current liabilities	2,515	2,340
 Total current liabilities	 \$ 48,522	 \$ 98,092
Convertible subordinated notes	315,000	315,000
Capital lease obligations	20,689	21,632
Deferred revenue	57,027	61,349
Deferred gain	7,323	8,680
Other long-term liabilities	11,159	5,911
 Total liabilities	 \$ 459,720	 \$ 510,664
Commitments and contingencies		
Stockholders' equity:		
Preferred stock		

Edgar Filing: NEKTAR THERAPEUTICS - Form 10-Q

Common stock, \$0.0001 par value; 300,000 authorized; 92,443 shares and 92,301 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively	9	9
Capital in excess of par value	1,309,973	1,302,541
Accumulated other comprehensive income	(478)	1,643
Accumulated deficit	(1,200,872)	(1,089,754)
Total stockholders' equity	108,632	214,439
Total liabilities and stockholders' equity	\$ 568,352	\$ 725,103

(1) Derived from audited consolidated financial statements at this date.

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

**Table of Contents**

**NEKTAR THERAPEUTICS**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share information)

(Unaudited)

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Revenue:				
Product sales and royalties	\$ 9,474	\$ 37,497	\$ 28,855	\$ 159,818
Contract research	11,965	18,824	32,977	47,436
Total revenue	21,439	56,321	61,832	207,254
Operating costs and expenses:				
Cost of goods sold	5,349	27,457	18,020	123,469
Cost of idle Exubera manufacturing capacity			6,821	
Research and development	38,265	35,773	109,138	114,265
General and administrative	12,149	12,426	36,951	42,339
Amortization of other intangible assets	237	237	710	710
Total operating costs and expenses	56,000	75,893	171,640	280,783
Loss from operations	(34,561)	(19,572)	(109,808)	(73,529)
Non-operating income (expense):				
Interest income	2,375	5,519	10,578	16,444
Interest expense	(3,988)	(4,773)	(11,835)	(14,408)
Loss on equity investment	(705)		(705)	
Other income (expense), net	117	206	1,188	189
Total non-operating income (expense)	(2,201)	952	(774)	2,225
Loss before provision for income taxes	(36,762)	(18,620)	(110,582)	(71,304)
Provision for income taxes	276		536	500
Net loss	\$ (37,038)	\$ (18,620)	\$ (111,118)	\$ (71,804)
Basic and diluted net loss per share	\$ (0.40)	\$ (0.20)	\$ (1.20)	\$ (0.78)
Shares used in computing basic and diluted net loss per share	92,425	92,028	92,413	91,764

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



**Table of Contents**

**NEKTAR THERAPEUTICS**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Nine months ended</b>	
	<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>
<b>Cash flows used in operating activities:</b>		
Net loss	\$ (111,118)	\$ (71,804)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation	6,955	11,712
Depreciation and amortization	18,610	22,964
Loss on equity investment	705	
Foreign currency transaction loss	428	
Loss on disposal of assets	282	1,776
Amortization of gain related to sale of building	(656)	(656)
Changes in assets and liabilities:		
Decrease (increase) in trade accounts receivable	13,122	10,343
Decrease (increase) in inventories	2,326	(2,519)
Decrease (increase) in prepaids and other assets	2,659	6,846
Increase (decrease) in accounts payable	(1,476)	(2,784)
Increase (decrease) in accrued compensation	(229)	(2,170)
Increase (decrease) in accrued expenses to contract manufacturers	(40,444)	
Increase (decrease) in accrued expenses	3,269	6,622
Increase (decrease) in interest payable	(2,553)	(2,684)
Increase (decrease) in deferred revenue	(11,972)	61,777
Increase (decrease) in other liabilities	5,027	152
Net cash provided by (used in) operating activities	\$ (115,065)	\$ 39,575
<b>Cash flows from investing activities:</b>		
Purchases of investments	(411,417)	(342,807)
Maturities of investments	506,348	468,245
Sales of investments	28,590	
Purchases of property and equipment	(15,064)	(20,726)
Investment in Pearl Therapeutics Inc.	(4,236)	
Net cash provided by investing activities	\$ 104,221	\$ 104,712
<b>Cash flows used in financing activities:</b>		
Repayments of convertible subordinated notes		(36,026)
Payments of loan and capital lease obligations	(1,910)	(787)
Proceeds from issuance of common stock related to employee stock plans	477	3,479
Net cash used in financing activities	\$ (1,433)	\$ (33,334)
Effect of exchange rates on cash and cash equivalents	(303)	

Edgar Filing: NEKTAR THERAPEUTICS - Form 10-Q

Net increase (decrease) in cash and cash equivalents	\$ (12,580)	\$ 110,953
Cash and cash equivalents at beginning of period	76,293	63,760
Cash and cash equivalents at end of period	\$ 63,713	\$ 174,713

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

**Table of Contents**

**NEKTAR THERAPEUTICS**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2008**  
**(Unaudited)**

**Note 1 Organization and Summary of Significant Accounting Policies**

**Organization and Basis of Presentation**

We are a biopharmaceutical company headquartered in San Carlos, California and incorporated in Delaware. Our mission is to develop breakthrough products that make a difference in patients' lives. We create differentiated, innovative products by applying our platform technologies to established or novel medicines. Our two leading technology platforms are pulmonary technology and PEGylation technology.

We prepared the Condensed Consolidated Financial Statements following the requirements of the Securities and Exchange Commission ( SEC ) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. generally accepted accounting principles ( GAAP ) can be condensed or omitted. In the opinion of management, these financial statements include all normal and recurring adjustments that we consider necessary for the fair presentation of our financial position and operating results.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Revenues, expenses, assets, and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year. The information included in this quarterly report on Form 10-Q should be read in conjunction with the consolidated financial statements and the accompanying notes to these financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007.

**Principles of Consolidation**

Our condensed consolidated financial statements include the financial position, results of operations and cash flows of our wholly-owned subsidiaries: Nektar Therapeutics AL, Corporation ( Nektar AL ), Nektar Therapeutics (India) Private Limited, Nektar Therapeutics UK, Ltd. ( Nektar UK ) and Aerogen, Inc. On November 30, 2007, we sold Aerogen Ireland Ltd, a subsidiary of Aerogen, Inc. ( Aerogen Ireland ), and therefore Aerogen Ireland was not included in our financial position as of December 31, 2007 or September 30, 2008, nor in our results of operations or cash flows for the three months and nine months ended September 30, 2008. All intercompany accounts and transactions have been eliminated in consolidation.

Our Condensed Consolidated Financial Statements are denominated in U.S. dollars. Accordingly, changes in exchange rates between the applicable foreign currency and the U.S. dollar will affect the translation of each foreign subsidiary's financial results into U.S. dollars for purposes of reporting our consolidated financial results. Translation gains and losses are included in accumulated other comprehensive income in the Stockholders' equity section of the Condensed Consolidated Balance Sheet. To date, such cumulative translation adjustments have not been material to our consolidated financial position.

**Reclassifications**

Certain items previously reported in specific financial statement captions have been reclassified to conform to the current period presentation. Such reclassifications do not impact previously reported revenues, operating loss or net loss or total assets, liabilities or stockholders' equity.

**Segment Information**

We operate in one business segment which focuses on applying our technology platforms to improve the performance of established and novel medicines. We operate in one segment because our business offerings have similar economics and other characteristics, including the nature of products and production processes, types of customers, distribution methods and regulatory environment. We are comprehensively managed as one business segment by our President and Chief Executive Officer and his management team. Within our one business segment we have two components, pulmonary technology and PEGylation technology.



**Table of Contents****Significant Concentrations**

Our customers are primarily pharmaceutical and biotechnology companies that are located in the U.S. and EU. Our accounts receivable balance contains billed and unbilled trade receivables from product sales, royalties, and collaborative research agreements. We provide for an allowance for doubtful accounts by reserving for specifically identified doubtful accounts. We have not experienced significant credit losses from our accounts receivable or collaborative research agreements and none are expected. We perform a regular review of our customers' payment histories and associated credit risk. We generally do not require collateral from our customers.

We are dependent on our partners, vendors and third party manufacturers to provide certain raw materials, active pharmaceutical ingredients and pulmonary delivery devices of the appropriate quality and reliability to meet applicable regulatory requirements. Consequently, in the event that supplies are delayed or interrupted for any reason, our ability to develop and meet our supply commitments could be impaired, which could have a material adverse effect on our business, financial condition and results of operation.

**Income Taxes**

We account for income taxes under the liability method in accordance with Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ), and FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109* ( FIN 48 ). Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Realization of deferred tax assets is dependent upon future earnings, the timing and amount of which are uncertain. At September 30, 2008 and December 31, 2007, we have provided a full valuation allowance against our net deferred tax assets generated by our domestic net operating loss and we have recorded a provision for foreign income taxes payable in India at an effective rate in India of approximately 34%.

**Recent Accounting Pronouncements***APB 14-1*

In May 2008, the FASB issued FSP Accounting Principles Board ( APB ) 14-1 Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) ( FSP APB 14-1 ). FSP APB 14-1 requires the issuer of certain convertible debt instruments that may be settled in cash (or other assets) on conversion to separately account for the liability (debt) and equity (conversion option) components of the instrument in a manner that reflects the issuer's non-convertible debt borrowing rate. FSP APB 14-1 is effective for fiscal years beginning after December 15, 2008 on a retroactive basis. We are assessing the potential impact that the adoption of FSP APB 14-1 may have on our results of operations and financial position.

**Note 2 Assets held for sale**

On October 20, 2008, we entered into an Asset Purchase Agreement with Novartis Pharmaceuticals Corporation and Novartis Pharma AG (together referred to as Novartis ). Under the terms of the agreement, at the closing of the transaction we will receive \$115.0 million and will transfer to Novartis certain assets and obligations related to our pulmonary technology, development and manufacturing operations including:

dry powder and liquid pulmonary technology platform including but not limited to our pulmonary inhalation devices, formulation technology, manufacturing technology and related intellectual property;

manufacturing and associated development services payments for the ciprofloxacin inhaled powder program;

manufacturing and royalty rights to the Tobramycin inhalation powder program;

capital equipment, information systems and facility lease obligations for our pulmonary development and manufacturing facility in San Carlos, California;

certain other interests that we have in two private companies, Pearl Therapeutics Inc. and Stamford Devices Limited; and

approximately 140 of our personnel primarily dedicated to our pulmonary technology, development programs, and manufacturing operations whom Novartis is expected to hire immediately following the closing of the transaction.

**Table of Contents**

We will retain all of our rights to NKTR-061 (inhaled amikacin) partnered with Bayer Healthcare, all royalty rights for the inhaled ciprofloxacin development program partnered with Bayer AG, all rights to the ongoing development program for NKTR-063 (inhaled vancomycin) and certain intellectual property rights specific to inhaled insulin. In connection with this Asset Purchase Agreement, the net book value of the capital equipment and information systems for our pulmonary development and manufacturing facility and our investment in Pearl Therapeutics Inc. has been classified as *Assets held for sale* in our Condensed Consolidated Balance Sheet. As of September 30, 2008, *Assets held for sale* includes:

	<b>September 30, 2008</b>	
Property and equipment, net	\$	38,553
Investment in Pearl Therapeutics Inc. and Stamford Devices Limited		3,531
Prepaid expenses and other		891
<b>Assets held for sale</b>	<b>\$</b>	<b>42,975</b>

We expect the transaction contemplated by the Asset Purchase Agreement will be completed on or about December 31, 2008.

**Note 3 Cash, Cash Equivalents, and Available-For-Sale Investments**

Cash, cash equivalents, and available-for-sale investments are as follows (in thousands):

	<b>Estimated Fair Value at</b>	
	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Cash and cash equivalents	\$ 63,713	\$ 76,293
Short-term investments (less than one year to maturity)	280,803	406,060
<b>Total cash, cash equivalents, and available-for-sale investments</b>	<b>\$ 344,516</b>	<b>\$ 482,353</b>

Our portfolio of cash, cash equivalents, and available-for-sale investments includes (in thousands):

	<b>Estimated Fair Value at</b>	
	<b>September 30, 2008</b>	<b>December 31, 2007</b>
U.S. corporate commercial paper	\$ 154,782	\$ 293,866
Obligations of U.S. government agencies	151,179	37,333
Obligations of U.S. corporations	19,207	100,727
Cash equivalents and money market funds	11,280	40,922
Cash	8,068	9,505
<b>Total cash, cash equivalents, and available-for-sale investments</b>	<b>\$ 344,516</b>	<b>\$ 482,353</b>

Gross unrealized gains on the portfolio were nil and \$0.5 million as of September 30, 2008 and December 31, 2007, respectively. Gross unrealized losses on the portfolio were \$1.3 million and \$0.1 million as of September 30, 2008 and December 31, 2007, respectively. The gross unrealized losses were primarily due to changes in interest rates on fixed income securities. We have a history of holding our investments to maturity. Except as discussed in Note 11, we have the ability and intent to hold our debt securities to maturity when they will be redeemed at full par value. Accordingly, we consider these unrealized losses to be temporary and have not recorded a provision for impairment.

**Note 4 Fair Value**

On January 1, 2008, we adopted the provisions of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS 157 ), for financial assets and financial liabilities. SFAS 157 defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. FASB Statement of Position No. 157-2 defers adoption of SFAS 157 for non-financial assets and non-financial liabilities.



**Table of Contents**

The following table represents the fair value hierarchy for our financial assets (cash equivalents and available-for-sale investments) measured at fair value on a recurring basis as of September 30, 2008 (in thousands):

	Quoted Prices in Active Markets for Identical Assets <b>Level 1</b>	Significant Other Observable Inputs <b>Level 2</b>	Significant Unobservable Inputs <b>Level 3</b>	<b>Total</b>
U.S. corporate commercial paper	\$	\$ 154,782	\$	\$ 154,782
Obligations of U.S. corporations		19,207		19,207
Obligations of U.S. government agencies		151,179		151,179
Money market funds	11,280			11,280
Cash equivalents and available-for-sale investments	\$ 11,280	\$ 325,168	\$	\$ 336,448

**Note 5 Inventory**

Inventory consists of the following (in thousands):

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Raw materials	\$ 6,487	\$ 9,522
Work-in-process	2,677	1,749
Finished goods	697	916
Inventory	\$ 9,861	\$ 12,187

Inventory consists of raw materials, work-in-process and finished goods for our commercial PEGylation business. Reserves are determined using specific identification plus an estimated reserve for potential defective or excess inventory based on historical experience or projected usage. Inventory is reflected net of reserves of \$4.5 million and \$5.8 million as of September 30, 2008 and December 31, 2007, respectively.

**Note 6 Commitments and Contingencies***Legal Matters*

From time to time, we may be involved in lawsuits, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. In accordance with the SFAS No. 5, *Accounting for Contingencies*, we make a provision for a liability when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed at least quarterly and adjusted to reflect the impact of negotiations, settlements, ruling, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. If any unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period or on our cash flows and liquidity.

*Collaboration Agreements for Pulmonary Products*

As part of our collaboration agreements with our partners for the development, manufacture and supply of products based on our pulmonary technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreements, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreement. There is no limitation on the potential amount of future payments we could be required to make under

these indemnification obligations.

To date we have not incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount under these agreements is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. No liabilities have been recorded for these obligations on our Condensed Consolidated Balance Sheets as of September 30, 2008 or December 31, 2007.

**Table of Contents***License, Manufacturing and Supply Agreements for Products Based on our PEGylation Technology*

As part of our license, manufacturing and supply agreements with our partners for the development or manufacture and supply of PEG reagents or intellectual property licenses based on our PEGylation technology, we generally agree to defend, indemnify and hold harmless our partners from and against third party liabilities arising out of the agreements, including product liability and infringement of intellectual property. The term of these indemnification obligations is generally perpetual any time after execution of the agreements. There is no limitation on the potential amount of future payments we could be required to make under these indemnification obligations. We have never incurred costs to defend lawsuits or settle claims related to these indemnification obligations. If any of our indemnification obligations is triggered, we may incur substantial liabilities. Because the obligated amount in these agreements is not explicitly stated, the overall maximum amount of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations, and no liabilities have been recorded for these obligations in our Condensed Consolidated Balance Sheets as of September 30, 2008 or December 31, 2007.

*Other Agreements*

We maintain a number of other commercial agreements to support our business such as technology licensing agreements, third party manufacturing agreements, consulting agreements, and certain business development agreements. These agreements often contain complex terms and conditions that from time to time can result in disputes that may lead to arbitration or litigation. For example, we currently have an ongoing dispute in arbitration related to a consulting agreement that had a partnership success fee provision related to one of our collaboration partner agreements. Unfavorable outcomes in these disputes, if and when they arise, could result in a material adverse impact on our results of operations for any given period and our financial position. No liabilities have been recorded for these obligations on our Condensed Consolidated Balance Sheets as of September 30, 2008 or December 31, 2007.

**Note 7 Workforce Reduction Plans**

In an effort to reduce ongoing operating costs and improve our organizational structure, efficiency and productivity, we executed workforce reduction plans in May 2007 (the 2007 Plan ) and on February 2008 (the 2008 Plan ) designed to streamline the company, consolidate corporate functions, and strengthen decision-making and execution within our business units.

The 2007 Plan reduced our workforce by approximately 180 full-time employees, or approximately 25 percent of our regular full-time employees, and was substantially complete as of December 31, 2007. During the three months and nine months ended September 30, 2008, we made payments for severance, medical insurance, and other termination benefits related to the 2007 Plan.

The 2008 Plan reduced our workforce by approximately 110 employees, or approximately 20 percent of our regular full-time employees. We notified the employees affected by the 2008 Plan on February 11, 2008. We estimate the 2008 Plan will cost approximately \$5.1 million, comprised of cash payments for severance, medical insurance, and outplacement services. Certain notified employees voluntarily terminated prior to their scheduled termination dates or were offered other permanent positions within Nektar. As a result, we have reversed \$0.2 million of net workforce reduction charges related to the 2008 Plan as a change in estimate during the three months ended September 30, 2008. We expect to record less than \$0.1 million during the remainder of 2008 for employees with termination dates longer than two months from the date of notification. We expect the 2008 Plan will be substantially complete by December 31, 2008.

Since May 2007, we have incurred \$13.4 million related to our two workforce reduction plans, \$5.0 million related to the 2008 Plan and \$8.4 million related to the 2007 Plan, which includes \$0.2 million which was recognized during the last quarter of 2007. For the three months and nine months ended September 30, 2008, workforce reduction charges were recorded in our Condensed Consolidated Financial Statements as follows (in thousands):

	<b>Three months ended September 30,</b>			
	<b>2007 Plan</b>	<b>2008</b>	<b>Total</b>	<b>2007</b>
	<b>2007 Plan</b>	<b>2008 Plan</b>	<b>Total</b>	<b>2007 Plan</b>
Cost of goods sold, net of inventory change	\$	\$ (12)	\$ (12)	\$ 36

Edgar Filing: NEKTAR THERAPEUTICS - Form 10-Q

Research and development expense			(136)	(136)	115
General and administrative expense			(20)	(20)	342
Total workforce reduction charges	\$	\$	(168)	\$ (168)	\$ 493

**Table of Contents**

	<b>Nine months ended September 30,</b>			
	<b>2007 Plan</b>	<b>2008</b>		<b>2007</b>
	<b>2007 Plan</b>	<b>2008 Plan</b>	<b>Total</b>	<b>2007 Plan</b>
Cost of goods sold, net of inventory change	\$	\$ 149	\$ 149	\$ 974
Cost of idle Exubera manufacturing capacity		1,221	1,221	
Research and development expense	17	3,139	3,156	5,335
General and administrative expense		517	517	1,888
Total workforce reduction charges	\$ 17	\$ 5,026	\$ 5,043	\$ 8,197

The following table summarizes the liabilities associated with the 2007 Plan and 2008 Plan included in accrued compensation in our Condensed Consolidated Balance Sheet as of September 30, 2008 and the activity during the nine months ended September 30, 2008 (in thousands):

	<b>2007 Plan</b>	<b>2008 Plan</b>	<b>Total</b>
Balance at December 31, 2007	\$ 580	\$	\$ 580
Charges	17	5,026	5,043
Payments	(597)	(4,846)	(5,443)
Balance at September 30, 2008	\$	\$ 180	\$ 180

**Note 8 Stock-Based Compensation**

Total stock-based compensation costs were recorded in our Condensed Consolidated Financial Statements as follows (in thousands):

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Cost of goods sold, net of inventory change	\$ 91	\$ (388)	\$ 212	\$ 679
Cost of idle Exubera manufacturing capacity			23	
Research and development expense	1,590	(636)	2,700	4,663
General and administrative expense	1,411	726	4,020	5,140
Total stock-based compensation costs	\$ 3,092	\$ (298)	\$ 6,955	\$ 10,482

Our stock-based compensation expense decreased by \$3.5 million for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The decrease in stock-based compensation expense is attributable to decreased expense related to performance based restricted stock unit awards, lower fair market value of options granted in the nine months ended September 30, 2008 compared to 2007, and an increase in our estimated annual forfeiture rates.

*Aggregate Unrecognized Stock-Based Compensation Expense*

Aggregate total unrecognized stock-based compensation expense is expected to be recognized as follows (in thousands):

<b>Fiscal Year</b>	<b>As of</b>
	<b>September 30, 2008</b>
2008 (remaining 3 months)	\$ 3,225
2009	10,584

2010	9,376
2011	7,164
2012 and thereafter	1,092
	\$ 31,441

**Table of Contents****Note 9 Net Loss Per Share**

Basic net loss per share is calculated based on the weighted-average number of common shares outstanding during the periods presented. For all periods presented in the Condensed Consolidated Statements of Operations, the net loss available to common stockholders is equal to the reported net loss. Basic and diluted net loss per share are the same due to our historical net losses and the requirement to exclude potentially dilutive securities which would have an anti-dilutive effect on net loss per share. The weighted average of these potentially dilutive securities has been excluded from the diluted net loss per share calculation and is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Convertible subordinated notes	14,638	15,958	14,638	16,089
Stock options	14,740	11,195	13,944	10,993
Total	29,378	27,153	28,582	27,082

**Note 10 Comprehensive Loss**

Comprehensive loss is comprised of net loss and other comprehensive income and includes the following components (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
Net loss, as reported	\$ (37,038)	\$ (18,620)	\$ (111,118)	\$ (71,804)
Change in net unrealized gains (losses) on available-for-sale investments	(996)	(195)	(1,736)	152
Translation adjustment	(221)	246	(385)	304
Total comprehensive loss	\$ (38,255)	\$ (18,569)	\$ (113,239)	\$ (71,348)

The components of accumulated other comprehensive income are as follows (in thousands):

	September 30, 2008	December 31, 2007
Unrealized gain (loss) on available-for-sale securities	\$ (1,308)	\$ 428
Translation adjustment	830	1,215
Accumulated other comprehensive income	\$ (478)	\$ 1,643

**Note 11 Subsequent Events**

At September 30, 2008, we had \$315.0 million of outstanding 3.25% convertible subordinated notes due 2012. Since September 30, 2008, we have repurchased approximately \$100.0 million face value of our 3.25% convertible subordinated notes for an aggregate purchase price of \$47.8 million. As of November 7, 2008, the outstanding balances of our convertible subordinated notes is \$215.0 million.

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

*The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this section as well as factors described in Part II, Item 1A Risk Factors.*

**Overview**

We are a biopharmaceutical company that develops and enables differentiated therapeutics with our leading PEGylation and pulmonary drug development technology platforms. Our mission is to create differentiated, innovative products by applying our platform technologies to established or novel medicines. By doing so, we aim to raise the standards of current patient care by improving one or more performance parameters, including efficacy, safety or ease of use. Nine products using these technology platforms have received regulatory approval in the U.S. or Europe. Our two technology platforms are the basis of nearly all of our partnered and proprietary products and product candidates.



**Table of Contents**

We create or enable potential breakthrough products in two ways. First, we develop products in collaboration with pharmaceutical and biotechnology companies that seek to improve both already approved drugs and, in certain cases, novel drug candidates in various stages of development. All of the approved products today that use our technology platforms are a result of collaborations with partners. Second, we develop our own product candidates by applying our technologies to already approved drugs and, in some cases, novel drug candidates in various stages of development, to create and develop our own differentiated, proprietary product candidates that are designed to target serious diseases in novel ways. We currently have two proprietary product candidates in mid-stage clinical development and a number of other candidates in preclinical development.

Our two leading technology platforms enable improved performance of a variety of existing and new molecules. Our PEGylation technology is a chemical process designed to enhance the performance of most drug classes with the potential to improve solubility and stability, increase drug half-life, reduce membrane transfer, reduce immune responses to an active drug and improve the efficacy or safety of a molecule in certain instances. Our pulmonary technology makes drugs inhalable to deliver them to and through the lungs for local lung applications.

There are two key elements to our business strategy. First, we are developing a portfolio of proprietary product candidates by applying our PEGylation and pulmonary technology platforms and know-how to improving already approved drugs and, in some cases, novel drug candidates in various stages of development. Our strategy is to identify molecules that would benefit from the application of our technologies and potentially improve one or more performance parameters, including efficacy, safety and ease of use. Our objective is to create value by advancing these product candidates into clinical development and then deciding on a product-by-product basis whether we wish to continue development and commercialize on our own or seek a partner, or pursue a combination of these approaches. Our most advanced proprietary product candidates are NKTR-102 (PEG-irinotecan) for the treatment of solid tumors, including colorectal cancer, and NKTR-118 (oral PEG-naloxol) for the treatment of opioid-induced bowel dysfunction, both of which are currently in Phase 2 clinical development.

Second, we have collaborations or licensing arrangements with a number of pharmaceutical and biotechnology companies. Our partnering strategy enables us to work towards developing a larger and more diversified pipeline of drug products and product candidates using our technologies. As we have shifted our focus away from being a drug delivery service provider and have advanced research and development of our proprietary product pipeline, we expect to engage in selected high value partnerships in order to optimize revenue potential, probability of success and overall return on investment. Our partnering options range from a comprehensive license to a co-promotion and co-development arrangement with the structure of the partnership depending on factors such as the cost and complexity of development, commercialization needs and therapeutic area focus.

Historically, we had depended on revenue from Pfizer Inc. related to Exubera and our next-generation inhaled insulin product development program ( NGI ) contract research and Exubera manufacturing. Our revenue from Pfizer related to Exubera and NGI was approximately \$34.4 million and \$140.7 million, representing 61% and 68% of revenue, for the three months and nine months ended September 30, 2007, respectively, and nil for the three months and nine months ended September 30, 2008.

On October 18, 2007, Pfizer announced that it was exiting the Exubera business and gave notice of termination under our collaborative development and licensing agreement. On November 9, 2007, we entered into a termination agreement and mutual release with Pfizer. Under the termination agreement and mutual release, we received a one-time payment of \$135.0 million in November 2007 from Pfizer in satisfaction of all outstanding contractual obligations under our then-existing agreements relating to Exubera and NGI. All agreements between Pfizer and us related to Exubera and NGI, other than the termination agreement and mutual release and a related interim Exubera manufacturing maintenance letter, terminated on November 9, 2007.

Pursuant to our termination agreement and mutual release with Pfizer, Pfizer agreed to provide certain cooperation to assist us in securing a new marketing and development partner for Exubera and NGI. On April 9, 2008, we announced that we had ceased all negotiations with potential partners for Exubera and NGI as a result of new data analysis from ongoing clinical trials conducted by Pfizer which indicated an increase in the number of new cases of lung cancer in Exubera patients who were former smokers as compared to patients in the control group who were former smokers. We have ceased spending associated with maintaining Exubera manufacturing capacity and any further NGI

development, including, but not limited to, terminating, in April 2008, a maintenance letter agreement, pursuant to which Pfizer had agreed to maintain a group of key Pfizer manufacturing personnel in Pfizer's Exubera manufacturing facility in Terre Haute, Indiana, and a termination and 2008 continuation agreement with Tech Group North America, Inc. ( Tech Group ), pursuant to which Tech Group had agreed to preserve key personnel and manufacturing facilities to support potential future Exubera inhaler manufacturing. We expensed \$4.5 million for these Pfizer and Tech Group agreements in January through April 2008.

**Table of Contents**

On October 20, 2008, we entered into an Asset Purchase Agreement with Novartis Pharmaceuticals Corporation and Novartis Pharma AG (together referred to as Novartis ). Under the terms of the agreement, at the closing of the transaction we have agreed to transfer to Novartis certain assets and obligations related to our pulmonary technology, development and manufacturing operations including:

dry powder and liquid pulmonary technology platform including but not limited to our pulmonary inhalation devices, formulation technology, manufacturing technology and related intellectual property;

capital equipment, information systems and facility lease obligations for our pulmonary development and manufacturing facility in San Carlos, California;

manufacturing and associated development services payments for the ciprofloxacin inhaled powder program;

manufacturing and royalty rights to the Tobramycin inhalation powder program;

certain other interests that we have in two private companies; and

approximately 140 of our personnel primarily dedicated to our pulmonary technology, development programs, and manufacturing operations whom Novartis is expected to hire immediately following the closing of the transaction.

In consideration for the transfer of the above described pulmonary assets, we will be entitled to \$115.0 million in cash following the closing of the transaction. In addition, we will retain all of our rights to NKTR-061 (inhaled amikacin) partnered with Bayer Healthcare, all royalty rights for the inhaled ciprofloxacin development program partnered with Bayer AG, all rights to the ongoing development program for NKTR-063 (inhaled vancomycin) and certain intellectual property rights specific to inhaled insulin.

Our agreement with Novartis contains customary closing conditions for Novartis and Nektar, including no injunctions, compliance with anti-trust requirements and obtaining of any other government consents, correctness of representations and warranties, and material compliance with covenants. Novartis does not have to complete the transaction unless, among other things, Nektar has obtained certain required third party consents, and there is no significant litigation opposing the transaction. We currently expect the transaction to close on or about December 31, 2008. Following the closing of the transaction, we expect to focus our business on the advancement of our PEGylation technology platform, building our pipeline of new product opportunities, advancing our clinical development programs such as NKTR-102 and NKTR-118, and continuing to advance the pulmonary programs that we retain in the Novartis transaction.

At September 30, 2008, we had \$315.0 million of outstanding 3.25% convertible subordinated notes due 2012. Since September 30, 2008, we have repurchased approximately \$100.0 million in par value 3.25% convertible note for an aggregate purchase price of \$47.8 million. We may from time to time purchase or retire additional convertible subordinated notes through cash purchase or exchanges for other securities of the Company in open market or privately negotiated transactions, depending on, among other factors, our levels of available cash and the price at which such convertible notes are available for purchase. We will evaluate such transactions, if any, in light of the then-existing market conditions. These transactions individually or in the aggregate may be material.

For the three months and nine months ended September 30, 2008, net cash used for our operating activities was \$18.6 million and \$115.1 million, respectively. For the three months and nine months ended September 30, 2008, we made the following payments, among others: (i) nil and \$39.9 million, respectively, to Bepak Europe Ltd. ( Bepak ) and Tech Group as payment for termination amounts due under our Exubera inhaler manufacturing and supply agreement with those companies, all of which was recorded as an expense in 2007, (ii) nil and \$3.4 million, respectively, to Tech Group to maintain Exubera inhaler manufacturing capacity through April 2008 and (iii) \$0.1 million and \$5.4 million, respectively, for severance, employee benefits and outplacement services in connection with our workforce reduction plans. The decrease in our cash used in operations for the three months ended September 30, 2008 as compared to the three months ended June 30, 2008 and the three months ended March 31,

2008 is a result of a \$10.0 million performance milestone payment received related to NKTR-061.

The investment required to advance our proprietary product development programs, our ability to manage ongoing expense and the cash generated by new partnerships, if any, will be the key drivers of our results of operations and financial position in 2008. To fund our research and development activities, we have raised significant amounts of capital through the sale of our equity and convertible debt securities. As of September 30, 2008, we had approximately \$349.2 million in indebtedness. Our ability to meet the repayment obligations of this debt is dependent upon our and our partners' ability to develop, obtain regulatory approvals for and successfully commercialize products. Even if we are successful in this regard, we may require additional capital to repay our debt obligations as they become due.

**Table of Contents****Recent Events**

Please refer to discussion above regarding the Asset Purchase Agreement that we entered into with Novartis on October 20, 2008.

Please refer to Liquidity and Capital Resources below for discussion regarding the repurchase of our convertible subordinated notes since September 30, 2008.

**Research and Development Activities**

Our product pipeline includes both partnered products and development programs and proprietary product development programs. We have ongoing collaborations or licensing arrangements with numerous biotechnology and pharmaceutical companies to provide our pulmonary and PEGylation technologies. Our technologies are currently being used in nine products approved in the U.S. or Europe, in three partnered programs that have been filed with the U.S. Food and Drug Administration ( FDA ) and twelve development programs in human clinical trials.

The length of time that a development program is in a given phase varies substantially according to factors such as the type and intended use of the potential product, the clinical trial design, the ability to enroll suitable patients and changing standards of care, all of which are affected by medical and scientific developments and other variables not controlled by us or our partners. Generally, for our partnered programs, advancement from one phase to the next and the related costs are dependent upon factors primarily controlled by our partners.

In connection with our research and development for partnered products and development programs, we earned \$12.0 million and \$33.0 million in contract research revenue for the three months and nine months ended September 30, 2008, respectively, and \$18.8 million and \$47.4 million in contract research revenue for the three months and nine months ended September 30, 2007, respectively. The estimated completion dates and costs for our programs are not reasonably certain. See Part II, Item 1A Risk Factors for discussion of the risks associated with our partnered and proprietary research and development programs and the timing and risks associated with clinical development.

**Results of Operations**

*Three Months and Nine Months Ended September 30, 2008 and 2007*

*Revenue (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Product sales and royalties	\$ 9,474	\$ 37,497	\$ (28,023)	(75%)
Contract research	11,965	18,824	(6,859)	(36%)
Total revenue	\$ 21,439	\$ 56,321	\$ (34,882)	(62%)

	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Product sales and royalties	\$ 28,855	\$ 159,818	\$ (130,963)	(82%)
Contract research	32,977	47,436	(14,459)	(30%)
Total revenue	\$ 61,832	\$ 207,254	\$ (145,422)	(70%)

The decrease in total revenue for the three months and nine months ended September 30, 2008, as compared to the three months and nine months ended September 30, 2007, was primarily due to the termination of our collaborative development and license agreement, and related agreements, with Pfizer related to Exubera and NGI. We had no revenue from Pfizer related to Exubera or NGI for the three months and nine months ended September 30, 2008 compared to \$34.4 million and \$140.7 million, representing 61% and 68% of our total revenue, for the three months and nine months ended September 30, 2007, respectively.

**Table of Contents***Product sales and royalties*

For the three months and nine months ended September 30, 2007, Exubera product sales and commercialization readiness revenue from Pfizer accounted for \$26.6 million and \$123.4 million, respectively, of our total revenue. We had no revenue from Pfizer related to Exubera for the three months and nine months ended September 30, 2008. Non-Exubera product sales and royalties decreased by approximately \$1.4 million, or 13%, for the three months ended September 30, 2008, compared to the three months ended September 30, 2007 and \$7.6 million, or 21%, for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007. The decrease in non-Exubera product sales and royalties is primarily attributable to lower PEGylation product sales and royalties and the November 30, 2007 sale of Aerogen Ireland Ltd., one of our former subsidiaries that manufactured and supplied general purpose nebulizer devices, and which accounted for \$1.6 million and \$4.1 million, respectively, in revenue for the three months and nine months ended September 30, 2007. The timing of PEGylation product sales depends upon the manufacturing requirements of our partners. In 2008, orders for PEGylation products are higher in the fourth quarter than the first three quarters, as a result we expect PEGylation product sales to increase during the fourth quarter of 2008.

*Contract research*

Contract research revenue includes reimbursed research and development expense as well as the amortization of deferred up-front signing fees and milestone payments received from our collaboration partners. Contract research revenue is expected to fluctuate from year to year and therefore it is difficult to estimate future contract research revenue for any given period. The level of contract research revenue depends in part upon the continuation of existing collaborations, signing of new collaborations and achievement of milestones under current and future agreements. For the three months and nine months ended September 30, 2007, contract research revenue from Pfizer related to Exubera and NGI accounted for \$7.8 million and \$17.3 million, respectively, of our total revenue. We had no contract research revenue from Pfizer related to Exubera or NGI for the three months and nine months ended September 30, 2008. Non-Pfizer contract research revenue increased by \$1.0 million and \$2.8 million, respectively, for the three and nine months ended September 30, 2008 compared to the same periods in 2007. For the three months and nine months ended September 30, 2008, we have recognized increased contract research revenue from Bayer under our collaboration agreements for NKTR-061 and ciprofloxacin inhalation powder ( CIP ); these increases are offset by decreases in contract research revenue from Solvay Pharmaceuticals, Inc. and Zelos Therapeutics Inc. following notice of termination of those collaboration agreements. The timing and future success of our product development programs are subject to a number of risks and uncertainties. See Part II, Item 1A Risk Factors for discussion of the risks associated with our partnered research and development programs.

*Cost of Goods Sold and Product Gross Margin (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Cost of goods sold	\$ 5,349	\$ 27,457	\$ (22,108)	(81%)
Product gross margin	\$ 4,125	\$ 10,040	\$ (5,915)	(59%)
Product gross margin %	44%	27%		
	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / Decrease) 2008 vs. 2007</b>
Cost of goods sold	\$ 18,020	\$ 123,469	\$ (105,449)	(85%)
Product gross margin	\$ 10,835	\$ 36,349	\$ (25,514)	(70%)

Product gross margin % 38% 23%

The decrease in product gross margin for the three months and nine months ended September 30, 2008, compared to the three months and nine months ended September 30, 2007, was primarily due to the termination of our agreements with Pfizer related to Exubera and timing differences in PEGylation product sales. For the three months and nine months ended September 30, 2007, Exubera cost of goods sold totaled \$20.6 million and \$99.8 million, respectively, and Exubera gross margin totaled \$6.0 million and \$23.6 million, respectively, or 23% and 19%. The increase in product gross margin percentage is attributable to the change in product mix.



**Table of Contents***Cost of Workforce Reduction Plans (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Cost of goods sold, net of change in inventory	\$ (12)	\$ 36	\$ (48)	(133%)
Research and development expense	(136)	115	(251)	(218%)
General and administrative	(20)	342	(362)	(106%)
Cost of workforce reduction plans	\$ (168)	\$ 493	\$ (661)	(134%)

	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / Decrease 2008 vs. 2007</b>
Cost of goods sold, net of change in inventory	\$ 149	\$ 974	\$ (825)	(85%)
Cost of idle Exubera manufacturing capacity	1,221		1,221	>100%
Research and development expense	3,156	5,335	(2,179)	(41%)
General and administrative	517	1,888	(1,371)	(73%)
Cost of workforce reduction plans	\$ 5,043	\$ 8,197	\$ (3,154)	(38%)

Since May 2007, we have incurred \$13.4 million related to our two workforce reduction plans, \$5.0 million related to the 2008 Plan and \$8.4 million related to the 2007 Plan, which includes \$0.2 million which was recognized during the last quarter of 2007. We estimate that the total cost of the 2008 Plan will be approximately \$5.1 million, comprised of cash payments for severance, medical insurance and outplacement services. Certain notified employees voluntarily terminated prior to their scheduled termination dates or were offered other permanent positions within Nektar. As a result, we have reversed \$0.2 million of net workforce reduction charges related to the 2008 Plan as a change in estimate during the three months ended September 30, 2008. During the remainder of 2008, we expect to record less than \$0.1 million related to the 2008 Plan for employees with termination dates longer than two months from the date of notification.

*Cost of Idle Exubera Manufacturing Capacity (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Cost of idle Exubera manufacturing capacity	\$	\$	\$	n/a
	<b>Nine months</b>	<b>Nine months</b>	<b>Increase /</b>	<b>Percentage</b>

	<b>ended September 30, 2008</b>	<b>ended September 30, 2007</b>	<b>(Decrease) 2008 vs. 2007</b>	<b>Increase / Decrease) 2008 vs. 2007</b>
Cost of idle Exubera manufacturing capacity	\$ 6,821	\$ 6,821	\$ 6,821	>100%

Cost of idle Exubera manufacturing capacity includes amounts payable to Pfizer and Tech Group under an interim manufacturing capacity maintenance agreements that terminated on April 9, 2008, and severance, employee benefits, and outplacement costs for Exubera commercial manufacturing employees terminated as part of the February 2008 workforce reduction. Cost of idle Exubera manufacturing capacity also includes an allocation of manufacturing costs shared between commercial operations and research and development. Shared costs include employee compensation and benefits, rent, and utilities.

We do not expect to incur any additional Exubera manufacturing capacity costs.

*Research and Development Expense (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Research and development expense	\$ 38,265	\$ 35,773	\$ 2,492	7%

	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / Decrease) 2008 vs. 2007</b>
Research and development expense	\$ 109,138	\$ 114,265	\$ (5,127)	(4%)

**Table of Contents**

As a result of our two workforce reductions executed in May 2007 and February 2008, our salaries and benefits for the three months and nine months ended September 30, 2008 are \$1.5 million and \$11.6 million less, respectively, than the three months and nine months ended September 30, 2007. Additionally, research and development expense for the three months and nine months ended September 30, 2007 includes Aerogen Ireland, which was sold in November 2007. The sale of Aerogen Ireland has resulted in decreased research and development expense of \$1.0 million and \$2.7 million, respectively, for the three months and nine months ended September 30, 2008 compared to the same periods in 2007.

The decreases in research and development expense due to the decreased headcount and sale of Aerogen Ireland discussed above, in addition to termination of our inhaled insulin, Delta 9, OCIP, and ABIP development programs, are offset by increased program spending for the three months and nine months ended September 30, 2008 compared to the three months and nine months ended September 30, 2007. In 2008, we have funded the Phase 2 clinical trials for our proprietary PEGylation product candidates, NKTR-102 and NKTR-118, begun pre-clinical research for our proprietary PEGylation product candidate NKTR-105 and our proprietary pulmonary product candidate NKTR-063, and we have continued our research and development activities under our collaboration agreements for NKTR-061, TIP, and CIP.

We expect research and development expense to decrease slightly in the fourth quarter of 2008 as we will not recognize depreciation expense on our assets classified as held for sale.

*General and Administrative Expense (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
General and administrative expense	\$ 12,149	\$ 12,426	\$ (277)	(2%)
	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / Decrease 2008 vs. 2007</b>
General and administrative expense	\$ 36,951	\$ 42,339	\$ (5,388)	(13%)

General and administrative expense is associated with administrative staffing, business development and marketing.

The decrease in general and administrative expense for the nine months ended September 30, 2008 compared to the nine months ended September 30, 2007 includes decreased employee related costs of \$7.2 million and decreased outside professional services expenses of \$3.7 million, partially offset by increased marketing costs of \$0.8 million for NKTR-061, and increased facilities and equipment costs of approximately \$3.9 million.

We expect general and administrative expense to remain at a consistent level in the fourth quarter of 2008.

*Interest Income and Interest Expense (in thousands except percentages)*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Interest Income	\$ 2,375	\$ 5,519	\$ (3,144)	(57%)
Interest Expense	\$ (3,988)	\$ (4,773)	\$ (785)	(16%)
	<b>Nine months</b>	<b>Nine months</b>	<b>Increase /</b>	<b>Percentage</b>

	<b>ended</b> <b>September 30,</b> <b>2008</b>	<b>ended</b> <b>September 30,</b> <b>2007</b>	<b>(Decrease)</b> <b>2008 vs.</b> <b>2007</b>	<b>Increase /</b> <b>Decrease)</b>  <b>2008 vs. 2007</b>
Interest Income	\$ 10,578	\$ 16,444	\$ (5,866)	(36%)
Interest Expense	\$ (11,835)	\$ (14,408)	\$ (2,573)	(18%)

The decrease in interest income for the three months and nine months ended September 30, 2008, compared to the three months and nine months ended September 30, 2007, was primarily due to lower interest rates on our cash, cash equivalents, and available-for-sale investments.

**Table of Contents**

The decrease in interest expense for the three months and nine months ended September 30, 2008, compared to the three months and nine months ended September 30, 2007, was primarily attributable to a lower average balance of convertible subordinated notes outstanding in the three months and nine months ended September 30, 2008. We repaid \$36.0 million of our 5% subordinated convertible notes in February 2007 and \$66.6 million of our 3.5% subordinated convertible notes in October 2007. In the three months and nine months ended September 30, 2008, we had \$315.0 million of 3.25% subordinated convertible notes due September 2012 outstanding.

We expect interest expense to decrease in the fourth quarter of 2008 as a result of the convertible subordinated note repurchases since September 30, 2008.

*Loss on equity investment*

	<b>Three months ended September 30, 2008</b>	<b>Three months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Loss on equity investment	\$ (705)	\$	\$ 705	>100%

  

	<b>Nine months ended September 30, 2008</b>	<b>Nine months ended September 30, 2007</b>	<b>Increase / (Decrease) 2008 vs. 2007</b>	<b>Percentage Increase / (Decrease) 2008 vs. 2007</b>
Loss on equity investment	\$ (705)	\$	\$ 705	>100%

For the three months and nine months ended September 30, 2008, we recorded our proportionate share of the net loss of Pearl Therapeutics Inc. ( Pearl ) resulting from our \$4.2 million equity investment made in July 2008. Our investment in Pearl is included in assets held for sale.

**Liquidity and Capital Resources**

We have financed our operations primarily through revenue from partner licensing and collaboration arrangements, public and private placements of debt and equity securities and financing of equipment acquisitions and certain tenant leasehold improvements.

We had cash, cash equivalents and short-term investments in marketable securities of \$344.5 million and indebtedness of \$349.2 million, including \$315.0 million of 3.25% convertible subordinated notes, \$22.1 million in capital lease obligations and \$12.1 million in other liabilities as of September 30, 2008.

At September 30, 2008, we had \$315.0 million of outstanding 3.25% convertible subordinated notes due 2012. Since September 30, 2008, we have repurchased approximately \$100.0 million in par value 3.25% convertible note for an aggregate purchase price of \$47.8 million. We may from time to time purchase or retire additional convertible subordinated notes through cash purchase or exchanges for other securities of the Company in open market or privately negotiated transactions, depending on, among other factors, our levels of available cash and the price at which such convertible notes are available for purchase. We will evaluate such transactions, if any, in light of the then-existing market conditions. These transactions individually or in the aggregate may be material.

Due to the recent adverse developments in the credit markets, we may experience reduced liquidity with respect to some of our short-term investments. These investments are generally held to maturity, which is less than one year. However, if the need arose to liquidate such securities before maturity, we may experience losses on liquidation. To date we have not experienced any liquidity issues with respect to these securities, but should such issues arise, we may be required to hold some, or all, of these securities until maturity. We have the intent and ability to hold our securities to maturity when they will be redeemed at par value. We believe that, even allowing for potential liquidity issues with respect to these securities, our remaining cash, cash equivalents, and short-term investments will be sufficient to meet our anticipated cash needs for at least the next twelve months.

In light of the volatility and developments that we have seen in the financial markets, we continued to review our cash equivalents and available-for-sale investments carefully. Our investment portfolio is maintained in accordance with our investment policy that defines allowable investments, specifies credit quality standards and limits the credit exposure of any single issuer. Maintaining the primary goals of our investment policy has protected us from much of the risks in the credit markets while allowing us to meet our operating cash flow requirements, as well as execute other opportunities including our convertible subordinated note repurchases discussed above.

*Cash flows used in operating activities*

Net cash used for our operating activities totaled \$115.1 million during the nine months ended September 30, 2008. To date, revenue has not been sufficient to cover our expenses and we are not generating positive cash flow through our operations. We do not utilize cash in operations ratably throughout the year and we utilized less cash in operations during the third quarter than the first two quarters of 2008. We expect our cash used in operations to increase during the last quarter of 2008.

**Table of Contents**

For the nine months ended September 30, 2008, cash used in operations includes a \$10.0 million performance milestone received from Bayer for NKTR-061, payments to Bepak and Tech Group of \$39.9 million for amounts due under our termination agreements with those companies, all of which was recorded as an expense in 2007, \$5.0 million to maintain Exubera manufacturing capacity at Tech Group's facility and Pfizer's Terre Haute facility, and \$5.4 million for severance, employee benefits, and outplacement services in connection with our workforce reduction plans.

For the nine months ended September 30, 2007, net cash provided by operating activities of \$39.6 million includes the up-front and milestone payments received from Bayer of \$50.0 million for NKTR-061 and upfront fees of \$24.6 million received from Pfizer under an interim agreement for joint development of NGI. Payments made in connection with our May 2007 workforce reduction totaled \$7.4 million for the nine-months ended September 30, 2007.

*Cash flows from investing activities*

We purchased \$15.1 million and \$20.7 million of property and equipment in the nine months ended September 30, 2008 and 2007, respectively.

In July 2008, we invested \$4.2 million in Pearl, in which we own a minority interest. In 2007, we granted Pearl a limited field license to certain proprietary pulmonary delivery technology. Pearl is utilizing the license to develop high-performance products in certain designated disease areas that reduce local and systemic side effects based on improved targeting and distribution of the drug throughout the lung.

We expect to receive the proceeds from the sale of our pulmonary assets of \$115.0 million during the fourth quarter of 2008.

*Cash flows used in financing activities*

We repaid nil and \$36.0 million, respectively, of our convertible subordinated notes and \$1.9 million and \$0.8 million, respectively, of our loan and capital lease obligations in the nine months ended September 30, 2008 and 2007.

**Contractual Obligations**

For the nine months ended September 30, 2008, other than the contract termination payments to Bepak and Tech Group of \$32.1 million, there has not been a material change to the summary of contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2007.

Since September 30, 2008, we have repurchased \$100.0 million face value of our convertible subordinated notes that were due in September 2012.

**Off-Balance Sheet Arrangements**

We do not utilize off-balance sheet financing arrangements as a source of liquidity or financing.

**Critical Accounting Policies and Recent Accounting Pronouncements**

For additional information on our critical accounting policies and recent accounting pronouncements, please refer to the discussion in "Recent Accounting Pronouncements" under Note 1 of the Notes to Condensed Consolidated Financial Statements in the Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2008 and June 30, 2008, and Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2007 on file with the Securities and Exchange Commission.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Our market risks at September 30, 2008 have not changed significantly from those discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2007 on file with the Securities and Exchange Commission.

**Table of Contents****Item 4. Controls and Procedures****Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Securities Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required financial disclosure.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15. Based upon, and as of the date of, this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

**Changes in Internal Control Over Financial Reporting**

We continuously seek to improve the efficiency and effectiveness of our internal controls. This results in refinements to processes throughout the company. However, there was no change in our internal control over financial reporting that occurred in the three months ended September 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on the Effectiveness of Controls**

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Approval of Non-Audit Services**

In the three months ended September 30, 2008, the Audit Committee of the Board of Directors approved no non-audit related services to be provided by Ernst & Young LLP, our independent registered public accounting firm.

**PART II: OTHER INFORMATION****Item 1. Legal Proceedings**

Reference is hereby made to our disclosures in "Legal Matters" under Note 6 of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q which is incorporated by reference herein.

**Item 1A. Risk Factors**

*Investors in Nektar Therapeutics should carefully consider the risks described below before making an investment decision. The risks described below may not be the only ones relating to our company. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Item 1A of our Quarterly Report on Form 10-Q for the three months ended June 30, 2008. Additional risks that we currently believe are immaterial may also impair our business operations. Our business, results of operation, financial condition, cash flow and future prospects and the trading price of our common stock and our abilities to repay our convertible notes could be harmed as a result of any of these risks, and investors may lose all or part of their investment. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q, our Annual Report on Form 10-K for the year ended December 31, 2007, including our consolidated financial statements and related notes, and our other filings*



*made from time to time with the Securities and Exchange Commission ( SEC ).*

**Table of Contents*****Risks Related to Our Business*****The termination of our partnership with Pfizer and the discontinuance of our efforts to find a new marketing and development partner for Exubera and NGI will reduce our revenue significantly in 2008 as compared to 2007.**

From our inception through the end of our 2007 fiscal year, we depended on Pfizer for revenue related to Exubera contract research and manufacturing. Our revenue from Pfizer related to Exubera and NGI was approximately \$34.4 million and \$140.7 million, representing 61% and 68% of total revenue, for the three months and nine months ended September 30, 2007, respectively. On November 9, 2007, we entered into a termination agreement and mutual release with Pfizer, pursuant to which Pfizer made a one-time payment of \$135.0 million to us in satisfaction of all outstanding contractual obligations under our then-existing agreements with Pfizer related to Exubera and the next-generation inhaled insulin development program, also known as NGI. All of our agreements with Pfizer, other than the termination agreement and mutual release, terminated as of November 9, 2007, including our collaborative development and licensing agreement with Pfizer.

Pursuant to our termination agreement and mutual release with Pfizer, Pfizer agreed to provide certain cooperation to assist us in securing a new marketing and development partner for Exubera and NGI. However, on April 9, 2008, we announced that we would cease all efforts to find a new marketing and development partner for Exubera and NGI in response to a new data analysis performed by Pfizer from ongoing clinical trials indicating an increase in the number of new cases of lung cancer in Exubera patients who were former smokers as compared to the control group. Prior to the termination of our partnership with Pfizer, Pfizer had sole responsibility for all regulatory matters, distribution, sales and marketing of Exubera and was also responsible for manufacturing and delivering bulk insulin for powder processing, filling the insulin powder into blister packs for the Exubera inhaler and providing the packaging for the final Exubera product. Thus, we could not derive any future revenue from Exubera or NGI without securing a new marketing and development partner to assist in the manufacture of the products and provide sales, marketing and distribution services. However, as a result of the termination of our partnership with Pfizer and the discontinuance of our efforts to find a new partner for Exubera and NGI, we expect to derive no revenue from Pfizer in 2008 and no future revenue from Exubera or NGI.

**If the preclinical testing or clinical trials conducted by us or our partners are delayed or unsuccessful, our business could be significantly harmed.**

We have a number of partnered product candidates and proprietary product candidates in research and development, including preclinical testing and clinical trials. Preclinical testing and clinical trials are long, expensive and uncertain processes. It may take us, or our collaborative partners, several years to complete clinical trials. We have limited experience in clinical development. Failure can occur at any stage and at any time, regardless of how successful the results from preclinical and prior clinical testing may have been. Typically, there is a high rate of attrition for product candidates in preclinical and clinical trials due to safety, efficacy or other factors. Success in preclinical testing and early clinical trials does not necessarily predict success in later clinical trials. A number of other companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in later stage clinical trials (i.e., Phase 2 or Phase 3 trials) due to factors such as inconclusive results and adverse medical events, even after achieving positive results in earlier trials. If our partnered product candidates or proprietary product candidates fail during any clinical trial stage, it could have a significant and adverse impact on our business prospects. The timing of the completion of clinical trials and the availability of data from those trials can be very difficult to estimate due to many factors, including but not limited to, clinical trial design, the rate of qualified patient enrollment, changing standards of care (alternative treatments, patient screening testing), the time it takes to reach clinical trial end points, and certain other medical and scientific developments that are not controlled by us or our partners. Therefore, the completion of clinical trials and the availability of data from those trials can take much longer than we plan.

**Table of Contents**

**Because our proprietary product candidates are in the early stages of development, there is a high risk of failure, and we may never succeed in developing marketable products or generating revenue from our proprietary product candidates.**

Our efforts to apply our pulmonary technology and PEGylation technology to our proprietary product development programs may fail. None of our proprietary product candidates have received regulatory approval and our development efforts may not result in a commercialized product. Drug development is an uncertain process that involves trial and error, and we may fail at numerous stages along the way or choose to discontinue development. Development of our proprietary product candidates will require extensive time, effort and cost in preclinical testing and clinical trials and will involve a lengthy regulatory review process before they can be marketed. In particular, successful pre-clinical and Phase 1 clinical study results do not necessarily predict success in later stage clinical trials. It can also be very difficult to estimate the commercial potential of early stage product candidates due to factors such as safety and efficacy when compared to other available treatments, including potential generic drug alternatives with similar efficacy profiles, changing standards of care, patient and physician preferences and the availability of competitive alternatives that may emerge either during the long drug development process or after commercial introduction. Although NKTR-102 (PEG-irinotecan) and NKTR-118 (oral PEG-naloxol) entered Phase 2 clinical development in late 2007, because of the substantial risks and uncertainties of clinical programs at this early stage of development, there is no assurance that either product will be approved for marketing or, if approved, will be accepted and used by patients and physicians.

**While we have entered into a definitive agreement to sell certain of our assets related to our pulmonary technology platform, certain pulmonary development programs and associated technology and intellectual property, we cannot guarantee that the transaction will close. If the transaction does not close, our business operations may be significantly disrupted and our capital resources and financial condition will be negatively affected.**

We have entered into an Asset Purchase Agreement with Novartis Pharmaceuticals Corporation, a Delaware corporation, Novartis Pharma AG, a Swiss corporation, and AeroGen, Inc., a Delaware corporation and a subsidiary of Nektar, to sell certain of our assets including (i) certain dry powder and liquid pulmonary formulation and manufacturing assets, including capital equipment and manufacturing facility lease obligations, (ii) certain intellectual property and manufacturing methods and associated information systems related to the pulmonary technology platform, (iii) manufacturing and associated payments for Ciprofloxacin inhaled powder, (iv) manufacturing and royalty rights to the Tobramycin inhalation powder program and (v) certain other interests in two private companies, in exchange for \$115.0 million in cash. While we have entered into a definitive agreement, we may not be able to consummate the transaction contemplated thereby if we are unable to satisfy various conditions and contingencies prior to closing or, if permissible, obtain a waiver of such conditions and contingencies from the other parties to the Asset Purchase Agreement. These conditions and contingencies include obtaining approvals from certain governmental and regulatory agencies and receiving consents from third parties, and that the representations and warranties made by us in the agreement remain true in all material respects at closing. Parties to the Asset Purchase Agreement may terminate the agreement if the transaction has not been consummated by October 20, 2009 or in the event of certain serious breaches by the parties. In the event that this transaction does not close, we will either need to continue our pulmonary platform technology development and the ongoing development programs based on this technology platform or consider other alternatives. However, the announcement of the transaction and the failure to consummate it may significantly adversely affect our relations with our pulmonary employees as well as the customers and suppliers. In addition, the sale of the pulmonary assets is expected to reduce our future operating expenses and the failure to consummate the transaction would not allow us to realize these benefits.

Prior to the closing of the sale of our pulmonary assets, our business operations may be disrupted due to a number of factors, any of which could harm our business or ability to complete the proposed sale. These factors may include the loss of key employees of the business, incurring expenses in connection with the proposed sale, and the diversion of management's attention from other important objectives that impact the success of our business.

**Our strategy to develop our proprietary product candidates prior to seeking partnership arrangements may be unsuccessful and adversely impact our business, results of operations and financial condition.**

Our strategy is to fund our proprietary product development programs, including some or all of the clinical trials, prior to partnering with pharmaceutical and biotechnology companies. While we believe this strategy may result in improved economics for our proprietary product candidates, it will require significant investment by us without reimbursement. For example, we may expand the number of clinical trials for one or more of our proprietary product candidates to additional therapeutic indications to increase the likelihood of success but such strategy can be very expensive and may not result in a successful trial in any of the therapeutic indications due to one or more factors. As a result, we bear an increased economic risk in the event one or more of our proprietary product candidates does not receive regulatory approval or is not successfully commercialized. Even if the development of a proprietary product is ultimately successful, our increased investment could adversely impact our business, results of operations, and financial condition prior to commercialization since we will have fewer funds available to invest in other products and efforts.

**Table of Contents**

**If we are unable to establish and maintain partnerships on commercially attractive terms, our business, results of operations and financial condition could suffer.**

We intend to continue to seek partnerships with pharmaceutical and biotechnology partners to fund some of our research and development expense and develop and commercialize product candidates. For instance, we secured partnerships in 2007 based on our pulmonary and PEGylation technology, namely with the execution of a co-development, license and co-promotion agreement with Bayer for NKTR-061 and an exclusive research, development, license and manufacturing and supply agreement with Baxter for Hemophilia B, respectively. The timing of any future partnership, as well as the terms and conditions of the partnership, will affect our results of operation and financial condition. If we are unable to find suitable partners or to negotiate acceptable collaborative arrangements with respect to our existing and future product candidates or the licensing of our technology, or if any arrangements we negotiate, or have negotiated, include unfavorable commercial terms, our business, results of operations and financial condition could suffer.

**If product liability claims are brought against us, we may incur significant liabilities and suffer damage to our reputation.**

The manufacture, clinical testing, marketing and sale of medical and pharmaceutical products involve inherent product liability risks. Although Pfizer owns the new drug application with the FDA for Exubera and had sole responsibility for preparing prescribing information for physicians and the Exubera patient medication guide, as well as for the sales and marketing of Exubera, there remains a risk of product liability claims being brought against us. Whether or not we are ultimately successful in any product liability litigation, such litigation would consume substantial amounts of our financial and managerial resources and might result in adverse publicity, potential decrease in demand for products based on our technology platforms, injury to our reputation, withdrawal of clinical trial volunteers and loss of revenue, all of which would impair our business, results of operations and financial condition. Further, product liability claims could result in substantial judgments or settlements. Our insurance coverage may not cover or be adequate to satisfy any liability that may arise, and we may not be able to maintain our clinical trial insurance or product liability insurance at an acceptable cost, if at all. If our product liability costs exceed our product liability insurance coverage, we may incur substantial liabilities that could have a severe negative impact on our business, results of operations and financial condition. For instance, such uninsured liabilities could deplete financial resources that would otherwise be used to complete the development or commercialization of our product candidates.

**We expect to continue to incur substantial losses and negative cash flow from operations and may not achieve or sustain profitability in the future.**

In the three months and nine months ended September 30, 2008, we reported net losses of \$37.0 million and \$111.1 million, respectively. If and when we achieve profitability depends upon a number of factors, including the timing and recognition of milestone payments and license fees received, the timing of revenue under collaboration agreements, the amount of investments we make in our proprietary product candidates, the regulatory approval and market success of our product candidates and the success of our strategy to fund our proprietary product development programs prior to partnering with other pharmaceutical and biotechnology companies. We may not be able to achieve and sustain profitability.

Other factors that will affect whether we achieve and sustain profitability include our ability, alone or together with our partners, to:

- develop products utilizing our technologies, either independently or in collaboration with other pharmaceutical or biotech companies;
- receive necessary regulatory and marketing approvals;
- maintain or expand manufacturing at necessary levels;
- achieve market acceptance of our partner products;

receive royalties on products that have been approved, marketed or submitted for marketing approval with regulatory authorities; and

maintain sufficient funds to finance our activities.

**Table of Contents**

**If we do not generate sufficient cash flow through increased revenue or raising additional capital, we may not be able to meet our substantial debt obligations.**

As of September 30, 2008, we had cash, cash equivalents, short-term investments and investments in marketable securities valued at approximately \$344.5 million and approximately \$349.2 million of indebtedness, including approximately \$315.0 million in convertible subordinated notes, \$22.1 million in capital lease obligations and \$12.1 million of other liabilities. We expect to use a substantial portion of our cash to fund our ongoing operations over the next few years. Since September 30, 2008, we have repurchased \$100.0 million of our 3.25% convertible subordinated notes. The remaining \$215.0 million of our 3.25% convertible subordinated notes will mature in September 2012.

Our substantial indebtedness has and will continue to impact us by:

making it more difficult to obtain additional financing;

constraining our ability to react quickly in an unfavorable economic climate;

constraining our stock price; and

constraining our ability to invest in our proprietary product development programs.

Currently, we are not generating positive cash flow and the negative impact to our revenue of the termination of our Exubera and NGI efforts, and corresponding expectation that we will derive no future revenue associated with those products, may further reduce our ability to meet our debt obligations. If we are unable to satisfy our debt service requirements, substantial liquidity problems could result. In relation to our convertible subordinated notes, since the market price of our common stock is significantly below the conversion price, the holders of our outstanding convertible subordinated notes are unlikely to convert the notes to common stock in accordance with the existing terms of the notes. If we do not generate sufficient cash from operations to repay principal or interest on our remaining convertible subordinated notes, or satisfy any of our other debt obligations, when due, we may have to raise additional funds from the issuance of equity or debt securities or otherwise restructure our obligations. Any such financing or restructuring may not be available to us on commercially acceptable terms, if at all.

**If we cannot raise additional capital, our financial condition will suffer.**

We have no material credit facility or other material committed sources of capital. To the extent operating and capital resources are insufficient to meet our future capital needs, we will have to raise additional funds from new collaboration partnerships or the capital markets to continue the marketing and development of our technologies and proprietary products. Such funds may not be available on favorable terms or may be completely unavailable. We may be unable to obtain suitable new collaboration partners on attractive terms and our substantial indebtedness as well as difficult conditions in the capital markets may limit our ability to obtain any additional capital markets financing or may completely prevent obtaining such financing. If adequate funds are not available on reasonable terms, we may be required to curtail operations significantly or obtain funds by entering into financing, supply or collaboration agreements on unattractive terms. Our inability to raise capital could harm our business and our stock price. To the extent that additional capital is raised through the sale of equity or convertible debt securities, the issuance of such securities would result in dilution to our stockholders which could be significant.

**Our revenue has historically depended on revenue from collaboration agreements, causing significant fluctuation in our revenue from period to period.**

Other than revenue from sales of Exubera inhalation powder and inhaler devices to Pfizer in 2007 and 2006, historically, our revenue is principally derived from collaboration agreements with partners. Such revenue includes milestone payments and reimbursement of a portion of our research and development expense charged to our partners pursuant to collaborative arrangements with them. The amount of our revenue derived from collaboration agreements in any given period will depend on a number of unpredictable factors, including our ability to find and maintain suitable partners, the timing of the negotiation and conclusion of collaboration agreements with such partners, whether and when we achieve milestones agreed upon with our partners, whether the partnership is exclusive or whether we can seek other partners, the timing of regulatory approvals and the market introduction of new products, as well as other factors.





**Table of Contents**

**If our partners, on which we depend to obtain regulatory approvals for and to commercialize our partnered products, are not successful, or if such collaborations fail, the development or commercialization of our partnered products may be delayed or unsuccessful.**

When we sign a collaborative development agreement or license agreement to develop a product candidate with a pharmaceutical or biotechnology company, the pharmaceutical or biotechnology company is generally expected to:

synthesize active pharmaceutical ingredients to be used in the product candidate;

design and conduct large scale clinical studies;

prepare and file documents necessary to obtain government approvals to sell a given product candidate; and/or

market and sell our products when and if they are approved.

Our reliance on collaborative relationships poses a number of risks, including risks that:

we may be unable to control whether, and the extent to which, our partners devote sufficient resources to the development programs or commercial efforts;

disputes may arise in the future with respect to the ownership of rights to technology or intellectual property developed with partners;

disagreements with partners could lead to delays in, or termination of, the research, development or commercialization of product candidates or to litigation or arbitration;

contracts with our partners may fail to provide us with significant protection, or to be effectively enforced, in the event one of our partners fails to perform;

partners have considerable discretion in electing whether to pursue the development of any additional product candidates and may pursue alternative technologies or products either on their own or in collaboration with our competitors;

partners with marketing rights may choose to devote fewer resources to the marketing of our products than they do to products of their own development;

the timing and level of resources that our partners dedicate to the development program will affect the timing and amount of revenue we receive;

partners may be unable to pay us as expected; and

partners may terminate their agreements with us unilaterally for any or no reason, in some cases with the payment of a termination fee penalty and in other cases with no termination fee penalty.

Given these risks, the success of our current and future partnerships are highly uncertain.

We have entered into collaborations in the past that have been subsequently terminated, such as our collaboration with Pfizer for Exubera and NGI. If other collaborations are suspended or terminated, our ability to commercialize certain other proposed product candidates could also be negatively impacted. If our collaborations fail, our product development or commercialization of product candidates could be delayed or cancelled, which would negatively impact our business, results of operations and financial condition.

**If we or our partners do not obtain regulatory approval for our product candidates on a timely basis, if at all, or if the terms of any approval impose significant restrictions or limitations on use, our business, results of operations and financial condition will be negatively affected.**

We or our partners may not obtain regulatory approval for product candidates on a timely basis, if at all, or the terms of any approval (which in some countries includes pricing approval) may impose significant restrictions or limitations on use. Product candidates must undergo rigorous animal and human testing and an extensive FDA mandated or equivalent foreign authorities review process for safety and efficacy. This process generally takes a number of years and requires the expenditure of substantial resources. The time required for completing testing and obtaining approvals is uncertain, and the FDA and other U.S. and foreign regulatory agencies have substantial discretion to terminate clinical trials, require additional testing, delay or withhold registration and marketing approval and mandate product withdrawals, including recalls. In addition, undesirable side effects caused by our product candidates could cause us or regulatory authorities to interrupt, delay or halt clinical trials and could result in a more restricted label or the delay or denial of regulatory approval by regulatory authorities.

**Table of Contents**

Even if we or our partners receive regulatory approval of a product, the approval may limit the indicated uses for which the product may be marketed. Our partnered products that have obtained regulatory approval, and the manufacturing processes for these products, are subject to continued review and periodic inspections by the FDA and other regulatory authorities. Discovery from such review and inspection of previously unknown problems may result in restrictions on marketed products or on us, including withdrawal or recall of such products from the market, suspension of related manufacturing operations or a more restricted label. For instance, Pfizer's update of the Exubera labeling in April 2008 to include information in the warnings section for doctors and patients regarding an imbalance of the number of new cases of lung cancer in Exubera patients who were former smokers as compared to the control group could have significantly and negatively impacted the market for Exubera had this product still been actively marketed. The failure to obtain timely regulatory approval of product candidates, any product marketing limitations or a product withdrawal would negatively impact our business, results of operations and financial condition.

**If we or our partners are not able to manufacture products in quantities and at costs that are commercially feasible, our proprietary and partnered product candidates will not be successfully commercialized.**

If we are not able to scale-up manufacturing to meet the drug or inhaler device quantities required to support large clinical trials or commercial manufacturing in a timely manner or at a commercially reasonable cost, we risk not meeting our supply requirements and contractual obligations. Building and validating large scale clinical or commercial-scale manufacturing facilities and processes, recruiting and training qualified personnel and obtaining necessary regulatory approvals is complex, expensive and time consuming. We also sometimes face very limited supply of a critical raw material that can only be obtained from a single, or a limited number of, suppliers, which could constrain our manufacturing output which could negatively impact our revenues or delay progress of clinical programs. In addition, in the past we have encountered challenges in scaling up manufacturing to meet the requirements of large scale clinical trials without making modifications to the drug formulation or device design which has the potential to cause significant and unanticipated delays in clinical development. Failure to manufacture products in quantities or at costs that are commercially feasible could cause us not to meet our supply requirements, contractual obligations or other requirements for our proprietary or partner product candidates and, as a result, would negatively impact our business, results of operations and financial condition.

**If government and private insurance programs do not provide reimbursement for our partnered products or proprietary products, those products will not be widely accepted, which would have a negative impact on our business, results of operations and financial condition.**

In both domestic and foreign markets, sales of our partnered and proprietary products that have received regulatory approval will depend in part on market acceptance among physicians and patients, pricing approvals by government authorities and the availability of reimbursement from third-party payers, such as government health administration authorities, managed care providers, private health insurers and other organizations. Such third-party payers are increasingly challenging the price and cost effectiveness of medical products and services. Therefore, significant uncertainty exists as to the pricing approvals for, and the reimbursement status of, newly approved healthcare products. Moreover, legislation and regulations affecting the pricing of pharmaceuticals may change before regulatory agencies approve our proposed products for marketing and could further limit pricing approvals for, and reimbursement of, our products from government authorities and third-party payers. A government or third-party payer decision not to approve pricing for, or provide adequate coverage and reimbursements of, our products would limit market acceptance of such products.

**We depend on third parties to conduct the clinical trials for our proprietary product candidates and any failure of those parties to fulfill their obligations could harm our development and commercialization plans.**

We depend on independent clinical investigators, contract research organizations and other third-party service providers to conduct clinical trials for our proprietary product candidates. Though we rely heavily on these parties for successful execution of our clinical trials and are ultimately responsible for the results of their activities, many aspects of their activities are beyond our control. For example, we are responsible for ensuring that each of our clinical trials is conducted in accordance with the general investigational plan and protocols for the trial, but the independent clinical investigators may prioritize other projects over ours or communicate issues regarding our products to us in an untimely manner. Third parties may not complete activities on schedule or may not conduct our clinical trials in

accordance with regulatory requirements or our stated protocols. The early termination of any of our clinical trial arrangements, the failure of third parties to comply with the regulations and requirements governing clinical trials or our reliance on results of trials that we have not directly conducted or monitored could hinder or delay the development, approval and commercialization of our product candidates and would adversely effect our business, results of operations and financial condition.

**Table of Contents****Our manufacturing operations and those of our contract manufacturers are subject to governmental regulatory requirements, which, if not met, would have a material adverse effect on our business, results of operations and financial condition.**

We and our contract manufacturers are required to maintain compliance with current good manufacturing practices (cGMP), including cGMP guidelines applicable to active pharmaceutical ingredients, and are subject to inspections by the FDA or comparable agencies in other jurisdictions to confirm such compliance. We anticipate periodic regulatory inspections of our drug manufacturing facilities and the device manufacturing facilities of our contract manufacturers for compliance with applicable regulatory requirements. Any failure to follow and document our or our contract manufacturers' adherence to such cGMP regulations or satisfy other manufacturing and product release regulatory requirements may lead to significant delays in the availability of products for commercial use or clinical study, result in the termination or hold on a clinical study or delay or prevent filing or approval of marketing applications for our products. Failure to comply with applicable regulations may also result in sanctions being imposed on us, including fines, injunctions, civil penalties, failure of regulatory authorities to grant marketing approval of our products, delays, suspension or withdrawal of approvals, license revocation, seizures or recalls of products, operating restrictions and criminal prosecutions, any of which could harm our business. The results of these inspections could result in costly manufacturing changes or facility or capital equipment upgrades to satisfy the FDA that our manufacturing and quality control procedures are in substantial compliance with cGMP. Manufacturing delays, for us or our contract manufacturers, pending resolution of regulatory deficiencies or suspensions would have a material adverse effect on our business, results of operations and financial condition.

**If any of our pending patent applications do not issue, or are deemed invalid following issuance, we may lose valuable intellectual property protection.**

The patent positions of pharmaceutical, medical device and biotechnology companies, such as ours, are uncertain and involve complex legal and factual issues. We own over 220 U.S. and over 1,200 foreign patents and a number of patent applications pending that cover various aspects of our technologies. We have filed patent applications, and plan to file additional patent applications, covering various aspects of our technologies, including our pulmonary technology, both in general and as it relates to specific molecules, our powder processing technology, our powder formulation technology, our inhalation device technology, our PEGylation technology and certain other of our early stage technologies. There can be no assurance that patents that have issued will be valid and enforceable or that patents for which we apply will issue with broad coverage, if at all. The coverage claimed in a patent application can be significantly reduced before the patent is issued and, as a consequence, our patent applications may result in patents with narrow coverage. Since publication of discoveries in scientific or patent literature often lag behind the date of such discoveries, we cannot be certain that we were the first inventor of inventions covered by our patents or patent applications. As part of the patent application process, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office (PTO), which could result in substantial cost to us, even if the eventual outcome is favorable. Further, an issued patent may undergo further proceedings to limit its scope so as not to provide meaningful protection and any claims that have issued, or that eventually issue, may be circumvented or otherwise invalidated. Any attempt to enforce our patents or patent application rights could be time consuming and costly. An adverse outcome could subject us to significant liabilities to third parties, require disputed rights to be licensed from or to third parties or require us to cease using the technology in dispute. Even if a patent is issued and enforceable, because development and commercialization of pharmaceutical products can be subject to substantial delays, patents may expire early and provide only a short period of protection, if any, following commercialization of related products.

There are many laws, regulations and judicial decisions that dictate and otherwise influence the manner in which patent applications are filed and prosecuted and in which patents are granted and enforced. Changes to these laws, regulations and judicial decisions are subject to influences outside of our control and may negatively affect our business, including our ability to obtain meaningful patent coverage or enforcement rights to any of our issued patents. New laws, regulations and judicial decisions may be retroactive in effect, potentially reducing or eliminating our ability to implement our patent-related strategies to these changes. Changes to laws, regulations and judicial decisions that affect our business are often difficult or impossible to foresee, which limits our ability to adequately adapt our

patent strategies to these changes.

**Table of Contents****We rely on trade secret protection and other unpatented proprietary rights for important proprietary technologies, and any loss of such rights could harm our business, results of operations and financial condition.**

We rely on trade secret protection for our confidential and proprietary information. No assurance can be given that others will not independently develop substantially equivalent confidential and proprietary information or otherwise gain access to our trade secrets or disclose such technology, or that we can meaningfully protect our trade secrets. In addition, unpatented proprietary rights, including trade secrets and know-how, can be difficult to protect and may lose their value if they are independently developed by a third party or if their secrecy is lost. Any loss of trade secret protection or other unpatented proprietary rights could harm our business, results of operations and financial condition.

**We may not be able to obtain intellectual property licenses related to the development of our technology on a commercially reasonable basis, if at all.**

Numerous pending and issued U.S. and foreign patent rights and other proprietary rights owned by third parties relate to pharmaceutical compositions, medical devices and equipment and methods for preparation, packaging and delivery of pharmaceutical compositions. We cannot predict with any certainty which, if any, patent references will be considered relevant to our or our collaborative partners' technology by authorities in the various jurisdictions where such rights exist, nor can we predict with certainty which, if any, of these rights will or may be asserted against us by third parties. There can be no assurance that we can obtain a license to any technology that we determine we need on reasonable terms, if at all, or that we could develop or otherwise obtain alternate technology. If we are required to enter into a license with a third party, our potential economic benefit for the products subject to the license will be diminished. The failure to obtain licenses on commercially reasonable terms, or at all, if needed, would have a material adverse effect on us.

**Significant competition for our technology platforms, our partnered and proprietary products and product candidates could make our technologies, products or product candidates obsolete or uncompetitive, which would negatively impact our business, results of operations and financial condition.**

Our platform technologies and partnered and proprietary products and product candidates compete with various pharmaceutical and biotech companies. In the PEGylation technology field, our competitors include Dow Chemical Company, Enzon Pharmaceuticals, Inc., SunBio Corporation, Mountain View Pharmaceuticals, Inc., Neose Technologies, Inc., NOF Corporation and Urigen Pharmaceuticals, Inc. Several other chemical, biotechnology and pharmaceutical companies may also be developing PEGylation technologies. Some of these companies license or provide the technology to other companies, while others are developing the technology for internal use. Our competitors in the pulmonary technology field include Alexza Pharmaceuticals, Inc., Alkermes, Inc., Aradigm Corporation, 3M Company, MannKind Corporation, Microdose Technologies, Inc., SkyePharma Plc and Vectura Group Plc.

There are several competitors for our proprietary product candidates currently in development. For NKTR-061 (inhaled Amikacin), the current standard of care includes several approved intravenous antibiotics for the treatment of either hospital-acquired pneumonia or ventilator-associated pneumonia in patients on mechanical ventilators. For NKTR-118 (PEGylated naloxol), there are currently several alternative therapies used to address opioid-induced constipation (OIC) and opioid-induced bowel dysfunction (OBD) including over-the-counter laxatives and stool softeners such as docusate sodium, senna and milk of magnesia. In addition, there are a number of companies developing potential products which are in various stages of clinical development and are being evaluated for the treatment of OIC and OBD in different patient populations, including Adolor Corporation, GlaxoSmithKline plc, Progenics Pharmaceuticals, Inc., Wyeth, Mundipharma International Limited, Sucampo Pharmaceuticals, Inc. and Takeda Pharmaceutical Company Limited. For NKTR-102 (PEG-irinotecan), there are a number of approved therapies for the treatment of colorectal cancer, including Eloxatin, Camptosar, Avastin, Erbitux, Vectibix, Xeloda, Adrucil and Wellcovorin. In addition, there are a number of drugs in various stages of preclinical and clinical development from companies exploring cancer therapies or improved chemotherapeutic agents to potentially treat colorectal cancer, including, but not limited to, products in development from Bristol-Myers Squibb Company, Pfizer, GlaxoSmithKline plc, Alchemia Limited, Antigenics Inc., F. Hoffman La Roche Ltd., Novartis AG, Cell Therapeutics, Inc., Neopharm, Inc., Meditech Research Limited, Enzon Pharmaceuticals, Inc. and others.

There can be no assurance that we or our partners will successfully develop, obtain regulatory approvals and commercialize next-generation or new products that will successfully compete with those of our competitors. Many of our competitors have greater financial, research and development, marketing and sales, manufacturing and managerial capabilities. We face competition from these companies not just in product development but also in areas such as recruiting employees, acquiring technologies that might enhance our ability to commercialize products, establishing relationships with certain research and academic institutions, enrolling patients in clinical trials and seeking program partnerships and collaborations with larger pharmaceutical companies. As a result, our competitors may succeed in developing competing technologies, obtaining regulatory approval or gaining market acceptance for products before we do. These developments could make our products or technologies uncompetitive or obsolete.



**Table of Contents**

**Our collaboration agreements with our partners contain complex commercial terms that could result in disputes or litigation that could adversely affect our business, results of operations and financial condition.**

We currently derive, and expect to derive in the foreseeable future, all of our revenue from collaboration agreements with biotechnology and pharmaceutical companies. These collaboration agreements contain complex commercial terms, including:

research and development performance and reimbursement obligations for our personnel and other resources allocated to partnered product development programs;

clinical and commercial manufacturing agreements, some of which are priced on an actual cost basis for products supplied by us to our partners with complicated cost calculation and allocation formulas and methodologies;

intellectual property ownership allocation between us and our partners for improvements and new inventions developed during the course of the partnership;

royalties on end product sales based on a number of complex variables, including net sales calculations, cost of goods, geography, patent life and other financial metrics; and

indemnity obligations for third-party intellectual property, infringement, product liability and certain other claims.

From time to time, we have informal dispute resolution discussions with our partners regarding the appropriate interpretation of the complex commercial terms contained in our collaboration agreements. One or more disputes may arise in the future regarding our collaborative contracts that may ultimately result in costly litigation and unfavorable interpretation of contract terms, which would have a material adverse impact on our business, results of operations or financial condition.

**We could be involved in legal proceedings regarding our intellectual property rights, or those of our partners, and may incur substantial litigation costs and liabilities that will adversely affect our business, results of operations and financial condition.**

From time to time, third parties have asserted, and may in the future assert, that we or our partners infringe their proprietary rights. The third party often bases its assertions on a claim that its patents cover our technology. Similar assertions of infringement could be based on future patents that may issue to third parties. In certain of our agreements with our partners, we are obligated to indemnify and hold harmless our partners from intellectual property infringement, product liability and certain other claims, which could cause us to incur substantial costs if we are called upon to defend ourselves and our partners against any claims. If a third party obtains injunctive or other equitable relief against us or our partners, our ability, and that of our partners, to develop or commercialize, or derive revenue from, certain products or product candidates in the U.S. and abroad which could be effectively blocked. For instance, F. Hoffman-La Roche Ltd, to which we license our proprietary PEGylation reagent for use in the manufacture of Roche's MIRCERA product, is currently the subject of a significant patent infringement lawsuit brought by Amgen Inc. related to Roche's patents for the use of MIRCERA to treat chemotherapy anemia in the U.S. Amgen has received a favorable ruling in U.S. federal district court in the state of Massachusetts and the parties are currently litigating the remedy phase. It is uncertain whether Roche will be prevented from marketing and selling MIRCERA in the U.S. or whether an economic settlement with Amgen will be concluded and approved by the court. Although we are not a party to this lawsuit, if Roche is prevented from marketing and selling MIRCERA in the U.S., it will have a negative impact on our revenue from our license with Roche. Third-party claims could also result in the award of substantial damages to be paid by us or a settlement resulting in significant payments to be made by us. For instance, a settlement might require us to enter a license agreement under which we pay substantial royalties to a third party, diminishing our future economic returns from the related product. For instance, on June 30, 2006, we entered into a litigation settlement related to an intellectual property dispute with the University of Alabama in Huntsville pursuant to which we paid \$11.0 million and agreed to pay an additional \$10.0 million in equal \$1.0 million installments over ten years

beginning on July 1, 2007. We cannot predict with certainty the eventual outcome of any pending or future litigation. Costs associated with such litigation, substantial damage claims, indemnification claims or royalties paid for licenses from third parties could have a material adverse effect on our business, results of operations and financial condition.

**Table of Contents**

**Our future depends on the proper management of our current and future business operations and their associated expenses.**

Our business strategy requires us to manage our business to provide for the continued development and potential commercialization of our proprietary and partnered product candidates. Our strategy also calls for us to undertake increased research and development activities and to manage an increasing number of relationships with partners and other third parties, while simultaneously managing the expenses generated by these activities. If we are unable to manage effectively our current operations and any growth we may experience, our business, financial condition and results of operations may be adversely affected. Our restructuring efforts in February 2008 resulted in a reduction of approximately 110 employees, or approximately 20 percent of our regular full-time staff. If we are unable to effectively manage our expenses, we may find it necessary to reduce our personnel-related costs through further reductions in our workforce, which could harm our operations, employee morale and impair our ability to retain and recruit talent. Furthermore, if adequate funds are not available, we may be required to obtain funds through arrangements with partners or other sources that may require us to relinquish rights to certain of our technologies or products that we would not otherwise relinquish.

**We are dependent on our management team and key technical personnel, and the loss of any key manager or employee may impair our ability to develop our products effectively and may harm our business, results of operations and financial condition.**

Our success largely depends on the continued services of our executive officers and other key personnel. The loss of one or more members of our management team or other key employees could seriously harm our business, results of operations and financial condition. The relationships that our key managers have cultivated within our industry make us particularly dependent upon their continued employment with us. We are also dependent on the continued services of our technical personnel because of the highly technical nature of our products and the regulatory approval process. Because our executive officers and key employees are not obligated to provide us with continued services, they could terminate their employment with us at any time without penalty. We do not have any post-employment non-competition agreements with any of our employees and do not maintain key person life insurance policies on any of our executive officers or key employees. On February 8, 2008, Hoyoung Huh, our Chief Operating Officer and Head of the PEGylation Business Unit, resigned from his positions with us effective February 29, 2008. In May 2008, we appointed Bharatt M. Chowrira as our Chief Operating Officer and Head of the PEGylation Business Unit and as Chairman of Nektar Therapeutics India Pvt. Ltd. In the future, if we are unable to retain our executive officers and key employees or integrate new members of our management team, our operations may be disrupted and we may not be able to achieve our business objectives.

**Because competition for highly qualified technical personnel is intense, we may not be able to attract and retain the personnel we need to support our operations and growth.**

We must attract and retain experts in the areas of clinical testing, manufacturing, regulatory, finance, marketing and distribution and develop additional expertise in our existing personnel. We face intense competition from other biopharmaceutical companies, research and academic institutions and other organizations for qualified personnel. Many of the organizations with which we compete for qualified personnel have greater resources than we have. Because competition for skilled personnel in our industry is intense, companies such as ours sometimes experience high attrition rates with regard to their skilled employees. Further, in making employment decisions, job candidates often consider the value of the stock options they are to receive in connection with their employment. Our equity incentive plan and employee benefit plans may not be effective in motivating or retaining our employees or attracting new employees, and significant volatility in the price of our stock may adversely affect our ability to attract or retain qualified personnel. If we fail to attract new personnel or to retain and motivate our current personnel, our business and future growth prospects could be severely harmed.

**If earthquakes and other catastrophic events strike, our business may be harmed.**

Our corporate headquarters, including a substantial portion of our research and development and manufacturing operations for bulk powder drugs, are located in the Bay Area, a region known for seismic activity and a potential terrorist target. In addition, we own facilities for the manufacture of products using our PEGylation technology in Huntsville, Alabama and lease offices in Hyderabad, India. There are no backup facilities for our manufacturing

operations located in the Bay Area and Huntsville, Alabama. In the event of an earthquake or other natural disaster or terrorist event in any of these locations, our ability to manufacture and supply certain products would be significantly disrupted and our business, results of operations and financial condition would be harmed. Our collaborative partners may also be subject to catastrophic events, such as hurricanes and tornadoes, any of which could harm our business, results of operations and financial condition. We have not undertaken a systematic analysis of the potential consequences to our business, results of operations and financial condition from a major earthquake or other catastrophic event, such as a fire, power loss, terrorist activity or other disaster, and do not have a recovery plan for such disasters. In addition, our insurance coverage may not be sufficient to compensate us for actual losses from any interruption of our business that may occur.

**Table of Contents**

**We have implemented certain anti-takeover measures, which make it more difficult to acquire us, even though such acquisitions may be beneficial to our stockholders.**

Provisions of our certificate of incorporation and bylaws, as well as provisions of Delaware law, could make it more difficult for a third party to acquire us, even though such acquisitions may be beneficial to our stockholders. These anti-takeover provisions include:

establishment of a classified board of directors such that not all members of the board may be elected at one time;

lack of a provision for cumulative voting in the election of directors, which would otherwise allow less than a majority of stockholders to elect director candidates;

the ability of our board to authorize the issuance of blank check preferred stock to increase the number of outstanding shares and thwart a takeover attempt;

prohibition on stockholder action by written consent, thereby requiring all stockholder actions to be taken at a meeting of stockholders;

establishment of advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and

limitations on who may call a special meeting of stockholders.

Further, we have in place a preferred share purchase rights plan, commonly known as a poison pill. The provisions described above, our poison pill and provisions of Delaware law relating to business combinations with interested stockholders may discourage, delay or prevent a third party from acquiring us. These provisions may also discourage, delay or prevent a third party from acquiring a large portion of our securities, or initiating a tender offer or proxy contest, even if our stockholders might receive a premium for their shares in the acquisition over the then current market prices. We also have a change of control severance benefits plan which provides for certain cash severance, stock award acceleration and other benefits in the event our employees are terminated (or, in some cases, resign for specified reasons) following an acquisition. This severance plan could discourage a third party from acquiring us.

***Risks Related to Our Securities***

**The prices of our common stock and senior convertible debt are expected to remain volatile.**

Our stock price is volatile. In the three months ended September 30, 2008, based on closing bid prices on the NASDAQ Global Select Market, our stock price ranged from \$3.10 to \$5.36. We expect our stock price to remain volatile. In addition, as our convertible senior notes are convertible into shares of our common stock, volatility or depressed prices of our common stock could have a similar effect on the trading price of the notes. Interest rate fluctuations can also affect the price of our convertible senior notes. A variety of factors may have a significant effect on the market price of our common stock or notes, including:

announcements of data from, or material developments in, our clinical trials or those of our competitors, including safety data indicating potential risks in the use of our proprietary or partnered product candidates, such as the inclusion of information in the labeling regarding a data imbalance observing an increased number of lung carcinoma in users of Exubera who were former smokers, or delays in the development, approval or launch of our proprietary product candidates;

announcements of changes in governmental regulation, orders or recommendations affecting us or our competitors, such as Pfizer's update of the Exubera labeling in April 2008;

public concern as to the safety of drug formulations, such as Exubera, developed by us or others;

product liability claims against us or our partners or litigation brought against us by, or by us against, third parties to whom we have indemnification obligations;

announcements by collaboration partners as to their plans or expectations related to products using our technologies;

announcements or terminations of collaborative relationships by us or our competitors, such as Pfizer's announcement late in our 2007 fiscal year that it had terminated our partnership for Exubera and NGI;

developments in patent or other proprietary rights;

**Table of Contents**

announcements of technological innovations or new therapeutic products that may compete with our approved products or products under development;

hedging activities by purchasers of our convertible senior notes;

fluctuations in our results of operations; and

general market conditions.

**Our securityholders may be diluted, and the price of our securities may decrease, by the exercise of outstanding stock options and warrants or by future issuances of securities.**

We may issue additional common stock, preferred stock, restricted stock units or securities convertible into or exchangeable for our common stock. Furthermore, substantially all shares of common stock for which our outstanding stock options or warrants are exercisable are, once they have been purchased, eligible for immediate sale in the public market. The issuance of additional common stock, preferred stock, restricted stock units or securities convertible into or exchangeable for our common stock or the exercise of stock options or warrants would dilute existing investors and could adversely affect the price of our securities.

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

None, including no purchases of any class of our equity securities by us or any affiliate pursuant to any publicly announced repurchase plan in the three months ended September 30, 2008.

**Item 3. Defaults Upon Senior Securities**

None.

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

None.

**Item 5. Other Information**

None.

**Table of Contents**

**Item 6. Exhibits**

Except as so indicated in Exhibit 32.1, the following exhibits are filed as part of, or incorporated by reference into, this Quarterly Report on Form 10-Q.

<b>Exhibit Number</b>	<b>Description of Documents</b>
10.1(1)	Offer Letter Agreement between Nektar Therapeutics and Dr. Moreadith dated July 29, 2008.
31.1(2)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2(2)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1(3)	Section 1350 Certifications.

(1) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on August 7, 2008.

(2) Filed herewith.

(3) Furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall such exhibit be deemed to be incorporated by



reference in any  
registration  
statement or  
other document  
filed under the  
Securities Act  
of 1933, as  
amended, or the  
Securities  
Exchange Act,  
except as  
otherwise stated  
in such filing.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirement 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.

By: /s/ John Nicholson  
John Nicholson  
*Senior Vice President and Chief Financial  
Officer*

Date: November 7, 2008

By: /s/ Jillian B. Thomsen  
Jillian B. Thomsen  
*Vice President and Chief Accounting Officer*

Date: November 7, 2008

**Table of Contents**

**EXHIBIT INDEX**

Except as so indicated in Exhibit 32.1, the following exhibits are filed as part of, or incorporated by reference in, this Quarterly Report on Form 10-Q.

<b>Exhibit Number</b>	<b>Description of Documents</b>
10.1(1)	Offer Letter Agreement between Nektar Therapeutics and Dr. Moreadith dated July 29, 2008.
31.1(2)	Certification of Nektar Therapeutics principal executive officer required by Rule 13a-14(a) or Rule 15d-14(a).
31.2(2)	Certification of Nektar Therapeutics principal financial officer required by Rule 13a-14(a) or Rule 15d-14(a).
32.1(3)	Section 1350 Certifications.

(1) Incorporated by reference to the indicated exhibit in Nektar Therapeutics Current Report on Form 8-K, filed on August 7, 2008.

(2) Filed herewith.

(3) Furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section, nor shall such exhibit be deemed to be incorporated by

reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Securities Exchange Act, except as otherwise stated in such filing.